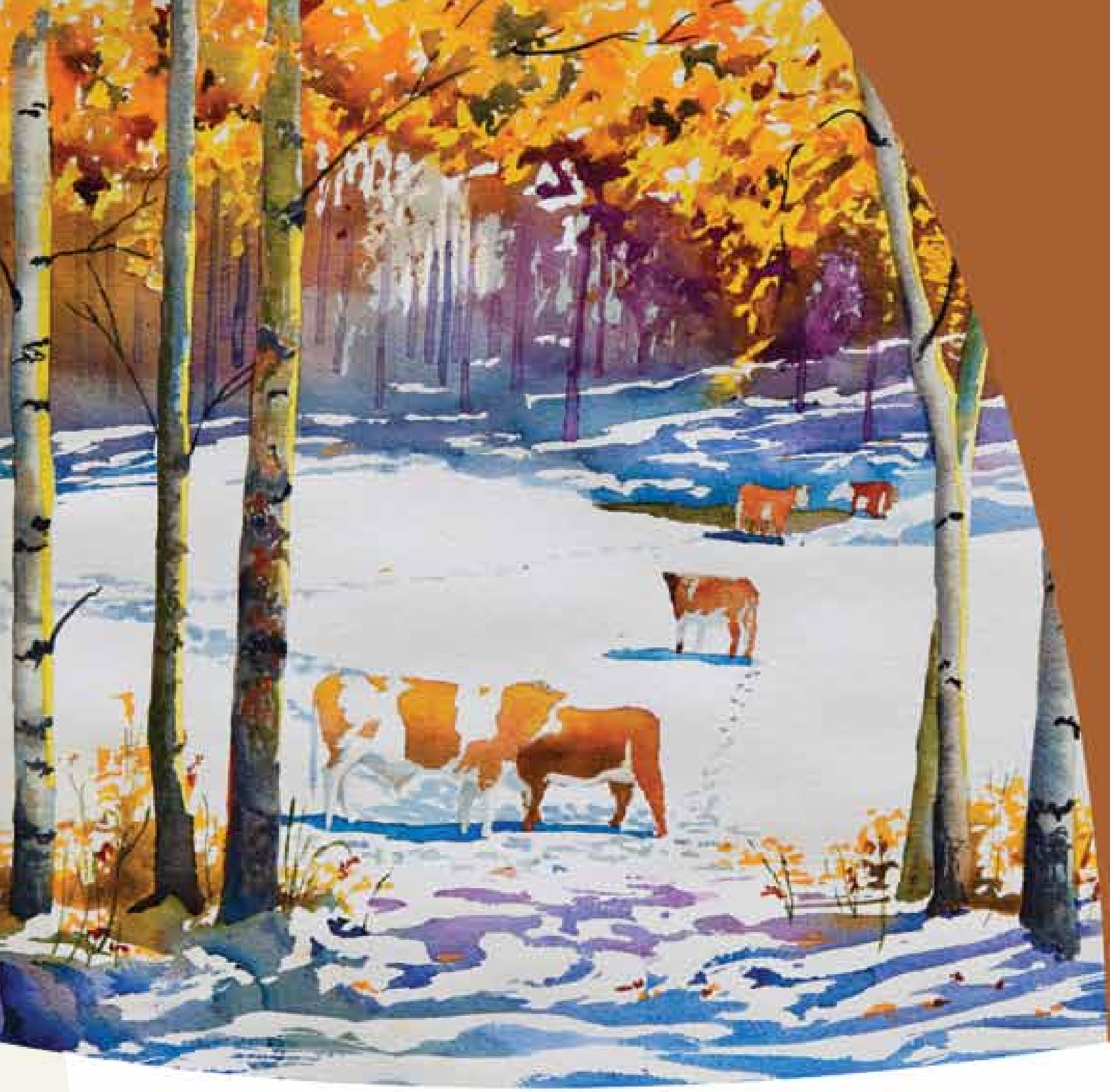

Canadian Dairy Commision | Commision canadienne du lait

Canadian Dairy Commission

Annual Report

11-12

Canada

Mandate of the Canadian Dairy Commission

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

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

Mission statement

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

Values

Integrity, leadership, respect and dignity, professionalism.

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

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Letter From the Chairman

Mister Minister,

I am pleased to submit the Canadian Dairy Commission's Annual Report for the 2011-2012 dairy year. As we conclude the year, the Canadian Dairy Commission (CDC) is in a sound financial position and has achieved most of the objectives it had set for itself. Some of these objectives were not reached either because the industry was not ready to move forward on some issues or because circumstances required a change in direction. Overall, the CDC continued to help the Canadian dairy industry and its stakeholders respond positively to the many challenges that arose.

This year, the CDC board completed the changes that were recommended in the 2011 Special Examination Report from the Office of the Auditor General (OAG). The board periodically assesses its skills and uses outside expertise when deemed necessary for specific projects, as it did for the transition to International Financial Reporting Standards. Furthermore, the board follows new procedures for the management of potential conflicts of interest of board members. These new procedures are derived from modifications to the CDC bylaws following a recommendation by the OAG. Overall, the OAG found no significant deficiencies in the CDC's systems and practices.

Last February, the board welcomed Mr. Jacques Laforge as the new CEO of the CDC for a three-year term. Mr. Laforge replaces Mr. John Core, who had served as the CEO for 9 years. I wish to take this opportunity to thank John for his leadership, his vision, and his excellent management of the operations of the CDC.

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

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

Randy Williamson

Message From the CEO

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

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

In 2011-2012 domestic demand for dairy products decreased slightly for the first time in several years. Industrial milk quota finished the year at 189.47 million kg of butterfat compared to 189.62 million kg one year ago. This slowdown was mostly noticeable in the butter market and was partly compensated by growth in demand for products such as cheese and yogurt. Milk production increased during the year and the CDC was able to replenish its stocks which had been largely used to supply the market in the fall of 2011 when production was below demand. At the end of the 2011-2012 dairy year, private stocks of butter and cheese were normal and CDC stocks of butter were higher than usual.

This year, world prices for skim milk powder were lower than last year. The CDC tried to take advantage of high price periods to export part of the structural surplus of solids non fat. As a result, the equivalent of 9,277 t of skim milk powder was exported in 2011-2012 compared to 11,176 t during the previous year. In the case of butter, Canada had no surplus to export in 2011-2012.

Because of higher production, the removal of surplus milk solids non fat (SNF) from the Canadian market increased significantly this year. The CDC's year end stocks of class 4(m) skim milk powder[2] were 22,619 t compared to 10,022 t a year ago. In the coming year, the CDC will increase its sales of this product to the animal feed industry in order to reduce its inventories to a reasonable level.

Last December, the CDC announced an increase in support prices of skim milk powder and butter for February 1, 2012. The rise in the cost of producing milk in Canada warranted this modest increase of 1.5%.

The dairy industry continues to try to be more market-responsive while reducing market risks for producers. The CDC, in collaboration with Dairy Farmers of Canada (DFC), facilitated discussions between provincial producer organizations, provincial governments and processor representatives on the creation of a national pool for all milk classes. As a result of these discussions, the Canadian Milk Supply Management Committee (CMSMC) created sub-classes of milk and agreed to put in place a mechanism to redirect liquid skim milk from the production of skim milk powder to other markets that are more lucrative for milk producers.

From a financial point of view, the CDC had another successful year in managing its commercial operations. As a result of conservative and prudent purchasing practices, it was able to generate a surplus of $18.3 million which will be refunded to producers through the provincial milk marketing boards and agencies. Overall, retained earnings at year-end were only slightly lower than those of the previous year.

Dairy Industry Trends

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

[2] Mostly destined for animal feed.

while consumers enjoy a continuous supply of quality dairy products at predictable prices.

The trend towards harmonization of policies and integration of activities among provinces which began four years ago is continuing in both regional milk pools. In the Western Milk Pool (WMP), the main areas of emphasis are milk transportation, milk receiving at plants, and policies on milk allocation to plants. The pool is currently holding consultations with provincial stakeholders on a proposed milk receiving policy. In addition, the WMP is now treated as one entity for the purpose of continuous quota management and it has developed and approved self-imposed mechanisms should the WMP go over or under its allowable production limits.

In the Eastern Pool (the P5), the milk marketing boards recently hired a P5 Pool Harmonization Coordinator to support existing working groups in their continuing efforts to harmonize milk utilization and audit standards, milk transportation and milk quality rules. Furthermore, the P5 is working to establish a harmonized governance structure and will be hiring a consultant to help establish a vision and propose options. The P5 is also treated as one entity for the purpose of continuous quota management. The WMP and P5 have committed to reduce the gap in farm prices for industrial milk between the two pools over a three-year period. The first price adjustment for this purpose was applied to the February 2012 prices.

Discussions are ongoing with provincial auditors responsible for auditing milk utilization at the plant level in order to promote uniform best practices across the country during those audits. The CDC acts as a facilitator and a technical advisor in these discussions and negotiations. The result of greater harmonization is a more level playing field for both producers and processors.

A recent development was the revision of the guidelines for the auditing of class 4(a)1. In this case, declarations often occur in a different province from where the final product is made, making the exchange of information between auditors crucial. All stakeholders were consulted in the process and the CMSMC approved the revisions to the *Milk Utilization Audit Standards.*

On the international front, negotiations are still ongoing at the World Trade Organization but it is unclear at this time whether or not a new trade agreement will be reached in the next dairy year (2012-2013). On the other hand, trade negotiations between Canada and the European Union are progressing at a fast pace, targeting the end of 2012 to reach an agreement. Any potential impact of such an agreement on the Canadian dairy industry is not known at this time. Furthermore, Canada will likely participate in the negotiations of the Trans-Pacific Partnership. The CDC continues to monitor trade negotiations and market fluctuations very closely.

Current trade rules already pose a risk to the domestic dairy market. World dairy prices and exchange rates are increasingly volatile. On a few occasions in the past year, the tariff that protects domestic markets from large volumes of imports has been almost insufficient. In 2012, world prices have been low and the risk of a breach in the tariff wall is still present, especially for cheese and fluid milk. The risk is even higher when the Canadian dollar is strong. Depending on volumes, such imports could disrupt milk supply management significantly.

Financial Trends

Given the slow global economic recovery, interest rates are expected to remain low in 2012-2013. Since the CDC borrows money from the Consolidated Revenue Fund and from a line of credit to administer programs on behalf of the dairy industry, higher interest rates would increase its transaction costs. However, increases in interest costs would not have an impact on the financial results of the CDC because these costs are paid for either by the dairy producers or by the marketplace.

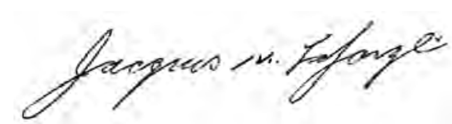
The CDC has adopted the International Financial Reporting Standards (IFRS) as its basis of accounting. The CDC's accounting systems have been prepared for this change and the new standards have not had a major impact.

As part of the 2012 federal Budget, the appropriations that the CDC receives will be reduced by 10% over the course of the next three fiscal years. The CDC made plans to accommodate this budget reduction.

Workplace Trends

Recruiting employees with specialized knowledge in the fields of agricultural economics and the dairy industry remains a challenge due to the small number of potential skilled candidates. Employee attraction and retention are therefore important. The CDC is aware that it faces strong competition from other government departments and the private sector to replace people who move on or retire. In order to deal with a lean workforce and increased stakeholder demands, the CDC will continue to manage its succession plan and to automate and streamline its processes to increase efficiency. These parameters, as well as the workforce adjustment contained in the 2012 federal Budget, will guide the CDC's management and planning of human resources.

The CDC took these trends into account when planning its activities and objectives for the 2012-2013 dairy year. These can be found in the section of this report entitled *Performance and Goals*.



Jacques Laforge

The Canadian Dairy Commission

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

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

Since supply management was first applied to the dairy sector, the CDC has been directly involved in two of the three pillars of the system: support prices[3] and industrial milk quota. Once a year, the CDC sets the support price of butter and skim milk powder following consultations with industry stakeholders. These prices are used as references by the provincial milk marketing boards to establish the price of industrial milk in each province. Through its many roles and central facilitating function in the dairy industry, the CDC ensures that Canadian dairy farmers receive sufficient revenues from the marketplace to achieve decent living standards and invest in their businesses.

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

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

To achieve its mandate, the CDC works with provincial governments, Agriculture and Agri-Food Canada, and dairy industry stakeholders such as dairy producers, processors, further processors, consumers and restaurateurs. It supports the dairy industry in the development and implementation of major programs. On the industry's behalf, the CDC administers the Special Milk Class Permit Program[4], the Domestic Dairy Product Innovation Program, the Dairy Marketing Program as well as the pooling agreements.

The CDC chairs the Canadian Milk Supply Management Committee (CMSMC)[5] and in this capacity, apprises the committee on matters of interest or concern that require resolution and, when necessary, proposes various solutions, alternatives or recommendations to enhance orderly and efficient marketing with an eye to avoiding deficit or surplus milk production. The CDC performs a similar role for the Eastern Canadian Milk Pool (P5) and the Western Milk Pool (WMP)[6].

CDC at a glance

Created in 1966

61 employees (as of July 31, 2012)

Location: Ottawa

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

Budget 2012-2013 (dairy year): $7.990 million

Dairy year: August 1 to July 31

Mission

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

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

Values

Integrity, leadership, respect and dignity, and professionalism

3 Support prices are the prices at which the CDC buys and sells Canadian butter and skim milk powder under its domestic seasonality programs.

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

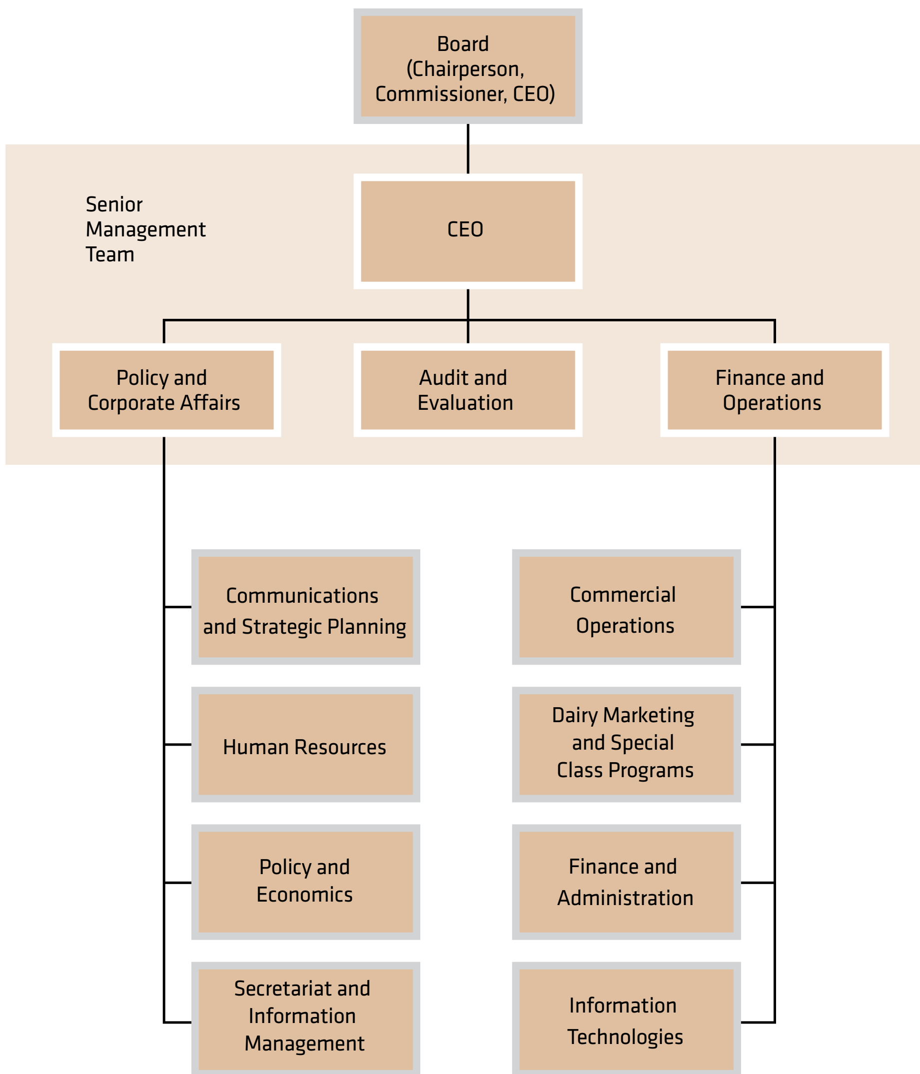
5 The CMSMC is the main national decision-making body of the dairy industry.

6 See p. 21-22 for more information on these pools.

Structure

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

Structure of the Canadian Dairy Commission



The Canadian Dairy Industry

Farm cash receipts

As a key contributor to the Canadian economy in the 2011 calendar year, the dairy industry ranked third behind grains and oilseeds and red meats, generating $5.8 billion in total net farm receipts.

Number of farms and production per farm

In the 2011-2012 dairy year, Canada had 12,746 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 2011-2012 dairy year was 24,645 kg of butterfat, a 4.5% increase from the previous year. Based on Canadian Dairy Herd Improvement records, the average annual production of a dairy cow in Canada is 9,774 kg of milk.

In the 2011-2012 dairy year, Quebec and Ontario had the greatest percentage of dairy farms at 82%, followed by 13% in the Western provinces, and 5% in the Atlantic provinces.

Milk processing

In the 2011 calendar year, the dairy processing industry generated $13.7 billion worth of products shipped from approximately 453 processing plants (273 of which are federally registered) accounting for 16.4% of all processing sales in the food and beverage industry. The dairy processing sector employed more than 22,500 people.

Milk markets

Canadian dairy producers supply two main markets:

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

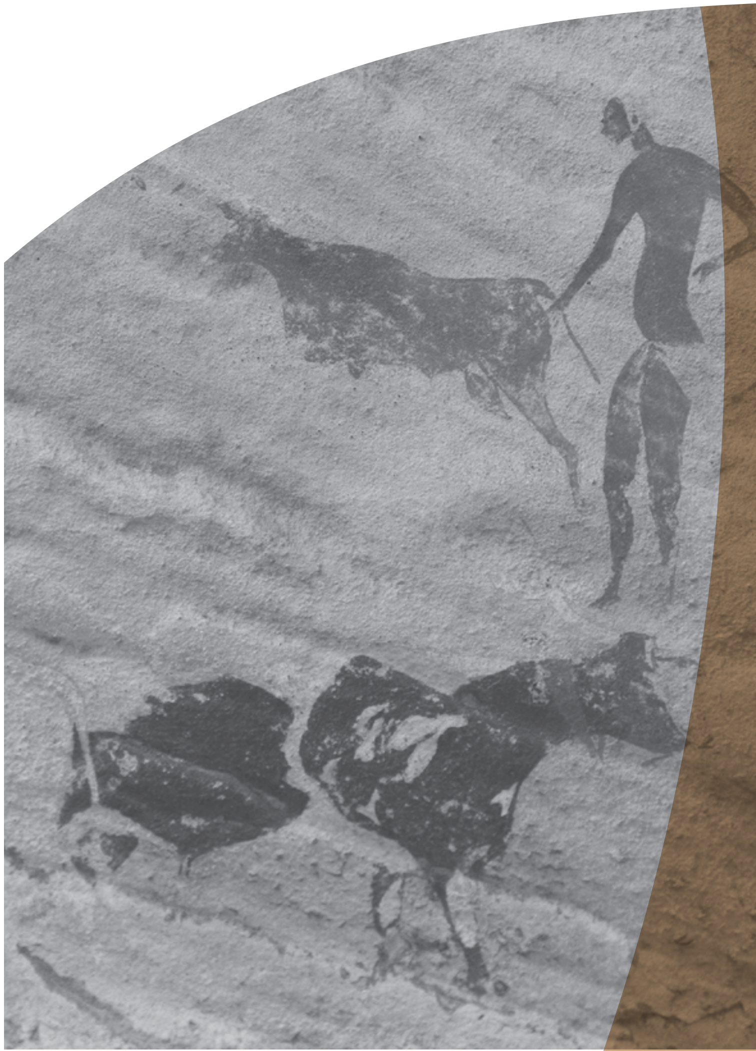
In the 2011-2012 dairy year, the fluid milk market accounted for approximately 38% of total producer shipments, or 117.95 million kg of butterfat[7]. The industrial milk market accounted for the remaining 62% of total producer shipments or 196.18 million kg of butterfat.

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[8]. The price paid for milk by processors varies according to the milk class. The following table shows how Canadian milk production was used in 2011-2012.

Milk Utilization per Class

Class	Million kg of butterfat	% of total butterfat
1	92.16	29.42
2	24.66	7.87
3(a) and 3(b)	105.42	33.65
4(a) and 4(a)1	59.37	18.95
4(b), 4(c), 4(d), 4(m)	4.81	1.53
5(a), 5(b), 5(c)	26.00	8.30
5(d)	0.90	0.29
TOTAL	**313.31****	**100.0**

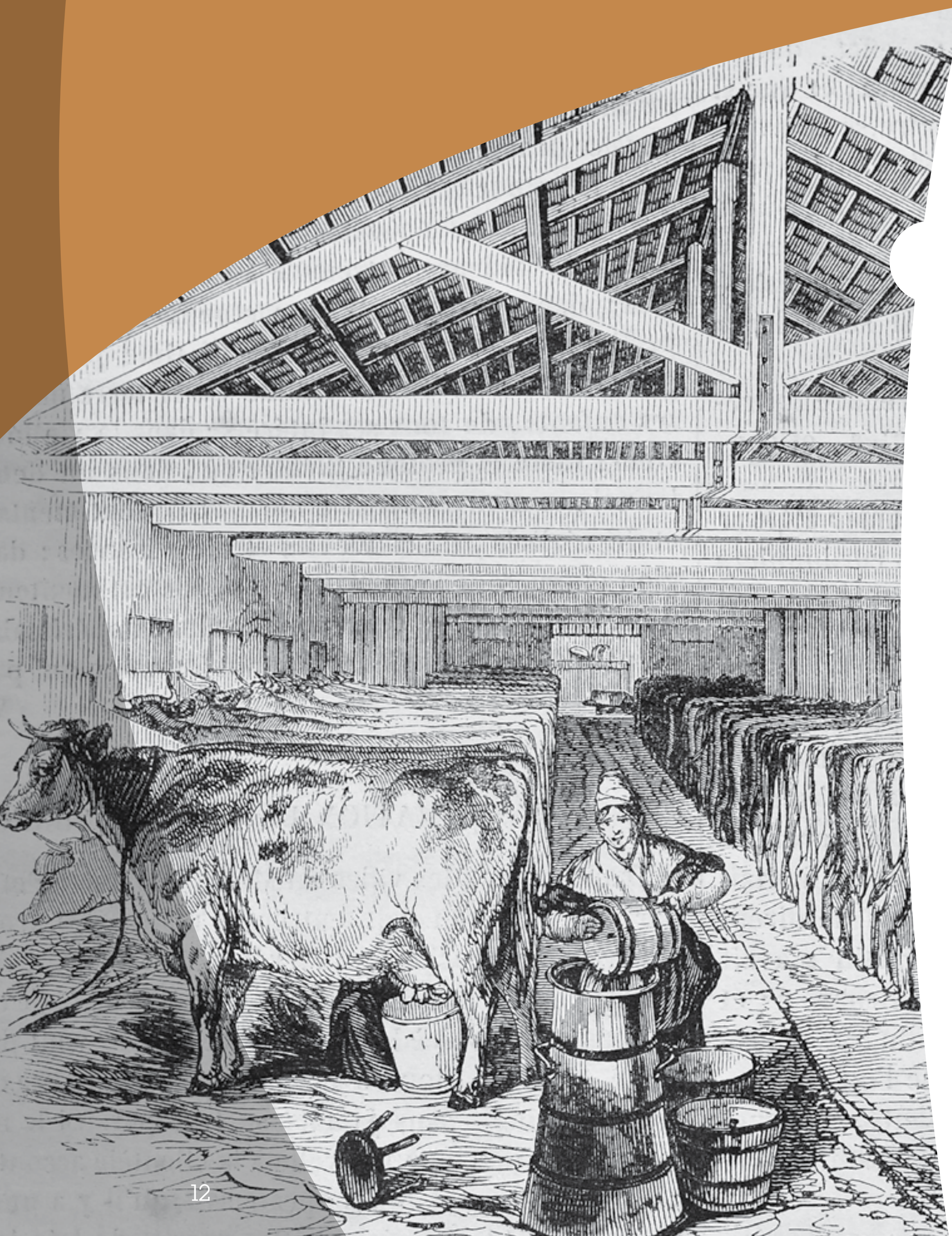
** This figure cannot be compared to the data on page 67 (in Tables and Data) because it excludes milk supplied to food banks, milk sold at fairs and losses.



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

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

Governance



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

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

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

Governing Board

The governing board for the CDC is composed of the chairperson, the commissioner, and the chief executive officer (CEO). The CDC board members are appointed by the Governor in Council and all three positions are part-time appointments. The board meets every four to six weeks.

The members of the board have many years of dairy industry experience and together they bring a balanced approach to satisfying the objectives of the stakeholders.

Commissioners

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

Randy Williamson

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

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

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

Gilles Martin

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

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

Gilles Martin, Commissioner; **Randy Williamson**, Chairman; **Jacques Laforge**, Chief Executive Officer

Chief Executive Officer (appointed February 2, 2012 for a three-year term)

Jacques Laforge

Mr. Laforge is well known for his leadership in agriculture both nationally and in his home province of New Brunswick, where he and his wife operate a successful 1,000-acre mixed farming operation. Throughout his farming career, Mr. Laforge has shown a strong dedication to serving his fellow farmers. He served as an executive on the Dairy Farmers of New Brunswick board of directors for 10 years before taking on the role of chairman from 1995 to 2000. From 1997 to 2000, he also served as chairman of the Atlantic Dairy and Forage Institute, an organization which provides a venue for on-farm research trials to producers and manufacturers. Having served on the board of directors of the Dairy Farmers of Canada since the 1980s, he joined the executive committee in 1999. In 2004, he took on the role of president, a title he held until 2011.

Board Committees

Audit Committee

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

Members

Commissioner (chair)

Chairperson

Chief Executive Officer

Nominating Committee

The Committee met in April and July of 2011 and also by teleconference to discuss and recommend candidates for the CEO position which became vacant in the fall of 2011.

Members

A member of the board (chair)

Senior Director, Policy and Corporate Affairs

Executive Director, Dairy Farmers of Canada

President and CEO, Dairy Processors Association of Canada

Representative from the Consumers Association of Canada at the Canadian Milk Supply Management Committee

As part of its overall stewardship in 2011-2012, the governing board approved the CDC's Corporate Plan for the period starting in 2012-2013 and ending in 2016-2017. The Corporate Plan contains all the major directions of the corporation as well as its forecasted budgets and borrowing plan. The Corporate Plan was approved by Treasury Board on May 31, 2012.

The CDC updated its Corporate Risk Profile. This is an internal document that is reviewed at least once per year (latest review was March 2012) by CDC management. It outlines the risks identified by managers and directors as posing a threat to the core mandate of the CDC or to the achievement of its goals. The plan defines each risk, describes the existing measures for managing the risk, incremental risk management strategies and the group responsible for implementing these strategies. The profile is taken into consideration when doing the environmental analysis during the strategic planning session.

The board also approved the Annual Report and Financial Statements for dairy year 2010-2011 as well as a transition budget for the four-month transition period between April and July 2012. It completed a process to evaluate its performance. The conclusion of this evaluation was that the board functions efficiently. The results were communicated to the Minister of Agriculture and Agri-Food and the Treasury Board Secretariat (TBS).

To follow up on recommendations contained in the Special Examination Report 2011 of the Office of the Auditor General, the board added provisions in its by-laws related to the management of conflicts of interests by Board members and also instituted procedures to deal with possible conflicts of interest.

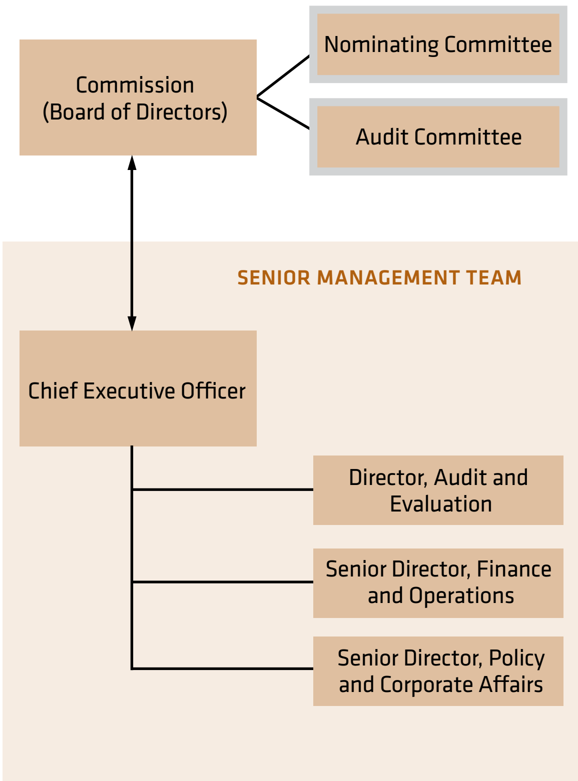
The board adopted a new Code of Ethics based on the model provided by TBS in December 2011. This Code of ethics includes a section on conflicts of interests and post-employment.

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

As outlined in the CDC's Audit Plan, internal audits performed during the year included the Matching Investment Fund, which was up for renewal, the Business Resumption Plan (monitoring), and threat risk assessment (monitoring). A peer review of the internal audit function was also performed and an audit of freight and warehousing was undertaken. Executive summaries of internal audit reports were approved by the Audit Committee.

As outlined in the CDC's five-year Program Evaluation Cycle, a program evaluation was performed on the Matching Investment Fund. Although the Treasury Board Secretariat Policy on Evaluation does not apply to the CDC, the corporation strives to comply with its general principles. Program evaluation summary reports are approved by the Audit Committee.

In accordance with the requirements of the Canadian Accounting Standards Board (AcSB), the CDC adopted International Financial Reporting Standards (IFRS) as of August 1, 2011. The financial statements presented in this annual report are the first annual financial statements prepared using these new standards. The adoption of IFRS has not had a significant impact on the financial results of the CDC.



Senior Management Team

The senior management team is responsible for the day-to-day operations of the Canadian Dairy Commission.

Members

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

Senior Managers

Director, Audit and Evaluation

Robert Hansis, CGA, MBA, CFE

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

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

Senior Director, Finance and Operations

Gaëtan Paquette

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

Mr. Paquette has been Senior Director, Finance and Operations, at the CDC since 2002. He has helped the Canadian dairy industry adapt to changes such as the 1994 WTO Agreement on Agriculture, the new export rules, and the constant challenge of disposing of structural surplus. Mr. Paquette is responsible for key programs such as the Special Milk Class Permit Program, the Dairy Marketing Program, the domestic seasonality programs, the Surplus Removal Program and the Domestic Dairy Product Innovation Program.

He is also responsible for the finance, administration and IT functions of the CDC. For the past 20 years, Mr. Paquette has chaired and been a member of various committees of the International Dairy Federation (IDF).

Senior Director, Policy and Corporate Affairs

Gilles Froment

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

Since 2002, he has been the Senior Director of Policy and Corporate Affairs, a section that oversees Policy and Economics, Communications and Strategic Planning, and Human Resources. Among his other duties, he is secretary to the Canadian Milk Supply Management Committee and an advisor to the P5 Supervisory Body and Western Milk Pool Coordinating Committee. He also chairs various technical committees. For the last seven years, Mr. Froment has been the Canadian representative on the IDF Standing Committee on Dairy Policies and Economics and in March 2012, he was appointed deputy chair of that committee. He is currently vice-president of the Canadian FIL-IDF National Committee after serving four years as president.

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

Activities and Programs

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

Milk Supplies

Chairing of the Canadian Milk Supply Management Committee (CMSMC)

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

Over the course of the 2011-2012 dairy year, the CMSMC took several important decisions. In July 2011, it endorsed the mandate for a P10 Negotiating Committee consisting of representatives from provincial boards, provincial governments and processors, to negotiate the creation of a national milk pool. This committee met seven times between September 2011 and July 2012 and presented its recommendations to the CMSMC in July 2012. An additional meeting of the committee is scheduled for September 5, 2012 to address the remaining outstanding issues. Unless significant progress is made at that meeting, it is anticipated that the committee will suspend negotiations.

In October 2011, the CMSMC approved a two-year extension of the Domestic Dairy Product Innovation Program (DDPIP) and at the same time, it modified some of the conditions of the program. The milk available under the DDPIP went from 2 to 3% of the market sharing quota (MSQ)[9].

In April 2012, the CMSMC agreed to discontinue the Concentrated Milk Assistance Program as of August 1, 2012. Low levels of utilization of this program by the industry justified its termination. It also allowed groups of provinces to elect to be treated as a single entity for the purpose of continuous quota management. This will provide more flexibility to individual provinces in respecting their quota.

At its meeting in July 2012, the CMSMC adopted the following recommendations of the P10 Negotiating Committee. It approved a new program that will allow the redirection of liquid skim milk from the production of skim milk powder to the production of yogurt and other products. In addition to enhancing the supply of milk for these two growing markets, the program will improve producer revenues since yogurt belongs to a more lucrative class than skim milk powder. It also approved the allocation of a permanent growth allowance equivalent to 1% of MSQ to supply growing markets. Finally, it adopted changes to the Harmonized Milk Classification System to track milk utilization for products such as yogurt and specialty cheeses.

The CMSMC also decided to encourage the use of skim milk powder by further processors by making SMP eligible in special class 5(b) as of August 1, 2012.

Determining and Adjusting Quota

The CDC monitors trends in Canadian requirements[10] (demand) and industrial milk production (supply) on a monthly basis. This allows it to adjust the MSQ every two months to reflect changes in the domestic demand for industrial milk products, as well as changes in planned exports. The objective when establishing the MSQ is to minimize the possibility of shortages or surpluses in the domestic market. Any surplus that occurs is managed by adjusting the MSQ, by temporarily storing surpluses at the expense of producers or, in exceptional circumstances, by exporting within Canada's trade commitments.

Over the course of the 2011-2012 dairy year, Canadian requirements were 187.86 million kg of butterfat, down 0.86% from the previous year. A decrease in domestic demand for butter has more than countered growth in other markets.

[9] National production target for industrial milk in Canada, expressed on a butterfat basis. The MSQ takes into account the fact that a portion of the butterfat from the fluid milk market will be used in the industrial milk market (skim-off).

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

During the same period, industrial milk production increased to 196.18 million kg of butterfat compared to 186.87 million kg of butterfat a year earlier. In the Eastern provinces, production was strong and displayed a steady growth of around 2% during the year. In the Western provinces, production which started at a lower level has grown tremendously throughout the year. Butter stocks, which are currently high following the growth in production in both pools, are expected to remain above normal for many months to come.

Domestic Seasonality Programs

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

Summary of Transactions under the domestic seasonality programs

	Opening inventory	Purchases	Sales	Closing inventory
	Tonnes			
Butter	9,754	28,863	21,801	16,816
Skim milk powder	1,671	2,038	2,322	1,387

Data include imported butter and butter oil.

Imports

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

Surplus Removal Program

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

In 2011-2012, 79.4 tonnes of skim milk powder equivalent were removed from the market. This quantity is broken down as follows.

Product	Market	Tonnes
CDC purchases of skim milk powder	Export	9.0
CDC purchases of skim milk powder	Animal feed	34.2
Processor sales of skim milk powder	Animal feed	13.5
Other skim milk powder and milk protein concentrate	Domestic use	5.0
Dairy blends	Export	8.7
Milk protein concentrate	Export	6.3
Other products	Export	2.7
TOTAL		**79.4**

Producer Revenues

Pricing

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

Two elements of the CDC's mandate are taken into account in the pricing decision: providing efficient producers with an adequate return on their labour and investment, and providing Canadian consumers with an adequate supply of high quality dairy products. Each year, the CDC holds pricing consultations and the views of dairy industry stakeholders are carefully considered before making this decision. Commissioners also examine the results of an annual study on the cost of producing one hectolitre of milk in Canada which is conducted by the CDC and its partners.

Because of the increase in farm input costs in 2010, support prices of butter and skim milk powder were increased on February 1, 2012. The support price of butter increased from $7.1922 to $7.2810 per kg whereas the support price of skim milk powder increased from $6.2721 to $6.3673 per kg. This increase was announced on December 2, 2011.

The price paid by processors for fluid milk is established by the provinces. From February 2010 to August 1, 2011, all provinces used the same fluid milk pricing formula. This formula was modified in 2011-2012 and applies for two years. It triggered a reduction in the price of fluid milk of 0.7% as of February 1, 2012 when compared to August 1, 2012.

Pooling of Markets and Producer Returns

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

Comprehensive Agreement on Pooling of Milk Revenues

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

Agreement on the Eastern Canadian Milk Pooling

This agreement provides a means for revenues from all milk sales (fluid and industrial), transportation costs, markets, and the responsibility for skim-off[11] to be pooled among dairy producers in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island (the P5). The CDC chairs the Supervisory Body of the pool, administers the pooling agreement, does the pooling calculations and provides technical expertise and secretariat services to the pool.

The CDC also assists P5 marketing boards in their ongoing efforts to harmonize policies. Working groups are tasked with considering further harmonization of milk utilization audit standards and milk quality rules, while the P5 transportation team has the mandate of promoting greater integration of transportation activities amongst P5 provinces. In the spring of 2012, the P5 marketing boards hired a P5 pool harmonization coordinator to assist these working groups in their efforts. The marketing boards also plan to hire a consultant who will propose options for the creation of an enhanced governance structure for the pool. Finally, the P5 provinces elected to be treated as a single entity for the purpose of continuous quota management.

[11] Excess butterfat from the fluid milk market

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.

The trend towards the harmonization of policies and the integration of activities among provinces which began three years ago continues. The main areas of emphasis are milk transportation, milk receiving at plants, and milk allocation to plants. The pool is currently holding consultations with provincial stakeholders on a proposed milk receiving policy.

In addition, the WMP is now treated as one entity for the purpose of continuous quota management, and in the spring of 2012, it approved self-imposed mechanisms should the WMP go over or under its allowable production limits. The WMP and P5 have committed to reduce the gap in farm milk prices between the two pools over a three-year period. The first price adjustment for this purpose was applied to the February 2012 prices.

The WMP continues its efforts to promote innovation and the development of niche markets within the pool through its innovation champion and studies of its niche markets.

Pools in Numbers 2011-2012

	Fluid milk produced (million kg butterfat)	Industrial milk produced (million kg butterfat)	Blend price to producer* ($/hl)
P5	80.15	157.18	75.17
WMP	36.31	38.60	77.75

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

External Audits

Most external audits are performed on companies participating in the Special Milk Class Permit Program, using risk assessment to identify high risk companies among program participants. During the 2011-2012 dairy year, 63 companies were audited compared to 65 the previous year. This resulted in claims of $1,363,700 from these companies. The increased number of audits the past few years (over 60 compared to 41 two years ago) was made possible by performing desk audits in cases that presented a lower level of risk.

If audited companies also participate in the Import for Re-export Program which is administered by Foreign Affairs and International Trade Canada, the CDC performs the audit related to this program. In 2011-2012, the CDC audited 9 participants of the Import for Re-Export Program.

The CDC continues to work with provincial auditors to assist in the audit of special class transactions. It provides advice on practices related to milk plant utilization audits and on the implementation of the *Milk Utilization Audit Standards* to further harmonize these audit practices across Canada. The *Milk Utilization Audit Standards* were recently revised to more clearly define the transfer of information among provincial auditors and to establish reporting requirements with deadlines with an eye to achieving appropriate accountability for the class 4(a)1 transactions. The revision was a result of extensive consultation with all stakeholders.

A technical committee composed of P5 representatives reviewed audit practices among the provinces and suggested further areas for harmonization. The milk utilization reporting software now in use in Ontario and Quebec is being promoted for use in the Maritime provinces.

The CDC also performs the milk plant utilization audits in Manitoba, Newfoundland and Labrador, Nova Scotia, Prince Edward Island, New Brunswick and Saskatchewan on a cost-recovery basis. The contracts with Nova Scotia, PEI and Saskatchewan expire once the audit work of the July 31, 2012 dairy year is complete and will need to be renegotiated.

Market Development

Dairy Marketing Program

The Matching Investment Fund (MIF) took effect on August 1, 2009. For three years, two million dollars in funding is offered yearly on a matching basis to companies that develop new products using milk components. A total of 89 proposals have been submitted since the MIF was created. During the 2011-2012 dairy year, 31 applications were submitted, and as of July 31, 2012, five had received approval for funding amounting to approximately $213,000. Approved projects include consultation services, recipe formulation and technology transfer initiatives. Cheese, cream, skim milk powder, fluid milk and cream cheese are the main dairy ingredients involved in these projects.

In 2011-2012, the CDC organized two successful artisan cheese-making workshops in Edmonton, Alberta, and Charlottetown, Prince Edward Island. These two-day workshops focused on the art and science of cheese-making and consisted of classroom sessions and visits to the cheese plant for hands-on learning. The courses were expertly designed to respond to the unique and challenging requirements of small and medium-sized artisanal cheese makers.

The CDC's innovation champion participated in the annual Canadian Institute of Food Technologists Suppliers Night in Toronto and Montreal and in the Bakery Showcase Trade Show held in Toronto. The CDC's champion and marketing group also conducted 29 on-site visits across Canada with dairy and food processing companies to provide business advice and explore opportunities that contribute to market growth for dairy products.

The CDC continued to work closely on dairy sourcing and regulatory issues, especially in the context of two new large food processing companies establishing plant facilities in Canada. One is approaching the final stages of construction and will cause a major increase in the use of Canadian milk ingredients in infant food formula.

Domestic Dairy Product Innovation Program

The Domestic Dairy Product Innovation Program (DDPIP) encourages the manufacture of new and innovative products on the domestic market. It allows for the addition of specific volumes of milk to provincial quotas to ensure that the milk supply needed to produce innovative products is available to successful applicants. In October 2011, the CMSMC agreed to extend the DDPIP until July 31, 2013 and to modify the conditions of the program. On August 1, 2011, the milk available under this program went from 2% to 3% of the MSQ.

During the 2011-2012 dairy year, firms in Quebec, Ontario, Alberta, British Columbia and Prince Edward Island used 107.0 million litres of milk under the DDPIP compared to 73.4 million litres in 2010-2011. This volume of milk used is the highest ever since the program was put in place 20 years ago and exceeded the previous limit of 2% of MSQ. Milk utilization under this program is expected to increase again in 2012-2013.

This year, the selection committee met in January and in June 2012. It received 66 applications, most of which were for new specialty cheeses. Of these 66 applications, 39 met the program criteria and were accepted, and 24 were rejected. The committee needs additional information before making decisions on the remaining three applications.

Special Milk Class Permit Program

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

Further processors used the equivalent of 26 million kg of butterfat in the 2011-2012 dairy year, an increase of 1.5 % over the previous year. The average revenues

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

Class		2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
5(a) (cheese)	Volume	7.78	7.54	7.62	7.85	7.46
	Price	$43.71	$36.19	$29.76	$35.20	$40.73
5(b) (other ingredients)	Volume	11.12	10.70	11.91	12.96	13.59
	Price	$42.02	$31.67	$28.92	$38.87	$39.26
5(c) (confectionery)	Volume	5.66	4.63	4.64	4.81	4.95
	Price	$40.98	$29.32	$29.73	$37.58	$33.74
Total	**Volume**	**24.56**	**22.87**	**24.17**	**25.62**	**26.00**
	Price	**$42.43**	**$33.24**	**$29.36**	**$36.74**	**$38.24**

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

obtained for producers from these three classes amounted to $38.24/hl compared to $36.74/hl for the previous year. A total of 1,886 permits were issued this dairy year for classes 5(a), (b) and (c), most of which were class 5(b) permits. The number of active further processors registered in the program on July 31, 2012 amounted to 1,498.

Because of the strength of the Canadian dollar, Canadian food processors have continued to face more competition from imported prepared foods in 2011-2012. The use of Canadian dairy ingredients in food processing still managed to grow, more notably the use of skim and whole milk powder, liquid milks and yogurt. The Special Milk Class Permit Program also experienced some growth in the use of butter.

Scholarship Program

The CDC helps introduce new products, technologies and markets to the dairy industry through its support of the CDC Scholarship Program. Launched in the fall of 2006, this program promotes graduate studies in agricultural economics and policy, and food, dairy or animal science as these fields relate to the dairy industry. It provides $20,000 per year for up to two years to full time M. Sc. students and $30,000 per year for up to three years to full time Ph. D. students. Between 2006 and 2011, the CDC funded 57 masters' projects and 20 doctorates[12]. The program was renewed for another five-year period as of August 1, 2011. Three million dollars will be distributed to institutions across Canada as follows.

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

[12] For more information on these research projects : http://www.cdc-ccl.gc.ca/CDC/index-eng.php?id=4001

Exports

During the 2011-2012 dairy year, the majority of dairy product exports were performed by the private sector under permits from the CDC. The main role of the CDC was to dispose of the structural surplus of solids non fat mainly in the form of skim milk powder or blends containing skim milk solids. During the 2011-2012 dairy year, Canada exported 9,300 tonnes of skim milk powder.

In regard to cheese exports, the CDC's major responsibility is to deliver certificates to Canadian exporters that give them access to the aged cheddar market in the European Union. In 1980, Canada negotiated a special access quota with the European Union which amounts to 4,000 tonnes. For the fourth year in a row, Canada was not able to take advantage of part of that access. This was partly compensated by issuing export permits for other markets. In total, Canada has exported 4,896 tonnes of cheese within the limits of Canada's export commitments under its WTO obligations.

Exports Limits and Product Exported

Category	Export limit (million $)	Product exported (million $)
Butter	11.025	0*
Cheese	16.228	14.384
Skim milk powder	31.149	31.149
Others	22.505	22.473
Incorporated products	20.276	20.276

*There was no surplus butter to export in 2011-2012

Industry Support

The CDC regularly supports a number of initiatives that benefit the entire dairy industry. One of these is the Canadian Quality Milk (CQM) Program which is administered by Dairy Farmers of Canada (DFC). This quality assurance programme is HACCP-based. In 2011-2012, the CDC contributed $300 for each Canadian dairy farm validation for a total of $638,400. This reduced the costs of the program for farmers and created an incentive for them to participate. CDC's contribution to the CQM program will be reduced to $200 per farm in 2012-2013 and to $100 per farm in 2013-2014, and is set to expire on July 31, 2014.

In 2011-2012, the CDC continued its partnership with Agriculture and Agri-Food Canada, the Natural Sciences and Engineering Research Council of Canada and DFC to fund a dairy research cluster. It supports 48 research projects on the role of dairy products or key components on cardiovascular health, their impact on healthy weight and body composition, and their role in optimal nutrition, development and maintenance, as well as studies on the environmental footprint of the dairy sector in Canada. Important achievements were made in the past year, the second of three years for most projects underway in the program.

Performance and Goals

Achievements for 2011-2012

A) BUSINESS SEGMENT: PRODUCER REVENUE

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

Pricing of industrial and fluid milk

The CDC plays two roles when it comes to the pricing of milk at the farm level. The most important is to establish support prices for butter and skim milk powder (SMP). The CDC conducts an annual survey to establish the national cost of producing one hectolitre of milk. This cost is one of the main drivers of support prices. The CDC also calculates the pricing formula for fluid milk twice a year. The old formula, which was agreed to by dairy industry stakeholders from coast to coast, expired in August 2011.

Expected result	Performance indicator	Achievements	% complete
Efficient producers of milk receive adequate revenues.	• In 2011-2012, revenues from milk sales covered the cost of a reasonable percentage of the milk produced in Canada.	• In 2011-2012, revenues from milk sales covered the cost of a reasonable percentage of the milk produced in Canada.	100

Specific activities for 2011-2012	Achievements	% complete
Continue to refine the calculation of the cost of production by updating the rates allocated to management time by producers.	The CDC did not change the rates allocated to management for its February 1, 2012 support price decision. Analyses are ongoing.	30
Facilitate discussions with all industry stakeholders to arrive at a formula for fluid milk for the period after August 2011.	An industry committee facilitated by the CDC arrived at a new fluid pricing formula in October 2011. This formula is in place for two years effective February 1, 2012.	100

Market development

The CDC administers several programs aimed at expanding the market for dairy products and ingredients. Some of these programs encourage innovation and education while others involve public policy. The Domestic Dairy Product Innovation Program (see p. 23) aims at encouraging dairy processors to develop new dairy products by providing access to additional milk. The Dairy Marketing Program (see p. 23) provides expertise and easy access to programs and services that encourage the manufacture and use of dairy ingredients. Through its Scholarship Program (see p. 24), the CDC encourages graduate students to choose research topics that are related to the dairy industry.

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

Expected result	Performance indicators	Achievements	% complete
Canadian demand for dairy products and components is sustained or increased.	• 5 new projects approved under the Matching Investment Fund (MIF)	• 5 new projects were approved under the MIF.	100
	• New version of Domestic Dairy Product innovation Program (DDPIP) is up and running.	• The revised DDPIP guidelines were implemented August 1, 2011.	100

Specific activities for 2011-2012	Achievements	% complete
Review the MIF to determine whether it should be renewed beyond 2012 and in what form.	The board renewed the MIF for two years starting on August 1, 2012.	100
Renew the Scholarship Program for five years, from August 2011 to July 2016. Canadian establishments will receive $3 million to fund graduate studies related to the dairy industry and will continue to be encouraged to match the CDC's contribution.	The CDC Scholarship program has been renewed for five years.	100
In an effort to gain efficiency in the administration of the SMCPP (including audits and IT requirements), conduct a business process analysis of the program from start to finish.	The CDC hired a private firm to conduct the business process analysis and the report was presented to the board who decided to proceed with the revamping of the computer system for the administration of the SMCPP.	100

Pool administration

The CDC administers three federal-provincial agreements that frame the sharing of revenues and markets among Canadian milk producers (see p. 21-22). As the administrator of the pools, the CDC chairs the decision making bodies and provides them with technical expertise and secretariat services.

Expected result	Performance indicators	Achievements	% complete
Market and revenues are shared between pool partners in accordance with federal-provincial agreements.	• Pooling calculations are done within 3 working days of reception of all provincial data.	• Pooling calculations were done within 3 working days of reception of all provincial data.	100
	• Funds are transferred no later than 5 working days after calculations.	• Funds were transferred no later than 5 working days after calculations.	100
	• No requests for recalculation of pooling transfers were received from provincial marketing boards.	• No requests were received.	100

Specific activities for 2011-2012	Achievements	% complete
Facilitate negotiations among industry stakeholders to arrive at a new federal-provincial agreement that would pool all milk from British Columbia to Newfoundland and Labrador.	Since September 2011, the CDC has been facilitating and providing technical expertise to the P10 Negotiating Committee (P10 NC). This committee has had 7 meetings. Discussions are centered on market and revenue sharing, as well as milk allocation to plants. The P10 NC should complete its work in September 2012. Several recommendations were made to the CMSMC in July 2012, and adopted, regarding milk allocation and market growth.	50

External Audits

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

Expected results	Performance indicators	Achievements	% complete
Milk components are paid for in accordance with their end use and products imported under the Import for Re-export Program (IREP) are re-exported.	• 40 audits of special class participants	• 62 audits of special class participants have been completed.	100 (field work)
	• 6 audits of IREP participants	• 9 IREP audits	100
	• Milk plant utilization audits in 6 provinces	• 21 milk plant utilization audits in 6 provinces have been completed.	100
	• Milk plant utilization audits are monitored and reported on twice a year in the 4 other provinces.	• Reports have been prepared for 4 provinces.	100
	• An audit of pooling data has been performed in all 10 provinces and data have been accurately reported.	• Reports of pooling data have been completed for 9 provinces.	90

Specific activities for 2011-2012	Achievements	% complete
Seek to further harmonize audit practices in all provinces and further promote the use of software to automate the declaration of milk utilization in all provinces.	The CDC met with Quebec and Ontario to harmonize audit practices across the Eastern milk pool. The conclusion of this meeting was to extend the reporting software in use in Ontario and Quebec to the Maritime provinces. Discussions have been held with the Maritime provinces. Producers and processors in each province must next agree on the initiative. Eastern provinces have met with the CDC and following discussions, improved some audit practices.	20

B) BUSINESS SEGMENT: SUPPLY OF DAIRY PRODUCTS

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

National industrial milk supply

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

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

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

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

Expected results	Performance indicator	Achievements	% complete
• The Canadian milk production matches demand.	• Milk production is between 99.5 and 100.5% of total quota.	• In 2011-2012, milk production was at 100.8% of total quota. Production increased drastically throughout the year as producers fully used their quota.	90
• Exports of solids non fat are maximized.	• Subsidized export categories of skim milk powder and incorporated products are filled at least at 95%.	• In 2011-2012, these two exports categories are filled at 100%.	100

Specific activities for 2011-2012	Achievements	% complete
Continue discussions and technical analysis with members of the Secretariat in order to monitor potential improvements in methods to evaluate demand and adjust quota accordingly.	The CDC developed tools to illustrate any lag between demand and production and the resulting pressure on stocks. These tools allow for better decision making related to the implementation of a growth allowance on the milk quota.	100
Reduce its class 4(m) inventories of skim milk powder to 5,000 t by the end of the dairy year.	At year end, class 4(m) inventories of SMP stand at 22 619 t. This is due to increased milk production and reduced use in the animal feed market.	0
Reduce meeting expenses by making better use of existing technologies and by implementing new ways of working with the industry.	At year end, the number of meetings held via conference calls and Webinars increased by 9% while the number of participants increased by approximately 100 people compared to last year. This increased the meeting costs using these two technologies by only $825. The increase in meeting costs would have been much greater if all these people had travelled. Webinars and conference calls were used as appropriate.	100
Hold targeted technical discussions and brainstorming sessions among its staff members. These sessions will be related to key issues of the industry and will allow different staff members to contribute opinions and solutions. If this format of discussions seems to be beneficial, people from outside the CDC, including experts from AAFC, may be invited from time to time, depending on the issue to be discussed.	The CDC held two of these brainstorming sessions. In August 2011, 10 employees participated in a session on national all milk pooling and in February 2012, 15 employees participated in a session on a comprehensive long term strategy for the marketing of milk solids non fat.	70

Seasonality programs

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

Expected results	Performance indicator	Achievements	% complete
Dairy products are available to Canadians throughout the year.	• Provincial milk marketing boards report no seasonal shortages of dairy products.	• No shortages have been reported by provincial milk marketing boards.	100
	• Plan A butter stocks do not fall below 90% of normal level.	• Plan A butter stocks were already low at the beginning of the dairy year and remained below 90% of their normal level during the entire year. Low production made it difficult to rebuild stocks and butter manufacturers favoured Plan B, where they retain the ownership of the product.	0

Specific activities for 2011-2012	Achievements	% complete
Continue to administer the seasonality programs.	The CDC continued to administer these programs. In December 2011, it announced some changes to its program policies to encourage butter manufacturers to sell butter to the CDC under the Plan A program in 2012 to ensure supplies during that calendar year.	100

Canadian Quality Milk program (CQM)

The CDC supports the Dairy Farmers of Canada (DFC) in the national implementation of this milk quality assurance program at the farm level. It offers financial support for the validation of farms under the program (see p. 25).

Expected results	Performance indicator	Achievements	% complete
Implement a milk quality assurance program at the farm level.	60% of Canadian milk producers are validated under the CQM by August 1, 2012.	According to reports submitted by provinces in August 2012, 49% of producers were validated. Some provinces are experiencing delays in the implementation of the program.	80

C) BUSINESS SEGMENT: IMPROVE THE CDC

Internal Services

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

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

Complete the transition to IFRS

Activity	Achievement	% complete
Make CDC financial systems compliant with IFRS on August 1, 2011.	The Office of the Auditor General (OAG) gave a clean opinion of the 2011-2012 financial statements prepared using IFRS.	100

Implement the recommendations contained in the OAG Special Examination Report

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

Activity	Achievement	% complete
The board will periodically assess its collective skills and continue to seek outside expertise when deemed necessary for specific projects such as IFRS and it will continue to explore possible approaches with federal government central agencies.	The board periodically assesses its collective skills and continues to seek outside expertise when deemed necessary for specific projects.	100
The board will create a provision in its by-laws that will require each member to put on record any existing (potential, real or perceived) conflict under the *Conflict of Interest Act*, and will develop procedures to manage such conflicts. The CDC will discuss specific issues with the Privy Council Office and the Office of the Conflict of Interest and Ethics Commissioner in an attempt to find workable solutions.	The board created a provision in its by-laws that requires each member to put on record any existing (potential, real or perceived) conflicts under the *Conflict of Interest Act*, and developed procedures to manage conflicts.	100

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

In the fall of 2010, TBS circulated new guidelines on the annual reports of Crown corporations. Although the version circulated was not quite final, the CDC undertook to examine the changes that would be required to comply with these new guidelines. In January 2011, the CDC decided that its next annual report would comply with the draft guidelines and that adjustments would be made later if the final version of the guidelines differed from the draft.

Activity	Achievement	% complete
Produce the annual report on dairy year 2010-2011 using the draft TBS guidelines.	The 2010-2011 Annual Report was produced according to the TBS guidelines and future reports will follow these guidelines as well.	100

Adopt the government fiscal year for all activities

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

Activity	Achievement	% complete
Identify and analyze the repercussions of planning all activities and reporting on them on a fiscal year basis only. This analysis will include consultations with the industry and central government agencies.	After analysis and consultation, the board decided to align all the activities of the CDC on the dairy year. A four-month transition budget was therefore adopted for the period April 1 to July 31, 2012. All activities are on a dairy year basis as of August 1, 2012.	100

Prepare and post unaudited quarterly financial statements

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

Activity	Achievement	% complete
Prepare quarterly financial statements, post them on the Internet site, and send them to TBS within 60 days of the end of each quarter.	The CDC prepared quarterly financial statements, posted them on its Internet site and sent them to TBS and the minister of Agriculture and Agri-Food within 60 days of the end of each quarter.	100

Program evaluations

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

Activity	Achievement	% complete
As part of its 5-year program evaluation cycle, the CDC will conduct a program evaluation of the Matching Investment Fund to provide input to decision makers regarding its renewal.	The CDC conducted a program evaluation of the Matching Investment Fund to provide input for decisions regarding its renewal.	100

Internal audits

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

Activity	Achievement	% complete
As part of its 6-year audit plan, the CDC will conduct internal audits on the following activities: business continuity plan (monitoring), threat risk assessments (monitoring), financial statements and responsiveness of management accounting to accountability needs, freight and warehousing, Matching Investment Fund and a peer review of the internal audit function.	The CDC conducted an internal audit of the Matching Investment Fund, the business resumption plan and the threat risk assessment. A peer review of the internal audit function was also performed by a private firm and the report was approved by the board in January 2012. The audit of financial statements and responsiveness of management accounting to accountability needs is postponed to the following year. The work on freight and warehousing is 60% complete.	90

Appointment of a CEO

The Minister of Agriculture and Agri-Food announced the appointment of Mr. Jacques Laforge as the CEO of the Canadian Dairy Commission for a three-year term starting February 2, 2012.

Activity	Achievement	% complete
Once the new CEO is appointed by the Governor-in-Council, the CDC's Corporate Services staff, the senior management team and the other two board members will ensure that he or she gets all the training and orientation required to fully participate in board activities and efficiently lead the CDC towards the accomplishment of its goals.	The new CEO was rapidly presented with a briefing book and he met with all CDC managers who explained the roles of the various teams within the CDC. The secretary to the board, other commissioners and senior management ensured that he received all the required information.	100

Implement a new code of values and ethics

All organizations that are part of the federal government are required to adopt and implement a new values and ethics code. Adherence to the new code is a condition of employment for employees of the CDC.

Activity	Achievement	% complete
Implement a new code of values and ethics based on the model provided by TBS.	The CDC Code of Ethics was approved by the board in March and became effective April 2, 2012.	100

Increase the efficiency of CDC's operations

The CDC has vast amounts of valuable data in its possession. In the past years, the CDC has put a lot of effort into presenting this information to the industry. As there is an increasing number of requests from the industry, there is now an even greater demand for more analysis of the data. This presents a problem for the IT section as it has to prioritize these demands. Certain administrative functions at the CDC are performed by several staff members in various teams. It might be more efficient for the CDC to centralize some of these functions, to automate certain steps of these functions, or to review some of the processes.

Activity	Achievement	% complete
Create an internal committee to prioritize the reporting and analysis needs of the CDC, so that the IT section is able to respond to the most important requests.	The internal committee that the CDC planned to create to prioritize the reporting and analysis needs of the CDC has not been put in place. In the new dairy year, this mandate will be given to an IT Advisory Committee (see objectives for dairy year 2012-2013).	0
Create a small internal task force that will be mandated to study how to make some administrative functions, such as travel claims and bill payment, more efficient. This group will report to the senior management team (SMT).	The CDC created a small internal task force mandated to study how to make some administrative functions, such as travel claims and bill payment, more efficient. This group reported its recommendations to the SMT in May 2012. Implementation of the recommendations has started.	100

GOALS FOR THE PERIOD 2012-2013 TO 2016-2017

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

Pricing of industrial and fluid milk

Expected result	Performance indicator
Efficient producers of milk receive adequate revenues.	Revenues from milk sales cover the cost of a reasonable percentage of the milk produced in Canada.

Specific activities for 2012-2013	Performance indicator
Review the calculations of the labour component of the COP study.	• Analysis of labor calculations • Allocation of appropriate rates to producer management time
Update and harmonize the procedures for the COP study.	• A COP Technical Committee is in place and makes recommendations to the CDC regarding the harmonization of COP data collection and reconciliation with a focus on reducing the cost of this annual study.

Market development

Expected result	Performance indicator
Canadian demand for dairy products and components is sustained or increased.	Programs that the CDC administers and that promote innovation are used by their intended audience.

Specific activities for 2012-2013	Performance indicator
Implement the new guidelines of the DDPIP and monitor compliance by program participants with the new guidelines.	• Communication of new guidelines to participants • Participants comply with the new guidelines • Reception of 40 applications
Implement the new format of the MIF program.	• Reception of 5 applications under the new program
Increase the level of activity under the Dairy Marketing Program.	• 55 visits to targeted dairy ingredient users • 5 trade shows • 5 outreach activities
Implement the agreed to recommendations of the business process analysis report.	• Undertake the creation of the new special class Web-based, interactive computer application under the supervision of an internal steering committee.

Pool administration

Expected result	Performance indicator
Market and revenues are shared between pool partners in accordance with federal-provincial agreements.	• Pooling calculation is done within 3 working days of reception of all provincial data. • Funds are transferred no later than 5 working days after calculations. • No requests for recalculation of pooling transfers received from provincial marketing boards.

Specific activities for 2012-2013	Performance indicator
Continue working with the P10 Negotiating Committee to arrive at an agreement on revenue sharing, market sharing and milk allocation. Provide relevant and required technical analyses.	• Circulation of a draft agreement to all provinces and reception of comments

External audits

Expected results	Performance indicators
Milk components are paid for in accordance with their end use and any audited company that does not comply with Import for Re-export Program (IREP) requirements is reported to the Department of Foreign affairs and International Trade (DFAIT).	• 45 audits of special class participants • 6 audits of IREP participants • Milk plant utilization audits in 6 provinces • Milk plant utilization audits are monitored and reported on twice a year in the other 4 provinces. • Audit assurance is obtained through specified procedures performed in all 10 provinces and data are accurately reported.

Specific activities for 2012-2013	Performance indicators
Hold a meeting of provincial auditors at the national level to promote the use of harmonized best audit practices.	Hold meeting
Participate in harmonization efforts at the regional levels (East and West).	More harmonized audit practices in the East and the West
Report on progress of audit activities in the four provinces where the CDC is not the auditor and promote continuity of services and the use of a common milk utilization audit software.	Presentation of reports
Continue to encourage the reception of audited electronic data from Ontario and Quebec for the purpose of administering the program and auditing participants of the Special Milk Class Permit Program.	Regular reception of audited data from Ontario and Quebec

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

Manage the national industrial milk supply

Expected results	Performance indicators
• The Canadian milk production matches demand. • Exports of solids non fat are maximized.	• Milk production is between 99.5 and 100.5% of total quota. • Subsidized export categories of skim milk powder and incorporated products are filled at least at 95%.

Specific activities for 2012-2013	Performance indicators
Review the calculation of total demand and the level of stocks needed to ensure sufficient supplies of dairy products year round.	• Presentation of recommendations to the CMSMC Secretariat.
Examine the need for a permanent growth reserve to be added to the quota for industrial milk. This reserve would ensure that enough milk is available during periods of significant market growth.	• Close monitoring and periodical assessment of the need for a growth allowance. In addition, develop a recommendation for a permanent growth reserve to ensure that enough milk is available during periods of significant market growth.
Initiate discussions and consultations with the industry to develop a long term ingredient strategy that would build on past initiatives and increase utilization of surplus solids non fat.	• Presentation of a draft strategy to the CMSMC • Agreement on a final strategy by the CMSMC

Seasonality programs

Expected results	Performance indicators
Dairy products are available to Canadians throughout the year.	• Provincial milk marketing boards report no seasonal shortages of dairy products. • CDC butter stocks never fall below 90% of normal level.

Specific activities for 2012-2013	Performance indicators
Monitor the effects of the changes to seasonality program policies for the 2012 calendar year to ensure that they meet their objectives and adjust policies for 2013 if required.	• Submission of report to the board on the effects of the 2012 changes • Presentation to the board of adjustments to the policies

Internal Services

The CDC plans to undertake the following strategic activities during dairy year 2012-2013.

Adopt a dairy year basis for all activities

Harmonize all CDC activities and operations to be based on the dairy year (August 1 to July 31).

Program evaluations

Conduct a program evaluation of milk class 4(a)1, a class put in place in 2005 to encourage the use of solids non fat in the manufacture of non-standardized products in the processed cheese category.

Internal audits

Perform internal audits of the following activities: funding of the Dairy Research Cluster by the CDC, conformity of the annual report to TBS guidelines, the memorandum of understanding (MOU) between the CDC and Justice Canada for legal services, the MOU between the CDC and Agriculture and Agri-Food Canada for IT services, the management of butter resale, data collection for the annual survey on the cost of production and financial statement and responsiveness of management accounting to accountability needs. Internal auditors will also monitor and provide advice for the design of the new computer application for the Special Milk Class Permit Program.

Implement new code of values and ethics

The *Public Servants Disclosure Protection Act* requires that all organizations that are part of the federal government adopt and implement a new values and ethics code. The CDC board adopted a code of ethics for the CDC on March 28, 2012 and this code constitutes a condition of employment for employees. This new code replaces the Values and Ethics Code for the Public Service.

Communicate its new code of ethics to its staff. This code includes employee obligations related to conflicts of interest and post-employment.

Increase the efficiency of CDC's operations

Create an IT advisory committee to prioritize the needs of the CDC, so that the IT section is able to respond first to the most important requests.

Implement the agreed upon recommendations made by a small internal task force that was mandated in 2011-2012 to study how to make some administrative functions more efficient.

Maintain employee engagement in a cost-reduction environment

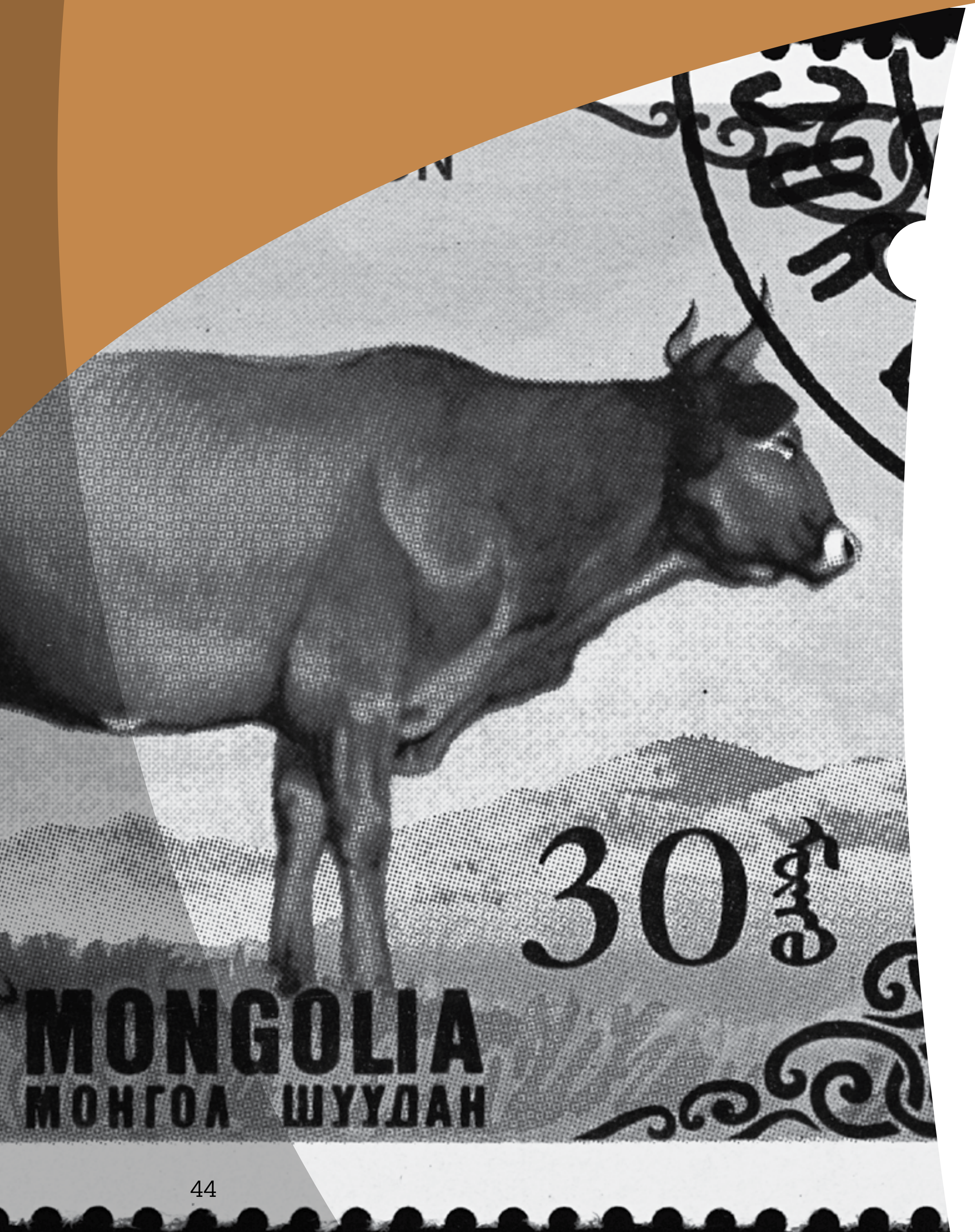
The administrative budget of the CDC will be reduced over the next three years. This may cause some employees to feel insecure and disengaged if nothing is done to reassure and inform them of the situation.

Assess current and future HR requirements and work load to mitigate the impact of the budgetary constraints on the CDC workforce and on the delivery of programs and services.

Implement mechanisms that encourage co-operation, exchange of ideas and sharing of resources within the CDC to produce efficiency gains and reduce costs.

Ensure continuous communication with its staff members about the actual budget constraints and how they will be managed.

Financial Report



Management Discussion and Analysis

The following discussion and analysis of the operating results and financial position of the Canadian Dairy Commission (CDC) for the year ending July 31, 2012 should be read in conjunction with the financial statements of the CDC enclosed herein and the annual report.

Selected Key Results of Operations

Domestic activities

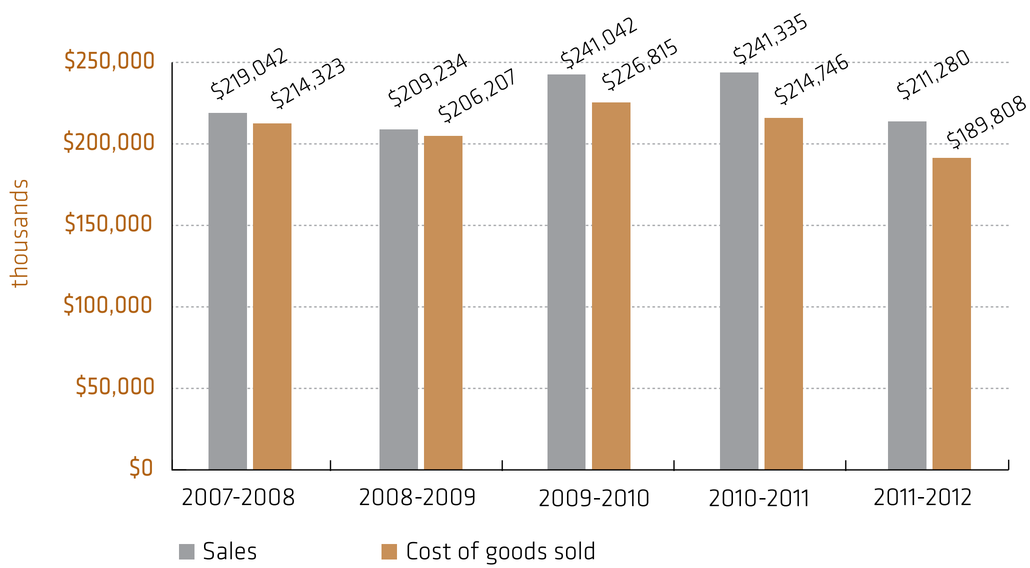
Sales

In the 2011-2012 dairy year, total revenues from domestic sales decreased by $30 million or 12% compared to the previous year. This is mainly due to lower sale revenues for Plan A butter. A quantity of 1,399 tonnes of Plan A butter was sold this year compared to 5,255 tonnes in the previous year. This decreased revenues by approximately $26 million. The decrease in the quantity of Plan A sold is the result of the CDC carrying lower inventories compared to the previous year. Lower milk production than anticipated in the 2010-2011 dairy year created greater demand for the CDC butter stocks to supply the market. As a result of incentives by provincial marketing boards and agencies to increase production along with favorable conditions, milk production gradually increased throughout the year and the CDC was able to partly rebuild its Plan A butter stocks toward normal levels.

The CDC purchases Plan B butter and skim milk powder (SMP) from processors with the requirement that processors repurchase their product within a pre-determined period. A decrease in the resale of Plan B butter this year compared to dairy year 2010-2011 was offset by an increase in sales of Plan B SMP.

As for imported butter, the volume sold decreased by 18% which decreased revenues by $2.4 million compared to the previous year.

Domestic activities



SMP sold to the animal feed sector under class 4(m) amounted to 22,005 tonnes in 2011-2012, a decrease of 3,320 tonnes compared to the previous year which reduced domestic revenues by $1.7 million.

Cost of goods sold

For the dairy year ending July 31, 2012, the cost of goods sold amounted to $189.8 million compared to sales revenues of $211.3 million. This resulted in a gross profit before transport and carrying charges of $21.5 million for domestic activities.

Over 85% of the domestic gross profit before transport and carrying charges is due to activities in the animal feed market ($18.5 million out of $21.5 million).

The cost of butter and skim milk powder sold under Plan B was almost equal to the selling prices obtained during the year as these products were purchased and sold at prevailing support prices.

The CDC continues to import butter as part of Canada's obligations under the World Trade Organization Agreement (WTO). This butter is purchased at prevailing world prices and is directed to the further processing industry through butter manufacturers.

Export activities

Sales

Export sales revenues were lower compared to the previous year, mainly due to the fact that the CDC exported less SMP at lower prices.

The quantity of skim milk powder sold in 2011-2012 amounted to 9,259 tonnes compared to 10,828 tonnes for the previous dairy year. This decreased revenues by $10.01 million. In spite of depressed export prices during the year, the CDC managed to generate more revenues from this activity than in 2008-2009 and 2009-2010.

Cost of goods sold

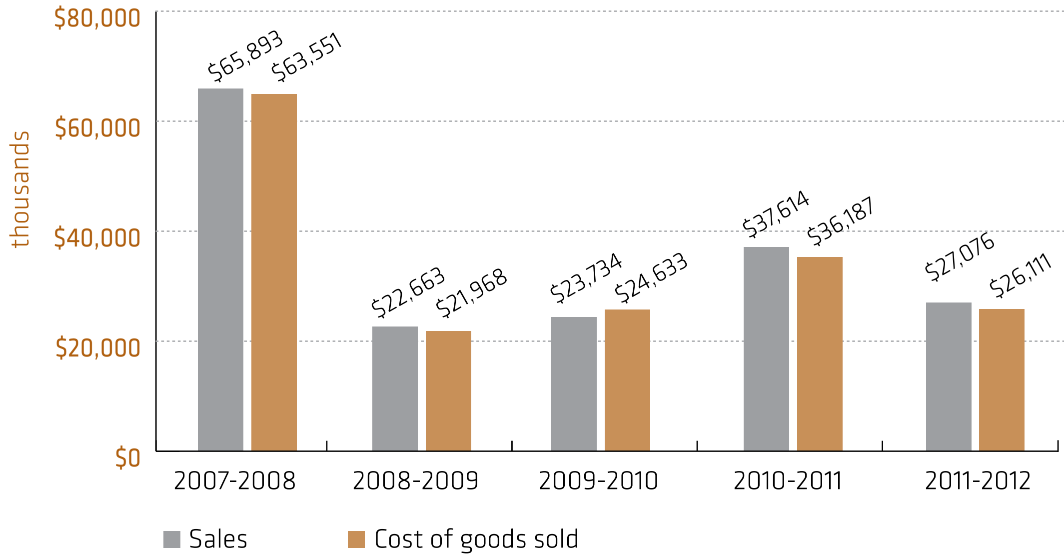
The CDC purchases surplus dairy products destined for export at prices that reflect the prevailing world market conditions with the intent of breaking even over the course of each dairy year. As these markets are very difficult to predict, the CDC may sometimes finish the dairy year with minimal gains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

For the dairy year ending July 31, 2012, the cost of goods sold totalled $26.1 million compared to sales revenues of $27.1 million, resulting in a gross profit before transport and carrying charges of $0.97 million compared to a profit of $1.4 million in the previous dairy year.

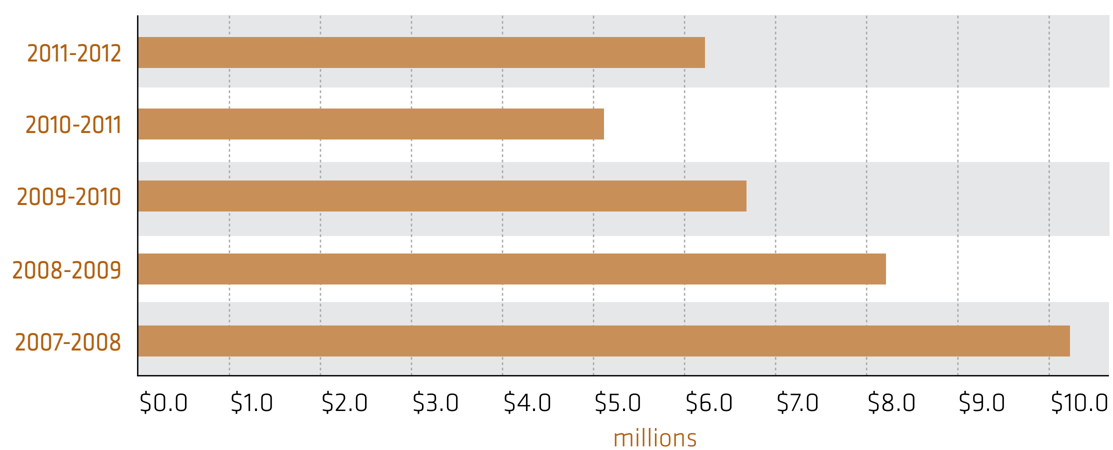
Transport, carrying, and financing costs

Transport, carrying, and financing costs are mainly comprised of transportation expenses, interest expenses on loans, handling and storage charges, and insurance. Transport costs increased by $0.6 million compared to those of 2010-2011, totalling approximately $1.8 million for the current year. Financing costs were slightly higher at $0.6 million compared to $0.5 million, but still much

Export activities



Transport and carrying charges



lower than the historical average because of continued low borrowing rates. These rates are expected to remain at relatively low levels well into 2013.

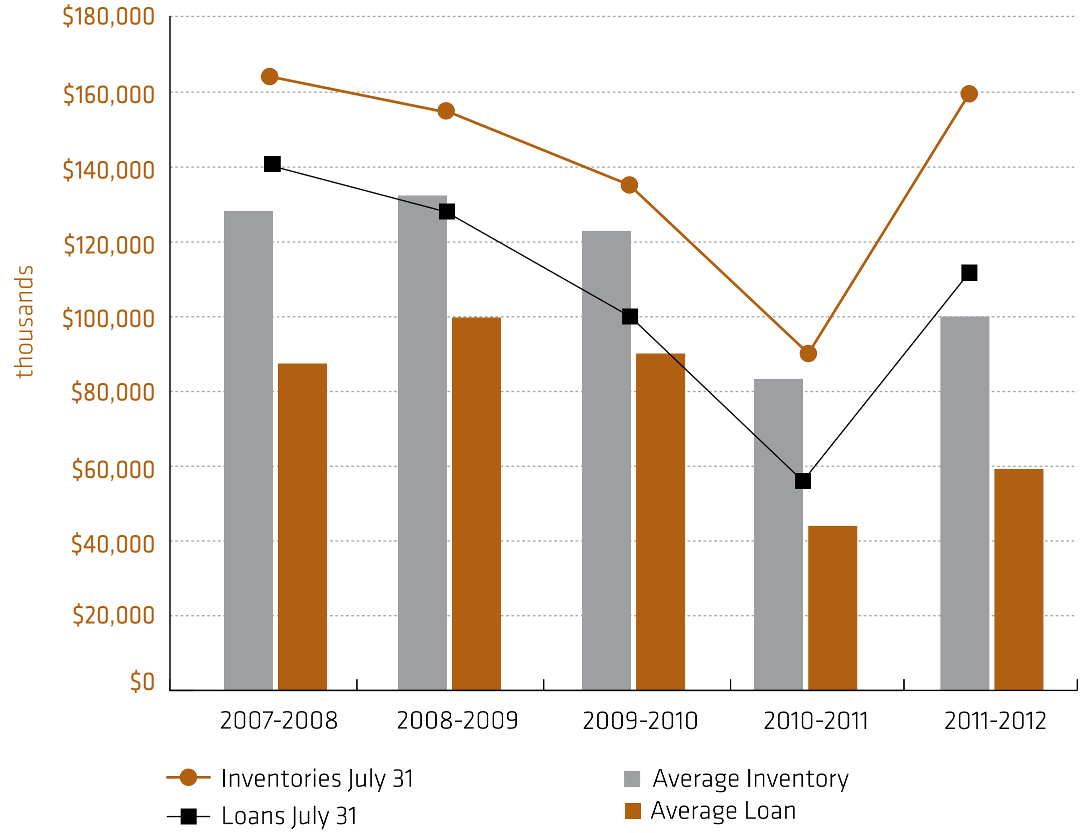
The other factors responsible for the increase in transport, carrying charges and finance costs are storage and handling charges. These have increased from $3.2 million in 2010-2011 to $3.6 million in 2011-2012. This increase was directly attributable to the building up of CDC's inventory levels throughout 2011-2012.

Inventories and loans

Average inventory values were up 20% in the 2011-2012 dairy year compared to the previous year, resulting in an increase in our year over year average loan requirements which rose on average by 16%. Butter stocks have returned to normal levels and the inventory of SMP for the animal feed market was 12.6 million kg higher than at the end of the previous year. As a result of improved milk production, the CDC was able to rebuild its stocks of butter but as a consequence, stocks of SMP for animal feed also increased.

The CDC, in consultation with the Minister of Finance, has retained its loan limit for 2012-2013 at $165 million. The CDC determined that this limit would be sufficient to maintain its capacity to respond to unforeseen circumstances brought on by changing market conditions.

Inventories and loans



Risk management

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

The CDC has prepared a Corporate Risk Profile which is reviewed and updated at least once per year (latest review was March 2012) by management. It outlines the risks identified by managers and directors as posing a threat to the core mandate of the CDC or to the achievement of its goals. The profile defines each risk, describes the existing measures for managing the risk, as well as incremental risk management strategies and identifies the group responsible for implementing these strategies. The profile is taken into consideration when doing the environmental analysis during the Commission's annual strategic planning session.

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

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

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

Administrative expenses

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

The total 2011-2012 administrative budget was $8.1 million. Actual administrative expenses for the year totalled $7.9 million. Salaries and employee benefits of $5.8 million make up the bulk of these expenses. The remaining significant expense groupings are for rent, travel and administrative support.

The government has undertaken a Deficit Reduction Action Plan with the goal of reducing expenditures on an ongoing basis until fiscal year 2014-2015. According to the Federal Budget, tabled in Parliament on March 29, 2012, the funding that the CDC receives from the government will be reduced by 10% or $393,000 by April 1, 2014. The CDC has taken cost reduction measures to reduce its overall 2012-2013 administrative budget by $96,000. Further budgetary reductions are planned for dairy years 2013-2014 and 2014-2015 in order to take into account the 10% reduction in government funding.

Future accounting changes

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

Challenges for the future

As in the past, the main factor that could affect the financial results of the CDC in the coming years is the fluctuations in world prices for dairy products. In recent years, these have been increasingly volatile. This directly affects the CDC revenues for skim milk powder export sales and indirectly affects revenues for the sales of surplus skim milk powder on the animal feed market. Close monitoring of world prices, choosing niche markets and strategically taking advantage of periods in which prices are increasing allows the CDC to maximize its revenues from these markets.

During much of the last dairy year, provincial boards and agencies put several production incentives in place to satisfy a growing demand for dairy products and replenish butter stocks. Those initiatives were successful and butter stocks were replenished but as a result, surplus skim milk powder stocks increased significantly. To reduce SMP inventories to a reasonable level, the CDC will need to be more aggressive when selling its SMP to the animal feed sector and stimulate the direct use of solids non fat in the ingredients market. Also, the Canadian Milk Supply Management Committee recently created a new program for the redirection of liquid skim milk to yogurt manufacturers who experience growth in their market and require more milk. If successful, this program will assist yogurt manufacturers in obtaining the additional skim milk they require and will reduce the volumes of surplus SMP being offered for sale to the CDC.

On the international front, negotiations at the WTO have not progressed during the last 18 months and it is unclear whether or not a new multilateral trade agreement will come into force in 2012-2013. Consequently, there is no indication whether WTO members will implement their commitment to eliminate all forms of export subsidies by the end of 2013. The possibility of Canada's subsidized exports being reduced to zero and the CDC's inability to export the structural surplus of SMP is therefore delayed. That being said, the industry continues to face competition from substitute products. Soy beverages, cheese analogs, frozen desserts and flavoured milk beverages are serious threats for the markets traditionally occupied by milk, mozzarella cheese, real ice cream and chocolate milk. The industry will continue to closely monitor the market erosion for Canadian dairy products and consider offering incentive programs to sustain growth in the consumption of dairy products.

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 the International Financial Reporting Standards, 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 CDC policies and statutory requirements. This process includes the communication and ongoing practice of the CDC's Code of Ethics.

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 CDC'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 CDC have been audited by the Auditor General of Canada, the independent auditor for the Government of Canada.

Jacques Laforge, CEO

Gaëtan Paquette, Senior Director,
Finance and Operations

Ottawa, Canada
September 27, 2012

Auditor General of Canada
Vérificateur général du Canada

Independent Auditor's Report

To the Minister of Agriculture and Agri-Food

Report on the Financial Statements

I have audited the accompanying financial statements of the Canadian Dairy Commission, which comprise the statements of financial position as at 31 July 2012, 31 July 2011 and 1 August 2010, and the statements of operations and comprehensive loss, statements of changes in equity and statements of cash flows for the years ended 31 July 2012 and 31 July 2011, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audits. I conducted my audits in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Canadian Dairy Commission as at 31 July 2012, 31 July 2011 and 1 August 2010, and its financial performance and its cash flows for the years ended 31 July 2012 and 31 July 2011 in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

As required by the *Financial Administration Act*, I report that, in my opinion, the accounting principles in International Financial Reporting Standards have been applied, after giving retrospective effect to the adoption of the new standards as explained in Note 15 to the financial statements, on a basis consistent with that of the preceding year.

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

Dale Shier, CA
Principal
for the Auditor General of Canada

27 September, 2012
Ottawa, Canada

Statement of Financial Position

(in thousands of Canadian dollars)

	July 31, 2012	July 31, 2011	August 1, 2010
Assets			
Current			
Cash	$ 134	$ 146	$ 182
Trade and other receivables			
Trade	2,909	6,340	1,148
Advance to provincial milk boards and agencies	1,794	1,154	2,314
Milk pools	993	1,072	1,332
Derivative asset - foreign exchange contracts	54	67	1
Inventory (Note 4)	159,888	94,322	135,228
	$ 165,772	$ 103,101	$ $140,205
Liabilities			
Current			
Bank overdraft (Note 5)	$ 1,794	$ 1,154	$ 2,314
Trade and other payables			
Trade	14,321	14,563	17,276
Distribution to provincial milk boards and agencies payable	8,672	14,573	4,385
Other liabilities	1,211	1,254	1,209
Derivative liability - foreign exchange contracts	61	294	4
Loans from the Government of Canada (Note 6)	127,277	55,848	98,927
	153,336	87,686	124,115
Long-term			
Post-employment benefits (Note 11)	596	643	1,175
Equity			
Retained earnings	11,840	14,772	14,915
	$ 165,772	$ 103,101	$ $140,205

Commitments (Note 13)

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

These financial statements were approved and authorized for issue on September 27, 2012.

Jacques Laforge
Chief Executive Officer

Randy Williamson
Chairman

Gaëtan Paquette
Senior Director, Finance and Operations

Statement of Operations and Comprehensive Loss

(in thousands of Canadian dollars)

	Twelve months ended July 31, 2012	Twelve months ended July 31, 2011
Sales and Cost of Sales		
Domestic sales revenue	$ 211,280	$ 241,335
Cost of goods sold - domestic	189,808	214,746
Transport and carrying charges	4,790	3,694
Finance costs	579	505
Gross profit on domestic sales	16,103	22,390
Export sales revenue	27,076	37,614
Cost of goods sold - exports	26,111	36,187
Transport and carrying charges	978	910
Finance costs	1	9
Gross profit (loss) on export sales	(14)	508
Total gross profit	16,089	22,898
Other income		
Funding from milk pools (Note 9)	5,676	6,419
Funding from the Government of Canada (Note 10)	4,668	4,031
Audit services	237	124
	10,581	10,574
Total	**26,670**	**33,472**
Operating Expenses		
Industry initiatives	2,524	426
Concentrated Milk Assistance Program	4	109
Cost of Production study	840	824
Other charges (recoveries)	(305)	91
	3,063	1,450
Administrative Expenses		
Salaries and employee benefits (Note 11)	5,842	5,683
Other administrative expenses	2,025	1,909
	7,867	7,592
Total	**10,930**	**9,042**
Profit before distribution to provincial milk boards and agencies	**15,740**	**24,430**
Distribution to provincial milk boards and agencies	18,672	24,573
Total comprehensive loss	**$ (2,932)**	**$ (143)**

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

Statement of Changes in Equity

(in thousands of Canadian dollars)

	Twelve months ended July 31, 2012	Twelve months ended July 31, 2011
Retained earnings, beginning of year	$ 14,772	$ 14,915
Total comprehensive loss for the year	(2,932)	(143)
Retained earnings, the end of the year	$ 11,840	$ 14,772

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

Statement of Cash Flows

(in thousands of Canadian dollars)

	Twelve months ended July 31, 2012	Twelve months ended July 31, 2011
Cash flows (used in) from operating activitiess		
Cash receipts from sales of goods	$ 242,055	$ 273,833
Cash paid to suppliers and others	(298,965)	(226,593)
Cash receipts from provincial milk boards and agencies (pooling)	5,115	7,838
Cash paid to provincial milk boards and agencies (operating surplus)	(24,573)	(14,385)
Cash receipts from the Government of Canada	4,668	4,031
Interest paid on loans	(382)	(521)
Cash flows (used in) from operating activities	(72,082)	44,203
Cash flows from (used in) financing activities		
New loans from the Government of Canada	235,186	157,921
Loan repayments to the Government of Canada	(163,756)	(201,000)
Cash flows from (used in) financing activities	71,430	(43,079)
Net increase in cash (bank overdraft)	(652)	1,124
Net bank overdraft at beginning of year	(1,008)	(2,132)
Net bank overdraft at end of year	$ (1,660)	$ (1,008)
Components:		
Cash	$ 134	$ 146
Bank overdraft	(1,794)	(1,154)
	$ (1,660)	$ (1,008)

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

Notes to Financial Statements

July 31, 2012

(In thousands of Canadian dollars unless otherwise indicated)

1. Authority and objectives

The Canadian Dairy Commission (CDC) was established in 1966 through the *Canadian Dairy Commission Act*. It is a federal Crown corporation named in Part I, Schedule III and Schedule IV to the *Financial Administration Act* and is not subject to the provisions of the *Income Tax Act.* It is an agent of Her Majesty the Queen in right of Canada and reports to Parliament through the Minister of Agriculture and Agri-Food.

The objectives of the CDC are to provide efficient producers of milk 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. To achieve its objectives, the CDC works closely with the Canadian Milk Supply Management Committee (CMSMC), which it chairs, as well as with provincial governments and provincial milk marketing boards. This collaboration is framed by federal-provincial agreements.

The CDC is partly funded by parliamentary appropriations. This is supplemented by funding from milk producers and the market, as well as by the CDC's own commercial operations.

2. Basis of preparation

Compliance with International Financial Reporting Standards

These financial statements have been prepared in accordance with IFRS 1 - *First-time Adoption of IFRS using International Financial Reporting Standards* (IFRS) accounting policies that the CDC adopted in its annual financial statements ending July 31, 2012.

These are the CDC's first IFRS annual financial statements. The CDC has elected August 1, 2010 as the date of transition from Canadian generally accepted accounting principles to IFRS. An explanation of how the transition to IFRS has affected the financial statements is included in Note 15. The significant accounting policies followed in the preparation of these financial statements are summarized in Note 3.

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

Key sources of estimation uncertainty

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Valuation of inventories, pension and post-employment 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 of the period in which they become known.

Functional and presentation currency

The CDC's functional and presentation currency is the Canadian dollar.

3. Significant accounting policies

Cash

Cash includes only funds on deposit at financial institutions.

Financial instruments

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

Classifications:

Trade and other receivable	Loans and receivables
Bank overdraft	Financial liabilities measured at amortized cost
Trade payable and other payables	Financial liabilities measured at amortized cost
Loans from the Government of Canada	Financial liabilities measured at amortized cost
Derivative assets and liabilities	Financial assets or liabilities measured at fair value through profit or loss (FVTPL)

Loans and receivables

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

Financial liabilities measured at amortized cost

Financial liabilities measured at amortized cost are measured at amortized cost using the effective interest method.

Financial assets or liabilities at FVTPL

Financial assets or liabilities classified as FVTPL are measured at fair value at the statement of financial position date with changes in fair value recorded in profit or loss on the statement of operations and comprehensive loss.

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

The CDC does not designate its foreign exchange forward contracts as hedges of underlying assets, liabilities, firm commitments or anticipated transactions and accordingly does not apply hedge accounting. As a result, foreign exchange forward contracts are recorded on the statement of financial position 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.

Inventory

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

Inventory excludes storage charges, which are expensed when incurred.

Distribution to (recoveries from) provincial milk boards and agencies

Distributions to (recoveries from) provincial milk boards and agencies represent gross profit (loss) on sales excluding imported butter. Distributions to (recoveries from) provincial boards and agencies are recorded as expense (revenue) in the year that they are determined.

Revenues

Sales revenues

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

Funding from milk pools

Funding from milk pools is recognized as revenue in the period the services are rendered.

Funding from the Government of Canada

Funding from the Government of Canada is recognized as revenue in the period the expenses are incurred.

Audit services

Revenues from audit services are recognized in the period the services are rendered.

Cost of sales

The CDC purchases all butter and skim milk powder tendered to it at either the Canadian support price or at other prices established by the CDC, depending on the intended resale markets, except for a portion of butter imported by the CDC at international market price. These costs are charged to cost of sales when the goods are shipped to customers.

Foreign currency translation

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

Trade receivable and payable in foreign currencies are adjusted to reflect the exchange rate in effect at the statement of financial position date. Any corresponding gains or losses are recognized in operating expenses.

Most sales and purchases in foreign currencies have corresponding foreign exchange forward contracts (see "Derivative financial instruments" on p. 57 and Note 12 - Financial Instruments – *Currency risk*).

Employee benefits

Pension benefits

Substantially all of the employees of the CDC are covered by the public service pension plan (the "Plan"), a contributory defined benefit plan established through legislation and sponsored by the Government of Canada. Contributions are required by both the employees and the CDC to cover current service cost. Pursuant to legislation currently in place, the CDC has no legal or constructive obligation to pay further contributions with respect to any past service or funding deficiencies of the Plan. Consequently, contributions are recognized as an expense in the year when employees have rendered service and represent the total pension obligation of the CDC.

Post-employment benefits

Eligible employees are entitled to post-employment benefits as provided for under labour contracts and conditions of employment. The cost of these benefits is accrued as employees render the services necessary to earn them. The obligation relating to the benefits earned by employees is calculated by management.

Scholarship program

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

Future accounting standards (accounting standards issued but not yet applied)

Certain new accounting standards and amendments have been published which are not required to be adopted for the current reporting period. As of the date of these financial statements, the following applicable standards and amendments were issued but not yet effective:

- IAS 19, *Employee Benefits*, effective for annual periods beginning on or after January 1, 2013;
- IFRS 9, *Financial Instruments*, effective for annual periods beginning on or after January 1, 2015;
- IFRS 7, *Financial Instruments: Disclosures*, effective for annual periods beginning on or after January 1, 2013 for enhancing disclosures about offsetting of financial assets and financial liabilities and effective for annual periods beginning on or after January 1, 2015 for requiring disclosures about the initial application of IFRS 9;
- IAS 32, *Financial Instruments: Presentation*, effective for annual periods beginning on or after January 1, 2014; and
- IFRS 13, *Fair Value Measurement*, effective for annual periods beginning on or after January 1, 2013.

The CDC is currently assessing the impact of these standards on its financial statements.

4. Inventory

Under section 9(1) of the *Canadian Dairy Commission Act*, the CDC operates domestic seasonality programs, which include the purchase and sale of Plan B inventory (butter and skim milk powder). Under Plan B, as set out in agreements with manufacturers, the CDC purchases products from manufacturers. While manufacturers are contractually obligated to repurchase Plan B inventory during the calendar year at the prevailing support prices, the CDC is not contractually bound to sell to the manufacturers. However, the CDC has customarily honoured all manufacturers' requests.

(In thousands of Canadian dollars unless otherwise indicated)

Inventory expensed in the current year was $215.92 million (July 31, 2011: $250.93 million) and is presented on the statement of operations and comprehensive loss in cost of goods sold (domestically and exported).

Inventory in dollars:

	July 31, 2012	July 31, 2011	August 1, 2010
Plan B:			
Butter	$107,143	$69,524	$77,449
Skim milk powder	8,785	10,477	10,103
Other butter	15,004	635	21,686
Other skim milk powder	29,396	13,686	26,849
	160,328	94,322	136,087
Less: allowance for inventory write-down	(439)	-	(859)
Total net realizable value	$159,888	$94,322	$135,228

Inventory in tonnes:

	July 31, 2012	July 31, 2011	August 1, 2010
Plan B:			
Butter	14,706	9,650	10,905
Skim milk powder	1,387	1,671	1,635
Other butter	2,110	104	4,261
Other skim milk powder	22,641	11,059	23,179

5. Bank overdraft

The CDC has established a line of credit with a member of the Canadian Payments Association. The CDC has been granted the authority to establish this line of credit by the Minister of Finance up to a maximum of $50 million for advancing funds to the provincial milk marketing boards and agencies. During the dairy year, the CDC's available line of credit limit can vary up to $25 million (July 31, 2011: $25 million / August 1, 2010: $5 million).

The bank overdraft incurred under the CDC's line of credit is due on demand and bears interest at prime, which throughout the reporting period was 3.00% per annum (July 31, 2011: 2.75% to 3.00% / August 1, 2010: 2.25% to 2.75%).

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

Loans from the Government of Canada's Consolidated Revenue Fund, to a maximum of $165 million (July 31, 2011: $175 million/ August 1, 2010: $175 million), are available to finance operations. Individual loans are repayable within one year from the date the loan is advanced. Principal and accrued interest is repaid regularly during the year when funds are available.

Interest on the loans is at the normal rates established for Crown corporations by the government and based on the latest available yields of comparable Treasury bills plus one-eighth of one percent at simple interest.

(In thousands of Canadian dollars unless otherwise indicated)

Interest rates and interest expense were as follows:

	July 31, 2012	July 31, 2011	August 1, 2010
Interest rates			
Low	0.95%	0.39%	0.30%
High	1.17%	1.13%	1.42%
Interest expense	$ 580	$ 514	$ 379

7. Capital disclosures

The CDC's capital consists of its loans from the Government of Canada (see Note 6) and retained earnings. As of July 31, 2012 these accounts totaled $127.28 million (July 31, 2011: $55.85 million / August 1, 2010: $98.93 million) and $11.84 million (July 31, 2011: $14.77 million / August 1, 2010: $14.92 million) respectively. The CDC is not subject to any externally imposed capital requirements.

The CDC'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 CDC adjusts its capital management approach on an ongoing basis as the amounts fluctuate during the course of the year. The CDC does not utilize any quantitative measures to monitor its capital. There were no changes in the CDC's approach to capital management or the definition thereof as compared to the previous year.

8. Foreign exchange gains and losses

Export sales include amounts representing net gains or net losses arising from currency translation relating to transactions incurred in foreign currencies.

As well, domestic cost of sales include amounts representing net gains or net losses arising from currency translation relating to import purchase transactions incurred in foreign currencies.

	July 31, 2012	July 31, 2011
Net gain (loss):		
Export sales	$ 57	$ 201
Domestic cost of sales	$ 475	$ (136)

9. Funding from milk pools

As acting agent in carrying-out administrative functions of the Comprehensive Agreement on Pooling of Milk Revenues (a federal-provincial agreement), the CDC collects and redistributes producer market returns. For these services, the CDC receives from producers an annual fixed fee which offsets its cost for the administration of the agreement as well as the estimated carrying charges for normal levels of butter inventory. Furthermore, the CDC is reimbursed for other direct costs as set out in the agreement including carrying charges for surplus butter inventories.

10. Funding from the Government of Canada

Funding of the CDC's administrative expenses is shared among the federal government, dairy producers, commercial operations and the market place. During the reporting period, the Government of Canada funded $4.67 million (July 31, 2011: $4.03 million) of the CDC's administrative expenses of $7.87 million (July 31, 2011: $7.59 million).

11. Salaries and employee benefits

Salaries and employee benefits includes:

	July 31, 2012	July 31, 2011
Salaries expense	$4,702	$4,648
Pension contributions	757	689
Medical insurance expense	229	218
Others	154	128
Total	$5,842	$5,683

Pension plan

Substantially all of the employees of the CDC are covered by the public service pension plan (the "Plan"), a contributory defined benefit plan established through legislation and sponsored by the Government of Canada. Contributions are required by both the employees and the CDC. The President of the Treasury Board of Canada sets the required employer contributions based on a multiple of the employees' required contribution. The general contribution rate effective at year end was 1.74 times the employee's rate (1.86 times for the prior year). Total contributions of $0.61 million (July 31, 2011: $0.55 million) were recognized as expense in the current year.

(In thousands of Canadian dollars unless otherwise indicated)

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

Post-employment benefits

The CDC provides post-employment benefits to its eligible 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 are paid from future appropriations and other sources of revenue. Information about this benefit plan, measured as of the statement of financial position date, is as follows:

	July 31, 2012	July 31, 2011	August 1,2010
Accrued benefit obligation, beginning of year	$1,083	$ 1,294	$1,217
Benefits paid during the period	(487)	(131)	(21)
Increase (decrease) of obligation for the year	-	(80)	98
Accrued benefit obligation, end of year	$ 596	$ 1,083	$ 1,294

Of the total period end obligation, no amount (July 31, 2011: $0.44 million / August 1, 2010: $0.12 million) is estimated by the CDC to be payable within the next year.

12. Financial instruments

In the course of carrying out its ongoing operations, the CDC faces risks to its financial assets and financial liabilities. The CDC's exposure to risk from its use of financial instruments is presented below along with the CDC'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 CDC's income or the value of its holding of financial instruments.

Currency risk

The CDC operates internationally, exposing itself to market risks from changes in foreign exchange rates. The CDC partially manages these exposures by contracting only in U.S. dollars or Canadian dollars.

The CDC's foreign exchange risk management includes the use of foreign currency forward contracts to fix the exchange rates on certain foreign currency exposures. The CDC periodically enters into foreign exchange forward contracts to manage exposure to exchange rate fluctuations between Canadian and U.S. dollars.

As of the statement of financial position date, the notional value of the CDC's outstanding forward exchange contracts totaled $6.45 million Canadian equivalent (July 31, 2011: $18.12 million / August 1, 2010: $1.40 million Canadian equivalent). These contracts will mature over the period ending December 31, 2012. The maturity dates of the forward exchange contracts correspond to the estimated dates when the CDC 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 CDC's derivative financial instruments is determined using the Bank of Canada's published foreign exchange rates as of the statement of financial position date. The CDC's foreign exchange forward contracts as of July 31, 2012 are as follows:

(In thousands of Canadian dollars unless otherwise indicated)

Currency sold	Currency purchased	July 31, 2012		July 31, 2011		August 1, 2010	
		In USD	In CAD	In USD	In CAD	In USD	In CAD
USD	CAD	$1,930	$1,990	$4,521	$4,320	$1,002	$1,030
CAD	USD	$4,505	$4,579	$14,439	$13,796	$361	$371

Other charges (recoveries) under Operating expenses on the statement of operations and comprehensive loss include $0.22 million representing net gains incurred during the current year (July 31, 2011: net losses of $0.22 million) arising from the determination of fair value of the CDC's derivative financial instruments.

The CDC's exposure to foreign currency risk was as follows, based on Canadian dollar equivalent amounts:

In CAD	July 31, 2012	July 31, 2011	August 1, 2010
Trade receivable	$2,574	$5,632	$957
Trade payable	-	-	(357)
Net derivative asset (liability)	(7)	(227)	(3)
Net exposure	$2,567	$5,405	$597

Based on the net exposure as of July 31, 2012, and assuming that all other variables remained constant, had the Canadian dollar appreciated 10% against the US dollar, net income for the reporting period ended July 31, 2012 would have increased by $0.52 million (July 31, 2011: increased by $1.74 million). 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 CDC does not have any other such financial assets or liabilities exposed to this risk. The CDC'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 CDC is not exposed to this type of risk.

Liquidity risk

Liquidity risk is the risk that the CDC will not be able to meet its financial obligations as they fall due. As of the statement of financial position, virtually all of the CDC's assets and liabilities were current and the CDC had a current ratio equal to 1.09 (July 31, 2011: 1.18 / August 1, 2010: 1.13). In managing liquidity risk, the CDC has access to additional borrowings for commercial operations from the Government of Canada in the amount of $37.72 million as of July 31, 2012 (July 31, 2011: $119.15 million / August 1, 2010: $76.07 million) as well as $3.21 million (July 31, 2011: $3.85 million / August 1, 2010: $2.69 million) on its line of credit for the pooling of market returns.

Credit risk

Credit risk is the risk of loss due to a customer failing to meet its financial obligations to the CDC. Maximum credit exposure is the carrying amount of the pooling and trade receivable balances, net of any allowance for losses. The CDC 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 July 31, 2012, July 31, 2011 and August 1, 2010 the CDC did not have an allowance for doubtful accounts and all trade receivables were current.

(In thousands of Canadian dollars unless otherwise indicated)

The CDC 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 CDC 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 CDC.

Fair values

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

Fair value hierarchy

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

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

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

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

The fair value measurement of the CDC's derivative financial instruments is classified as level 2 (July 31, 2011: level 2 / August 1, 2010: level 2) in the fair value hierarchy. Changes in valuation methods may result in transfers into or out of levels 1, 2, and 3. For the reporting periods ended July 31, 2012, July 31, 2011 and August 1, 2010, there were no transfers between levels.

13. Commitments

a) Industry Initiatives

Summary:	July 31, 2012	July 31, 2011	August 1, 2010
Canadian Quality Milk	$ 945	$1,761	$2,275
Matching Investment Fund	938	2,000	4,000
Dairy Research Cluster	500	1,000	1,000
Iodine Study	116	231	340
Scholarship Program	1,700	3,000	0
Total Commitments	$4,199	$7,992	$7,615

Canadian Quality Milk (CQM)

This program is a quality assurance program for raw milk on farms. The CDC has agreed to partially fund this program under an agreement that commenced August 1, 2007 and was extended to July 31, 2014. Under the terms of the agreement, the CDC will contribute up to two hundred dollars per eligible farm until July 31, 2013 and one hundred dollars until July 31, 2014. In addition to the contributions per farm, the CDC has agreed to provide funding of $0.10 million towards the CQM's National Electronic Administration system.

Matching Investment Fund

The CDC funds and administers the Matching Investment Fund which provides non-repayable contributions to Canadian-registered companies or food technology centres for product development, on a matching investment basis. The program expired on July 31, 2012. It has been renewed until July 31, 2014.

Dairy Research Cluster

This Dairy Farmers of Canada initiative enables key industry-led agricultural organizations to mobilize a critical mass of scientific and technical resources to support innovation strategies for enhanced profitability and competitiveness in their sector. The CDC has agreed to partially fund this project under an agreement that commenced on July 1, 2010 and expires on March 31, 2013. Under the terms of the agreement the CDC will contribute $1.50 million during the period of January 1, 2010 to March 31, 2013 towards the $11.80 million project proposed by Dairy Farmers of Canada and approved under the Agriculture and Agri-Food Canada, Growing Canadian Agri-Innovations Program, Canadian Agri-Science Cluster Initiative.

(In thousands of Canadian dollars unless otherwise indicated)

Iodine Study

The CDC has agreed to contribute a maximum of $0.34 million to Dairy Farmers of Canada towards conducting an analysis for determining the level of iodine in bulk tank milk of individual dairy farms over a period of three years from August 1, 2010 to July 31, 2013.

Scholarship Program

As of August 1, 2011, the CDC funds a graduate Scholarship Program. The CDC grants $3.00 million in scholarships over five years to participating institutions across Canada.

b) Purchase Commitments

As of July 31, 2012, the CDC was committed to purchase certain quantities of butter and skim milk powder. These commitments amounted to approximately $2.01 million (July 31, 2011: $4.88 million / August 1, 2010: $0.42 million) and are due to be fulfilled by September 2012.

c) WTO Tariff Rate Quotas for Butter

Under the terms of the 1994 WTO Agreement, Canada has established tariff rate quotas (TRQ) for a number of dairy products. TRQs are the quantities of products that can enter Canada with little or no tariff. With the support of the industry, the CDC has acted as the receiver of imports of butter under federal permit since 1995 and has directed this product through butter manufacturers to the food sector. The 2013 TRQ for butter remains at 3,274 tonnes. World prices at the time of purchase will determine the total financial commitment.

Total cost to purchase imported butter under the WTO requirements for the year ended July 31, 2012 was $15.49 million (July 31, 2011: $14.47 million / August 1, 2010: $10.20 million).

d) Operating Lease

The CDC is committed under a long term lease with Agriculture and Agri-Food Canada for office accommodation ending in March 31, 2017. The lease contains escalation clauses regarding maintenance costs and taxes. This lease may be automatically renewed at the CDC's option for another period of five years with rates possibly revised in order to reflect the rental market value pursuant to Treasury Board's Policy on Real Property.

The minimum lease payments are as follows:

	July 31, 2012	July 31, 2011	August 1, 2010
Less than one year	$ 351	$ 208	$ 312
Greater than one year and less than five years	$1,289	$ 0	$ 208

14. Related party transactions

Government of Canada entities

The CDC, as per the Canadian Dairy Commission Act, is an agent of Her Majesty the Queen in right of Canada. This effectively makes the Government of Canada de jure owner of the CDC, having significant influence over its activities.

The CDC is related in terms of common ownership to all other Government of Canada-created departments, agencies and Crown corporations. The CDC enters into transactions with these entities in the normal course of business and at normal trade terms.

In accordance with disclosure exemption regarding "government related entities", the CDC is exempt from certain disclosure requirements of IAS 24 relating to its transactions and outstanding balances with:

- a government that has control, joint control or significant influence over the reporting entity; and
- another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

Based on this exemption, the CDC has not disclosed any further details of its transactions with the Government of Canada and departments thereof, and all federal Crown corporations not considered to be individually or collectively significant entered into in the normal course of operations.

(In thousands of Canadian dollars unless otherwise indicated)

Related party transactions such as employee benefit expenses for contributions to the Plan (Note 11), accommodations and professional services are recorded at their exchange amounts and totaled $1.78 million during the reporting period (July 31, 2011: $1.64 million).

Loans from the Government of Canada at terms available to Crown corporations (Note 6), which are recorded at carrying value due to the absence of an observable market rate, represent the CDC's largest related party transaction.

Significant transactions, excluding loans, were with the following related parties:

Government entity	July 31, 2012	July 31, 2011
Public Works and Government Services Canada	$ 1,123	$ 1,037
Agriculture and Agri-Food Canada	$ 543	$ 570

Key management personnel

The CDC's key management personnel are the CEO, the Chairman, the Commissioner and the three directors.

No loans or other such transactions with key management were outstanding as of July 31, 2012 or occurred at any time during the reporting period.

The post-employment benefit liability for key management personnel as of July 31, 2012 was $0.21 million (July 31, 2011: $0.21 million / August 1, 2010: $0.15 million) and is included in post-employment benefits on the statement of financial position.

Compensation of key management personnel for the year ended July 31, 2012 was $0.76 million (July 31, 2011: $0.68 million).

15. Transition to International Financial Reporting Standards

The CDC adopted International Financial Reporting Standards on August 1, 2011 with a date of transition effective August 1, 2010. Prior to the adoption of IFRS, the CDC prepared its financial statements in accordance with Canadian GAAP. The CDC has prepared its opening IFRS statement of financial position as of the transition date of August 1, 2010.

These financial statements have been prepared using accounting policies in accordance with the requirements of IFRS 1 - *First-Time Adoption of IFRS*, which is applicable upon first-time adoption of IFRS. IFRS 1 requires that the same policies are applied for all periods presented and that those policies are based on IFRS effective at the end of the first IFRS year-end, or July 31, 2012 for the CDC.

After performing an extensive review of all components of the CDC's financial statements that may be affected by the adoption of IFRS, it was determined that no adjustments or elections were required. Therefore, the opening IFRS statement of financial position of the CDC has no changes in presentation or amounts compared to the closing statement of financial position prior to the adoption of IFRS (August 1, 2010 *vs*. July 31, 2010).

Tables and Data

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

	Production	MSQ*	Canadian requirements
2007-2008	182.21	183.75	179.57
2008-2009	179.66	182.08	180.14
2009-2010	183.39	181.80	183.82
2010-2011	186.87	188.73	189.49
2011-2012	196.18	193.78	187.86

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

Production of Milk* (million kg butterfat)

Province	2010-2011			2011-2012		
	Fluid	Industrial	Total	Fluid	Industrial	Total
Newfoundland and Labrador	1.52	0.38	1.90	1.48	0.40	1.88
Prince Edward Island	0.56	3.42	3.98	0.55	3.50	4.05
Nova Scotia	4.00	2.75	6.75	3.90	2.97	6.87
New Brunswick	2.63	2.67	5.30	2.54	2.85	5.39
Quebec	26.32	90.68	117.00	26.37	92.28	118.65
Ontario	47.30	52.41	99.71	46.79	55.58	102.37
Manitoba	4.97	7.06	12.03	4.99	7.88	12.87
Saskatchewan	2.59	5.96	8.55	2.59	6.46	9.05
Alberta	14.76	10.35	25.11	15.04	11.35	26.39
British Columbia	14.15	11.19	25.34	13.69	12.91	26.60
Total	**118.80**	**186.87**	**305.67**	**117.94**	**196.18**	**314.12**

* Before pooling

Number of Farms and Cows, and Total Production

	Number of farms	Number of cows (thousands)	Total production (million kg BF)
2007-2008	14,036	998.5	300.17
2008-2009	13,587	978.4	298.41
2009-2010	13,214	981.0	300.82
2010-2011	12,965	987.0	305.67
2011-2012	12,746	985.3	314.12