

1966. The Canadian Dairy Commission Act was proclaimed. **1970.** Supply management was introduced through market sharing quotas. **1974.** All provinces, except Newfoundland, became signatories to the Interim Comprehensive National Milk Marketing Plan. **1975.** First federal long-term dairy policy implemented. **1980.** Canada negotiated a special access quota for exports of cheese to the European Union. **1980.** Animal Feed Assistance Program created to provide higher returns than exports for surplus skim milk powder. **1983.** National Milk Marketing Plan replaces the Interim Plan of 1974. **1989.** The Domestic Dairy Product Innovation Program was introduced. **1990.** The dairy industry generated \$3.4 billion in farm cash receipts. **1991.** Rebate Program for Further Processors established to assist competitiveness of dairy ingredient users. **1993.** Butter use in the Canadian bakery sector doubles. **1994.** Industry develops pricing and pooling system to adapt to new business environment. **1995.** The Special Milk Class Pricing and Pooling System was implemented. **1996.** The Agreement on All Milk Pooling was created, providing a means for revenues from all milk sales to be pooled among dairy producers in 6 provinces. **1997.** The Western Milk Pooling Agreement was implemented. **1999.** A Special Committee of the Canadian Milk Supply Management Committee was created to address outstanding issues related to the sharing of markets in Canada. **2000.** There were approximately 1.16 million dairy cows in Canada, producing an average of 9,152 kilograms of milk per cow. **2000.** The processing industry generated \$9.8 billion worth of products shipped from 261 processing plants.

Progress

Canadian Dairy Commission

Service Standards

In carrying out its responsibilities, the Canadian Dairy Commission will strive to treat every client request:

In a timely manner — when unusual circumstances arise, we will explain the steps that we will take to respond fully with the least delay.

Courteously — we recognize the importance of your request, and will politely help you understand the procedures, regulations and requirements that we must apply.

Fairly — we will treat all requests equitably. If, in your view, a matter is not resolved to your satisfaction, we will promptly explain how to seek redress.

Clearly — you have a right to know, in plain courteous language, how we are handling your request.

Commission staff are available to serve you, in either official language, from 8:00 a.m. to 4:30 p.m. eastern time, Monday to Friday (statutory holidays excluded). We welcome comments on our procedures and always appreciate suggestions for improvement.

Should you require further information on the activities of the Commission or on the dairy industry in general, we would be pleased to assist you.

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Letter to the Minister

Mr. Minister,
We are pleased to submit the Canadian Dairy Commission's Annual Report for the 2000-2001 dairy year. In this, the Commission's 34th year of operation, a great deal was accomplished to strengthen the industry and bring us closer to meeting our overall objective of achieving harmonized dairy policies to maintain a viable Canadian dairy sector.

The year 2000-2001 was a year of progress for our industry in many respects. It was a year of growth in the domestic demand for dairy products. For the fourth consecutive year, demand increased for products such as cheese, ice cream and yogurt.

The market for dairy ingredients also grew in the past dairy year. Under the Special Milk Class Permit Program, 4.1 million hectolitres of milk was used to make dairy ingredients for products such as frozen entrées, soups, baked goods and confectionery products. This market is indeed becoming increasingly important to Canada's dairy industry and for this reason, the Canadian Dairy Commission (CDC) prepared a Dairy Ingredient Marketing Plan to help promote the increased use of Canadian dairy ingredients in manufactured products. The Plan was well received by our stakeholders and the

first and largest portion of the plan was implemented in the reporting period.

Last year, unprecedented advances were made in policy development. Domestically, a number of major policies were endorsed by the Canadian Milk Supply Management Committee (CMSMC) to achieve greater harmonization of policies between the eastern and western pools. The committee adopted a series of recommendations proposed by a Special Committee. Among several proposals adopted, the most important one changed the way provinces share in increases and decreases in Market Sharing Quota (MSQ). Additionally, major negotiations that took place between the CMSMC and the province of Newfoundland led to an agreement for the province's entry into the National Milk Marketing Plan effective August 1, 2001.

The CDC's activities in the export market were significantly reduced during the reporting period. This coincides with the Directions issued last winter to ensure Canada's compliance with decisions reached by the WTO Panel and Appellate Bodies on Canada's exports of dairy products. In conjunction with the Directions, new dairy marketing regulations were enacted on December 13, 2000. Class 5(e) was eliminated July 31, 2000. While the CDC's activities in the export market have been dramatically reduced, we will continue to provide advice and technical



Lyle Vanclief:
Minister,
Agriculture and
Agri-Food Canada

information to the legal team and industry in preparing Canada's defense of its compliance with its obligations under the WTO .

As you will denote through the report, there was a great deal of progress made in the year 2000-2001 and we expect to build on our accomplishments in the year ahead. In making these important gains, we would like to recognize the hard work and dedication of our staff in contributing to the tasks set out to achieve the CDC's objectives. We are confident more progress will be made as our team continues to strive to meet our goals in support of a strong dairy industry in Canada.

Original signed by:
Michel Pagé, Chairman
Louis Balcaen, Vice-Chairman
Carl Harrison, Commissioner



Key Highlights of 2000–2001

The Canadian dairy industry operates on a “dairy year” basis which runs from August 1st of one calendar year to July 31st of the next calendar year.

The industry can be proud of its accomplishments during the 2000–2001 dairy year. Some key highlights of those accomplishments include:

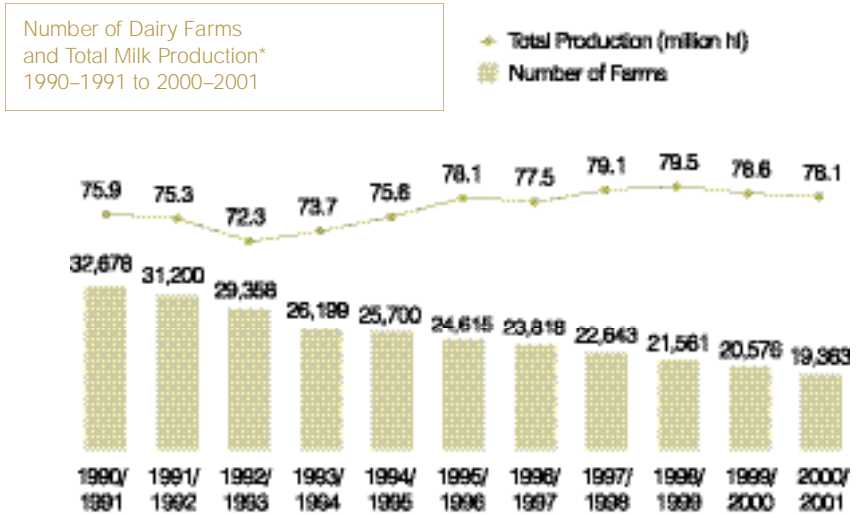
- Entry of Newfoundland into the national dairy system for industrial milk marketing;
- Market growth for the fourth consecutive year;
- Resolution of a number of issues outstanding in the industry for a long period of time; and
- Steps taken towards the achievement of a Canadian national all milk pool.

Progress Through the 1990s and the New Millennium

The Commission, along with the industry, has experienced many challenges and changes over the past 10 years. The industry has managed these changes and has continued to prosper and grow.

Farm Cash Receipts

In 1990, the dairy industry generated \$3.4 billion in farm cash receipts. As a key contributor to the Canadian economy in the 2000 calendar year, the dairy industry ranked third behind meats, and grains and oilseeds, generating \$4.1 billion in total farm cash receipts.



*Calculated on a standard 3.6 kg of butterfat per hectolitre basis

Number of Farms and Production per Farm

The industry has experienced a 41 percent decline in the number of dairy farms over the past 10 years from 32,678 in the 1990–1991 dairy year to 19,363 in the 2000–2001 dairy year. However, individual farming units have grown in size over the past decade, and have become more effective and efficient in operation. The average production per farm has increased significantly — by 69 percent from 2,215 hectolitres per farm in the 1990–1991 dairy year to 3,746 hectolitres per farm in the 2000–2001 dairy year.

Similar to the distribution of dairy farms in the early 90s, in the 2000–2001 dairy year, Quebec and Ontario had the greatest number of dairy farms at 81 percent, followed by 14 percent in the Western provinces and 5 percent in the Atlantic provinces.

Number of Cows and Production per Cow

Although the number of milk cows has decreased over the past 10 years, the production per cow has increased by 23 percent. In 1990, there were 1.43 million dairy cows in Canada producing an average of 7,412 kilograms of milk per cow. In 2000, there were approximately 1.16 million dairy cows in Canada, producing an average of 9,152 kilograms of milk per cow.

Number of Cows and Total Production 1990–1991 to 2000–2001

	Number of Cows (millions)	Total Production (million hl)
1990–1991	1.43	75.9
1991–1992	1.38	75.3
1992–1993	1.26	72.3
1993–1994	1.27	73.7
1994–1995	1.27	75.6
1995–1996	1.24	78.1
1996–1997	1.24	77.5
1997–1998	1.20	79.1
1998–1999	1.18	79.5
1999–2000	1.14	78.6
2000–2001	1.16	78.1

Number of Milk and Cream Producers in 2000–2001

	Cream	Milk	Total
Prince Edward Island	20	312	332
Nova Scotia	1	367	368
New Brunswick	0	313	313
Quebec	0	9,248	9,248
Ontario	128	6,340	6,468
Manitoba	6	643	649
Saskatchewan	0	373	373
Alberta	2	892	894
British Columbia	0	718	718
Total	157	19,206	19,363

**“The dairy industry
in Canada can say
we truly have a
national system
from coast to coast.”**

Gerard Cormier, *Chairman*
Dairy Farmers of Newfoundland
and Labrador

Processing Industry 2000–2001

In the 2000 calendar year, the processing industry generated \$9.8 billion* worth of products shipped from approximately 261 processing plants accounting for 15 percent of all processing sales in the food and beverage industry. During the 2000–2001 dairy year, the dairy processing sector employed approximately 21,000 people representing 10 percent of all employees in the food and beverage industry.

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

Value of Manufactured Shipments Canada (2000)

A Dairy Products	14.3%
B Beverages	13%
C Meat	26.4%
D Poultry	6.9%
E Fruits and Vegetables	7.9%
F Bakery	6.2%
G Seafood Products Preparation	6.8%
H Others	18.6%

Source : Statistics Canada

Industrial and Fluid Milk Production 2000–2001

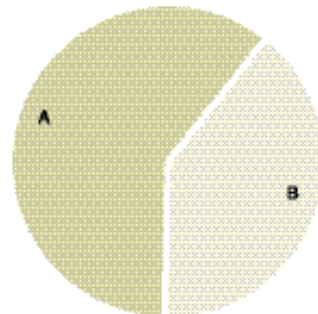
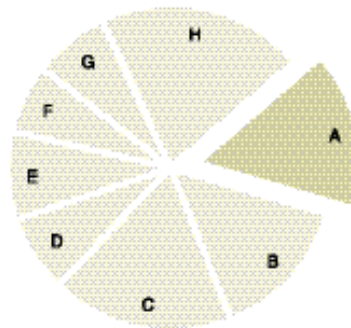
A Industrial Milk	47.1 million hectolitres
B Fluid Milk	31.1 million hectolitres

Milk Markets

Canadian dairy producers supply two main markets:

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

In the 2000–2001 dairy year, the fluid market accounted for approximately 40 percent of total producer shipments of milk, or 31.1 million hectolitres (at 3.6 kilograms of butterfat per hectolitre). The industrial market accounted for the remaining 60 percent or 47.1 million hectolitres (at 3.6 kilograms of butterfat per hectolitre) of total producer shipments.



Ingredients Market

As part of the industrial milk market, dairy products are also sold as ingredients in other food markets. In the 2000–2001 dairy year, this market represented 5 percent of total milk production, or 4.1 million hectolitres of milk. This volume represented approximately 9 percent of Market Sharing Quota.

The dairy ingredients market includes traditional as well as non-traditional products. Examples of ingredients for traditional product markets are:

- butter used in a wide range of bakery products;
- milk;
- cream;
- condensed and powdered milk used in confectionery goods, dry mixes and baby food formulas; and
- cheddar, mozzarella, and cream cheeses used in frozen, dried, or canned finished products such as frozen dinner entrées, sauces and soups.

A fast growing ingredients market is the functional food market which uses non-traditional ingredients such as whey powder and whey protein concentrates, which are by-products of the cheese-making process and used to manufacture products such as nutritional bars and drinks.

“In the 2000–2001 dairy year, the ingredients market represented 5 percent of total milk production, or 4.1 million hectolitres of milk.”

Harmonized Milk Classification System

Most provincial marketing boards and agencies purchase milk from producers and sell it to processors for the manufacture of dairy products. The milk produced

in Canada is sold to processors through a Harmonized Milk Classification System for the manufacture of products according to the following five classes of milk listed below:

Class	Products	Milk Utilization Based on End Use (2000–2001)	
		Volume (million hl)	% of overall use
Class 1	1 a) fluid milks 1 b) fluid creams 1 c) milk-based beverages 1 d) fluid milks for the Yukon, Nunavut, and Northwest Territories (these markets are supplied by British Columbia and Alberta)	28,107,922	38.82%
Class 2	yogurt, sour cream and ice cream	3,186,721	4.40%
Class 3	3 a) specialty cheeses 3 b) cheddar cheese	26,741,139	36.93%
Class 4	4 a) butter, butteroil, powders and concentrated milk for ingredient purposes 4 b) concentrated milk for retail 4 c) new products for the domestic market 4 d) inventories and losses 4 m) domestic marginal markets	4,771,362	6.59%
Class 5	5 a) cheese ingredients for further processing for the domestic and export markets 5 b) all other dairy products for further processing for the domestic and export markets 5 c) domestic and export activities of the confectionery sector 5 d) planned exports and other exports, the total of which shall not exceed Canada's WTO commitments	9,603,794	13.26%
Total		72,410,938	100%

(Note: volume of milk utilized is actual and not standardized)

“Close to 37 percent of the milk produced in Canada was used to make specialty and cheddar cheeses. ”



Corporate Profile

Structure

The Canadian Dairy Commission (CDC) is comprised of three Commissioners appointed by Governor in Council: a Chairman and Chief Executive Officer (Michel Pagé appointed in March 2001); a Vice-Chairman (Louis Balcaen appointed for a third term in December 2000); and a Commissioner (Carl Harrison appointed in December 2000). The CDC Commissioners are authorized and governed by the *Canadian Dairy Commission Act* and the *Financial Administration Act*. They provide leadership and supervision of the CDC's activities and approve its strategic direction as outlined in its five-year Corporate Plan.

The Commission is located in Ottawa, Ontario and employs approximately 65 staff working within the following sections: Audit, Finance and Administration, Economics, Policy and Strategic Planning, Communications Services, Marketing and Commercial Operations and Human Resources.

Authority

The Canadian Dairy Commission is a Crown corporation created in 1966 through the *Canadian Dairy Commission Act*. The Commission reports to Parliament through the Minister of Agriculture and Agri-Food to whom it serves as an important advisor on matters related to dairy.

Funded by the federal government (44 percent), dairy producers (36 percent) and the marketplace (20 percent), the CDC supports the interests of all dairy stakeholders — producers, processors, consumers and governments.

History

By the early 1960s, the dairy industry was experiencing a substantial build-up of butter stocks. Producers were coming to the realization that there was a need for the coordination of federal and provincial policies concerning the marketing of milk. Accordingly, the first Canadian Dairy Conference was convened in Ottawa in February 1963.

Following the conference, a Canadian Dairy Advisory Committee was set up and in its August 1965 report, recommended that a national board or authority be established for the marketing, regulation and administration of dairy policy. As a result, the House of Commons passed an *Act* on June 23, 1966 providing for the establishment of a Dairy Commission for Canada. The *Canadian Dairy Commission Act* was proclaimed on October 31, 1966.

“The CDC is a central facilitator for the multi-billion dollar Canadian dairy industry.”

Mission

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.

As a central facilitator for the multi-billion dollar Canadian dairy industry, the CDC works closely with industry stakeholders represented by organizations such as Dairy Farmers of Canada, the Consumers' Association of Canada and provincial boards and agencies. The Commission also works in co-operation with processors, represented by provincial organizations, and further processors represented by the Food and Consumer Products Manufacturers of Canada, the Baking Association of Canada, and the Confectionery Manufacturers Association of Canada.

Activities

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

- Through its chairmanship and work for the Canadian Milk Supply Management Committee (CMSMC), the CDC provides ongoing support to the Canadian dairy industry while operating in close co-operation with provincial stakeholders and provincial governments;
- It acts as a facilitator and provides secretariat services to the revenue pooling and market sharing systems. Provisions for these functions are set out in the All Milk Pooling Agreement (P6), the Western Milk Pooling Agreement (WMP), and the Comprehensive Agreement on Pooling of Milk Revenues;
- It calculates and makes a recommendation to the CMSMC on the level of the national milk production target for industrial milk, or Market Sharing Quota;
- It has the authority to purchase, store, process, or sell dairy products within Canada's World Trade Organization (WTO) commitments;
- It administers the federal government's industrial milk subsidy payments to dairy producers, reducing the returns required by producers from the marketplace. In turn, the subsidy payments provide consumers with moderately-priced industrial milk products on the domestic market;
- The Commission determines support prices at which it will purchase butter and skim milk powder. These support prices are used as references by provinces to establish prices for milk used to manufacture products such as butter, cheese, and ice cream;
- It administers the Special Milk Class Permit Program and issues permits to further processors for purposes of obtaining access to competitively-priced dairy ingredients, and to exporters for the export of dairy products within Canada's WTO commitment levels; and
- The CDC carries out internal audits of its systems and practices as well as external audits, which are in large part, performed on companies participating in the Special Milk Class Permit System.

Goals and Performance



Goals and Achievements for the Planning Period 2000–2001 to 2004–2005

1. Support the implementation of the WTO Panel and Appellate Body rulings on Canada's Special Milk Class Permit System and make the necessary changes within its responsibilities to ensure the system for dairy exports is in conformity with trade agreements while maintaining the integrity of the domestic system.

Measure of Achievement for 2000–2001:

- As of July 31, 2000, Class 5(e) for exports was eliminated and a system of rigorous tracking was implemented to monitor exports under Class 5(d) to ensure consistency with Canada's WTO subsidy reduction commitments.
- The *Dairy Product Marketing Regulations*, enacted under the *Canadian Dairy Commission Act*, were amended and went into effect on December 13, 2000 to comply with Canada's trade obligations.
- Amendments were made to the Comprehensive Agreement on Special Class Pooling, the All Milk Pooling Agreement and the Western Milk Pooling Agreement.
- A new Comprehensive Agreement on Pooling of Milk Revenues was adopted by the Canadian Milk Supply Management Committee on February 1, 2001.
- A method to better manage quota domestically was adopted by establishing a new domestic Class 4(m).

2. Coordinate and facilitate efforts to refine and harmonize Canada's pooling systems administered by the CDC in order to simplify the Canadian milk supply management system.

Measure of Achievement for 2000–2001:

- A Special Committee of the CMSMC, supported by the CDC, reached an agreement to resolve a number of key issues among industry participants that were outstanding for many years.
- Members of the All Milk Pooling Agreement (provinces in the east and Manitoba) adopted policies to improve the movement of milk within the pool in the east. This means milk in the east will move interprovincially where it is needed most.
- A Forum bringing together over 130 participants from industry and government at the provincial and federal levels was organized. The objective of providing background information and the promotion of open discussion of the pooling arrangements in the east was met. The results will foster more discussion on harmonizing policies among provinces in implementing the All Milk Pooling Agreement.
- Members of the Western Milk Pool agreed to pool revenues on the basis of multiple component pricing — a major step in harmonizing policies in the west.

- A negotiating committee comprised of representatives from Newfoundland and the CMSMC reached an agreement for Newfoundland's entry into the National Milk Marketing Plan. Newfoundland entered the national system for dairy on August 1, 2001. A major event in the industry's history!

3. Work with industry and Agriculture and Agri-Food Canada to promote the use of dairy ingredients and value-added dairy products domestically and abroad while keeping Canada's trade agreement commitments.

Measure of Achievement for 2000–2001:

- A *Dairy Ingredient Marketing Plan* was developed and implemented by the CDC to promote the use of dairy ingredients in the further processing sector.
- An analysis of the Plan's target groups was conducted. Questionnaires were sent to the processing, further processing and distribution sectors regarding their use of dairy ingredients.
- As a key component of the Plan, an ingredients information centre was launched on the Internet in July. *MILKINGREDIENTS.CA* is the first bilingual information centre of its kind in Canada.
- Meetings were held with key companies, associations and groups in the further processing and processing sectors as well as the scientific community seeking contributions in the form of technical expertise and support for further development of the Plan.

4. Develop, implement and coordinate a national audit system.

Measure of Achievement for 2000–2001:

- The CDC is continuing its work with stakeholders and the provinces to develop procedures to strengthen accountability for milk used in the domestic market.
- In cooperation with stakeholders, the CDC is redesigning a national Milk Utilization Audit Manual. The Manual is used by provincial inspectors when performing milk plants utilization audits.
- The CDC is also continuing to issue certificates to appoint inspectors and Instructions to Inspectors, as set out in the Ministerial Directions and the *CDC Act*. This provides the delegation of authority to provincial auditors to audit milk subject to interprovincial and export trade and is part of maintaining accountability for all milk received by processing plants.
- The Commission, at the request of provinces, is coordinating the exchange of information between provinces and the CDC to ensure proper tracking and to prevent duplicate reporting when transactions involve more than one province.

5. Enhance communication with Boards of Directors of national and provincial stakeholder organizations.

Measure of Achievement for 2000–2001:

- A new Chairman and Commissioner were appointed during the course of the year. The new Chairman immediately embarked on a national tour to meet with as many stakeholders as possible. Further work involving this goal will continue in the next planning period.

Goals for the period 2001–2002 to 2005–2006

- In cooperation with provinces, governments and industry, ensure that Canada's system of dairy exports is in compliance with international trade agreements, and support the work to defend the Canadian system before a WTO Compliance Panel and WTO Appellate Body.
- Co-ordinate and facilitate efforts to refine and harmonize Canada's pooling systems administered by the Canadian Dairy Commission and support industry deliberations to consider the establishment of an all milk national pool.
- Implement and coordinate an audit system that will protect the integrity of the domestic market.
- Improve communications with industry stakeholders and assess and establish a comprehensive means of communicating with the CDC's client groups.

- Conduct a comprehensive review of the administration of the Special Milk Class Permit System to improve administrative processes, structure and management of the program.
- Achieve administrative efficiencies through the implementation of the Financial Information Strategy, the relocation of the CDC's offices and a records management system.



**“MILKINGREDIENTS.CA
is the first bilingual
Internet-based
information centre
on dairy ingredients
in Canada.”**

Achievements in Detail

Dairy Ingredient Marketing Plan Update

In October 2000, the Canadian Dairy Commission (CDC) introduced a new *Dairy Ingredient Marketing Plan* to promote increased awareness and utilization of Canadian manufactured dairy ingredients.

During the months of December 2000 and January 2001, the CDC met with milk processors, further processors, industry associations and government agencies to discuss in greater detail, the initiatives called for in the Plan. The discussions proved useful in exchanging views and ideas on the objectives and initiatives of the Plan. Many groups shared a common interest in wanting to learn more about current and future trends in the supply and utilization of traditional and non-traditional dairy ingredients as well as the use of animal and vegetable fat substitutes.

Market Analysis Initiative

Based on initiatives called for in the Plan, marketing questionnaires were developed and remitted to individual companies in the distribution, processing and further processing sectors.

Responses to the questionnaires will help the CDC in researching the current level of dairy ingredient utilization (both inside and outside the Special Milk Class Permit Program) and will provide our industry partners with a more complete understanding of the Canadian dairy ingredients market.

New Dairy Ingredients Internet Site

As part of the *Dairy Ingredients Marketing Plan*, *MILKINGREDIENTS.CA*, a CDC- sponsored Web site, was launched on July 31, 2001. *MILKINGREDIENTS.CA* is the first Canadian Internet-based industry services and information tool designed to support Canadian dairy ingredient manufacturers, further processors, supplier-distributors and exporters, and industry partners.

Information, Interaction and Innovation

The CDC believes that this collaborative effort, involving various industry partners, will contribute to the strengthening of business and industry relationships, create new opportunities, communicate useful information and support services related to dairy ingredients, and foster growth and development in the Canadian dairy ingredients sector.

Adoption of a Special Committee Report Promotes Increased Harmonization of Dairy Policies

With regional representation from the Atlantic provinces, Quebec, Ontario and the West, the CMSMC's Special Committee was chaired by the CDC's Chairman. Over the course of 10 months, the group developed a final report, which was presented to the CMSMC in July 2000. An agreement on the proposed recommendations was reached at this same meeting and the recommendations went into effect on

August 1, 2000. The recommendations were as follows:

- A commitment to work towards a common approach to the removal of milk components surplus to the domestic market;
- Agreement to examine price differences between the All Milk Pool (P6) and the Western Milk Pool and address any significant unjustifiable differences;
- Develop a national harmonized milk classification system with the objective of reducing the number of milk classes;
- Discontinue British Columbia's special quota allocation formula as of August 1, 2003 in exchange for a one-time additional allotment of Market Sharing Quota (MSQ);
- Implementation of a new amending formula for MSQ adjustments on the basis of 10 percent of a province's historical shares and 90 percent on its population;
- MSQ allotment for provinces where Domestic Dairy Product Innovation Program projects are in effect;
- All provinces agreed to sign a new Comprehensive Agreement on Pooling of Milk Revenues; and
- The establishment of a "peace clause" to ensure that the issues addressed will not be re-opened for a period of six years.



Activities and Programs

National Dairy Policy

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

The Canadian Dairy Commission's role in this policy context is to act as a facilitator within the various forums that are involved in dairy policy such as the Canadian Milk Supply Management Committee (CMSMC).

The CMSMC is a permanent body created by the provincial signatories to the National Milk Marketing Plan (NMMP). Its mandate is to determine policies and to supervise the provisions of the NMMP as well as the Comprehensive Agreement on Pooling of Milk Revenues — formerly the Comprehensive Agreement on Special Class Pooling. The National Milk Marketing Plan is a federal/provincial agreement that governs the supply management system for dairy in Canada. The CMSMC is chaired by the Commission and has representation from dairy producers, processors and governments from all provinces. National dairy producer and consumer representatives also participate on the committee as non-voting members.

The National Milk Marketing Plan contains the key elements of how to manage and monitor the industrial market for milk. For example, it contains a formula that is used to calculate the national production target, or Market Sharing Quota (MSQ), to ensure that consumer demand for various dairy products is met. The Plan establishes each province's share of the MSQ and the

mechanism for sharing in any increase or decrease in the target. Each province in turn allocates its share of the MSQ to its dairy producers, according to provincial policy and other agreements established for the sharing of markets and producer returns.

While the supply of milk is managed carefully to meet the needs in the Canadian market throughout the year, surpluses can occur due to fluctuations in milk production or demand. These are managed by adjusting the Market Sharing Quota, stocks or by exporting surpluses, within Canada's trade agreements. Since the system and quotas are calculated on the basis of butterfat (fat in cow's milk), the industry is often faced with a surplus of solids non-fat or of products like skim milk powder. Surpluses are managed through the Surplus Removal Program, the costs of which are funded through pooling.

Production and Demand

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

In the 2000–2001 dairy year, Canadian Requirements were 45.99 million hectolitres, a 0.7 percent increase over the previous dairy year. During the same period, industrial milk and cream production totaled 47.1 million hectolitres, a 0.7 percent decrease over the 1999–2000 dairy year.

Market Sharing Quota (MSQ)

Each year, the CMSMC determines the national production target for industrial milk, called the Market Sharing Quota (MSQ). This target is constantly monitored and, when necessary, adjusted to reflect changes in the domestic demand for industrial milk products, as measured in terms of butterfat, as well as changes in planned export activity plus a buffer (called the Growth Allowance) to minimize the possibility of shortages on the domestic market.

The CMSMC applies the terms of the National Milk Marketing Plan to establish the provincial shares of the MSQ.

MSQ at July 31, 2001 was 46.4 million hectolitres. For the 2000–2001 dairy year, industrial milk and cream production exceeded the Market Sharing Quota by 0.7 million hectolitres.

Pooling of Producer Returns

Changing conditions in the global trading environment as well as in domestic markets in recent years resulted in new pooling arrangements across Canada for the marketing of milk. In its role as a national industry facilitator, the Canadian Dairy Commission administers these pooling arrangements on behalf of the dairy industry.

Comprehensive Agreement on Pooling of Milk Revenues

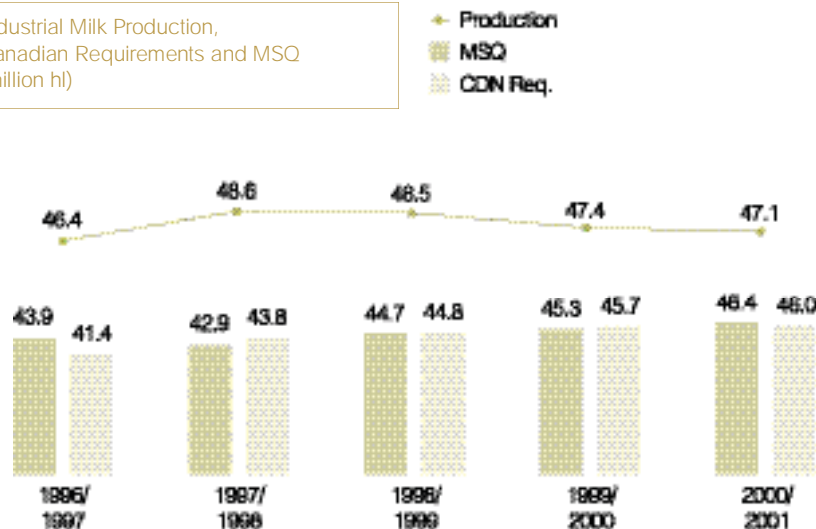
Under the Special Milk Class Pricing and Pooling System implemented in August 1995, industrial milk is classified and made available for use in dairy products and products containing dairy ingredients at

Production of Industrial Milk and Cream* (thousands of kg of butterfat)

	1998–1999	1999–2000	2000–2001
Prince Edward Island	3,061	3,063	3,041
Nova Scotia	2,437	2,173	2,099
New Brunswick	2,248	2,183	2,094
Quebec	84,151	83,326	83,117
Ontario	53,207	49,725	49,267
Manitoba	6,523	6,609	6,467
Saskatchewan	4,591	5,375	5,728
Alberta	10,143	10,045	9,285
British Columbia	8,363	8,208	8,440
Total	174,724	170,707	169,538

* Before Pooling

Industrial Milk Production, Canadian Requirements and MSQ (million hl)



Provincial Shares of MSQ* July 31, 2001

	Butterfat (thousands of kg)	Milk (million hl)	%
Prince Edward Island	3,056	0.849	1.8%
Nova Scotia	2,099	0.583	1.3%
New Brunswick	2,106	0.585	1.3%
Quebec	78,323	21.756	46.9%
Ontario	52,294	14.526	31.3%
Manitoba	5,821	1.617	3.5%
Saskatchewan	4,529	1.258	2.7%
Alberta	10,454	2.904	6.3%
British Columbia	8,340	2.317	5.0%
Total	167,022	46.395	100.0%

* Base MSQ before sharing of markets

prices which vary according to its end use. Formerly known as the Comprehensive Agreement on Special Class Pooling, the Comprehensive Agreement on Pooling of Milk Revenues provides a means for the market returns from the sale of milk to processors for Special Class purposes to be shared among all dairy producers. During the 2000–2001 dairy year, revenues were shared (or pooled) among nine provincial signatories to the National Milk Marketing Plan. As of August 1, 2001, Newfoundland will also share Special Milk Class Revenues since it has become a signatory to the National Milk Marketing Plan and the Comprehensive Agreement on Pooling of Milk Revenues.

Agreement on All Milk Pooling (P6)

Since August 1996, the Agreement on All Milk Pooling (P6) has provided a means for revenues from all milk sales (fluid and industrial) to be pooled among dairy producers in Manitoba, Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island.

Western Milk Pooling Agreement (WMP)

In March 1997, the four Western provinces (Manitoba, Saskatchewan, Alberta and British Columbia) also implemented an all milk pooling system. Although Manitoba is part of the Western Milk Pool, it also participates in revenue sharing under the Agreement on All Milk Pooling (P6).

Special Milk Class Permit System

Purpose

The Special Milk Class Permit System was created and implemented on August 1, 1995 in order to allow processors, exporters and further processors to remain competitive on international and domestic markets. Through this system, milk components are made available for use in dairy products and products containing dairy ingredients according to their end use at competitive prices.

Types of Permits

Processors, exporters and further processors can access certain volumes of dairy components through permits issued by the Canadian Dairy Commission.

There are three types of permits. The first type is a permit issued to further processors using dairy products for specific purposes as ingredients. Permits

are issued under Class 5(a) for cheese ingredients, under Class 5(c) for dairy product ingredients used in the confectionery sector, and under Class 5(b) for all other dairy product ingredients.

The second type of permit is issued to exporters for individual transactions. The exporters' permit specifies the maximum quantity of dairy products which may be exported according to the volume of milk identified as available for export. Permits are issued under Class 5(d) for the volume of milk covered under planned exports incorporated into MSQ, as well as other exports, the total of which falls within Canada's WTO commitment levels.

The third type of permit is issued under Class 4(m). Surplus of milk under this class is sold through a permit system into animal feed and other similar uses.

Achievements for the 2000–2001 Dairy Year

Further processors used the equivalent of 4.1 million hectolitres of milk in 2000–2001. A total of 961 permits were issued last year for Classes 5(a), (b) and (c), the majority of which were Class 5(b) permits. The number of businesses participating in the program rose to 747 in 2000–2001, up from 717 in the previous year. A total of 42 businesses operating in the confectionery sector used Class 5(c) permits during the year.

Pricing

The Commission's role in pricing is two-fold: first, it administers the payment of a federal subsidy which reduces the returns required by dairy producers from the marketplace. Secondly, the Commission annually reviews and announces support prices for butter and skim milk powder. Support prices are used as references by provincial milk

Volume of Milk Sold and Producers' Revenues in Classes 5(a), (b) and (c)*

Class		1996–1997	1997–1998	1998–1999	1999–2000	2000–2001
5(a)	Volume	1.336	1.535	0.885	1.517	1.791
	Price	\$39.52	\$39.01	\$44.20	\$37.17	\$35.48
5(b)	Volume	1.425	1.817	0.895	1.452	1.221
	Price	\$40.04	\$38.74	\$43.21	\$38.84	\$42.87
5(c)	Volume	0.797	0.828	1.154	1.033	1.053
	Price	\$32.22	\$32.73	\$33.03	\$33.60	\$31.91
Total	Volume	3.558	4.180	2.934	4.002	4.065
5(a), 5(b) & 5(c)	Price	\$37.74	\$37.54	\$39.50	\$36.61	\$36.37

*Volumes (in million hectolitres) and prices are calculated on a standard hectolitre basis at 3.6 kg of butterfat per hl.

boards and agencies in setting the prices for milk sold to processors.

Together, these two elements serve as a means for the Commission to fulfill its mandate to ensure that producers receive an adequate return for their labour and investment and ensure consumers a continuous supply of high quality dairy products. The two elements are factored into a yearly pricing announcement made by the CDC in December — a decision which then takes effect the following February.

Support Price Announcement

In December 2000, following careful consideration of the views of dairy industry stakeholders, as well as other factors such as the result of a national cost of production survey conducted by the CDC, and other economic indicators, the Canadian Dairy Commission announced that, effective February 1, 2001, the support price for skim milk powder would rise to \$4.8394 from \$4.6842 per kilogram, and for butter, to \$5.7261 from \$5.5407 per kilogram.

The market revenues resulting from these higher support prices provided dairy farmers with an additional amount of \$2.13 per hectolitre. Of this amount, \$0.85 per hectolitre was included for the purpose of continuing to allow for the recovery of the consumer subsidy from the marketplace — which is being reduced until its elimination on January 31, 2002. Consequently, net returns to dairy farmers increased by \$1.28 per hectolitre or 2.3 percent above the previous year's net returns.

Federal Subsidy Program

The Government of Canada has provided funding under the federal subsidy program since before the establishment of the CDC in 1966. However, in 1996, as part of the federal budget, it was announced that the program would be phased-out over a five year period until its elimination on January 31, 2002. The last of the annual reductions of \$0.76 per hectolitre will be applied at that time.

Payments to producers under the federal dairy subsidy program in the 2000–2001 dairy year totaled \$50.977 million for the production of 161.064 million kilograms of butterfat or 44.74 million hectolitres of milk produced for domestic consumption.

Imports of Dairy Products

Prior to 1995, Canada maintained a range of measures which placed limits on dairy product imports to uphold the stability of its

national milk supply management system. These controls changed significantly in 1995 as a result of the World Trade Organization (WTO) Agreement on Agriculture. In signing this Agreement, Canada and the other signatories agreed to replace former quantitative import restrictions with tariffs and Tariff Rate Quotas.

Under the terms of the 1995 WTO Agreement, Canada has established Tariff Rate Quotas (TRQs) for a number of dairy products. With the support of the industry, the CDC has acted as the first receiver of imports of butter under federal permit since 1995 and directed this product through butter manufacturers to the further processing sector.

The first year the Agreement was in effect, the Tariff Rate Quota for butter was 1,964 tonnes. Last year the Tariff Rate Quota reached 3,274 tonnes. Of the total Tariff Rate Quota, approximately two thirds of the amount is a country allocation to New Zealand, amounting to 2,000 tonnes last year.

Domestic Dairy Product Innovation Program

The Domestic Dairy Product Innovation Program (DDPIP) encourages the manufacture of new and innovative products on the domestic market by adding specific volumes to provincial milk quotas in order to ensure that necessary milk supplies are available. Accordingly, the DDPIP allows for a certain amount of flexibility within the national supply management system.

The DDPIP was first implemented in 1989 following approval by the CMSMC. It was most recently renewed in July 1999 and extended until the end of the 2004-2005 dairy year.

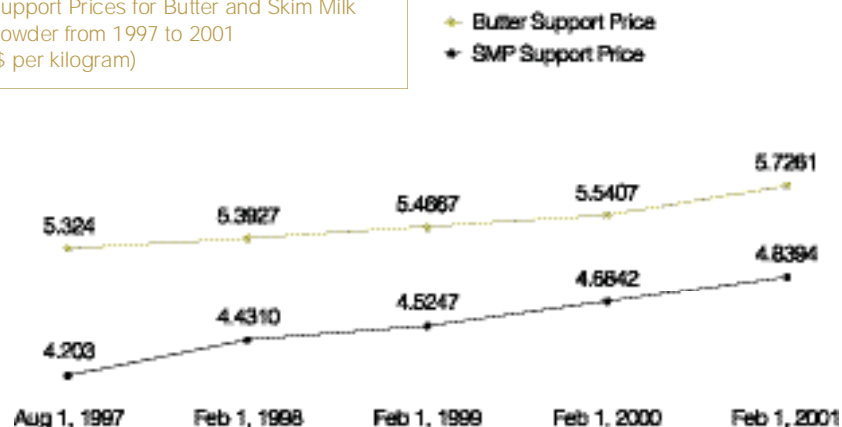
Achievement During the 2000–2001 Dairy Year

During the 2000–2001 dairy year, Canadian firms in Quebec, Ontario, Alberta and British Columbia utilized approximately 22 million litres of milk under the DDPIP.

The CMSMC also conducted a review of the Program. As a result, the criteria were modified to ensure that the Program is used for new and innovative products that will positively impact on domestic market demand. In addition, a new Selection Committee, comprised of representatives of six organizations (three regional and three national including the CDC), was formed to review all applications to the Program.

During the year, eight companies submitted applications and nine new products were accepted, mainly for the development of new specialty cheeses. Companies whose applications are rejected can now appeal the decision of the Committee to an

Support Prices for Butter and Skim Milk Powder from 1997 to 2001 (\$ per kilogram)



Direct Payments to Producers —
Value from 1996–1997 to 2000–2001
(in thousands)

	1996–1997 ⁽¹⁾	1997–1998	1998–1999	1999–2000 ⁽²⁾	2000–2001
Prince Edward Island	\$ 2,134	\$ 2,024	\$ 1,610	\$ 1,205	\$ 742
Nova Scotia	3,781	3,514	2,730	2,002	1,225
New Brunswick	2,824	2,658	2,103	1,563	956
Quebec	61,135	57,824	46,430	34,525	21,073
Ontario	54,489	51,081	39,923	29,725	18,208
Manitoba	5,049	4,158	3,425	2,441	1,515
Saskatchewan	3,504	2,996	2,465	1,754	1,075
Alberta	9,329	8,501	7,018	5,016	3,096
British Columbia	7,776	8,485	6,994	4,945	3,087
Total	\$150,021	\$141,241	\$112,698	\$83,176	\$50,977

⁽¹⁾Start of Market Sharing under Pooling arrangements

⁽²⁾Modified for cream producers' year-end adjustments

appeal body composed of the three Commissioners of the CDC. Appeals were filed by two companies. Following a review of the applications, the three Commissioners accepted one as eligible under the Program criteria.

Domestic Seasonality Programs

Milk production fluctuates on a seasonal basis. It is highest in the spring when cows tend to produce more milk, while in the fall and winter months, production may drop slightly. Conversely, demand for dairy products such as butter and cheese is highest in the fall and winter months, particularly in the period leading up to the Christmas season and tends to be lower in the post-Christmas period.

Domestic Seasonality Programs are a key function in enabling the industry to match supplies of product with consumer demand on the domestic market, particularly during seasonal periods of fluctuation in production. The industry has mandated the CDC to operate these programs, in cooperation with the private sector, to balance the seasonal demand and supply of dairy products.

Storage Programs

Butter

The CDC holds a pre-determined amount of butter in storage throughout the year. The Canadian Milk Supply Management Committee sets a target of 11 million kilograms of butter at the beginning of each

dairy year referred to as the "normal butter inventories." These stocks are considered necessary to ensure that the domestic market has a constant supply throughout the year.

Within this targeted level, two types of programs are operated to manage stocks. Plan A is a storage program for butter which is held in 25 kilogram blocks. The CDC purchases the butter and holds it for resale in the domestic market at the support price when manufacturers run low on supply of cream to make butter. During the 2000–2001 period, the goal for Plan A normal stocks as at July 31 was 2.5 million kilograms.

Plan B is a storage program used by processors to balance the seasonality of their own production and sales during the calendar year. Under the Plan B program

for butter, manufacturers can sell butter in retail packaging (454 g), or in 25 kilogram bulk blocks to the Commission. They must then repurchase this butter within one calendar year from the date of the product's manufacture. Companies make their own decisions on the level of butter they want to put in storage under this program. Because of the need to repurchase the product, this program is self-limiting and for this reason, there is no set limit on the quantity of product accepted by the CDC.

The total of stocks of butter under Plans A and B serves as an indicator to the industry of possible surpluses or shortages of butterfat in the marketplace. This information is used to assess whether production quotas should be adjusted or it may indicate the need to manage surpluses. However, in the past few years, butter produced in the domestic market has, in large part, been consumed in Canada. As a result, Canada only exported small amounts of surplus butterfat in the form of butter.

Butteroil

In January 2000, the Canadian Milk Supply Management Committee approved the inclusion of butteroil as an eligible product in the existing Plan B program for butter on a temporary basis. It was approved on the basis that the program would assist in the supply for fresh cream during the fall period when the supply of butterfat is tight.

In January 2001, the Committee approved the permanent eligibility of butteroil under Plan B. A total of 384 tonnes of butteroil was stored during the dairy year.

Milk Powders

The CDC also operates a program for the storage of specialty types of milk powders. It encourages manufacturers to make these products when the supply of milk is plentiful and minimizes the demand for fresh milk to make these products in the fall when milk production is usually low. Stocks held under this program act to balance the supply and demand of non-fat milk solids.

Concentrated Milk Assistance Program

The Concentrated Milk Assistance Program (CMAP) is used to encourage the production of evaporated and sweetened condensed milk during the period of the year when milk supply is abundant. Unlike the other Domestic Seasonality Programs where the CDC actually purchases and sells the products, the CMAP is a financial assistance program for which manufacturers retain possession of the product and are responsible for storage arrangements. A set amount of financial assistance is offered under the program to compensate manufacturers for the carrying charges associated with additional product storage time.

This program underwent a review by the Commission, at the request of industry, to determine how evaporated milk manufacturers could make better use of the program. It was determined that a 60-day waiting period for products to become eligible for assistance was too long at certain times of the year. As a result, the CMSMC authorized the Milk Management Committee to reduce the waiting period to 30 days to encourage the production of this product during certain times of the year

when milk may be over-abundant. This product is then marketed domestically in the periods of the year when it is needed most. The eligibility period in which manufacturers can register products under this program has been reduced to products manufactured during the period of January 1st to July 31st.

Butter and Skim Milk Powder Inventories

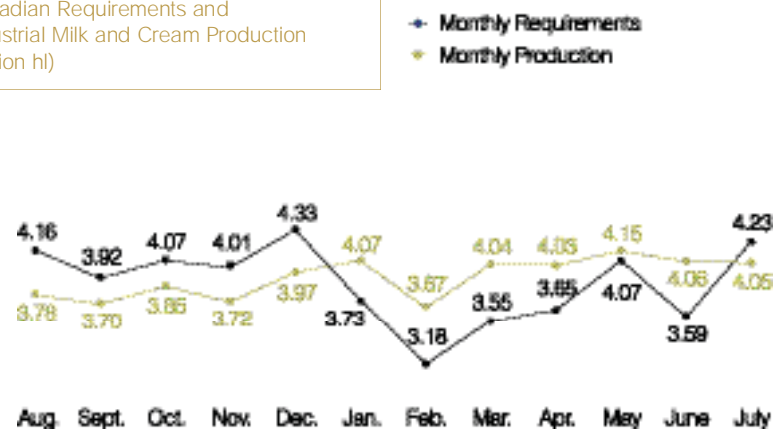
The Commission began the 2000–2001 dairy year with 11.80 million kilograms of butter and 6.66 million kilograms of skim milk powder in inventory. During the year, the CDC purchased 20.89 million kilograms of butter and 39.49 million kilograms of skim milk powder. Sales of 18.29 million kilograms of butter and 37.36 million kilograms of skim milk powder left respective closing inventories of 14.40 and 8.79 million kilograms as of July 31, 2001 (butter statistics include imports).

Surplus Removal Program

The CDC administers a Surplus Removal Program (SRP), on the industry's behalf. The program was designed to minimize the manufacture of products for unplanned exports when unfulfilled domestic and planned export opportunities exist. The program ensures that milk that is surplus to the domestic market is removed in the form of dairy products that are most suited for export.

Changes to the program were implemented in August 2000 in compliance with a WTO ruling on Canada's exports of dairy products. The CMSMC created the Milk Management Committee (MMC) and

Canadian Requirements and Industrial Milk and Cream Production (million hl)



gave it authority to direct the CDC in operating the Surplus Removal Program. This Committee is comprised of representatives from the production and processing sectors at the provincial and national levels. The Milk Management Committee assesses market conditions and the milk production situation for the purpose of determining when surplus removal activities are required and the quantity of milk that the CDC is authorized to remove from the marketplace.

Exports

The CDC's role in exporting dairy products underwent important changes in the last few years. Except for sales of skim milk powder to the governments of Mexico and Cuba, the CDC no longer directly exports dairy products.

Exports of all dairy products are essentially achieved by private exporters using Class 5(d) permits administered by the

CDC, as directed by the Milk Management Committee and within Canada's WTO export commitments.

Only those export activities authorized by the Milk Management Committee (MMC) can be carried out by the CDC.

The only product directly exported by the CDC during the year was skim milk powder. A total of 34.7 million kilograms was sold by the CDC.

In the case of cheese exports, the CDC's main responsibility is to issue certificates to Canadian exporters giving them access to the European Union's Aged Cheddar market. Canada negotiated a special access quota in 1980 with the European Union. The current access level is 4,000 tonnes, which allows Canada to continue to market its finest aged cheddar to the United Kingdom. Consumers in the UK have been able to obtain this famous Canadian product for almost a century.

Warehousing and Charges

Warehousing of Stocks — The Commission enters into contracts with public warehouses across Canada for the safe storage of its products. In the 2000–2001 dairy year, the CDC stored mostly butter and milk powders in 43 warehouse locations across Canada.

Carrying Charges — Carrying charges associated with the CDC's Domestic Seasonality Programs for butter and skim milk powder totaled \$5.03 million in 2000–2001.

Financing — In order to defray the costs associated with storing the normal levels of butter stocks, an amount is collected by the Commission through pooling arrangements and is adjusted as required to correspond to the actual costs associated with these stocks. On February 1, 2001, the CDC maintained this charge at \$0.07 per hectolitre.

Audit

The Audit Section has a dual accountability:

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

This dual accountability is emphasized by the joint funding provided by both the government and dairy producers. Accordingly, the Audit Section's many responsibilities include both external and internal audit work.

Internal Audits

As mandated by the *Financial Administration Act*, internal audits must be carried out on the systems and practices of the Commission. An internal committee of the Commission, comprised of directors and managers and chaired by a Commissioner, reviews audit priorities and develops an annual, as well as a five-year audit plan.

During the 2000–2001 dairy year, the section performed an important review of the CDC's freight and warehousing practices, as well as its Corporate Plan. The Section works with management in order to ensure that operations are carried out economically, efficiently and effectively. The Audit Section also co-operates and assists the Auditor General with its annual audit by providing relevant reports and information on CDC practices.

External Audits

External audits are, in large part, performed on companies participating in the Special Milk Class Permit System. During the 2000–2001 dairy year, 33 companies were audited, resulting in claims of \$833,000, which were returned to Canadian dairy producers. Risk assessment is used to identify high risk companies among the seven hundred companies that generated \$280 million in revenue under the program during the 2000–2001 dairy year.

The CDC Audit Section also establishes mandates and reviews the work contracted with professional audit firms in each province. This provides assurance on the reliability of revenues reported to the Commission to run the national pools.

In cooperation with provincial milk plant auditors, the CDC Audit Section developed a national Milk Utilization Plant Audit Manual establishing a set of minimum audit standards to be followed in the performance of milk plant audits. Following Newfoundland's entry into the National Milk Marketing Plan on August 1, 2001, these audit standards will apply to all 10 provinces.

During the 2000–2001 dairy year, the Section provided historic summary utilization data in order to assist in the negotiating process for Newfoundland's entry into the national system.

Significant Factors Affecting Financial Results

Sales revenues increased by 14 percent in the last dairy year (\$222 million) as compared to the same period in the previous year (\$194 million), with a corresponding margin that doubled to over \$18 million in 2001 as compared to a \$9 million margin achieved in the year 2000. This performance is mainly attributable to the export sales of skim milk powder at world prices which have continued to rise throughout the year. Apart from the Commission's traditional markets in Mexico and Cuba, the majority of the sales were made to Canadian exporters.

Favorable margins were generated on the sales of Plan A and Plan B butter as a result of an increase in support prices in February 2001. In addition, imported butter purchased by the CDC in respect of Canada's commitments at the World Trade Organization (WTO), was sold domestically for use by the further processing industry and contributed to the Commission's overall profit margin on domestic sales.

Export market returns have decreased due to WTO limits applicable on eligible exports.

With the continuation of the gradual phase-out of dairy subsidies, year-over-year payments to eligible dairy producers have decreased by \$32 million. Next year will be the last year for subsidy payments as the program will end on January 31, 2002.

In accordance with recommendations made by the Canadian Milk Supply Management Committee, the Commission has built-up its inventories of Plan A butter to avoid a shortfall during the fall months when the milk supply of butterfat may not be sufficient to fully satisfy demand. While Plan B butter is repurchased by processors at current support price, inventories of Plan B butter were slightly higher than average at year-end. Inventory levels of Skim Milk Powder were also higher at year-end compared to last year due mainly to a build up of stocks for shipments to be made in the first few months of the next dairy year. Consequently, loans from the Government of Canada are up by \$20 million at year-end in comparison to the previous year in order to finance the additional inventories.

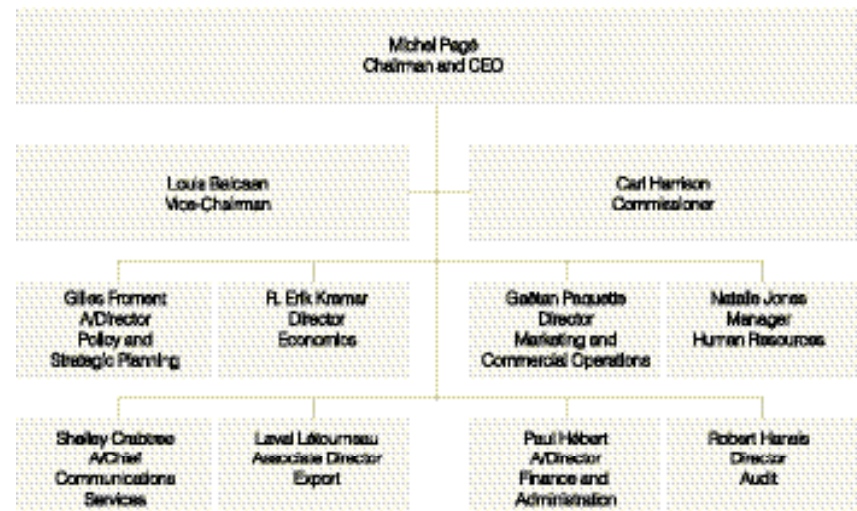
Human Resources



From left to right:
Michel Pagé, Louis Balcaen and Carl Harrison

The success of the Canadian Dairy Commission's services depends largely on its human resources as well as on its pursuit of excellence in the services it offers. The Canadian Dairy Commission is committed to providing its human resources in a quality work environment in which fairness, employment equity and inclusiveness, respect, continuous learning and development, recognition, leadership and team work prevail. With that in mind, the CDC reaffirms its commitment to continually implementing programs and internal initiatives which are aimed at encouraging and supporting good individual and company performances.

The Canadian Dairy Commission (CDC) places great importance on improvement and therefore has been re-examining and adapting its services and organizational structure to better respond to current and future client needs and to effectively continue the CDC's role in the Canadian dairy industry. In the past year, the function of communications began operating under a separate unit headed by a Chief and called Communications Services. Additionally, the Commercial Operations and Domestic and International Marketing sections were merged in August 2000 forming a new section called Marketing and Commercial Operations. This Section is now responsible for all marketing activities of the CDC.





Financial Statements

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. The statements have been prepared in accordance with Canadian generally accepted accounting principles, using management's best estimates and judgements where appropriate. Financial information presented elsewhere in the Annual Report is consistent with the statements provided.

In discharging its responsibility for financial reporting, management maintains and relies on financial and management control systems and practices designed to provide reasonable assurance that transactions are authorized, assets are safeguarded, and proper records are maintained. These controls and practices ensure the orderly conduct of business, the accuracy of accounting records, the timely preparation of reliable financial information and the adherence to Commission policies and statutory requirements. The process includes management's annual communication to employees of Treasury Board's guidelines on conflict of interest and code of conduct.

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

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

Original Signed by:
Michel Pagé, Chairman
Paul Hébert, A/Director of Finance

Ottawa, Canada
September 21, 2001

Auditor's Report

To the Minister of Agriculture
and Agri-Food,

I have audited the balance sheet of the Canadian Dairy Commission as at July 31, 2001 and the statement of costs funded by the Government of Canada, the statement of operations and the statement of cash flows for the year then ended. These financial statements are the responsibility of the Commission's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining,

on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Commission as at July 31, 2001 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, I report that, in my opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of the Commission that have come to my

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

Original signed by:

John Wiersema, CA
*Assistant Auditor General
for the Auditor General of Canada*

Ottawa, Canada
September 21, 2001

Balance Sheet

as at July 31, 2001

	2001	2000
		(in thousands)
ASSETS		
Cash and term deposits	\$ 1,024	\$ 4,460
Accounts receivable		
Trade (Note 4)	13,417	12,139
Government of Canada	8,550	14,338
Due from provincial milk marketing boards and agencies	23,376	21,478
Inventories (Note 5)	110,266	76,913
	\$156,633	\$129,328
LIABILITIES		
Bank indebtedness — pooling account (Note 6)	\$ —	\$ 364
Accounts payable and accrued liabilities		
Trade	19,280	14,056
Other liabilities	1,445	1,470
Due to provincial milk marketing boards and agencies	22,092	23,600
Subsidies payable to producers	8,525	14,313
Loans from Government of Canada (Note 7)	78,523	58,379
	129,865	112,182
Surplus at end of year (Note 8)	26,768	17,146
	\$156,633	\$129,328

Commitments (Notes 10 and 12)

Approved:

Original Signed by:

Michel Pagé, Chairman

Louis Balcaen, Vice-Chairman

Paul Hébert, A / Director of Finance

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

Statement of Costs Funded by the Government of Canada

for the year ended July 31, 2001

	2001	2000
		(in thousands)
Subsidies to producers of industrial milk and cream	\$50,977	\$83,176
Operating expenses	2,775	2,730
Costs of production and dairy policy studies	542	410
Total costs funded by the Government of Canada (Note 9)	\$54,294	\$86,316

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

Statement of Operations

for the year ended July 31, 2001

	2001	2000
	(in thousands)	
Export sales	\$114,262	\$89,463
Cost of sales	101,628	87,054
Margin on export sales	12,634	2,409
Domestic sales	107,739	104,789
Cost of sales	101,186	97,638
Margin on domestic sales	6,553	7,151
Total margin on sales	19,187	9,560
Pooling of market returns activities		
Contributions from provincial marketing boards and agencies	117,324	136,563
Equalization payments to provincial marketing boards and agencies	110,138	130,314
Contributions withheld to fund operating expenses	7,186	6,249
Operating expenses	12,726	10,285
Net results of operations before Government funding	13,647	5,524
Operating expenses funded by the Government of Canada	2,775	2,730
Net results of operations after Government funding	16,422	8,254
Surplus at beginning of year	17,146	12,942
	33,568	21,196
Refund of surplus to producers	6,800	4,050
Surplus at end of year	\$ 26,768	\$17,146

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

Statement of Cash Flows

for the year ended July 31, 2001

	2001	2000
		(in thousands)
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers	\$220,723	\$185,918
Cash paid to suppliers and others	(241,732)	(187,554)
Cash receipts from producers	7,152	6,212
Cash receipts from provincial milk pools	242,378	157,958
Cash paid to provincial milk pools and others	(245,793)	(157,198)
Cash receipts from the Government of Canada	60,082	90,466
Subsidies paid to producers	(56,765)	(87,218)
Interest paid	(2,461)	(1,554)
Cash flows from operating activities	(16,416)	7,030
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in term deposits	-	3,781
Cash flows from investing activities	-	3,781
CASH FLOWS FROM FINANCING ACTIVITIES		
New loans from the Government of Canada	198,857	129,865
Loan repayments to the Government of Canada	(178,713)	(136,229)
Decrease in milk pooling line of credit	(364)	(760)
Cash paid to refund surplus to producers	(6,800)	(4,050)
Cash flows used in financing activities	12,980	(11,174)
NET DECREASE IN CASH	(3,436)	(363)
Cash at beginning of year	4,460	4,823
Cash at end of year	\$ 1,024	\$ 4,460

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

Notes to Financial Statements

July 31, 2001

1. The Commission

The Canadian Dairy Commission (the "Commission") is an agent Crown corporation named in Part I, Schedule III to the *Financial Administration Act* and is not subject to the provisions of the *Income Tax Act*. The objects of the Commission, as established by the *Canadian Dairy Commission Act (CDC Act)*, are "to provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality".

The Commission administers subsidy payments to producers and other costs funded by the Government of Canada. In co-operation with the Canadian Milk Supply Management Committee (CMSMC), which it chairs, the Commission undertakes the management and administration of operations funded by producers. The results of the Commission's operations in each of these areas are presented in the Statement of Costs Funded by the Government of Canada, and in the Statement of Operations, respectively, in order to reflect and distinguish the accountability relationships for them.

The Commission purchases all butter and skim milk powder tendered to it at either the Canadian support price or at the international market price, depending on the intended resale markets, except for a portion of butter imported by the Commission at international market price for domestic consumption in accordance with Canada's commitments at the World Trade Organization (WTO). While a major portion of the butter purchased by the Commission is later resold in the domestic market, most of the skim milk powder is in excess of domestic needs and is exported. The Commission sells production surplus to domestic requirements in the form of whole milk products, skim milk powder and butter on international markets.

The Commission administers, on behalf of the industry, a pricing and pooling of market returns system which provides milk components to further processors and exporters through processors at competitive prices. This system is administered by the Commission in accordance with the "Comprehensive Agreement on Pooling of Milk Revenues" to allow dairy producers to share special class revenues nationally, as well as with the "Western Milk Pooling Agreement" and the "Agreement on All Milk Pooling", which allow dairy producers to share revenues regionally.

2. Significant accounting policies

Inventories

Inventories are valued at the lower of cost or estimated net realizable value.

Foreign currency translation

A portion of sales in foreign currencies are hedged by forward exchange contracts and are translated into Canadian dollars at the exchange rates provided therein. Sales in foreign currencies that are not hedged are translated into Canadian dollars at the exchange rate in effect on the transaction date.

Contributions to Public Service Superannuation Plan

The Commission's employees participate in the Public Service Superannuation Plan administered by the Government of Canada. Both the employees and the Commission contribute to the cost of the Plan. Contributions by the Commission are expensed in the year incurred.

The Commission is not required under present legislation to make contributions with respect to actuarial deficiencies of the Public Service Superannuation Plan.

3. Fair value of financial instruments

The transactions related to cash and term deposits, accounts receivable, bank indebtedness, accounts payable and accrued liabilities, subsidies payable to producers and loans from the Government of Canada are entered into in the normal course of business. The carrying amounts of each of these accounts approximate their fair values because of the short term to maturity.

4. Accounts receivable — Trade

Most of the trade accounts receivable are in foreign currencies and their Canadian dollar value has been determined using the rate to be paid under forward exchange contracts as further explained in Note 10. These foreign accounts receivable are guaranteed by letters of credit, are payable on demand and are non-interest bearing.

5. Inventories

	2001	2000
	(in thousands)	
Butter	\$ 78,299	\$ 59,722
Skim milk powder	29,155	17,186
Other dairy products	2,812	5
	<u>\$110,266</u>	<u>\$ 76,913</u>

6. Bank indebtedness — Pooling account

To provide bridge financing and ensure the efficient operation of the pricing and pooling of market returns system, the Commission established a \$10 million line of credit with a member of the Canadian Payments Association. The bank indebtedness incurred under this line of credit is due on demand and bears interest at prime which on July 31, 2001 was 6.00% per annum. The bank indebtedness is repaid monthly. An offsetting amount is included in the amount due from provincial milk marketing boards and agencies.

7. Loans from Government of Canada

Loans from the Government of Canada, to a maximum of \$100 million, are available to finance operations. Individual loans are repayable within one year from the date the loan is advanced. Principal and accrued interest are repaid regularly during the year when funds are available. Interest on the loans are at the normal rates established for Crown corporations by the Government and varied from 4.29% to 6.02% (2000 — 4.42% to 5.88%).

8. Surplus at end of year

The Commission collects amounts from consumers through pooling arrangements to fund carrying charges associated with normal levels of butter inventory. This amount is reflected in contributions withheld to fund operating expenses. The surplus at the end of the year is made up of an accumulated surplus of this funding and surplus amounts relating to commercial sales.

The refund of surplus to producers relating to commercial sales is determined on an annual basis and recorded in the year in which it is authorized.

9. Costs funded by the Government of Canada

Agriculture and Agri-Food Canada provides funding to the Commission for subsidy payments to producers of industrial milk and cream shipments produced to meet domestic requirements. The rate of subsidy payments from August 1, 2000 to January 31, 2001 was \$0.422 per kilogram of butterfat or \$1.52 per hectolitre of milk containing 3.6 kilograms of butterfat (August 1999 to January 2000 — \$0.632 or \$2.28 respectively) and was \$0.211 per kilogram of butterfat or \$0.76 per hectolitre from February 1, 2001 to July 31, 2001 (February 2000 to July 2000 — \$0.422 or \$1.52 respectively). The federal subsidy program will end January 31, 2002.

Funding of the Commission's administrative expenses is shared among the federal government (44%), dairy producers (36%) and the market place (20%). The Government of Canada funded \$2.8 million (2000 — \$2.7 million) of the Commission's administrative expenses of \$6.5 million (2000 — \$5.5 million), as well as professional services relating to cost of production and dairy policy studies. While Government funding remained relatively constant during the past two fiscal years ending March 31, the year-over-year spending on a dairy year basis fluctuated due to the timing of expenditures.

10. Forward exchange contracts

As part of its foreign exchange risk management, the Commission enters into forward exchange contracts with regard to a portion of its export sales contracts. At the end of the dairy year, the Commission's outstanding forward exchange contracts totaled \$18 million Canadian equivalent (2000 — \$12 million Canadian equivalent). These contracts mature from August to September 2001. The maturity dates of the forward exchange contracts correspond to the estimated dates when the Commission expects to receive the foreign currency proceeds arising from export sales contracts.

11. Representatives' fees

The Commission used the services of representatives for sale of dairy products on the export market. Total fees for the year were \$1.1 million (2000 — \$0.7 million) and are included in cost of sales.

12. Purchase commitments

As at July 31, 2001, the Commission was committed to purchase certain butter, skim milk powder and other dairy products produced prior to that date. These commitments amounted to approximately \$2.4 million (2000 — \$2.4 million).

13. Related party transactions

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

Government departments provided the Commission with certain administrative services without charge. The value of these services is not recorded in the Commission's accounts.

14. Financial statement presentation

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

Schedule of Operations by Product

for the year ended July 31, 2001

(in thousands)

	2001				2000			
	Butter	Skim Milk Powder	Other Products*	Total	Butter	Skim Milk Powder	Other Products*	Total
Export sales	\$ —	\$ 114,162	\$ 100	\$ 114,262	\$ 2,454	\$ 86,790	\$ 219	\$ 89,463
Cost of sales	—	101,528	100	101,628	2,635	84,190	229	87,054
Margin (loss) on export sales	—	12,634	—	12,634	(181)	2,600	(10)	2,409
Domestic sales	96,350	11,389	—	107,739	93,906	10,883	—	104,789
Cost of sales	89,838	11,348	—	101,186	88,457	9,181	—	97,638
Margin on domestic sales	6,512	41	—	6,553	5,449	1,702	—	7,151
Total margin (loss) on sales	\$ 6,512	\$ 12,675	\$ —	\$ 19,187	\$ 5,268	\$ 4,302	\$ (10)	\$ 9,560
Operating expenses:								
Domestic dairy product assistance	\$ 44	\$ —	\$ 345	\$ 389	\$ 32	\$ —	\$ 511	\$ 543
Carrying charges	3,770	1,261	4	5,035	3,170	774	1	3,945
Recovery of doubtful accounts	—	—	—	—	—	—	(13)	(13)
	\$ 3,814	\$ 1,261	\$ 349	\$ 5,424	\$ 3,202	\$ 774	\$ 499	\$ 4,475
Administrative expenses				6,487				5,530
Pool cost of production, interest and bank charges				815				280
Total operating expenses				\$ 12,726				\$ 10,285

*Includes whole milk powder and evaporated milk