Canadian Dairy Commission | Commission canadienne du lait

Quarterly Financial Report

August to October 2011

Canada

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Management Discussion and Analysis

The following discussion and analysis of the operating results and financial position of the Canadian Dairy Commission (CDC) for the quarter ending October 31, 2011 should be read in conjunction with the financial statements enclosed herein and the 2010-2011 Annual Report.

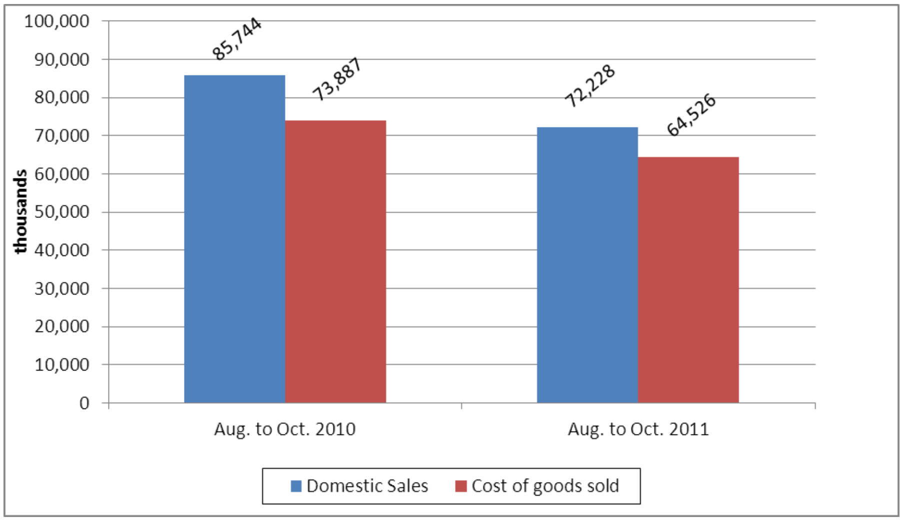
1. Basis of Preparation

This discussion was prepared in accordance with the Treasury Board Standard on Quarterly Financial Reports for Crown Corporations (Treasury Board Standard). This narrative discussion is not intended to be a full Management Discussion and Analysis (MD&A). Disclosures and information in the Canadian Dairy Commission's July 31, 2011 annual report are assumed to apply to the current quarter unless otherwise updated below.

The financial statements are unaudited and have been prepared in Canadian dollars in accordance with International Accounting Standard 34, *Interim Financial Reporting* (IAS 34) and the Treasury Board Standard. Since the three months ended October 31, 2011 represent the Commission's first reporting period under International Financial Reporting Standards (IFRS), the interim financial statements were also prepared in accordance with IFRS 1, *First-time Adoption of International Financial Reporting Standards*. The opening statement of financial position as at August 1, 2010 was included as a comparative column in the Commission's balance sheet, along with October 31, 2011 and July 31, 2011. Further details on the basis of preparation are disclosed in Note 2 of the accompanying interim financial statements while details of the impacts of the transition from Canadian GAAP to IFRS are disclosed in Note 16.

2. Financial Results

Domestic Activities



Revenues

Domestic sales revenues for the three months ending October 31, 2011 decreased by $13.5 million or 15.7% compared to the quarter ending October 31, 2010. This is mainly due to lower sales of Plan A butter, Plan B butter and 4(m) skim milk powder (SMP). This decrease was partly offset by an increase in the sales of imported butter.

The decrease in the quantity of Plan A sold in the first quarter is the result of the CDC carrying lower inventories compared to the same period in 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 recent initiatives by provincial marketing boards and agencies to increase production, the CDC expects to rebuild its butter stocks to normal levels during the current dairy year.

To counter the lower sales of Plan A butter, the CDC sold larger quantities of imported butter in the fall to satisfy the market.

As for the decrease in sales of Plan B butter and 4(m) SMP it is mainly attributable to a slight delay in sales.

Cost of goods sold and gross profit

For the three months ending October 31, 2011 the cost of goods sold amounted to $64.53 million compared to sales revenues of $72.23 million. This resulted in a gross profit after factoring transport and carrying charges of $6.3 million for domestic activities.

This amount is lower than the $10.7 million generated the previous year due to lower product sales.

Export Activities

Revenues

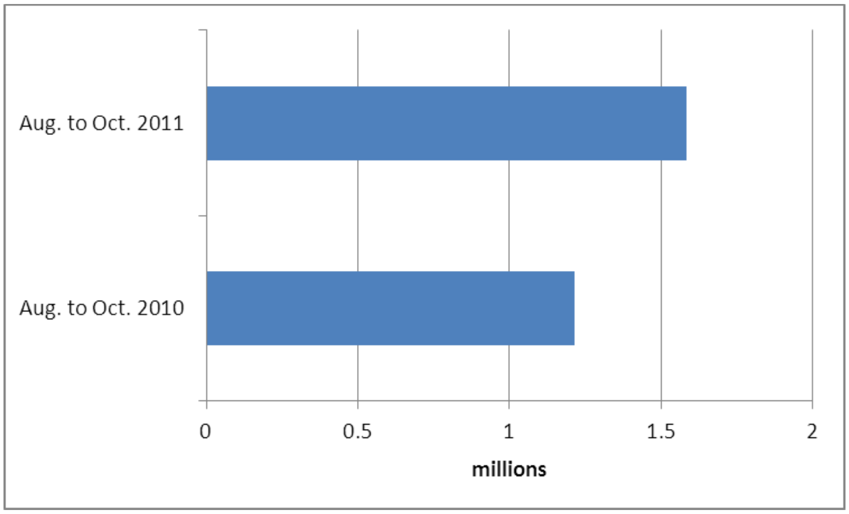
Export sales revenues were slightly higher at $2.21 million for the first quarter ending October 31, 2011 compared to$2.12 million for the same period in the previous year. This was mainly due to the fact that the CDC exported more skim milk powder (SMP) at higher prices during the most recent quarter.

Cost of goods sold and gross profit

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.

For the first quarter ending October 31, 2011, the cost of goods sold totalled $1.79 million compared to sales revenues of $2.21 million, resulting in a gross profit after factoring transport and carrying charges of $0.22 million for export activities.

Transport and Carrying charges



Transport and carrying charges are mainly comprised of transportation expenses, interest expenses on loans, handling and storage charges, and insurance.

Transport and carrying charges totalled $1.58 million in the first quarter of 2011-2012 compared to $ 1.21 million last year for the same period. The increase in charges is mainly due to the timing of purchases and sales of dairy products for which the CDC was responsible for transport.

Other Revenues

Funding from Government of Canada

Parliamentary appropriations for operating expenditures are recognized in the Statement of Operations and Comprehensive Income based on government-funded administrative expenses. Parliamentary appropriations for operating expenditures recognized as revenue increased by $739,000 for the three-month period ending October 31, 2011, compared to the same period last year.

Part of this increase was due the fact that certain expenditures were incurred in the first quarter of 2011-2012 as opposed to being incurred later last year. Another important part of this increase is re-imbursement for severance benefits paid to employees according to a new collective agreement. An agreement was reached with a major Public Service union representing more than half of the CDC employees to terminate the accumulation of severance benefits. Employees were given the option to cash out now, or at time of retirement, any accumulated severance pay. The majority of employees opted to cash out their accumulated severance benefits right away.

Operating and Administrative Expenses

Operating expenses

“Other charges / recoveries” include amounts representing unrealized gains or losses on outstanding foreign exchange contacts as of the balance sheet date. These gains or losses are determined using the difference between the contracted rates and exchange rates as of the balance sheet date applied to the contract amount and vary with the movement of exchange rates as well as the value of outstanding foreign exchange contracts at the end of the period.

As of October 31, 2011 outstanding foreign exchange contacts were in a gain position while in the previous year, outstanding foreign exchange contracts were in a loss position, explaining the difference.

Administrative expenses

The administrative expenses increased by $304,000 compared to the first quarter of 2010-2011. This increase is mainly attributable to expenses occurring earlier this year that last year.

In response to a request from government, the CDC has budgeted and acted to ensure fiscal restraint such that administrative expenses for the current year will not exceed those for 2010-2011, as outlined in our Corporate Plan Summary.

Inventories and Loans

Inventory value as of October 31, 2011 was $79.49 million which is comparable to the $82.44 million of October 31, 2010.

Stock levels normally decline at this time of year, reaching their lowest levels by end of December. This is a normal seasonal cycle as demand for butter increases during the pre-Christmas period and manufacturers repurchase their Plan B butter stocks from the CDC. In direct correlation with this trend, the loan from the Government of Canada also declined, reaching its lowest level of the year by the end of December. As at the end of the reporting period, the outstanding loan was $52.30 million which is slightly higher than the $45.31 balance on October 31, 2010.

Statement of Cash Flows

(in thousands)	Three months ended Oct 31, 2011	Oct 31, 2010
Cash flows from operating activities	$ 4,720	$ 54,446
Cash flows used in financing activities	(3,544)	(53,613)
Net increase in cash	1,176	833
Net bank indebtedness at beginning of quarter	(1,008)	(2,133)
Net cash (bank indebtedness) at end of quarter	**$ 168**	**$ (1,300)**

Overall, CDC's closing cash position at the end of the first quarter of 2011-2012 increased by $1.5 million compared to the first quarter of 2010-2011 when bank indebtedness was at $1.3 million.

Operating Activities

Operating activities resulted in a net cash inflow of $4.7 million during the first quarter of 2011-2012 compared to a net inflow of $54.4 million in the first quarter of 2010-2011. This resulted from a decrease in cash received from customers combined with an increase in cash paid to suppliers as well as equalization payments to provincial milk boards and agencies.

Financing Activities

Financing activities involved a net outlay of $3.5 million in the first quarter of 2011-2012 compared to a net outlay of $53.6 million in the first quarter of 2010-2011. This decrease in cash outflows results from new loans that were $31.1 million higher in the first quarter of 2011-2012 compared to the first quarter of 2010-2011, combined with a decrease of $18.9 million in loan repayments for the same period.

3. Outlook against Corporate Plan Summary

The key factors that may impact the budget indicated in the CDC's Corporate Plan Summary are total production of industrial milk, domestic requirements, support prices and world market conditions for the sales of dairy products. Any significant changes in the assumptions will affect the budgeted results.

In this first quarter, milk production started to increase compared to last year. The increase was not sufficient to meet the growing demand which resulted in having to use CDC butter stocks to fill the market. Provinces have put incentives in place to encourage production and as a measure of precaution the CDC also decided to implement a 1% increase in industrial quota for a four-month period starting December 1, 2011. We expect that production in the remainder of the dairy year will be stronger and will enable the rebuilding of the CDC butter stocks beginning in January 2012. Domestic requirements are forecasted to be slightly higher than anticipated in the Corporate Plan Summary due to continued strong demand for dairy products.

4. Appropriations

The following table reconciles the appropriations received and disbursed.

	3 months ending October 31			
	2011		2010	
Opening Balance	$	-	$	-
Parliamentary appropriations allotted for operating expenditures	$	1,517	$	778
Amount disbursed	$	(1,517)	$	(778)
Ending Balance	$	-	$	-

These appropriations were granted via the Main Estimates and Treasury Board Vote 30 – Paylist requirements. Parliamentary appropriations are used to fund part of the CDC's administrative expenses. The remainder of the CDC's administrative expenses is funded by dairy producers, commercial operations, and the market place.

Government of Canada funding for administrative expenses is appropriated to the Commission based on the Government fiscal year (April to March) while the use of these funds is presented in these statements on a dairy year (August to July) basis. The Commission does present the use of its appropriation on a Government fiscal year basis in the Public Accounts of Canada.

The Government has commenced a Strategic and Operating Review with the goal of reducing expenditures on an ongoing basis by fiscal year 2014-2015. As a Crown corporation the CDC is subject to this review and was asked to develop scenarios that would result in either 5% or 10% reductions in their funding. The CDC has provided its proposals to the Minister of Agriculture and Agri-Food Canada. A decision by Government is expected in the next federal budget of February or March 2012.

5. Risk Management

There have been no changes in the risk that the CDC faces since the publication of the CDC's 2010-2011 Annual Report.

6. Significant Changes

The following significant changes in operations, personnel, objectives, industry initiatives and programs have occurred between August 1 and October 31, 2011, compared to the Corporate Plan Summary.

Operations, industry initiatives and programs	There has been no significant change in operations, industry initiatives or programs compared to the Corporate Plan Summary.
Personnel	There has been no significant change in personnel compared to the Corporate Plan Summary.
Objectives	There has been no significant change in objectives compared to the Corporate Plan Summary. The CDC is on track to reach its objectives for dairy year 2011-2012.
Governing Board	The mandate of the CEO officially ended on October 3, 2011 but the minister of Agriculture and Agri-Food extended the CEO's term until December 31, 2011. The replacement process is under way and interested candidates had until October 31, 2011 to submit their application to the Privy Council Office.

Management Responsibility for Financial Statements

Management is responsible for the preparation and fair presentation of these quarterly financial statements in accordance with the requirements of International Accounting Standard 34: Interim Financial Reporting (IAS 34), and for such internal controls as management determines is necessary to enable the preparation of quarterly financial statements that are free from material misstatement. Management is also responsible for ensuring all other information in this quarterly financial report is consistent, where appropriate, with the quarterly financial statements. These statements are unaudited and have not been reviewed by an external auditor.

Based on our knowledge, these unaudited quarterly financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the corporation, as at the date of and for the periods presented in the quarterly financial statements.

Original signed by:

John Core, Chief Executive Officer

Original signed by:

Gaëtan Paquette, Senior Director, Finance and operations

Ottawa, Canada

December 21, 2011

Balance Sheet

(unaudited)

(in thousands)

	Oct 31, 2011	Jul 31, 2011	Aug 1, 2010
Assets			
Current			
Cash	$ 596	$ 146	$ 182
Accounts receivable			
Provincial milk boards and agencies (pooling) receivable	30,945	33,462	37,330
Trade	1,402	6,340	1,148
Derivative asset - foreign exchange contracts	0	67	1
Inventory (Note 4)	79,492	94,322	135,228
	$ 112,435	$ 134,337	$ 173,889
Liabilities			
Current			
Bank indebtedness (Note 5)	$ 428	$ 1,154	$ 2,314
Accounts payable and accrued liabilities			
Provincial milk boards and agencies (pooling) payable	29,499	31,236	33,684
Trade	6,177	14,563	17,276
Distribution to provincial milk boards and agencies payable	0	14,573	4,385
Other liabilities	1,628	1,254	1,209
Derivative liability - foreign exchange contracts	10	294	4
Loans from the Government of Canada (Note 6)	52,304	55,848	98,927
	90,046	118,922	157,799
Long-term			
Severance benefits (Note 12)	536	643	1,175
Equity (Note 7)			
Retained earnings	21,853	14,772	14,915
	$ 112,435	$ 134,337	$ 173,889

Commitments (Note 14)

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

Approved:

Original signed by

John Core	Randy Williamson	Gaëtan Paquette
Chief Executive Officer	Chairman	Senior Director, Finance and Operations

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Statement of Operations and Comprehensive Income

(unaudited)

(in thousands)

	Three months ended	
	Oct 31, 2011	Oct 31, 2010
Sales and Cost of Sales		
Domestic sales revenue	$ 72 228	$ 85 744
Cost of goods sold domestically	64 526	73 887
Transport and carrying charges	1 390	1 176
Gross profit on domestic sales	6 312	10 681
Export sales revenue	2 209	2 124
Cost of goods exported	1 793	1 893
Transport and carrying charges	193	38
Gross profit on export sales	223	193
Total gross profit	6 535	10 874
Other revenues		
Pooling contributions witheld to fund operating expenses (Note 10)	1 459	1 659
Funding from the Government of Canada (Note 11)	1 517	778
	2 976	2 437
Total	**9 511**	**13 311**
Operating Expenses		
Industry initiatives	497	531
Concentrated Milk Assistance Program	0	50
Cost of Production study	200	132
Other charges / (recoveries)	(281)	148
	416	861
Administrative Expenses		
Salaries and employee benefits	1 439	1 428
Other administrative expenses	575	282
	2 014	1 710
Total	**2 430**	**2 571**
Results of operations before distribution to provincial milk boards and agencies	**7 081**	**10 740**
Distribution to provincial milk boards and agencies	0	0
Results of operations and comprehensive income	**$ 7 081**	**$ 10 740**

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

Statement of Changes in Equity

(unaudited)
(in thousands)

	Three months ended	
	Oct 31, 2011	Oct 31, 2010
Retained earnings, beginning of quarter	$ 14 772	$ 14 915
Results of operations and comprehensive income	7 081	10 740
Retained earnings, the end of the quarter	$ 21 853	$ 25 655

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

Statement of Cash Flows

(unaudited)

(in thousands)

	Three months ended	
	Oct 31, 2011	Oct 31, 2010
Cash flows from operating activities		
Cash receipts from customers	$ 79 397	$ 88 460
Cash paid to suppliers and others	(63 730)	(33 087)
Cash receipts from provincial milk boards and agencies (pooling)	53 014	56 572
Cash paid to provincial milk boards and agencies (pooling)	(50 775)	(53 707)
Cash paid to provincial milk boards and agencies (operating surplus)	(14 573)	(4 385)
Cash receipts from the Government of Canada	1 517	778
Interest paid on loans	(130)	(185)
Cash flows from operating activities	4 720	54 446
Cash flows used in financing activities		
New loans from the Government of Canada	47 737	16 568
Loan repayments to the Government of Canada	(51 281)	(70 181)
Cash flows used in financing activities	(3 544)	(53 613)
Net increase in cash	1 176	833
Net bank indebtedness at beginning of quarter	(1 008)	(2 133)
Net cash (bank indebtedness) at end of quarter	$ 168	$ (1 300)
Components:		
Cash	$ 596	$ 7
Bank indebtedness	(428)	(1 307)
	$ 168	$ (1 300)

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

1. The Canadian Dairy Commission

The Canadian Dairy Commission (the “Commission”) is an agent 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.* Its office is situated in Ottawa, Ontario, Canada*.* The objects of the Commission, as established by the *Canadian Dairy Commission Act*, are “to provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality”. The Commission operates on a dairy year basis which starts August 1 and ends July 31.

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

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

2. Basis of preparation

Compliance with International Financial Reporting Standards

These interim financial statements have been prepared in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations and IFRS 1 - First-time Adoption of IFRS as well as IAS 34 – Interim Financial Reporting, using International Financial Reporting Standards (IFRS) accounting policies that the Commission will adopt in its annual financial statements ending July 31, 2012.

These are the Commission's first IFRS interim financial statements for part of the period covered by the first IFRS annual financial statements. The Commission has elected August 1, 2010 as the date of transition to IFRS. An explanation of how the transition to IFRS has affected the financial statements is included in Note 16. Any subsequent changes to IFRS that are given effect in the Commission's annual financial statements for the year ending July 31, 2012 could result in restatement of these interim financial statements, including any transition adjustments recognized with the adoption of IFRS.

These interim financial statements should be read in conjunction with the Commission's 2011 annual financial statements prepared in accordance with Canadian generally accepted accounting principles (GAAP) and in consideration of the IFRS transition disclosures included in Note 16 to the interim financial statements.

Use of estimates and measurement 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 severance benefits, and derivatives are the most significant items where estimates are used. Actual amounts could differ significantly from the current estimates. These estimates are reviewed quarterly and as adjustments become necessary, they are recognized in the financial statements in the period in which they become known.

Functional and presentation currency

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

Reporting period

The reporting period for these interim financial statements and notes thereto is August 1, 2011 to October 31, 2011. This represents the first quarter (Q1 2012) of operations for the Commission's 2011-2012 dairy year ending July 31, 2012.

3. Significant accounting policies

Cash and cash equivalents

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 Commission's designation of such instruments.

Classifications:

Cash	Held for trading
Accounts receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Loans from the Government of Canada	Other liabilities

Held for trading

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

Loans and receivables

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

Other liabilities

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

Transaction costs

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

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.

Derivative financial instruments

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

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

Distribution to provincial milk boards and agencies

Operational surplus resulting from pooling and operating activities is expensed and set up as a liability in the year that the surplus is earned. Operational losses from operating activities with a virtual certainty of recovery in the subsequent year are recognized as revenue and set up as a receivable in the year the loss is incurred.

Revenues

Sales revenue

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

Pooling contributions withheld to fund operating expenses

Pooling contributions withheld to fund operating expenses are recognized as revenue when the amounts are charged to the various milk pools.

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 when the service is completed.

Cost of sales

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

Foreign currency translation

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

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

Most sales and purchases in foreign currencies have corresponding foreign exchange forward contracts (see “Derivative financial instruments” above and Note 13 - Financial Instruments – *Currency risk*).

Employee future benefits

Pension benefits

Substantially all of the employees of the Commission 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 Commission to cover current service cost. Pursuant to legislation currently in place, the Commission 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 Commission. The Commission is not required under present legislation to make contributions with respect to actuarial deficiencies of the Plan.

Severance benefits

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

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 at the date of these financial statements, the following applicable standards and amendments were issued but are not yet effective:

- IAS 19, Employee Benefits, effective for annual periods beginning on or after January 1, 2013;
- IFRS 7, *Financial Instruments: Disclosures*, effective for annual periods beginning on or after July 1, 2011; and
- IFRS 13, *Fair Value Measurement*, effective for annual periods beginning on or after January 1, 2013.

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

4. Inventory

	Q1 2012	Q1 2011
	(in thousands)	
Butter	$54,100	$53,825
Skim milk powder	25,392	28,941
	79,492	82,766
Less: allowance for inventory write-down	-	(323)
Total net realizable value	$79,492	$82,443

The Commission's inventory includes 6,663 tonnes of Plan B butter and 1,127 tonnes of Plan B skim milk powder (Q1 2011 — 6,068 tonnes and 1,024 tonnes) with a total cost of $47.92 million and $7.07 million respectively (Q1 2011 — $43.10 million and $6.33 million) that must be repurchased by the manufacturers from the Commission within the course of the current calendar year at the then prevailing support prices. While manufacturers are contractually obliged to repurchase their product, the Commission is under no obligation to sell back the product. However, the Commission has customarily always honoured repurchase requests.

The balance of the inventory is comprised of 1,195 tonnes of butter and 16,653 tonnes of skim milk powder (Q1 2011 — 1,683 tonnes and 20,302 tonnes) with a total cost of

$6.18 million and $18.32 million respectively (Q1 2011 — $10.73 million and $22.61 million).

5. Bank indebtedness

The Commission has established a line of credit with a member of the Canadian Payments Association. The Commission has been granted the authority to establish this line of credit by the Minister of Finance up to a maximum of $50 million for the pricing and pooling of market returns system. During the dairy year, the Commission's available line of credit limit can vary up to $25 million (Q1 2011 — $5 million).

The bank indebtedness incurred under the Commission's line of credit is due on demand and bears interest at prime, which during the reporting period was 3.00% per annum (Q1 2011 — 2.75% to 3.00%).

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 (Q1 2011 — $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 are repaid regularly during the year when funds are available.

Interest on the loans, which is at the normal rates established for Crown corporations by the government and based on the latest available yields of comparable Treasury bills plus one-eighth of one percent, varied from 1.04% to 1.11% (Q1 2011 — 0.38% to 0.85%) during the reporting period and totaled $0.13 million (Q1 2011 — $0.12 million).

7. Equity

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

There have been no transactions during the reporting period ended October 31, 2011 resulting in other comprehensive income or losses and the Commission had no opening or closing balances for accumulated other comprehensive income or losses.

8. Capital disclosures

The Commission's capital consists of its loans from the Government of Canada (see Note 6) and retained earnings. As at October 31, 2011 these accounts totaled $52.30 million (Q1 2011 — $45.31 million) and $21.85 million (Q1 2011 — $25.66 million) respectively. The Commission is not subject to any externally imposed capital requirements.

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

9. Foreign exchange gains and losses

Export sales include $0.12 million representing net gains (Q1 2011 – net gains of $0.005 million) arising from currency translation relating to transactions incurred in foreign currencies.

Domestic cost of sales include $0.39 million representing net gains (Q1 2011 – net gain of $0.004 million) arising from currency translation relating to import purchase transactions incurred in foreign currencies.

10. Pooling contributions

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

The pool operates on a two month lag where contributions from and equalization payments to provincial milk boards and agencies that were not disbursed or collected at year-end are reported respectively as payables and receivables on the balance sheet.

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

	Q1 2012	Q1 2011
	(in thousands)	
Contributions from provincial boards and agencies	$ 50,498	$ 38,101
Equalization payments to provincial boards and agencies	49,039	36,442
Pooling contributions withheld to fund operating expenses	$ 1,459	$ 1,659

11. Costs funded by the Government of Canada

Funding of the Commission's administrative expenses is shared among the federal government, dairy producers, commercial operations and the market place. During the reporting period, the Government of Canada funded $1.52 million (Q1 2011 — $0.78 million) of the Commission's administrative expenses of $2.01 million (Q1 2011 — $1.71 million).

12. Employee benefits

Salaries and benefits includes:

(in thousands)	Q1 2012	Q1 2011
Salaries expenses	$1,159	$1,155
Pension contributions	185	186
Medical insurance expense	64	56
Others	31	31
Total	$1,439	$1,428

Pension plan

The President of the Treasury Board of Canada sets the Plan's required employer contributions based on a multiple of the employees' required contribution. The general contribution rate effective for the year ended July 31, 2011 was 1.90 times (1.93 times for the year ended July 31, 2010) and has not varied significantly during the reporting period.

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 per cent 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.

Severance benefits

The Commission provides severance 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 will be paid from future appropriations and other sources of revenue. Information about this benefit plan, measured as at the balance sheet date, is as follows:

	Q1 2012	July 31, 2011
	(in thousands)	
Accrued benefit obligation, beginning of year	$1,083	$ 1,294
Recovery for the period	(79)	(80)
Benefits paid during the period	405	131
Accrued benefit obligation, end of the period	$ 599	$ 1,083

Of the total period end obligation, $0.26 million (July 31, 2011 - $0.44 million) is estimated by the Commission to be payable by year end and is included in other liabilities, under current liabilities, on the balance sheet.

13. Financial instruments

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

Market risk

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

Currency risk

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

As of the balance sheet date, the notional value of the Commission's outstanding forward exchange contracts totaled $3.20 million Canadian equivalent (Q1 2011 — $7.62 million Canadian equivalent). These contracts will mature over the period ending February 2012. The maturity dates of the forward exchange contracts correspond to the estimated dates when the Commission expects to receive the foreign currency proceeds arising from export sales contracts or when payment for purchases in foreign currencies are due.

The fair value of the Commission's derivative financial instruments is determined using the Bank of Canada's published foreign exchange rates as of the balance sheet date. The Commission's foreign exchange forward contracts as at October 31, 2011 are as follows:

		(in thousands)	
Currency sold	Currency purchased	In USD	In CAD
U.S. dollars	Canadian dollars	$1,201	$1,197
Canadian dollars	U.S. dollars	$2,013	$2,007

As at October 31, 2011, the Commission's exposure to foreign currency risk was as follows, based on Canadian dollar equivalent amounts:

In CAD	Q1 2012	Q1 2011
	(in thousands)	
Accounts receivable (trade)	$ 453	$ 75
Accounts payable (trade)	(423)	(287)
Net derivative liability	(10)	(139)
Net exposure	$ 20	$ 501

Based on the net exposure as at October 31, 2011, 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 October 31, 2011 would have increased by $0.09 million (Q1 2011 – increased by $0.65 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 Commission does not have any other such financial assets or liabilities exposed to this risk. The Commission's exposure to interest rate risk is not significant given its low interest bearing loans.

Other price risk

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

Liquidity risk

Liquidity risk is the risk that the Commission will not be able to meet its financial obligations as they fall due. As of the balance sheet, virtually all of the Commission's assets and liabilities were current and the Commission had a current ratio equal to 1.25 (Q1 2011 – 1.36). In managing liquidity risk, the Commission has access to additional borrowings for commercial operations from the Government of Canada in the amount of $112.70 million as of October 31, 2011 (Q1 2011 — $129.69 million) as well as $4.57 million (Q1 2011 — $3.69 million) on its line of credit for the pooling of market returns activities.

Credit risk

Credit risk is the risk of loss due to a customer failing to meet its financial obligations to the Commission. Maximum credit exposure is the carrying amount of the pooling and trade accounts receivable balances, net of any allowance for losses. The Commission manages this risk using several strategies which include selling product on a "payment first" basis, securing of bank guarantees and obtaining letters of credit. As of both October 31, 2011 and 2010, the Commission did not have an allowance for doubtful accounts and all accounts receivable were current.

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

Fair values

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

Fair value hierarchy

Financial instruments recorded at fair value on the balance sheet 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 Commission 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 Commission's derivative financial instruments is classified as level 2 (Q1 2011 — 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 period ended October 31, 2011 there were no transfers between levels.

14. Commitments

a) Industry Initiatives

	Canadian Quality Milk	Matching Investment Fund	Dairy Research Cluster	Iodine Study	Scholarship Program	Total
	(in thousands)					
Total commitment	$2,953	$6,000	$1,500	$340	$3,000	$13,793
Distributed Prior year (s) Q1 2012	 1,192 -	 439 0	 500 500	 109 -	 - -	 2,240 500
Commitment remaining	$1,761	$5,561	$500	$231	$3,000	$11,053

Canadian Quality Milk

This program is designed to help producers improve the quality of raw milk on their farms. The Commission has agreed to partially fund this program under an agreement that commenced August 1, 2007 and was extended to July 31, 2014.

Matching Investment Fund

The Commission 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 CDC has committed $6 million over a three-year period commencing August 1, 2009 and ending July 31, 2012.

Dairy Research Cluster

This Dairy Farmers of Canada initiative is to enable key industry-led agricultural organizations to mobilize a critical mass of scientific and technical resources to support innovation strategies for enhanced profitability and competitiveness of their sector. The Commission has agreed to partially fund this project under an agreement that commenced on January 1, 2010 and expires on March 31, 2013.

Iodine Study

The Dairy Farmers of Canada are conducting an analysis to determine 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. The Commission has agreed to partially fund this study.

Scholarship Program

As of August 1, 2011, the Commission 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 at October 31, 2011, the Commission was committed to purchase certain quantities of butter and skim milk powder. These commitments amounted to approximately $2.12 million (Q1 2011 — $1.30 million) and are due to be fulfilled by December 2011.

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 2012 TRQ for butter remains at 3,274 tonnes. World prices at the time of purchase will determine the total financial commitment. For the reporting period the total cost to purchase imported butter under the WTO requirements was $12.33 million (Q1 2011 — $0.28 million).

d) Operating Lease

Agriculture and Agri-Food Canada has notified the Commission through a letter of intent that it will renew the lease for the Commission’s offices accommodations for another period of 5 years commencing April 1, 2012 with revised rates reflecting the rental market value pursuant to Treasury Board's Policy on Real Property. The remaining payments under the current lease agreement, which expires March 31, 2012, are $0.10 million.

15. Related party transactions

Government of Canada entities

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

The Commission is related in terms of common ownership to all other Government of Canada-created departments, agencies and Crown corporations. The Commission enters into transactions with these entities in the normal course of business and at normal trade terms. These transactions such as Employee Benefit Plans, accommodations and professional services, but excluding loans from the government, are recorded at their exchange amounts and totaled $0.49 million during the reporting period (Q1 2011 – $0.40 million).

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

Other significant related party transactions are as follows:

Government Entity	Q1 2012	Q1 2011
	(in thousands)	
Public Works and Government Services Canada	$280,956	$281,369
Agriculture and Agri-Food Canada	$184,717	$117,405

Key management personnel

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

No loans or other such transactions with key management were outstanding as of October 31, 2011 or occurred at any time during the reporting period.

Compensation of key management personnel:	Q1 2012	Q1 2011
	(in thousands)	
Salaries and other short term benefits	$160	$137

16. Transition to International Financial Reporting Standards

The Commission 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 Commission prepared its financial statements in accordance with Canadian GAAP. The first annual financial statements issued by the Commission that will comply with IFRS will be those issued for the year ending July 31, 2012. Accordingly, the Commission will make an unreserved statement of compliance with IFRS beginning with its 2012 annual financial statements. The Commission has prepared its opening IFRS Balance sheet as of the transition date of August 1, 2010.

These financial statements have been prepared with 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 Commission.

The Commission will ultimately prepare its opening balance sheet by applying existing IFRS with an effective date of July 31, 2012 or earlier. Accordingly, it is possible that the opening balance sheet and financial statements for 2011 and 2012 may differ from the information presented in these interim financial statements.

After performing an extensive review of all components of the Commission'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 balance sheet of the Commission has no changes in presentation or of amounts compared to the closing balance sheet prior to the adoption of IFRS (August 1, 2010 vs. July 31, 2010).