Canadian Dairy Commission

Special Examination Report—2011

Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

Ce document est également publié en français.

Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

To the Board of Directors of the Canadian Dairy Commission:

We have completed the special examination of the Canadian Dairy Commission in accordance with the plan presented to the Audit Committee of the Board of Directors on 4 March 2009. As required by Section 139 of the *Financial Administration Act* (FAA), we are pleased to provide the attached final special examination report to the Board of Directors.

We will be pleased to respond to any comments or questions you may have concerning our report at your meeting on 23 March 2011.

I would like to take this opportunity to express my appreciation to the Board members, management, and the Commission's staff for the excellent cooperation and assistance offered to us during the examination.

Yours sincerely,

Neil Maxwell
Assistant Auditor General

OTTAWA, 16 March 2011

Enclosure

240 rue Sparks Street, Ottawa, Ontario K1A 0G6

Table of Contents

Canadian Dairy Commission
Special Examination Report—2011

Main Points

What we examined

The Canadian Dairy Commission is a Crown corporation established in 1966 to coordinate the federal government's and the provinces' policies and roles in managing the dairy industry in Canada. Acting as both a facilitator and a stakeholder in various forums that influence Canadian dairy policy, the Commission supports the interests of all dairy stakeholders—producers, processors, exporters, consumers, and governments.

The Commission has about 65 employees. The federal government funds approximately half of its administrative costs. Other costs, including marketing activities, are funded by dairy producers and the marketplace.

The Commission reports to Parliament through the Minister of Agriculture and Agri-Food whom it advises on matters related to the dairy industry.

We examined whether the Canadian Dairy Commission's systems and practices provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. Our examination focused on areas important to all Crown corporations, such as corporate governance, risk management, and strategic planning, and on areas of particular importance to the Commission, such as determining support prices and market-sharing quotas. Our examination covered the systems and practices that were in place between March 2009 and August 2010.

Why it's important

In 2009, dairy production in Canada generated total net farm receipts of $5.5 billion and sales of $13.6 billion, representing 15 percent of the Canadian food and beverage sector, according to the Canadian Dairy Information Centre. The Canadian Dairy Commission plays a key role in ensuring that Canadians have a continuous supply of milk and other dairy products available and seeks to ensure that efficient producers have the opportunity to obtain a fair return on their labour and investment.

What we found

We found no significant deficiencies in the Commission's systems and practices. A significant deficiency is reported when there is a major weakness in the Commission's key systems and practices that could prevent it from having reasonable assurance that its assets are safeguarded and controlled, its resources are managed efficiently and economically, and its operations are carried out effectively.

We noted good practices in a number of areas. We also noted some areas where the Commission would benefit from improving its practices.

- The Commission has the key elements of an effective governance framework in place. The Board assumes stewardship of the Commission and works closely with management. Roles and responsibilities are clearly defined and understood, and the Board is supported by a simplified subcommittee structure. Some issues raised in our 2005 Special Examination Report have not been resolved—namely, it is difficult for the three-person Board to have the full range of skills needed for governance, and the Board does not have a process for directors to declare and manage conflicts of interest.
- The Commission manages its key operational functions well. Its practices for determining support prices and market-sharing quotas are consistent with its legislation and objectives. It also has systems and practices in place for protecting its inventory of butter and skim milk powder and for issuing permits under the Special Milk Class Permit Program.
- The Commission's management of human resources provides it with the core competencies and skills it needs as a small Crown corporation. It has recognized the need for succession planning. The work to prepare for future retirements is ongoing.

The Commission has responded. *The Commission agrees with our recommendations. Its responses follow the recommendations throughout the report.*

Special Examination Opinion

To the Board of Directors of the Canadian Dairy Commission

1. Under section 131 of the *Financial Administration Act* (FAA), the Canadian Dairy Commission is required to maintain financial and management control and information systems and management practices that provide reasonable assurance that its assets are safeguarded and controlled; its financial, human, and physical resources are managed economically and efficiently; and its operations are carried out effectively.

2. Section 138 of the FAA also requires the Commission to have a special examination of these systems and practices carried out at least once every 10 years.

3. Our responsibility is to express an opinion on whether there is reasonable assurance that during the period covered by the examination—from March 2009 to August 2010—there were no significant deficiencies in the Commission's systems and practices.

4. We based our examination plan on our survey of the Commission's systems and practices and a risk analysis. On 4 March 2009, we submitted the plan to the Audit Committee of the Board of Directors. The plan identified the systems and practices that we considered essential to providing the Commission with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. Those are the systems and practices that we selected for examination.

5. The examination plan also included the criteria that we used to examine the Commission's systems and practices. These criteria were selected for this examination in consultation with the Commission. The criteria were based on our experience with performance auditing and our knowledge of the subject matter. The criteria and the systems and practices we examined are listed in About the Special Examination at the end of this report.

6. We conducted our examination in accordance with our plan and with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants. Accordingly, it included the tests and other procedures we considered necessary in the circumstances. In carrying out the special examination, we did not rely on any internal audits.

7. In our opinion, based on the criteria established for the examination, there is reasonable assurance that during the period covered by the examination there were no significant deficiencies in the Commission's systems and practices.

8. The rest of this report provides an overview of the Commission and more detailed information on our examination observations and recommendations.

Neil Maxwell
Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada
31 August 2010

Overview of the Canadian Dairy Commission

9. The Canadian Dairy Commission is a Crown corporation named in Part 1, Schedule III of the *Financial Administration Act*. The Commission was established in 1966, under the *Canadian Dairy Commission Act*, and it reports to Parliament through the Minister of Agriculture and Agri-Food.

10. The Commission's mandate, as specified under its Act, is to provide

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

11. Canada's dairy industry is supply-managed to avoid costly surpluses. The Commission sets

- support prices—the prices at which the Commission purchases and sells butter and skim milk powder within its various programs; and
- the market-sharing quota—the national target for the production of industrial milk in Canada, which is constantly monitored and which is adjusted when necessitated by demand.

12. Both Canada and the provinces are responsible for regulating the Canadian dairy industry. The Commission also acts as a national facilitator; and the Commission's Chief Executive Officer chairs the Canadian Milk Supply Management Committee, which is composed of representatives from the Commission, provincial governments and boards, and observers.

13. The Commission operates a number of programs for itself and on behalf of the Canadian Milk Supply Management Committee, including

- the administration of pricing pools, which allow for the sharing of markets and revenues among producers across provinces;
- the administration of the Special Milk Class Permit Program, which allows eligible processors that use dairy ingredients to pay reduced prices for dairy ingredients in certain cases, which will help them remain competitive;
- the domestic seasonality program, which is used to balance the supply and demand for dairy products throughout the dairy year (from 1 August to 31 July);

- the surplus removal program, which is used to buy and resell dairy products that are surplus in the market; and
- other programs, such as those that encourage innovative uses of dairy products and dairy product marketing.

14. The Commission is headquartered in Ottawa and has approximately 65 employees. In its fiscal year ended 31 July 2010 (which is consistent with the industry's dairy year), the Commission received $3.8 million in contributions from the Government of Canada for operating expenses. It was also authorized to borrow a maximum of $175 million as of 31 July 2010, on which date it had borrowed $98.9 million. These amounts are currently being used to finance the Commission's inventory under its surplus removal and domestic seasonality programs.

15. The Canadian dairy industry faces a number of challenges, including the following:

- There is ongoing international scrutiny of Canada's supply management of the dairy industry, to determine whether it complies with international trade rules.
- Unpredictable dairy imports to Canada present a risk to supply management. While dairy products are supply-managed in Canada, they are commodities in many other parts of the world, with volatile pricing that depends on supply, demand, and international exchange rates. As the price of dairy products changes outside Canada, the risk of unpredictable imports into Canada also changes.

16. Within the Government of Canada, departments such as Agriculture and Agri-Food Canada and Foreign Affairs and International Trade Canada have important roles regarding the dairy industry. As this is a special examination of the Canadian Dairy Commission, this report examines only the Commission's roles.

Focus of the special examination

17. Our objective is to determine whether the Canadian Dairy Commission's systems and practices provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively during the period covered by the audit.
We focused on the areas of corporate governance, risk management, strategic planning, performance measurement and reporting, the establishment of support prices and market-sharing quotas, inventory

management, the management of special milk class permits, and human resource management.

18. Further details on the audit objective, systems and practices, and criteria are provided in **About the Special Examination** at the end of the report.

Observations and Recommendations

Corporate governance

19. Corporate governance refers to the structures, systems, and practices for overseeing the direction and management of an organization so that it can fulfill its mandate and achieve its objectives. Sound corporate governance practices are essential to meeting the statutory control objectives for Crown corporations outlined in Part X of the *Financial Administration Act*.

20. We examined whether, to maximize the corporation's effectiveness and its ability to balance public policy objectives with its commercial objectives, the Canadian Dairy Commission has a well performing corporate governance framework that meets the expectations of best practices in Board stewardship and shareholder relations.

21. When we audited the Commission's corporate governance framework and practices, we looked at important governance elements, including the Board of Directors' roles and responsibilities for exercising stewardship, overseeing the Commission's accountability, and providing management with strategic direction. We also looked at the Board's ability to be effective in discharging its responsibilities, including interpreting the Commission's legislative and public policy mandate.

22. We found that the Commission has an effective governance framework and follows sound corporate governance practices, although some issues we identified in our 2005 Special Examination Report, related to the breadth of skills and experience on the Board and to conflicts of interest, are still unresolved.

The Commission has elements of effective governance

23. The Board assumes stewardship of the Commission and works closely with management. It approves strategic direction as well as plans to manage risks and has a management succession plan under way.

24. There are clearly defined and understood roles and responsibilities for the Board and management, and the Board is supported by a simplified subcommittee structure. The Board has two subcommittees, the audit committee and the nominating committee, and all Board members are members of the audit committee.

25. The Commission's enabling legislation, the *Canadian Dairy Commission Act*, is 40 years old. The Act was written in an earlier era of the Canadian dairy industry, and the industry has gone through many structural changes over the years.

26. We found that, within its enabling legislation, the Commission has adapted its activities to today's dairy industry in the following areas:

- One of the Commission's objectives, according to the *Canadian Dairy Commission Act*, is to set prices for butter and skim milk powder at a level that provides efficient producers "with the opportunity of obtaining a fair return for their labour and investment." The section of this report entitled "Support prices and quotas" includes how the Commission performs this important pricing function. Another of the Commission's objectives is to provide consumers "with a continuous and adequate supply of dairy products of high quality." In light of the current structure of the dairy industry and regulation of food products, the Commission defines its role in "high quality" milk in a way that acknowledges that others have responsibility for food safety.
- The *Canadian Dairy Commission Act* requires that the Minister appoint a consultative committee, but currently there is none in place. The Act is not clear on the role of the consultative committee, although such a committee has existed in the past under different structures of the dairy industry. While the Commission is not responsible for appointing the committee, it feels that its current involvement with the Canadian Milk Supply Management Committee, which includes representatives from the Commission, provincial governments, and boards as well as observers, fulfills the needs of a consultative committee in today's dairy industry.

Issues related to the size of the Board of Directors remain

27. Our 2005 Special Examination Report raised issues related to the size and functioning of the Board. Before 2007, the positions of Chair and Chief Executive Officer were held by the same person; in 2007, these positions were separated. Otherwise, the structure of the Board remains similar to that of 2005.

28. There are a number of limitations imposed on the Commission's Board of Directors, including the following:

- The *Canadian Dairy Commission Act* limits the size of the Commission's Board to three people.
- The Act further requires that the Commission's Chief Executive Officer be a member of the Board. Therefore, the Board of Directors can have only two external (non-management) members.
- In addition, the Commission's current Governance Rules impose additional requirements concerning the two external directors. The Governance Rules state that "either the Chairperson or the Commissioner must have significant experience in the milk production sector; the other must have significant experience in the dairy processing sector."

29. It is reasonable for the Board's two external directors to have experience with milk production and processing. However, there are other functional skills typically represented on boards of directors, and it becomes difficult for two external directors to have a full range of skills needed for governance, for example, financial expertise.

30. Best practices for audit committees call for strong financial capabilities. This is of particular importance to the Commission now, since it is currently changing the accounting standards that it uses to prepare its financial statements, from Canadian standards to International Financial Reporting Standards.

31. We found that the Commission itself recognizes, in its Corporate Risk Profile, that this financial reporting conversion is complex and creates risks. Because the backgrounds of the two external members of the Board of Directors and audit committee do not include experience that is directly relevant to overseeing this accounting transition, the Commission has engaged outside accounting assistance to help management with the transition.

32. Financial expertise is an example of a functional skill that external members should have. We observed that commissioners do not periodically review their collective skills, and that the current constraint of only two external members makes it more difficult for the Board to have all skills needed for good governance.

33. **Recommendation.** The Canadian Dairy Commission's Board of Directors should periodically assess its collective skills. If the Board identifies a gap in its skills, it should seek outside expertise to complement the skills of its members.

The Commission's response. *The Commission agrees with the recommendation. The Commission's Board will periodically assess its collective skills and continue to seek outside expertise when deemed necessary for specific projects such as International Financial Reporting Standards. The Board will give consideration to adding an ex-officio member to its audit committee with financial expertise but is of the opinion that a better solution would be to remove the Chief Executive Officer position from the Board. Doing so would create a position on the Board that would be filled by a person with such expertise. The Commission will continue to pursue this solution with the government.*

Conflicts of interest are not well managed

34. Our 2005 Special Examination Report noted that, since he was an active dairy farmer, the Board member with significant dairy production experience was in a conflict of interest over pricing decisions. During our current examination, we observed that the Board member with significant dairy production experience is a different person, but is in a similar conflict position because he voted on pricing decisions and is a current dairy producer.

35. Given that this conflict of interest issue remains from our previous special examination, we examined whether the Commission has a process in place for directors to periodically declare and manage conflicts of interest, for example, by recusing themselves from decisions involving conflicts of interest. We found that the Commission does not.

36. **Recommendation.** The Commission's Board of Directors should develop procedures for members to declare and manage conflicts of interest.

The Commission's response. *The Commission agrees with the recommendation. Members of the Commission's Board are required to adhere to the requirements for "public office holders" as per the* Conflict of Interest Act. *The Board will create a provision in its bylaws that will require each member to put on record any existing conflicts under that Act, and will develop procedures to manage conflicts. The inherent conflict posed by the requirement that a Board member have a background in dairy production (often filled by an active milk producer) and the Board's responsibility for setting support prices is a challenge. As we did at the time of the previous special examination, the Commission will discuss this issue with the Privy Council Office in an attempt to find a workable solution.*

Risk management

37. The Commission's business involves risks, such as the impact of differing views and objectives between processors and producers, possible reductions in the Canadian demand for dairy products, and the potential entry of imported dairy products despite tariffs.

38. We examined whether the Commission focuses on risk and whether that focus is pervasive at all levels and supports the Commission's mandate, business goals, and objectives. We also examined whether risks were identified, measured, mitigated, monitored, and reported.

39. We examined the Commission's approach to risk management in the 2008–09 and 2009–10 fiscal years, including collecting and assessing information on the roles, responsibilities, and resources for risk management; examining meeting minutes and the Commission's Integrated Risk Management Plan (now called the Corporate Risk Profile); and conducting interviews with entity personnel. We also reviewed the Corporate Risk Profile that the Commission prepared for the 2010–11 fiscal year.

40. We found that the Commission's approach to risk management allows it to manage risk in a way that helps it achieve its objectives.

The Commission assesses risks annually and identifies risks on a regular basis

41. Our 2005 Special Examination Report noted that the Commission did not have a formal approach to risk management, and we recommended that the Commission adopt the Integrated Risk Management Framework published by the Treasury Board in 2001. The Commission accepted our recommendation and implemented an approach to risk management consistent with the 2001 guidance.

42. The Commission's current approach to risk management has two main elements: an annual assessment of risks and regular monitoring.

43. We found that the Commission carries out a series of annual discussions that lead to its Board of Directors approving the Corporate Risk Profile. We noted considerable improvements between the 2009–10 profile (then called the Integrated Risk Management Plan) and the 2010–11 profile. While the 2009–10 version did not include any changes from the previous fiscal year (2008–09), the 2010–11 version included many changes in assessed risks made since the 2009–10 fiscal year, and it demonstrated an improved analysis and ranking of risks. The Corporate Risk Profile includes descriptions of activities that mitigate the risks.

44. We examined whether risks identified in the 2009–10 Corporate Risk Profile were reported to and monitored by senior management and the Commission. While neither the Commission's recurring management meetings nor the Board of Director meetings have a regular agenda item that relates specifically to risk management, we found that the Commission's senior management and its Board do discuss identified risks on a regular basis, and they do identify actions needed to address changes in risks.

Strategic planning and performance measurement and reporting

45. The process of strategic planning includes assessing and adjusting the organization's direction in response to a changing environment. The annual Corporate Plan sets out the Commission's priorities and allocation of resources to achieve what is considered important to its success.

46. The closely related processes of performance measurement and reporting are important to ensure that there is quantitative information that allows the Commission's progress against its objectives to be assessed by management, the Board of Directors, and stakeholders.

47. We examined whether the Commission has a clearly defined strategic direction and specific and measurable goals and objectives to achieve its legislative, commercial, and public policy mandate; as well as whether its strategic direction and goals take into account government priorities, identified risks, and the need to control and protect its assets and manage its resources economically and efficiently. We also examined whether the Commission identifies performance indicators to measure the achievement of its mandate and statutory objectives; as well as whether it has reports that provide complete, accurate, timely, and balanced information for decision making and accountability reporting.

48. We looked at the Commission's annual strategic planning process leading up to its 2008–09 and 2009–10 Corporate Plan summaries, and its annual operating plan for those same years. This included assessing whether strategic planning is closely linked with identified risks and risk management processes. We also looked at how the Commission developed quantitative indicators to report on how well it achieves its objectives. This included examining the systems and practices in effect, to ensure the fairness and reliability of performance information; examining periodic reports that measure success in meeting goals and statutory control objectives; and examining the use of performance information, to determine whether it is integrated into regular management processes.

49. We found that the Commission has a strategic planning process that allows it to consider risks and government priorities and to guide and control its operations. However, in the closely related area of performance reporting, we found that the quantitative performance indicators used by the Commission do not allow it to assess how well it is achieving its mandate.

The Commission has developed strategic planning processes

50. In 2005, we recommended that the Commission develop an appropriate strategic plan that includes a clear vision, performance indicators, and an assessment of internal and external risks.

51. Since then, we found that the Commission has improved its practices, and it now has a suitable strategic planning process that produces

- an annual Corporate Plan, which is prepared by the Commission and approved by the government;
- an annual Corporate Plan summary, which is an abridged, public version of the Corporate Plan;
- an annual internal operating and strategic plan; and
- an annual report.

Performance measurement and reporting is poor

52. The Commission identifies and reports on the following in its annual report:

- **Goals.** For example, "The Canadian dairy industry successfully adapts to change."
- **Objectives (which are needed to attain the goal).** For example, for the goal mentioned above, one objective is "Key dairy industry stakeholders are discussing the evolution of the dairy industry within supply management."
- **Performance indicators (which measure the achievement of objectives and, ultimately, of goals).** For example, for the objective mentioned above, performance indicators include "A background document on the main issues facing the dairy industry . . . has been prepared; Key stakeholders have been consulted; and Stakeholders are engaged in discussions." These performance indicators are usually described as tasks or activities.

53. The current structure of goals, objectives, and performance indicators hampers clear performance reporting in the following two ways:

- Goals, objectives, and performance indicators are not linked to the Commission's overall mandate, which is set out in legislation. For example, one of the objectives that is established by legislation is that the Commission provide an efficient producer with the opportunity to earn a fair return. This is not reported on in the indicators in the Commission's annual report.
- The indicators used by the Commission focus on tasks or activities. Examples of current indicators include holding a meeting, holding a training session, or performing an evaluation. These types of activity-based indicators cannot provide management, the Board, and stakeholders with an appropriate sense of whether the Commission is achieving what it set out to do.

54. At the same time, the Commission's performance reporting efforts should be proportionate to its small size. The process of linking operations and indicators through the Commission's mandate could be accomplished as part of existing strategic planning sessions. Also, the data needed to provide better indicators may already exist. The Commission itself already tracks information that may lead to better performance information, such as trends in the prevalence of special milk class permits. Also, we observed that the Government of Canada publishes a public database of dairy-related statistics (the Canadian Dairy Information Centre at www.dairyinfo.gc.ca). It may be possible for the Commission to provide better quantitative information, on how well the Commission achieves its objectives, for a nominal cost.

55. **Recommendation.** The Canadian Dairy Commission should identify and report on quantitative performance indicators that better demonstrate whether it is achieving its mandate, rather than simply reporting on tasks or activities.

The Commission's response. *The Commission agrees with the recommendation. In its next strategic planning cycle, the Commission will establish its overall goals to be those outlined in the* Canadian Dairy Commission Act *and will report quantitative performance indicators for these goals.*

Support prices and quotas

56. The Commission's objectives, as specified in the *Canadian Dairy Commission Act*, include a requirement "to provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment." In turn, consumers are to have a "continuous and adequate supply" of dairy products.

57. We examined whether the Commission sets market-sharing quotas and support prices in a manner that is consistent with legislation and with the objectives set out in its corporate plans.

58. In particular, we examined key assumptions the Commission used to determine support prices for the period from March 2009 to August 2010 and the approach it used to set quotas to avoid shortages and surpluses. The Commission's approach to establishing quotas and support prices was consistent throughout the entire period of our examination, as it has been for many years.

59. We found that the Canadian Dairy Commission sets support prices and market-sharing quotas in a manner that is consistent with its legislation and objectives.

Production costs and support prices are calculated in accordance with legislative intent

60. There are a number of important concepts embedded in the Commission's legislated objectives related to quotas and prices. These include definitions of "an efficient producer," "opportunity," "fair return," "continuous and adequate," and "high quality."

61. To provide an efficient producer with the opportunity to obtain a fair return, the Commission determines cost of production, support prices, and market-sharing quotas.

62. Cost of production is a periodic calculation, performed by the Commission, of a producer's total cost to produce a hectolitre of milk. The Commission uses cost of production when setting the support prices (which are typically set annually) that the Commission uses to purchase and sell butter and skim milk powder.

63. Significant assumptions are required to translate broad legislative intent to determine actual support prices and quotas. To estimate costs of production and allow the setting of support prices, we found that the Commission surveys dairy producers across Canada. The Commission then sets support prices based on the cost of production of the most efficient 70 percent of producers surveyed.

64. A number of other important decisions and assumptions are used to set support prices. These include the assumption that family labour should be costed using industrial wage rates and the methodology used to perform the cost of production survey. In addition, the Commission uses a consultative process to determine actual support prices, which means it applies considerable judgment to ensure that support prices are consistent with its broad legislation.

Market-sharing quota is calculated according to legislative intent

65. The Commission's objectives require it to provide consumers with a "continuous and adequate supply" of dairy products. The market-sharing quota is the Commission's periodic estimate of the supply necessary to meet Canada's demand for industrial milk. The quota is a signal to dairy producers concerning production levels. Since, in practice, surpluses can be costly, the Commission sets quotas to try to avoid both shortages and surpluses. We observed that the Commission manages the quota to avoid surpluses and shortages.

Inventory management

66. The main milk components inventoried by the Commission are butter and skim milk powder. The Commission maintains inventory of both under its domestic seasonality and surplus removal programs.

67. Under the domestic seasonality program, the Commission purchases butter and skim milk powder from a processor and typically sells it back to processors later in the same dairy year. This allows the industry to cope with the seasonal demand of dairy products. Under its surplus removal program, the Commission sets a price and traditionally purchases all of the skim milk powder and butter offered to it by processors. The Commission then sells this inventory (referred to in the industry as "structural surpluses") to third parties, removing milk that is surplus to the domestic market in a timely fashion.

68. We examined whether the Commission protects its inventory of dairy products and develops new markets, as required, to deal with structural surpluses.

69. We found that the Commission has procedures in place to protect inventory and manage structural surpluses. We also found that, during our examination, the Commission did not have to develop new markets to deal with structural surpluses.

Physical safeguards and insurance are in place

70. The Commission had an inventory of about $135 million in dairy products as of 31 July 2010. The inventory is held in third-party, climate-controlled warehouses. We found that adequate insurance is in place, and the Commission has appropriate segregation of duties among the custody, recording, and authorizing of purchases and sales.

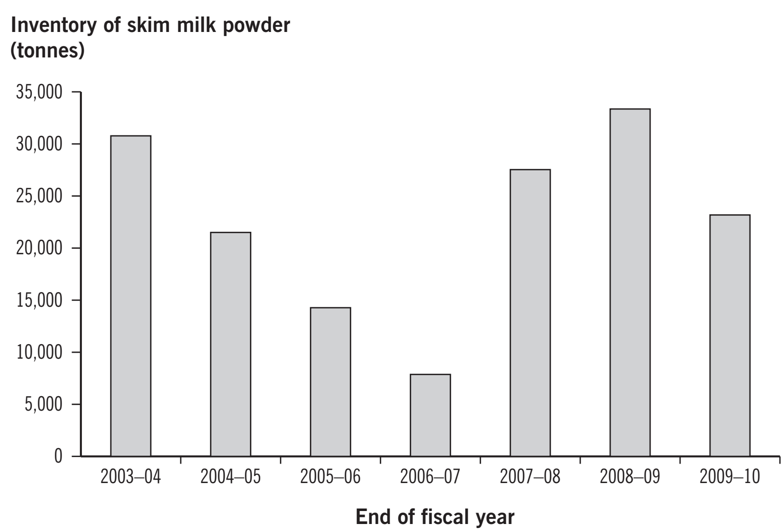
The Commission did not need to develop new markets for skim milk powder

71. The demand in Canada is greater for butter than for skim milk powder, resulting in a surplus of skim milk powder. This structural surplus periodically requires the Commission to develop new markets for skim milk powder.

72. A major market for surplus skim milk powder is the animal feed market. Skim milk powder is a commodity and is therefore subject to price variations. Another product, called whey protein concentrate, is a substitute for skim milk powder. Under international trade rules, Canada has only limited ability to sell skim milk powder abroad, while whey protein concentrate can be imported into Canada without limits. The commodity prices of whey protein concentrate vary over time, along with international exchange rates. When imported whey protein costs less than domestic skim milk powder, whey protein imports increase. This puts pressure on the prices that the Commission is able to obtain for its skim milk powder inventory and makes it harder to sell skim milk powder. As a result, inventories vary widely over time (Exhibit 1).

73. At the end of the 2008–09 fiscal year, the Commission had relatively high skim milk powder inventories. While we observed that the Commission undertook activities to develop new markets during the period of our examination, the marketplace changed, and the Commission was able to reduce inventories through existing markets by the end of 2009–10.

Exhibit 1 Skim milk powder inventory fluctuates significantly



Source: Canadian Dairy Commission annual reports

Special milk class permits

74. From time to time, certain types of dairy products can be imported, either individually or as part of another food product, at prices that are lower than Canadian support prices. In these cases, the Special Milk Class Permit Program (SMCPP) provides eligible "further processors" (those processors who use milk or other dairy products to manufacture other food products that are sold at the retail level), distributors, and animal feed manufacturers with the opportunity to access Canadian-manufactured dairy ingredients at prices that are lower than Canada's support price. This, in turn, reduces prices received by producers.

Canadian Milk Supply Management Committee (CMSMC)—A committee, chaired by the Canadian Dairy Commission, that is the national body responsible for policy development and discussions of Canada's dairy industry. Its members represent the Commission, provincial governments, and boards and include observers, such as consumer and producer organizations.

75. The **Canadian Milk Supply Management Committee (CMSMC)** has delegated administration of the SMCPP to the Commission.

76. We examined whether the Commission issues special milk class permits in a manner that is consistent with CMSMC direction, and whether it monitors compliance with the terms of the permits.

77. Specifically, we examined whether the Commission

- has policies or procedures in place to govern the issuance of special milk class permits;
- monitors the use of the issued permits (including independent audits by the Commission's internal audit function);
- follows up if the results of monitoring or audits indicate potential improper use of the permits and takes any necessary corrective action; and
- reports to the CMSMC about the SMCPP.

78. We found that the Commission issues special milk class permits in accordance with its policies and procedures, monitors the use of permits, and follows up on potential improper use.

Documented procedures were followed for approving permits and monitoring their use

79. The Commission's electronic procedures manual contains several procedures related to the SMCPP, including those for issuing and monitoring permits. These procedures assist program personnel in systematically ensuring that permits are only issued to those applicants who meet the requisite conditions. We reviewed permits issued by the Commission and found that the Commission had issued special milk class permits in accordance with eligibility criteria.

80. The Commission also has procedures for monitoring permits issued. This includes routine review and reconciliation of mandatory periodic reporting by permit holders. We examined a number of reconciliations prepared by the Commission, as well as their follow-up, and found that procedures were followed. Information obtained through monitoring is used to reconcile the usage reported by permit holders. We found that the Commission uses a risk-based approach to follow up on possible non-compliance with permit criteria. If the Commission investigates usage under a permit and the usage was not in accordance with the terms of the permit, the Commission bills the permit holder based on the reduced prices paid by the permit holder. We observed that when a balance was identified as being due from the permit holder, it was collected.

Human resource management

81. The Commission's success depends in large part on the quality and performance of its employees. We examined human resource management in part because the Commission, like most government institutions, faces a wave of retirements over the next several years.

82. We examined whether human resources are managed in a manner that provides the Commission with the human resource capacity and the work environment it needs to achieve its goals and objectives.

83. We held interviews with Commission personnel, analyzed staffing information, and examined employee training programs as well as the Commission's annual performance review process to determine

- whether the Commission has systems and practices in place to ensure that it has the appropriate number of competent employees in the right places, doing the right things at the right time; and
- whether workplace systems and practices enable the Commission to maintain the effective workforce needed to achieve the strategic and operational objectives required to fulfill its legal, commercial, and public policy mandates.

84. We found that the Commission manages human resources in a way that provides the Commission with the core competencies it needs to achieve its goals and its mandate.

85. The Commission's human resource systems and practices provide the essential services it requires, including staffing and performance management. Given the upcoming wave of retirements, succession planning is an important tool for ensuring that the Commission is able to staff key positions in the future.

Succession planning for key positions is ongoing

86. The Commission is aware of the importance of succession planning. It has a succession plan that focuses on key positions, which it defines as ones that may be difficult to fill because they require specialized skills or as ones that would put the achievement of goals at risk if they were left vacant for an extended period. We found that the Commission has identified 12 key positions across all of its operations, which collectively represent about 20 percent of its human resources.

87. Following the approval of the succession plan (which includes profiles for key positions) in April 2009, progress on implementation work was delayed due to other human resource priorities. Commission officials indicate that during the last performance evaluation cycle that ended in July 2010, managers were asked to identify employees interested in assuming key positions. Next steps include reviewing and comparing the key position profiles, creating an internal committee to review and evaluate the candidacy of interested employees, and preparing individual development plans to assist these employees in achieving their goal.

88. The dairy industry and the Commission's operations are highly specialized and complex. Given that many of the senior employees at the Canadian Dairy Commission are currently eligible to retire or will be eligible to retire in the near future, succession planning needs to be an ongoing priority.

Conclusion

89. We conclude that, during the period under examination, the Canadian Dairy Commission's systems and practices were maintained in a manner that provided the Commission with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

About the Special Examination

All of the audit work in this report was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objective

Under section 138 of the *Financial Administration Act* (FAA), federal Crown corporations are subject to a special examination once every 10 years. Special examinations of Crown corporations are a form of performance audit where the scope is set by the FAA to include the entire corporation. In special examinations, the Auditor General provides an opinion on the management of the corporation as a whole. The opinion for this special examination is found on page 3 of this report.

Special examinations answer the question: Do the Corporation's systems and practices provide reasonable assurance that assets are safeguarded and controlled, resources are managed economically and efficiently, and operations are carried out effectively? A significant deficiency is reported when there is a major weakness in the Corporation's key systems and practices that could prevent it from having reasonable assurance that its assets are safeguarded and controlled, its resources are managed efficiently and economically, and its operations are carried out effectively.

Key systems and practices examined and criteria

At the start of this special examination, we presented the Canadian Dairy Commission's audit committee with an audit plan that identified the systems and practices, and related criteria, that we considered essential to providing the Commission with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. These are the systems and practices and criteria that we used for our special examination.

These criteria were selected for this examination in consultation with the Commission. They were based on our experience with performance auditing—in particular with our special examinations of Crown corporations—and on our knowledge of the subject matter. Management reviewed and accepted the suitability of the criteria used in the special examination.

Key system and practice examined	Criteria
Corporate governance	To maximize the Canadian Dairy Commission's effectiveness and its ability to balance public policy objectives with its commercial objectives, the Commission has a well-performing corporate governance framework that meets the expectations of best practices in Board stewardship and shareholder relations.
Risk management	The Commission focuses on risk embedded in its corporate culture. That focus is pervasive at all levels of the corporation and supports the realization of its mandate, business goals, and objectives. Risks are identified, measured, mitigated, monitored, and reported in order to be kept within a level appropriate to the nature of the business.

Key system and practice examined	Criteria
Strategic planning	The Commission has clearly defined strategic directions and specific and measurable goals and objectives to achieve its legislative, commercial, and public policy mandate. Its strategic direction and goals take into account government priorities, identified risks, and the need to control and protect its assets and manage its resources economically and efficiently.
Performance measurement and reporting	The Commission has identified performance indicators to measure the achievement of its mandate and statutory objectives. It also has reports that provide complete, accurate, timely, and balanced information for decision making and accountability reporting.
Establishing quotas and support prices	The Commission sets industrial milk supply quotas and support prices in a manner consistent with legislation and objectives set out in its corporate plans.
Inventory management	The Commission adequately protects its inventory of dairy products, sets prices that allow it to recover the cost of inventory when it is sold, and develops new markets as required to deal with structural surpluses.
Special milk class permits	The Commission issues special class permits in a manner that is consistent with Canadian Milk Supply Management Committee direction and monitors compliance with the terms of the permits.
Human resource management	Human resources are managed in a manner that provides the Commission with the human resource capacity and the work environment it needs to achieve its goals and objectives.

Period covered by the audit

Audit work for this special examination was substantially completed on 31 August 2010. It covered the systems and practices that were in place between March 2009 and August 2010.

Audit team

Assistant Auditor General: Neil Maxwell
Principal: Dale Shier
Audit Project Leader: Amanda Lapierre

Ian Campbell
Maxine Leduc
Diana Thibeault
Juliet Woodfield

For information, please contact Communications at 613-995-3708 or 1-888-761-5953 (toll-free).

Appendix List of recommendations

The following is a list of recommendations found in the Special Examination Report. The number in front of the recommendation indicates the paragraph where it appears in the report. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Corporate governance	
33. The Canadian Dairy Commission's Board of Directors should periodically assess its collective skills. If the Board identifies a gap in its skills, it should seek outside expertise to complement the skills of its members. **(27–32)**	The Commission agrees with the recommendation. The Commission's Board will periodically assess its collective skills and continue to seek outside expertise when deemed necessary for specific projects such as International Financial Reporting Standards. The Board will give consideration to adding an ex-officio member to its audit committee with financial expertise but is of the opinion that a better solution would be to remove the Chief Executive Officer position from the Board. Doing so would create a position on the Board that would be filled by a person with such expertise. The Commission will continue to pursue this solution with the government.
36. The Commission's Board of Directors should develop procedures for members to declare and manage conflicts of interest. **(34–35)**	The Commission agrees with the recommendation. Members of the Commission's Board are required to adhere to the requirements for "public office holders" as per the *Conflict of Interest Act*. The Board will create a provision in its bylaws that will require each member to put on record any existing conflicts under that Act, and will develop procedures to manage conflicts. The inherent conflict posed by the requirement that a Board member have a background in dairy production (often filled by an active milk producer) and the Board's responsibility for setting support prices is a challenge. As we did at the time of the previous special examination, the Commission will discuss this issue with the Privy Council Office in an attempt to find a workable solution.
Strategic planning and performance measurement and reporting	
55. The Canadian Dairy Commission should identify and report on quantitative performance indicators that better demonstrate whether it is achieving its mandate, rather than simply reporting on tasks or activities. **(52–54)**	The Commission agrees with the recommendation. In its next strategic planning cycle, the Commission will establish its overall goals to be those outlined in the *Canadian Dairy Commission Act* and will report quantitative performance indicators for these goals.