

AGRICULTURE AND AGRI-FOOD CANADA

**AUDIT AND EVALUATION OF
TOBACCO TRANSITION PROGRAM (TTP) PARTICIPANTS**

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**Submitted by:
Samson & Associates**



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ACKNOWLEDGMENT AND AUDIT TEAM

The audit was conducted by Samson & Associates on behalf of AAFC. Although no external audit opinions were issued, we provide conclusions on the various elements part of the engagement.

The findings and conclusions in this report are provided following a detailed examination of available documentation, a review of the Board's processes and procedure for managing the Tobacco Transition Program and the issuance of tobacco licenses, and the review of a sample of business relationships between licensees and TTP participants.

Audit Team

The Samson & Associates audit team who performed the audits on behalf of AAFC included the following:

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EXECUTIVE SUMMARY

Background

Agriculture and Agri-Food Canada (AAFC) introduced the Tobacco Transition Program (TTP) to; replace the old tobacco quota system with the new licensing regime, to help producers exit the industry, transition to other crops or find new opportunities outside agriculture and to strengthen the viability of remaining and future tobacco producers.

The Ontario Flue-Cured Tobacco Growers Marketing Board delivered the Tobacco Transition Program (TTP). In exchange for payment, participants agreed not to acquire, rent, or obtain any right to produce or market flue-cured tobacco in Canada, directly or indirectly, and permanently. Furthermore, TTP participants agreed not to receive a license to grow the flue-cured tobacco. The limitations placed upon the voluntary TTP participant are extended to their spouses as well as their dependent children.

Furthermore, TTP participants cannot rent their land and/or equipment to a licensee, become an employee of his tenant; and/or loan or co-sign a loan for a licensee unless it can be demonstrated that the business relationships between the TTP participant and the licensee meet certain principles that make them arm's length business relationships.

Objectives and Scope

The engagement objectives can be summarized as follows:

- Audit the TTP participants and the Board to ensure compliance with the terms and conditions of the program;
- Evaluation of the program to determine if the objectives have been met.

The audit and evaluation was performed for the licenses issued during the year 2009 only.

Audit Approach and Methodology

The Audit approach and methodology were designed to address the key objectives of the engagement as follows:

- Verification of all 2009 licensees to ensure that none had been issued to non-eligible individuals;
- Audit of at least 60 business relationships between TTP participants and licensees to ensure that they are at arms' length and at fair market value;
- Evaluation of the Board's process for issuing licenses in accordance with the terms and conditions of the program; and

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- Evaluation of the effectiveness of the program.

Key Audit and Evaluation Findings

A review of all the 2009 licensees confirmed that the Board does not appear to have issued licenses to TTP participants, their spouses or dependent children.

We identified only five business relationships between licensees and TTP participants that appear not to meet the Fair Market Value requirement of program terms and conditions.

In our opinion the likelihood that many additional TTP participants would be found in breach of their commitment for 2009 is low, as the range of FMV is wide and it is a straight forward process in order to come into compliance with the stated terms and conditions.

However, it appears that the TTP participants adjusted their prices in 2010 as they understood that the licensees would still rent from them at a higher price due to the high profit margins as a result of the elimination of the quota. As the prices for non related business arrangements are adjusted starting in the year 2010, the range of FMV will get narrower and the likelihood of TTP participants that could be found in breach of their commitment regarding FMV will increase. This will be an increasing risk in the cases of family related business arrangements which may not adjust pricing in accordance with changing FMV as they are not as subject to market based pressure to the same extent.

Not all business relationships with TTP Participants had been declared to the Board by the licensees as required. At present, the Board has no verification process to ensure that licensees declare all relationships with TTP participants.

The profit margin from a tobacco operation when one does not need to rent any quota is high. From our review of financial statements regarding tobacco farm operations, we note that the net profit is approximately \$2,000 per acre, representing over 40% of the revenue, when the all-inclusive price for renting land, buildings and equipments is approximately \$1,000 per acre. As such, although the cost of some all-inclusive business arrangements might seem high, it still allows the licensee to make significant profit.

There are numerous formats for established business agreements, with numerous cost impacting variables involved. As such, we have established FMV for an all-inclusive (Land, Buildings & Equipment) agreement at between \$250 and \$1,282 per acre. The selection of the FMV range was based on the lowest and highest business arrangements between parties at arm's length, as long as multiple arrangements could be found at similar prices.

The high variance in price is partly due to the inexperience of many farmers in negotiating business arrangements and subsequently entering into lease agreement at low prices. We anticipate this gap to close in the future years.

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It is our opinion that the Board should have some knowledge about what constitutes FMV for the various business arrangements being declared in order to ensure compliance with program terms and conditions.

Of 46 TTP participants contacted by phone, 28% had rented a total of 1686 acres of land to licensees for the 2009 growing season. Notably, for the 2010 growing season, 58% of respondents have rented a total of 2383 acres of land to licensees for the purpose of tobacco production.

Preliminary data currently indicates that licensees from 2009 have applied for 2010 licenses along with additional producers. This would more than double production from 9,592 acres and 22,019,131 pounds produced to 20,447 acres and 49,767,872 pounds contracted.

Key Recommendations

That the Board review the license application form and clarify the questions to make clear that all business relations with TTP participants, family or otherwise, for land or equipment or labour be declared.

That the Board collects sufficient data at the close of each application, before the start of the season, to confirm that arrangements are being entered into at FMV. The Board should also perform procedures to confirm that they were no non-compliant changes to the stated arrangements at the end of the season. Caution should be used not to divulge competitive information to Tobacco producers.

AAFC should conduct a FMV analysis of the year 2010 to assess whether the apparent variances in FMV due to inexperience of involved parties are being corrected, and whether the variance between related and unrelated parties adjusts accordingly.

Overall Conclusion

In general, the processes and controls in place at the Board for the management of the issuance of licenses for the production of tobacco for the period under audit appear to be adequate and effective. However, we have identified some issues requiring management's attention, including the improvement of the application documentation and business relationship verification procedures.

Additionally, we found that most business relationships established between licensees and TTP participants met the terms and conditions of the program. There were only five cases where the requirement of fair market value does not appear to be met.

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The quota system has been eliminated. However, the encouragement of transition to other crops by TTP participants is not as far advanced as the objective to “strengthen the viability of remaining and future tobacco producers” based on the projected growth in 2010 over 2009.

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1. BACKGROUND

Agriculture and Agri-Food Canada (AAFC) introduced the Tobacco Transition Program (TTP) to; replace the old tobacco quota system with the new licensing regime, to help producers exit the industry, transition to other crops or find new opportunities outside agriculture and to strengthen the viability of remaining and future tobacco producers.

The Ontario Flue-Cured Tobacco Growers' Marketing Board (the Board) delivered the Tobacco Transition Program (TTP) on behalf of AAFC.

To apply to the TTP, quota holders had to complete and sign an agreement with the Board who was delivering the TTP. Through the agreement, TTP participants agreed not to acquire, rent or obtain any right to produce or market flue-cured tobacco in Canada, directly or indirectly, and permanently.

For the purpose of auditing and evaluating the TTP, participants also agreed that the Board provide to AAFC all the information pertaining to their participation in the program and provide access to AAFC to any documentation pertaining to their participation in the TTP. The agreement also indicates that a failure to comply with conditions will result in the Board or the federal government requesting repayment of any monies paid under the TTP with interest and penalties thereon.

The TTP terms and conditions are further laid out in the program fact sheet which clearly indicates that spouses and dependent child of TTP participants would not be allowed to obtain a license to grow tobacco. The fact sheet also states that some relationships may prevent an individual from obtaining a license and that the Board will be responsible to determine their eligibility. For greater clarity, principles defining acceptable business relationships were described by AAFC in the May 7, 2009 letter to the Board. As per that letter, TTP participants cannot rent their land and/or equipment to a licensee and become an employee of his tenant; and/or loan or co-sign a loan for a licensee unless it can be demonstrated that the business relationships between the TTP participant and the licensee meet certain principles that make them arm's length business relationships. These principles are:

- TTP participants do not acquire, rent or obtain any right to produce or market flue-cured tobacco in Canada, either directly or indirectly.
- A TTP participant cannot be a "principal" (e.g. an owner, partner, shareholder) of a tobacco growing enterprise.
- Business relationships and business relationships between a TTP participant and a licensee have to be at arm's length and transparent. In particular:
 - there must be a written agreement between the TTP participant and licensee with terms consistent with a genuine commercial transaction;

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- payments from a licensee to a TTP participant must be based on fair market value or current market rates for services and cannot be based on profits or losses from the tobacco production; and
- TTP participants will have the documentation to withstand an audit of his or her business relationships and relationships with a licensee.

In addition, to receive a license, growers had to have a contract with a manufacturer.

While the government has sought to build safeguards into the system to prevent abuse, there is a public perception that there are gaps in the structure of the program. The media has summarized these gaps as enabling those who have received buyout money to readily create business relationships that permit their continued involvement in tobacco production in contravention of the agreements they undertook. *"The government has designed a program with loopholes. The rules....allow people (who have accepted buyouts) to continue to be involved in tobacco growing"*. The media has pointed out that *"just as much tobacco has been harvested as the year before, and as many as 100 of the farmers who took the buyout still seem involved in producing tobacco"*.

In addition to cancelling TTP participants' Basic Production Quota (BPQ), the Board removed the quota system and established a licensing system for the purpose of monitoring future tobacco production. Before the appeals;

- Approximately 1,049 quota holders participated in the TTP;
- The TTP retired 271.1M pound of Basic Production Quota (BPQ) (about 99.8% of the quota);and,
- Only 4 quota holders did not participate in the TTP.

Furthermore;

- In 2008 there were 446 tobacco producers. In 2009, Ontario has issued tobacco licenses to only 118 producers; and,
- In the spring of 2009, an implementation audit was conducted and did not find any issue with the Board's process or with the quota transfers that took place prior to the TTP application period.

2. OBJECTIVES AND SCOPE

The engagement undertaken had multiple objectives:

- Audit of the TTP participants and the Board to ensure compliance with the terms and conditions of the program;
 - Evaluation of the program to determine if the objectives have been met.
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The audit will ensure that TTP participants who are still involved in the industry are meeting the TTP terms and conditions. This means they are only involved through the rental of their land and equipment or as employee of tobacco producers through business relationships that are at arms' length and at fair market value.

The audit and evaluation was performed for the licenses issued during the year 2009 only.

3. AUDIT APPROACH AND METHODOLOGY

The Audit approach and methodology was designed to address the key deliverables of the engagement and is presented as follows:

- Initial verification of all 2009 licensees;
- Audit of at least 60 business relationships between TTP participants and licensees to ensure that they are at arms' length and at fair market value;
- Evaluation of the Board's process for issuing licenses in accordance with the terms and conditions of the program; and
- Evaluation of the effectiveness of the program.

3.1 Initial verification of all 2009 licensees

The verification was executed by performing a comparison of the names of the 2009 licensees with the names of the TTP participants, their spouses and dependent children. To perform our review, we used the TTP participants and licensee lists and application forms provided by the Board.

3.2 Audit of 60 business relationships

In order to perform the audit of business relationships, we asked the Licensees about the details of their business relationships with TTP participants since they had a requirement to demonstrate the types of business relationships they have entered into and support the fair market value.

In total, the Board issued licenses to 118 individuals/companies in 2009. 19 Licensees declared not having any business relationships with TTP Participants and the other 99 Licensees declared 114 business relationships (i.e. some having 2 and 3 relationships). The total proposed acreage of the 2009 licensees was 9,271.

Sample Selection

We identified a sample of 51 Licensees for audit, representing 65 business relationships (43% of licensees and 57% of relationships). Furthermore, we identified 5 Licensees that had declared no business relationships with TTP Participants for which we requested detailed information to

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confirm their accuracy. The total acreage of the sample represented 6,439 acres or 69% of the proposed acreage cultivated in 2009.

The sample to audit was selected through a risk-based approach. We first selected the 30 licensees with the highest acreage (representing approx. 50% of total acreage). The remaining 21 were selected in order to have coverage for different number of relationships, licensees being companies or individuals and to obtain a mix of acreage (small, medium and large).

Audit Request to Licensees

We sent letters to 56 individuals/companies who received licenses in 2009 on April 14th, 2010 (by courier – next day), requesting that they provide the following information by April 23rd, 2010:

- Details on the relationships entered into to confirm the information declared to the Board;
- Details on the type of business relationships entered into i.e. renting of land, equipment, buildings or employment agreement;
- Supporting documentation with respect to the business relationships, such as lease agreements, invoices, contracts, T4, proof of payment, etc.

Modification to Sample of Relationship to Audit

As we started to obtain documentation from the licensees, we found that the majority of them were confirming a number of business relationships higher than what had been declared to the Board originally. As such, the number of relationships for the 56 licensees to whom requests were sent was significantly higher than the projected 65.

This also meant that the total number of relationships (114) for the 118 licensees was underestimated. Through our discussion with AAFC, we agreed to audit all of the relationships for which we received documentation. As indicated in Appendix A, this represented 101 business relationships.

Detailed Audit Methodology

Our audit of the business relationships involved the following procedures:

- Review responses to the audit questionnaire submitted by the licensees to ensure the relationships match those declared to the Board. For any new relationship, we verified that it was eligible;
- Review the supporting documentation provided to ensure that it included the following:
 - Signed agreements detailing the nature, terms and conditions and basis of payment for the business relationships;
 - Invoices, time records, T4 slips, cancelled cheques supporting a % of the expenses involved as part of the relationship. (our audit procedure involved a higher % of supporting documentation required for relatives);

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- An explanation of how FMV had been determined.
- Review the supporting documentation and establish a comparative price in order to perform the fair market value (FMV) assessment for this relationship. The prices were established by acre for the land, buildings and equipment and by hour for the workforce. In some cases the information provided only enabled us to establish an all-inclusive price per acre.
- Over 10 site visits were conducted for files where we felt additional information was necessary to obtain a better understanding of the relationships. These visits were performed for higher risk files i.e., when relationships were with mother, father, non-dependent son(s) and daughter(s) or when the price entered into appeared high or low.
- Due to the time constraint, we chose to perform phone interviews for some of the additional licensees we believed represented higher risk.

All audit results were reviewed by the Project Leader. Only 3 of the 56 Licensee did not provide us with sufficient information and documentation to include in our analysis and conclusions. We have not been able to contact these licensees to determine why they did not provide the requested information within the period of our engagement. The three licensees are identified in Appendix D.

Although we have obtained sufficient evidence to make the necessary conclusions for the audit and evaluation, AAFC may want to consider performing additional procedures to obtain the business relationships information from these licensees to confirm that they are meeting the terms of the program.

Fair Market Value Assessment

Since there was a limited market for renting land, buildings and equipment in the Tobacco industry before 2009, we had to gather the necessary information and comparative information to establish FMV as part of our procedures. The result of our approach and methodology for the establishment of FMV is described in Section 4 of this report.

3.3 Evaluation of the Board's Processes

In addition to our verification of licenses and audit of relationships, we were requested to determine if the Board had put in place the necessary processes to ensure that they did not issue licenses to any individual who would contravene the purpose and intent of the TTP. We also evaluated the need for the Board to put in place a process to verify rental or employment contracts when issuing licenses.

In order to conclude on this objective, we performed interviews with the key personnel at the Board, performed a process review at the Board, executed some analytical procedures in order to identify if the Board's process could be improved, and conducted interviews with some licensees.

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3.4 Evaluation of the Effectiveness of the Program

In order to evaluate the effectiveness of the program we reviewed the license applications of 56 tobacco producers. This included a review of their declarations of business relationships with TTP participants as well as a verification of established contracts with manufacturers for eventual sale of the tobacco. We supplemented this review with phone and on-site interviews with licensees and TTP participants.

4. AUDIT AND EVALUATION FINDINGS

The following section represents the results of our analysis of the documentation received from the Board and licensees as well the results of on-site and phone interviews with licensees and TTP participants. For reporting purposes we have grouped our analysis and findings into six specific areas of review as follows;

1. An audit of the 2009 licensees to determine if licenses were awarded to TTP participants, their spouses or dependent children,
2. A determination of Fair Market Value for land, machinery and labour,
3. An assessment of business relationships between licensees and TTP participants,
4. An evaluation of the processes put in place by the Board for the licensing of tobacco producers,
5. An evaluation of whether or not program objectives have been met, and,
6. An analysis of the risk that non-audited business relationships between licensees and TTP participants are not in compliance with program terms and conditions.

4.1 Audit of the 2009 List of Licensees

The Ontario Flue-Cured Tobacco Growers Marketing Board delivered the Tobacco Transition Program (TTP). In exchange for payment, participants agreed not to acquire, rent, or obtain any right to produce or market flue-cured tobacco in Canada, directly or indirectly, and permanently. Furthermore, TTP participants agreed not to receive a license to grow the flue-cured tobacco. The limitations placed upon the TTP participant were extended to their spouses as well as their dependent children. The determination of the adherence to the above requirement is relatively straight-forward.

As stated earlier, as a condition of receiving the TTP payment, recipients had to agree not to enter into the production of tobacco. Furthermore, in order to obtain a license to produce tobacco applicants were required to declare all business relationships with TTP recipients. For the year 2009 the Board issued 118 licenses for the production of tobacco for which 114 business relationships with TTP participants were declared.

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Initial Review Conclusion

An initial review of all the 2009 licensees and their relationship declarations indicated that the Board has not issued licenses to any TTP participants, their spouses or dependent children.

Conclusion Following the Audit of Relationships

Following the initial review, we performed the audit of relationships and found that not all relationships had been declared to the Board by the licensees. For the additional relationships found (31), we also verified that they did not represent an ineligible relationship according to the program and no exceptions were found.

As such, we can confirm that based on our audit of 53 licensees and the review of the Board documentation for all of the 2009 licensees, we have not found any cases where the Board issued licenses to TTP participants, their spouses or dependent children.

4.2 Determination of Fair Market Value

In order to make a determination of FMV for land, equipment and salaries we reviewed the 101 business relationships entered into by 53 licensees selected (eight of these relationships were with non-TTP participants). We asked for detailed information on the business relationships as it pertains to land, equipment, buildings and workforce. 48 of the 101 relationships were between unrelated individuals (see appendix A), which was used as a benchmark to establish FMV for the various types of costs.

Given the range of relationships or contracts entered into, such as land only, equipment only or all-inclusive, we followed up by phone, email or fax to collect supplemental documentation and evidence as required. In addition we selected approximately ten licensees (over 16 relationships) and conducted on-site visits and interviews to confirm our understanding of the nature of the agreements. Most on-site visits involved business arrangements that were either on the high or low side of initially determined FMV.

FMV Assessment Conclusion

Based on information collected, we have established FMV for the various cost categories as follows:

Cost categories	FMV price
Land	\$100 - \$282 / acre
Buildings (Mostly Kilns, Greenhouses & Barns)	\$150 - \$200 / acre
Buildings & Equipment (Planters, Harvesters, Tractors, etc)	\$150 - \$1,000 / acre
All-inclusive (Land, Buildings & Equipment)	\$250 - \$1,282 / acre
Workforce – Management & Expert	\$18 - \$40 / hour
Workforce – Farm Labour	\$9 - \$16 / hour

Our FMV assessment is based on our detailed review of business arrangements summarized in Appendix B for both the related and non-related business relationships. The selection of the

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FMV range was based on the lowest and highest business arrangements between unrelated parties, as long as multiple arrangements could be found at similar prices. This approach was used since other parties that are unrelated could also have different reasons (business partners or special friendship) for entering into non-FMV business arrangements. For example, in the case of buildings and equipment, we found one business relationship arrangement between unrelated parties that appeared to be significantly lower than comparable arrangements (see Appendix C).

Buildings and Equipment

One of the elements that stand out from our FMV assessment is the high standard deviation for the buildings & equipment cost categories (also impacting the all-inclusive prices). Although the variance appears high, we have identified a few reasons why it exists:

- The high variance in price is partly due to the inexperience of many farmers in negotiating similar business arrangements and subsequently entering into lease agreement at low prices because:
 - The production of tobacco was declining (trend in the past years) and they did not see how else they could make money with their land, buildings and equipment.
 - The prices couldn't be set too high since the profit margins were lower in their experience (taking into consideration the leasing cost of quota).
- The profit margin from a Tobacco operation when one does not need to rent any quota is important. From our review of financial statements regarding tobacco farm operations, we have identified that the net profit is approximately \$2,000 per acre, representing over 40% of the revenue, when the all-inclusive price is between \$1,000 - \$1,100. As such, although some All-inclusive business arrangements might seem high, it still allows the licensee to make a significant profit.
- The scale of operations. For renting 60 acres, you need essentially the same core equipment as if growing 120 acres which can drive up the cost per acre by \$200 an acre.
- The type of machinery and equipment. There are different costs to rent automated machinery (harvesting machinery) or high efficient equipment (kilns) verses labour intensive machinery or energy consuming equipment. In any cases, our maximum FMV price considers the latest technology available for Tobacco producers.

As a note, when we asked licensees if the price of land, buildings and equipment had increased from 2009 to 2010, most of them said that it did significantly. It appears that the TTP participants adjusted their prices in 2010 as they understood that the licensees would still rent from them at a higher price due to the high profit margins. In our opinion the gap in FMV should close somewhat this season and continue to do so as all parties adjust to true FMV. The apparent risk is that the FMV adjustments for business arrangements with relatives will not narrow to the extent that they do for unrelated individuals, resulting in more compliance issues with respect to FMV being identified in future years.

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Recommendation # 1

AAFC should conduct a FMV analysis of the year 2010 to assess whether the apparent variances in FMV due to inexperience of involved parties are being corrected, and specifically whether the variance between related parties adjusts accordingly.

Land

In most cases, the price of land was higher when it was the only component rented to a licensee. TTP participants were willing to rent their land at lower prices when the licensees were also renting the buildings and equipment. Also, land rental could vary by as much as \$100 per acre depending on whether or not it had been prepared by growing a crop of rye in the previous season.

Although the TTP participants could have chosen another crop to grow on their land, their land grows tobacco better than anything else.

Workforce

Salaries range widely as there is general farm labour which goes from \$9.50 an hour (with room and board) for offshore labour and \$10.00 an hour for local “unskilled” labour, to \$16.00 for harvester drivers and \$20.00 or more for those who have specialized skills such as field “fumigation” and curing of tobacco. Additionally, there were several cases where salaries in the range of \$25-40 an hour were established for manager / operators of farms.

4.3 Audit of Business Relationships between Licensees and TTP Participants

We selected 56 licensees and requested information pertaining to all business relationships they had entered into for the purposes of producing tobacco. According to information on record with the Board, there were 65 declared relationships with TTP participants. When we conducted our review we noted that licensees submitted 93 relationships with TTP participants, or 48% more than declared to the Board.

As mentioned before, five of the licensees we selected had not declared having any business relationships with TTP participants to the Board. We found out as part of our audit procedures that three out of them actually had entered into business relationships with TTP participants, two being with relatives (including mother/father).

As part of our review of relationships we requested copies of agreements or contracts and supporting documentation to demonstrate that payments had been made in accordance with those agreements or contracts. Evidence requested included invoices, T4s, and proof of payment primarily in the form of cancelled / bank processed cheques.

Our audit only identified five relationships between licensees and TTP participants that did not appear to meet the program terms and conditions for FMV. Four of the five arrangements were below FMV, and one of these was with an unrelated TTP participant. The other arrangement was in excess of FMV, and was with a related TTP participant. For all these business

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arrangements outside FMV, there was no evidence to substantiate the rationale for costs. The details of the business arrangements for these relationships are presented in Appendix C.

4.4 Evaluation of Board Processes for Licensing Tobacco Producers

As previously stated, we have been requested to determine if the Board had put in place the necessary processes to ensure that they did not issue licenses to any individual who would contravene the purpose and intent of the TTP.

As part of our file review and interviews, we can confirm that for the year 2009, the Board had a process where it verified the name (individuals and companies) of the licensees with the list of names of TTP participants (2005 TAP and 2009 TTP). However, we are not convinced that this procedure is sufficient to verify that licensees establish acceptable business arrangements with TTP participants. As a result, we have noted several areas of improvement.

Declaration of relationships

As stated earlier, our review noted that licensees had entered into 93 relationships with TTP participants as opposed to the information on record with the Board, which listed 65 declared relationships with TTP participants.

At the present, the Board has no verification process to ensure that licensees declare all relationships with TTP participants.

Additionally, through interview (either by phone or in person) with licensees, we understand that there was some confusion or misunderstanding about which relationships had to be declared. In our review of the forms for applying for licenses we believe that some questions are somewhat ambiguous and could lead to interpreting that some relationships need not be declared.

Recommendation #2

That the Board review the license application form and clarify the questions to make clear that all business relations with TTP participants, family or otherwise, for land, equipment or labour be declared.

Verification procedure for the owners of companies and relationships with relatives

Currently, the board does not make use of the available information on the shareholders of the companies that were TTP participants or licensees in order to verify that no ineligible applicants were approved.

Recommendation #3

That the Board reviews ownership of businesses applying for a license, with the information they collected on individuals and shareholders when they delivered the TTP, to ensure that the licensees are eligible.

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FMV analysis

It is our opinion that the Board should have some knowledge about what constitutes FMV for the various business arrangements being declared in order to ensure compliance with program terms and conditions. Furthermore, the board should have a role to play in verifying the business arrangements to ensure that they are within FMV.

Recommendation #4

That the Board collects sufficient data at the close of each application, before the start of the season, to confirm that arrangements are being entered into at FMV. The Board should also perform procedures to confirm that they were no non-compliant changes to the stated arrangements at the end of the season. Caution should be used not to divulge competitive information to Tobacco producers.

4.5 Evaluation of Achievement of Program Objectives

Impact of Licensing System on Production and Viability of a Licensee

Preliminary data currently indicates that the tobacco licensees from 2009 have recognized the benefits of the current regime and have applied for 2010 licenses that would more than double production from 9,592 acres and 22,019,131 pounds produced to 20,447 acres and 49,767,872 pounds contracted.

The lack of a requirement to lease quota from other producers had meant that licensees can more accurately predict costs as well as reduce the cost of production.

There is at least one case where the elimination of the quota has benefited non-quota holding farmers. In prior years they were required to rent quota to cover all of their production even though they had invested in land and equipment. This has directly contributed approximately \$1200 per acre to their financial results.

Transition to Other Crops

As part of our review we contacted approximately 46 TTP participants by phone to determine if they had transitioned tobacco land to other crops. 91% of respondents were still farming and 74% had converted some land to other crops, primarily beans and corn, both of which could have been grown in rotation with tobacco. However, 28% of respondents had rented a total of 1686 acres of land to licensees for the 2009 growing season. Notably, for the 2010 growing season, 58% of respondents have rented a total of 2383 acres of land to licensees for the purpose of tobacco production. This represents a doubling in the number of TTP participants renting land to licensees and a 41% increase in the acres rented to licensees.

Understanding of Program Objectives

As part of our various interviews and review of documentation and media releases, we found that various industry interest groups had a different understanding of the Program objectives, which were contrary to each other in some cases.

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For example, anti-tobacco advocacy groups expected a decrease in tobacco production, and the farmers involved in the Program still don't understand why they were not allowed to continue producing tobacco directly given the growth in the industry. Additionally, the media has emphasized that there are apparent gaps in the program, also related to the growth of tobacco production.

These items taken together demonstrate that the communications related to the overall program objectives to the various interest groups may have been deficient.

In summary, the quota system has been eliminated. However, the encouragement of transition to other crops by TTP participants is not as far advanced as the objective to "strengthen the viability of remaining and future tobacco producers" based on the projected growth in 2010 over 2009.

4.6 Risk assessment of non-audited business relationships between licensees and TTP participants not being in compliance with program terms and conditions

As stated earlier, we identified only five relationships between licensees and TTP participants that did not appear to meet the terms and conditions of the program due to business arrangements that were not considered at FMV.

In our opinion there is little likelihood that many additional TTP participants would be found in breach of their commitment for 2009, as the range of FMV is wide and it is a straight forward process in order to come into compliance with the stated terms and conditions. However, as the prices for non related business arrangements are adjusted starting in the year 2010, the range of FMV will get narrower and the likelihood of TTP participants that could be found in breach of their commitment regarding FMV will increase. This will be an increasing risk in the cases of family related business arrangements which may not adjust pricing in accordance with changing FMV as they are not as subject to market based pressure.

While we did not find any ineligible relationships, we did note that there is a trend for TTP participants to enter into business relationships with family members who have obtained a license for the production of tobacco. This can range from parents, as TTP participants leasing land and equipment to their non-dependent children, to adult children as TTP participants leasing land and equipment to their parents. Other situations include relationships between brothers and sister, uncle and nephew, grandparents and relationships with in-laws, all of which meet the terms and conditions of the program.

Agriculture and Agri-Food Canada
Audit and Evaluation of Tobacco Transition Program (TTP) Participants Audit

5. OVERALL CONCLUSION

In general, the processes and controls in place at the Board for the management of the issuance of licenses for the production of tobacco for the period under audit appear to be adequate and effective. However, we have identified some issues requiring management's attention, including the improvement of the application documentation and business relationship verification procedures.

Additionally, we found that most business relationships established between licensees and TTP participants met the terms and conditions of the program. There were only five cases where the requirement of fair market value does not appear to be met.

The quota system has been effectively eliminated. However, the encouragement of transition to other crops by TTP participants is not as far advanced as the objective to "strengthen the viability of remaining and future tobacco producers" based on the projected growth in 2010 over 2009.

Appendix A – Business Relationship' Summary

		Business Relationships				
		TTP participants			Non TTP participants	
		Relatives		Non-relatives		
Licenses		Father, Mother, Non-dependent Son and Daughter	Other relatives			Total
Information from the Board (according to declaration on license application forms)	118	114			N/A	114
Initial sample selection	56	65			N/A	65
Actual sample selection	53	37 37%	17 17%	39 39%	8 8%	101 *

**53%
with relatives**

* Of the 53 licenses for which information was received, we found that there was 93 relationships with TTP participants (101 - 8), representing 48% more than what was declared to the Board through the license application process.

Appendix B – Fair Market Value Analysis

Land, Buildings & Equipment		# of relationships included for analysis	Price per Acre				Standard Deviation	Standard Deviation (% of average)
			Average	Minimum	Maximum	Median		
Land	Relatives	31	\$ 188.39	\$ 150.00	\$ 250.00	\$ 200.00	\$ 29.79	16%
	Other	32	\$ 191.47	\$ 100.00	\$ 282.00	\$ 200.00	\$ 40.96	21%
<i>FMV established</i>			\$ 100.00	\$ 282.00				
Buildings (Mostly Kilns, Greenhouses & Barns)	Relatives	1	\$ 150.00	\$ 150.00	\$ 150.00	\$ 150.00	\$ -	0%
	Other	3	\$ 186.00	\$ 186.00	\$ 186.00	\$ 186.00	\$ -	0%
<i>FMV established</i>			\$ 150.00	\$ 186.00				
Buildings & Equipment* (Planters, Harvesters, Tractors, etc)	Relatives	27	\$ 491.71	\$ 150.00	\$ 2,051.82	\$ 375.00	\$ 374.14	76%
	Other	15	\$ 333.36	\$ 3.33	\$ 979.00	\$ 195.00	\$ 293.33	88%
<i>FMV established</i>			\$ 150.00	\$ 1,000.00				
All-inclusive* (Land, Buildings & Equipment)	Relatives	28	\$ 501.49	\$ 100.00	\$ 1,126.92	\$ 479.41	\$ 225.57	45%
	Other	26	\$ 507.64	\$ 153.33	\$ 1,179.00	\$ 427.65	\$ 265.49	52%
<i>FMV established</i>			\$ 250.00	\$ 1,282.00				

Workforce		# of relationships included for analysis	Price per Hour				Standard Deviation	Standard Deviation (% of average)
			Average	Minimum	Maximum	Median		
Management and Expert	Relatives	5	\$ 23.75	\$ 18.75	\$ 30.00	\$ 25.00	\$ 4.51	19%
	Other	3	\$ 29.00	\$ 22.00	\$ 40.00	\$ 25.00	\$ 9.64	33%
<i>FMV established</i>			\$ 18.75	\$ 40.00				
Farm Labour	Relatives	17	\$ 13.68	\$ 10.50	\$ 16.00	\$ 14.00	\$ 1.54	11%
	Other	5	\$ 12.50	\$ 9.50	\$ 15.00	\$ 13.50	\$ 2.21	18%
<i>FMV established</i>			\$ 9.50	\$ 16.00				

* Some of these business arrangements were considered not meeting FMV and were outside the "FMV established". See details at Appendix C.

Appendix C – Details on Non-Compliance

Business Arrangements at prices exceeding FMV

TTP Participant	TTP Payment to Participant	Licensee	License #	Relationship	Acres	Component	Price per Acre	FMV high end	Variance with FMV	
									\$	%
	\$ 73,221			Relatives	55	Buildings and Equipment	\$2,051.82	\$ 1,000.00	\$ 1,051.82	105%
	\$ 279,912									

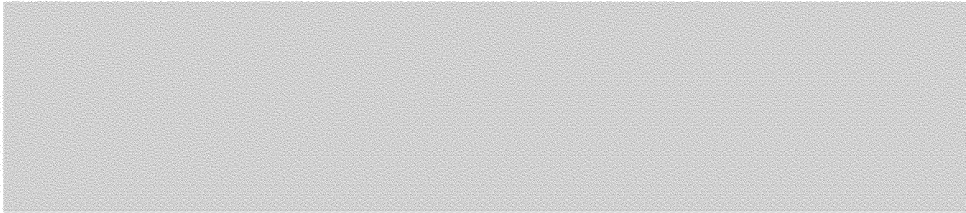
Business Arrangements at prices below FMV

TTP Participant	TTP Payment to Participant	Licensee	License #	Relationship	Acres	Component	Price per Acre	FMV low end	Variance with FMV	
									\$	%
	\$ 406,078			Relatives	41	All-inclusive	\$ 200.00	\$ 250.00	-\$ 50.00	-20%
	\$ 252,461			Relatives	85	All-inclusive	\$ 200.00	\$ 250.00	-\$ 50.00	-20%
	\$ 454,698			Relatives	45	All-inclusive	\$ 100.00	\$ 250.00	-\$ 150.00	-60%
	\$ 904,782			Unrelated	105	Buildings and Equipment	\$ 3.33	\$ 150.00	-\$ 146.67	-98%

Appendix D – Un-responsive Licensees

Licensees that did not provide requested information

Licensee	License #	Relationship with TTP Participant	Acres
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A large rectangular area of the table is completely redacted with a solid grey fill, obscuring all data rows.

BACKGROUND MATERIAL

TAB 1

ARTICLE ABOUT TTP ANNOUNCEMENT

Tobacco exit plan announced
Not all growers pleased with funding
Jeff Helsdon
Tillsonburg News
Aug 1, 2008

Tobacco farmers have their long-awaited exit package.

Federal Agriculture Minister Gerry Ritz announced a federal investment of more than \$300 million in the tobacco region earlier today. The majority of that – \$286 million – will assist farmers to transition out of the tobacco industry. Another \$15 million is being allocated for community development initiatives.

The announcement was made at the Delhi Tobacco Auction Exchange this morning. More than 400 tobacco producers, along with area politicians, attended the event. The last time farmers gathered for a meeting of this size, the mood in the room was somber. Even before Ritz announced any details, the mood was lighter, farmers seemed happier knowing they would be able to move forward.

Funding for the program will come from \$1.15 billion in payments levied against Imperial Tobacco and Rothmans Benson and Hedges in connection with assisting with contraband tobacco sales. That money will be split between Ottawa and the provinces.

{ For growers, the payment will be \$1.05 per pound. Ritz told the crowd there were no strings attached to the federal portion of the money.

“The federal money will flow regardless of the province,” he said.

If the province was to top up the federal portion with the traditional 60-40 sharing formula for agriculture programs, the payment would be \$1.74 per pound.

Interviewed after the announcement, Haldimand-Norfolk MP and Minister of Citizenship and Immigration Diane Finley said Ritz has promised the money will flow as quickly as possible. She understands Agriculture Canada staff already has instructions for applications to the program.

Ontario Flue-Cured Tobacco Growers’ Marketing Board chairperson Linda Vandendriessche called the announcement a bittersweet moment for flue growers and their families.

“Today’s announcement signals the beginning of the end for a way of life for generations of tobacco farm families,” she said. “What began nearly a century ago as the economic lynchpin of southern Ontario’s sand plain is now coming to an end.”

Most growers in the crowd were happy with the news.

“It feels like a weight has been lifted off my shoulders,” said Langton-area farmer Kris Demeester.

Wyecombe farmer Brian Baswick said the funding should be enough for him to move forward.

“The vast majority of us are grateful to the prime minister, Minister Ritz and local politicians,” he said. “We had our doubts at times but they recognized the problems and came to our aid.”

He said the announcement removes a cloud of uncertainty that has hung over growers for years. Baswick said the money would be not enough for some people and more than enough for others.

“We’re a diverse group of people like anybody else,” he said.

Other farmers, who chose to remain anonymous, weren’t as positive, stating Quebec farmers received more and questioning where the remainder of the money from the fines against the tobacco companies was going.

“They never mentioned they got \$1.15 billion and we only received a small portion of that,” said Livia Townsend of Walsingham. “Tobacco farmers have suffered the last 10 years. We are happy with what we got, but it’s still frustrating.”

“It’s a long time coming,” said grower John Keczan. “We’re not satisfied, but we’ll take it.”

Told there were farmers who were unhappy with the amount, Vandendriessche said the board had anticipated there would be some who weren’t happy.

“It’s all that was there and we were pleased to be able to snap it up,” she said. “We know there are many farmers who want to get out, or need to get out. They now have the ability to determine their own direction.”

Vandendriessche praised Finley and said her connections at the cabinet table were valuable. She also gave credit to Prime Minister Stephen Harper for recognizing the problem, along with Ritz, local mayors and farmers who wrote letters and met with their MPs.

“Most of our farmers have their last crop of tobacco in the field,” she said. “Many could not afford to plant a crop this year. In my time on this board, our families and communities have suffered from chronic uncertainty. A big part of that uncertainty has been lifted here today through the efforts of the federal government and for that we are eternally grateful.”

For Finley, the announcement was the culmination of 4.5 years of work. She has been “hounding” Ritz about a tobacco buyout from the time she was a candidate and Ritz was the party’s agriculture critic.

“Today our collective efforts are being rewarded,” she said.

Finley wanted a solution that wouldn’t pit farmer against farmer and would work for those who want to continue to grow tobacco, those who want to retire from farming and those who want to transition to another crop.

“It will bring closure to a challenging situation that’s never been addressed,” Ritz said.

The next challenge for the board is convincing provincial Agriculture Minister Leona Dombrowsky to come up with the province’s 40 per cent share. Vandendriessche said they have had a good working relationship in the past.

Finley said Ritz has already spoken to Dombrowsky and encouraged the province to step up with their share. Finley said Ontario would get \$157 million out of the settlement with tobacco companies.

“They do have the resources to put towards tobacco farmers,” she said. “The question is will they have the will?”

Haldimand-Norfolk MP Toby Barrett encouraged farmers to contact the province to encourage that government to provide their share. He saw no reason for the province not to come up with the money.

“The province in the past has indicated they will follow the federal lead,” he said.

The quota program will also help the tobacco board in its negotiations for the 2008 crop. Asked about the future of tobacco growing moving forward, Vandendriessche said that will be determined in the months and weeks ahead. She said the board only found out the details the same time as the farmers and members haven’t had a chance for any discussions.

Preston, who has led an economic task force with area mayors charged with finding ways to revive the economy of the region, was glad to have \$15 million set aside for community development. He wouldn’t speculate on how the money would be spent, saying that was a decision that would involve the mayors of the five communities, but he expected it would be spent quickly.

Norfolk Mayor Dennis Travale was happy for the farmers and that the community was receiving money.

“Madame Minister Finley made a promise and she kept it,” he said. “I’m very happy for tobacco farmers and their families and they can start to plan for the future.”

Tillsonburg Mayor Stephen Molnar has been a vocal advocate of helping tobacco producers, as well as tobacco communities. He was impressed the government came to the table with solutions.

Tillsonburg District Chamber of Commerce president Mike Bossy was hoping the announcement would help communities through the transition money and producers opening their purse strings.

“It takes a big burden off tobacco producers,” he said. “They should be ecstatic about the announcement.”

TAB 2

**LETTER TO THE TOBACCO BOARD
INTRODUCING THE RESTRICTIONS**



Agriculture and
Agri-Food Canada

Agriculture et
Agroalimentaire Canada

Farm Financial Programs
Branch

Direction générale des programmes
financiers pour l'agriculture

Your file Votre référence

LOB 131406

Our file Notre référence

Mrs. Linda Vandendriessche
Chair of the Board
Head Office
Ontario Flue-Cured Tobacco Grower's Marketing Board
P.O. Box 70, 4 Elm Street
Tillsonburg, ON N4G 4H4

Dear Mrs. Vandendriessche:

I am writing in response to your questions regarding the type of business arrangements into which Tobacco Transition Program (TTP) participants could enter, to rent their land and equipment or provide loans, without undermining the intent of the TTP.

As you know, TTP participants committed "*not to acquire, rent or obtain any right to produce or market flue-cured tobacco in Canada either directly or indirectly*". As well, the primary intent of the TTP is to help tobacco producers exit the tobacco industry.

As discussed during our April 8, 2009 conference call, the Government of Canada expects the Ontario Flue-Cured Tobacco Growers' Marketing Board to ensure that TTP participants honour their obligations under the TTP Application Form and that licensees do not contravene the intent of the program. Answers to some specific questions that you submitted to us regarding the future involvement of TTP participants with tobacco producers are provided below. However, there are multiple business arrangements, family situations and personal circumstances. As the body delegated by the province to issue licenses, we expect that the Ontario Flue-Cured Tobacco Growers' Marketing Board can issue licenses in respect of the spirit of our agreement.

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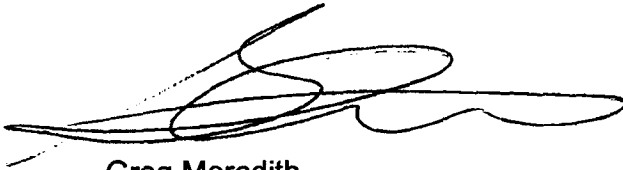
Canada

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Given the above, I encourage the Ontario Flue-Cured Tobacco Growers' Marketing Board to fulfil its mandate, request the necessary applicant information and evaluate every license application with due diligence and reasonable judgment to determine whether the applicant and his/her business arrangements meet your licensing regulations and do not undermine the intent of the TTP.

I trust that this information will be of assistance to you.

Sincerely,

A handwritten signature in black ink, appearing to read 'Greg Meredith', with a long horizontal flourish extending to the left.

Greg Meredith

Assistant Deputy Minister

Attachment

Answers to Specific Scenarios:

- 1. Can a TTP recipient, who has rented out his land and infrastructure to a licensee, pay bills for the day-to-day tobacco operation (fertilizer, chemicals, labour etc.?). Would it be necessary for the reimbursement of these costs to be documented in an agreement?**

No. TTP participants cannot pay for day-to-day tobacco operations. Paying for day-to-day tobacco operations would constitute an involvement in the operation of the production of tobacco that would be contrary to the intents and purposes of the TTP

Proper rental contracts will have to be in place to demonstrate that the land is being rented at a fair market value, comparable to rental rates for other agricultural land in the area. The rental cost will have to be determined upfront and not be tied to profits or losses related to the tobacco crop production. The rental contract could not include any reduction in the payment in the event that the tenant incurs a loss from tobacco production. Documents must be available to provide evidence that income received by TTP participants is from rental.

Furthermore, to ensure that the intent of the TTP is not undermined, license holders cannot rent the land of a:

- family member, who participated in the TTP; or
- business entity in which he/she previously had an ownership relationship with and which participated in the TTP (ownership interest greater than 10%).

- 2. Can a TTP recipient work for the licensee who has rented his land and equipment?**

No. A TTP participant can lease his land to a license holder (with restrictions listed above) and/or can work as an employee of another license holder on another tobacco farm, but he/she cannot rent his/her land and work as an employee for the license holder renting that same land.

As per the TTP fact sheet, a TTP participant can become an employee of another tobacco business entity if he/she does not have any direct or indirect interest in the ownership of this business entity for which he/she will be working. A contract will be required, demonstrating that the TTP applicant is hired as an employee and receives a salary.

Note that the employment agreement will have to demonstrate that a TTP participant is receiving a reasonable salary and payment to the employee is

not related to the profit and loss from tobacco production revenue. The salary would need to be comparable to what others would receive for similar work.

3. Could a TTP recipient, have an employment contract with the licensee which would allow the TTP recipient to make day to day decisions on the tobacco farming operation?

Yes. As per the TTP fact sheet, if a TTP participant is clearly hired as an employee, including an employee occupying a management position (and does not have an ownership interest), this would be acceptable on someone else's land only. The employment/management agreement will have to demonstrate that a TTP participant is receiving a reasonable salary and payment to the employee is not related to the profit and loss from tobacco production revenue. The salary would need to be comparable to what others would receive for similar work.

4. Can a TTP recipient loan money to a licensee?

No. To ensure that the intent of the TTP is not undermined, a TTP participant cannot loan money to a license holder for the purpose of producing tobacco.

5. Can a TTP recipient co-sign at the bank for a loan to a licensee for the production of tobacco?

No. By co-signing, the TTP participant would enter into tobacco production by becoming liable for a debt associated with tobacco production, and would be in a position to effectively pay the debt and thereby transfer the TTP assistance to the new licensee.

6. The son of a TTP recipient wants to apply for a licence. He did not take TTP and wishes to rent the parents land and infrastructure to grow a crop. Is this "relationship" and situation acceptable?

No. See the answer to Question 1.

7. Is a shareholder with ownership of less than 10% eligible for a license?

Yes. As per other TTP documents, principals of a business entity holding 10% ownership or less did not have to participate in the TTP. Therefore, unless they participated in the TTP, they are not subject to the TTP restrictions.

TAB 3

**LETTER TO THE EDITOR
COMPLAINING ABOUT THE RULES' CHANGE**

PUBLICATION: Simcoe Reformer
DATE: 2009.05.04
EDITION: Final
SECTION: Editorial/Opinion
PAGE: 4
COLUMN: Letters to the Editor
WORD COUNT: 512

Letters to the editor

GOVERNMENT WRONG TO CHANGE BUYOUT RULES

Open letter to the Honourable Gerry Ritz and the Honourable Diane Finley

Tobacco farming has been a dynamic economic driver in Norfolk County and the surrounding region for many decades. While its economic impact has eroded in recent years it would be a mistake to overlook its ongoing contribution. For this reason the Simcoe and District Chamber of Commerce has been closely monitoring the Tobacco Transition Program (TTP).

The purpose of this letter is to convey our extreme concern over the changing TTP rules, which threaten \$60 million to \$80 million of direct annual agricultural business in our community.

Owners of tobacco quota had until March 23, 2009 to decide whether to participate in the TTP. At that time the guidance provided by Agriculture Canada was relatively straightforward: Those who participated in the TTP could no longer produce tobacco. Shockingly, after the deadline for participation had passed Agriculture Canada changed the rules -- and not insignificantly.

Under the new rules, TTP participants are not permitted to rent their farms to their children, lend them money or guarantee their loans. They are also barred from working for anyone who rents their land.

Regardless of the product or circumstance, this is not the way policy should be developed or implemented. It is unfair and disrespectful. These changes affect real people with real families and real businesses within our community.

It is also a dangerous precedent to set. When dealing with government when will people know when a deal is really a deal? When can government guidance be relied upon when making fundamental business and life decisions? It is crucial that those affected can rely

on the word of the government. The substantial changes made to the TTP undermine this trust.

The stated intention of the TTP was to allow the industry to reposition itself and allow tobacco farmers to transition out of the industry. The changing rules are inconsistent with these objectives and unnecessarily risk the survival of an industry, which makes a significant contribution to our local economy.

We ask for your assistance in reviewing the TTP program and rethinking the recent changes to ensure that the deal made is the deal delivered. Failure to take such action will be to the detriment of government trust and will have harmful economic implications to our community at a time when we can least afford it.

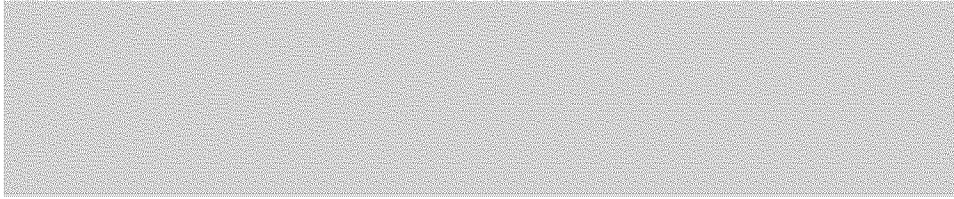
Gordon Malo

President

Simcoe & District

Chamber of Commerce

TAB 4



s.14(a)

s.23

s.14(a)

s.23

000963

s.14(a)

s.23

s.19(1)

s.23

s.19(1)

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s.19(1)

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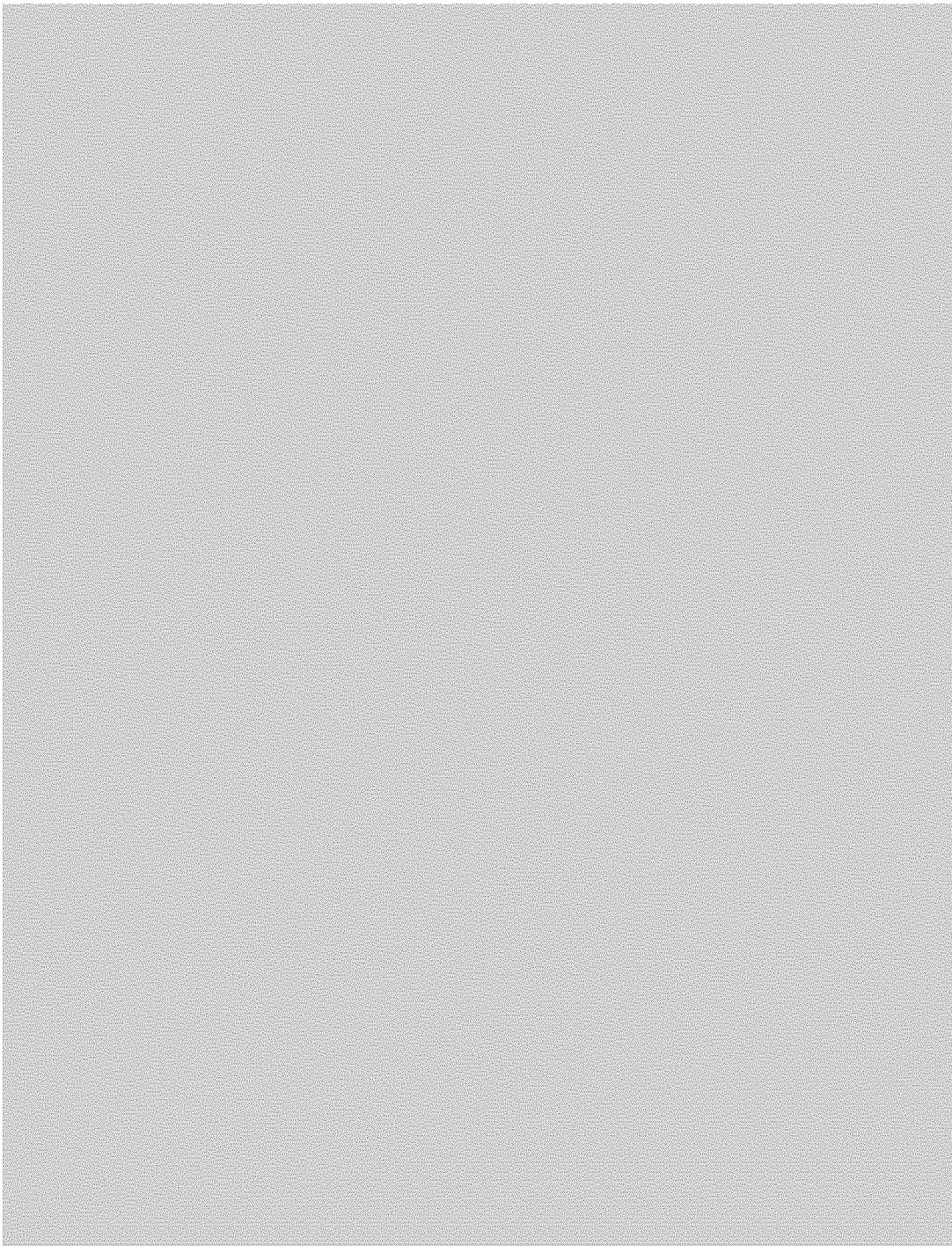
TAB 5

**SIGNED BRIEFING NOTE
APPROVING THE BUSINESS ARRANGEMENTS
PRINCIPLES**

s.21(1)(a)

s.21(1)(b)

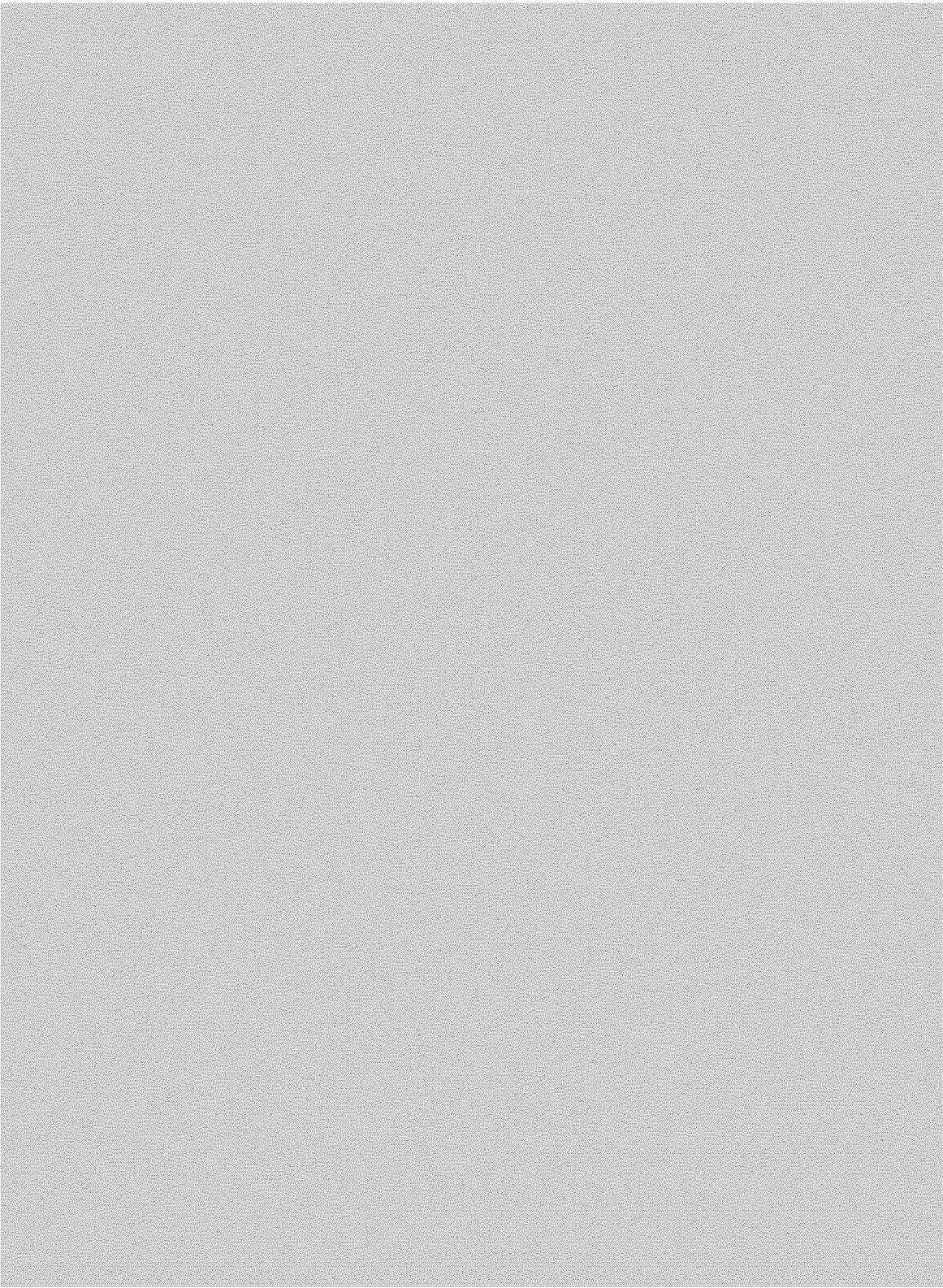
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s.21(1)(a)

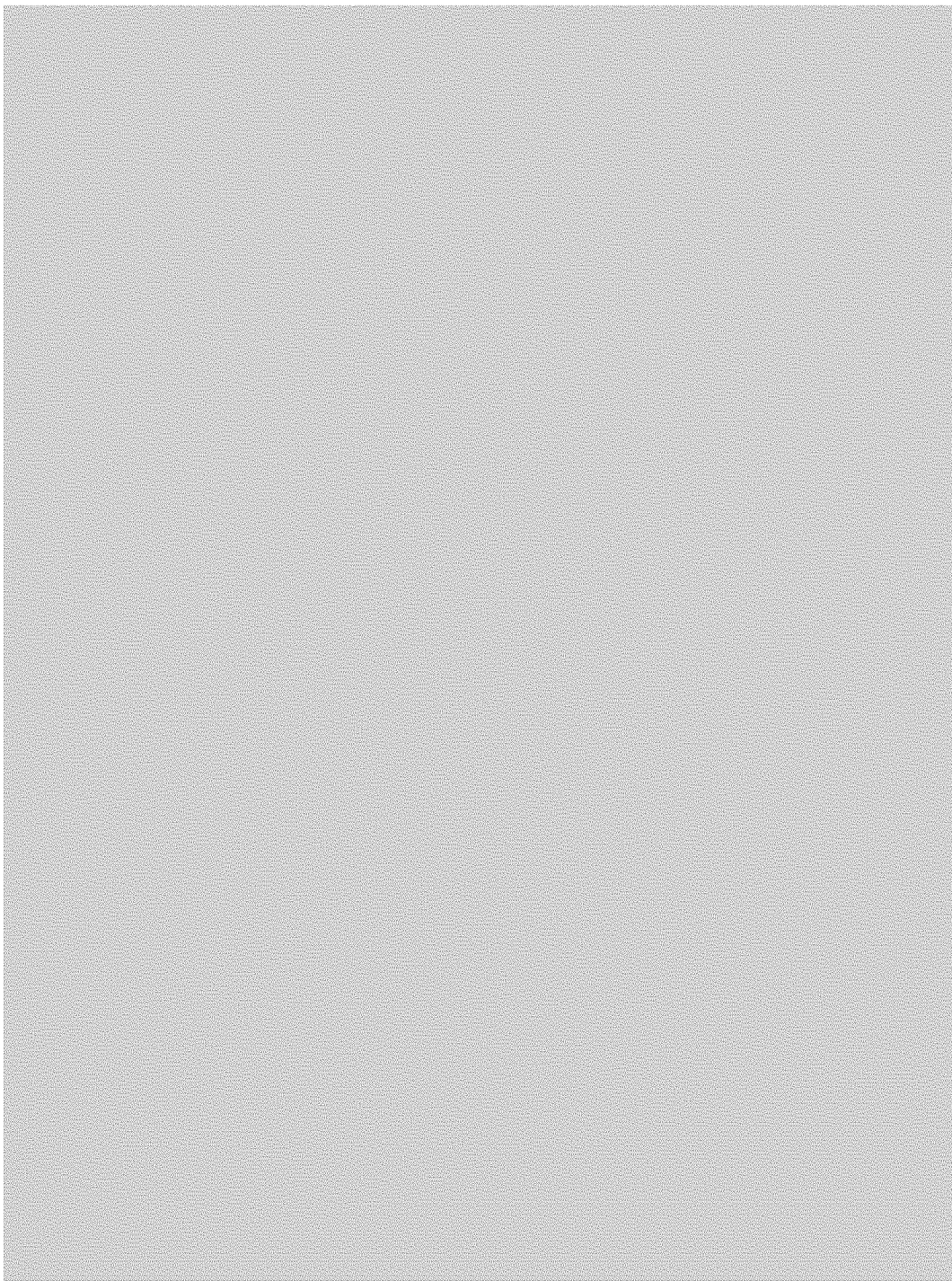
s.21(1)(b)

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s.21(1)(a)

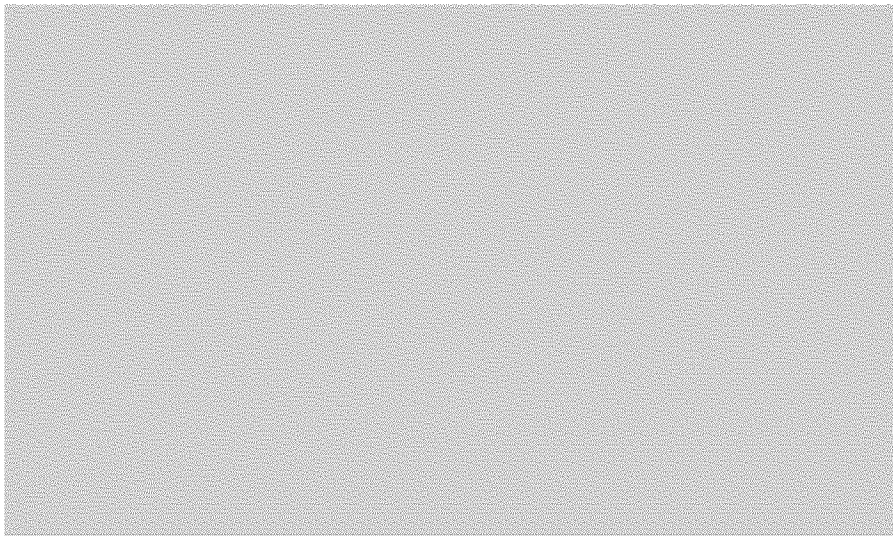
s.21(1)(b)



s.21(1)(a)

s.21(1)(b)

s.23



TAB 6

**LETTER TO THE TOBACCO BOARD
ON THE CLARIFICATIONS ON
ACCEPTABLE BUSINESS ARRANGEMENTS**



Agriculture and
Agri-Food Canada

Assistant Deputy Minister
Farm Financial Programs
Branch

Ottawa, Ontario
K1A 0C5

Agriculture et
Agroalimentaire Canada

Sous-ministre adjoint
Direction générale des programmes
de financement agricoles

Ottawa (Ontario)
K1A 0C5

Your file *Voire référence*

LOB 132893

Our file *Notre référence*

MAY 07 2009

Mrs. Linda Vandendriessche
Chair of the Board
Head Office
Ontario Flue-Cured Tobacco Grower's Marketing Board
P.O. Box 70, 4 Elm Street
Tillsonburg, ON N4G 4H4

Dear Mrs. Vandendriessche:

I am writing in response to your questions regarding the type of business arrangements that Tobacco Transition Program (TTP) participants could enter into without undermining the intent of the TTP.

First, I would like to confirm that the TTP rules continue to be in effect. Business arrangements between TTP participants and licence holders who are related will not be acceptable unless they can demonstrate to the Ontario Flue-Cured Tobacco Grower's Marketing Board that their business arrangements are at arm's length and respect the following principles:

- TTP participants do not acquire, rent or obtain any right to produce or market flue-cured tobacco in Canada, either directly or indirectly.
- A TTP participant is not a "principal" (e.g. an owner, partner, shareholder) of a tobacco growing enterprise.
- Business relationships and business arrangements between a TTP participant and a licensee are at arm's length and transparent. In particular:
 - There is a written agreement between the TTP participant and licensee with terms consistent with a genuine commercial transaction;

.../2

Canada

000980

- Payments from a licensee to a TTP participant are based on fair market value or current market rates for services and are not based on profits or losses from the tobacco production; and
- A TTP participant will have the documentation to withstand an audit of his or her business relationships and arrangements with a licensee.

Therefore, unless a TTP participant can demonstrate that such arrangements would not contravene the intent of the TTP, a TTP participant cannot rent his or her land and equipment to a family member who produces tobacco on that land; provide a loan or co-sign a loan for a tobacco producer; and cannot both rent land and become an employee of a tobacco farm on that land.

Based on these principles, if a TTP participant provides documentation to demonstrate to the Ontario Flue-Cured Tobacco Grower's Marketing Board that he or she has a business relationship or arrangement with a licensee that is at arm's length, where payments received from the licensee for rent or wages are at fair market value and are not based on profits or losses from tobacco production, then the TTP participant could rent land and/or equipment to a family member; rent land to and become an employee of a licensee; and/or loan or co-sign a loan for a licensee.

I would also like to note that Agriculture and Agri-Food Canada intends to audit the TTP and its participants.

I trust that this information will be of assistance to you, TTP participants and license holders, and, as such, I expect you to distribute the contents of this letter to all potential growers and advisors.

Sincerely,

A handwritten signature in black ink, appearing to read 'Greg Meredith', with a long horizontal flourish extending to the right.

Greg Meredith

TAB 7

**BALANCED MEDIA COVERAGE OF THE
PRINCIPLES ON ACCEPTABLE
BUSINESS ARRANGEMENTS**

Feds change tobacco license eligibility requirements

Former growers' family members now permitted to try their hand in the industry

Better Farming

© AgMedia Inc.

by SUSAN MANN

May 15, 2009

Agriculture and Agri-Food Canada's changes to some of the eligibility requirements for tobacco licenses means children or other family members of growers who took the federal buyout can now try their hand in the industry.

And those people still have time to get their licenses as the application deadline was extended to May 22 from May 15. But potential growers are also facing a tight deadline to prepare land for planting.

Linda Vandendriessche, chair of the Ontario Flue-Cured Tobacco Growers' Marketing Board, says "fumigants have to go on the soil at a particular time of year and it's getting very, very late."

Former West Lorne-area tobacco farmer Harry Vergeer says extending the deadline for license applications "allows for the crop size to be a bit larger than it would have been if the extension hadn't been put in place."

Vergeer and his brothers have grown tobacco for 42 years and have now switched to corn, soybeans and wheat. He's taken the federal tobacco buyout but his son, Mark, is looking to enter the industry.

"He will be the owner of the (tobacco) crop and we will be helping him," Vergeer says.

This is "about transition from one generation to the next," he adds. "That was the principle of the program – to help tobacco farmers leave the industry and reposition the industry in moving forward."

Vandendriessche says the board changed the deadline for the license applications after the federal government lifted restrictions May 7 prohibiting family members of farmers participating in the Tobacco Transition program from growing tobacco on their family's land.

But the family member getting the license must rent the land and equipment from their family. "It has to be a business deal, at arm's length and all documented according to government guidelines," she says.

The board challenged the previous prohibition on family members from being able to obtain a license. "The Tobacco Transition program recipient gave up his right to grow," she says. "He did not give up his right to manage his farm."

So far, about 70 people have received licenses. This year's crop size won't be known until after the May 22 license application deadline.

License applications are available at the board office in Tillsonburg. The fee is \$100 for the license plus a one-cent-a-pound assessment that goes to the tobacco board for its operations. The \$100 is deducted off of the assessment, Vandendriessche says. The license has to be renewed annually.

If a grower can't find a company willing to buy his or her product, they can't grow that year. "This is tobacco and there is still legislation and regulations that have to be followed for growing the crop," she says.

More information about the license applications is available from the board office at (519) 842-3661. BF