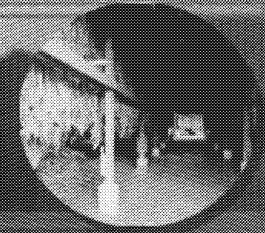
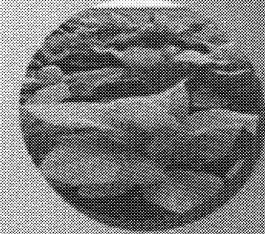


Agriculture and  
Agri-Food Canada

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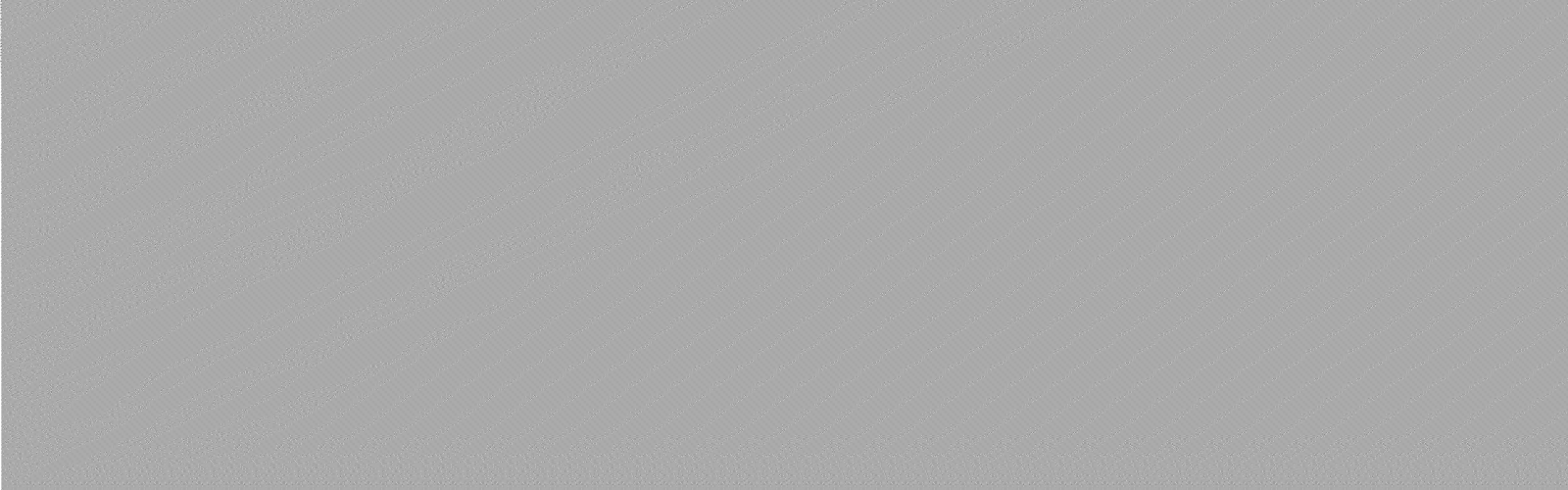


# Tobacco Transition Program (TTP)

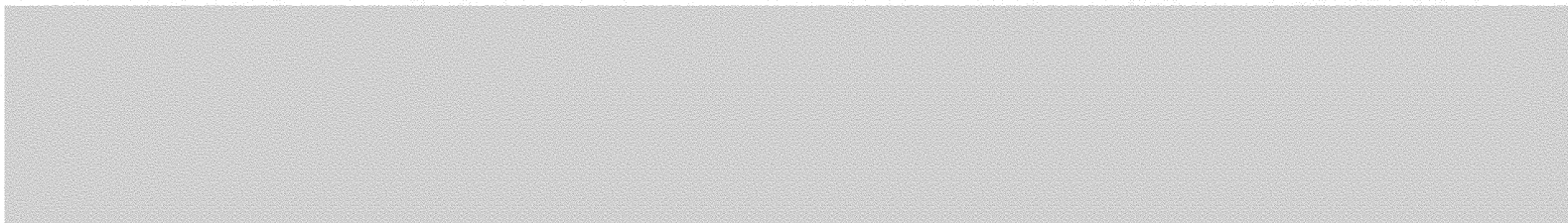
*Program Objectives, Rules and Audit/Evaluation  
Results*

MIN-DM Meeting  
June 3, 2010

# The design of the TTP

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- The expected outcomes were to move from an outdated marketing system to a free-market environment with a provincial licensing system for the purpose of monitoring where legal tobacco is being grown. (see Annex for results)

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- The FA clearly identifies these three objectives (Clause 2.2 of the FA).

# Established responsibilities between parties

The FA and the TTP application form established responsibilities for TTP participants and the Tobacco Board.

Responsibilities of TTP participants:

- Agree not to acquire, rent or obtain any right to produce or market flue-cured tobacco in Canada (i.e. not entitled to a license in Ontario).

Responsibilities of the Tobacco Board:

- Deliver the TTP on behalf of AAFC;
  - Remove the outdated marketing system and introduce a licensing system;
  - Ensure that no license is granted to a TTP participant; and
  - Ensure that no license is granted to any person whose relationship with a TTP participant is such that granting a license would undermine the intent of the TTP.
- AAFC advised that these included:
- » Spouse and dependent children of a TTP participant;
  - » Owner with 10% or more ownership of a business that participated in the TTP; and
  - » Individuals with relationships that would undermine the intent of the TTP.

# Principles were developed to define acceptable business arrangements

- [REDACTED]
- AAFC developed principles that TTP participants could follow to ensure that their business arrangements with a family member producing tobacco or another tobacco producer would not undermine the intent of the TTP.

## Principles for Acceptable Business Arrangements

- Based on income tax approach
- The restrictions hold unless business arrangements with licensees are:
  - at arms' length;
  - fair market value (FMV); and
  - can sustain an audit.
- The principles are providing TTP participants with the freedom they need to continue to make a living and/or transfer the farm to the next generation while upholding the intent of the TTP.

# AAFC initiated an audit evaluation in 2010

- Verify the process the Tobacco Board has to issue licenses within the terms of our agreement (recipient audit).
- Verify that business arrangements between TTP participants and licensees are meeting the conditions of the TTP.
  - Selected 56 licensees with 65 declared business arrangements from the 118 licensees.
  - Received information from 53 licensees with 101 business arrangements which were all verified (70% of all the known business arrangements)
    - 48% of the business arrangements were between non-related individuals
- Evaluate if the TTP met its objective of helping quota holders to exit and current producers to be viable.
- Assess the risk that TTP participants produce tobacco through unacceptable business arrangements.

# The auditors' findings on the Tobacco Board

- “In general, the processes and controls in place at the Board for the management of the issuance of licenses appear adequate and effective.”  
– TTP Audit Evaluation Report, Samson & Associates.
- The Tobacco Board did not issue licenses to non-eligible individuals or businesses.
- The Tobacco Board could improve the application documentation and verification procedure to capture all business arrangements.

## **Auditor's Recommendations to the Tobacco Board:**

1. That the Board clarify the licensee forms to ensure that all business arrangements are declared.
2. That the Board use the information it has to verify the eligibility of the shareholders of a business seeking a license.
3. That the Board establish a process to collect sufficient data on business arrangements on license applications and after the growing season to confirm that all arrangements are being entered into at Fair Market Value (FMV).

# The auditors' findings on business arrangements

- The audit of 101 business arrangements between Licensees and TTP participants found:
  - Five business arrangements between licensees and TTP participants in 2009 appear not to be meeting the Fair Market Value (FMV) test.
    - One is between non-related parties.
  - There was a lack of information about what can be charged for land, building and equipment rental in 2009 (wages were more similar).
    - This resulted in a wide range of prices and a high net profit for licensees (over \$2,000 per acre).
    - The prices for these inputs are expected to increase now that owners know the profits made by licensees and that their land and equipment are worth more. Consequently, the range of FMV should become narrower.
- The auditor determined that the likelihood that non-acceptable business arrangements exist is low.

## **Auditor's Recommendations to AAFC:**

4. Follow-up with the 3 licensees in the audit sample who did not participate in the audit.
5. Determine Fair Market Values for 2010.

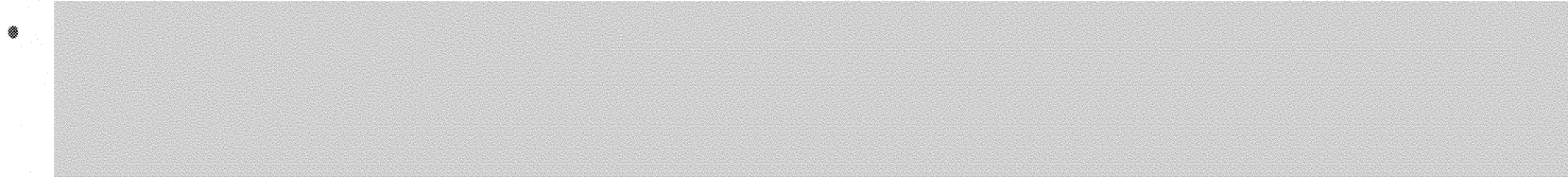
## The auditors' evaluation of the program

- “The objective to transition TTP participants to other crops is not as far advanced as the objective to strengthen the viability of remaining and future tobacco producers.”
  - In 2009, 74% of the TTP participants who were producing tobacco grew another crop (mainly what used to be their rotational crops).
  - However, this percentage is expected to decline in 2010.
- “Preliminary data indicates that the licensees are benefiting from the current regime”.
  - The program was successful at increasing the viability of producers.
  - Profit of licensees increased as they no longer have to incur the cost associated with the quota. This was particularly beneficial to share-growers who had land and equipment, but had been renting quotas for many years.
- “The communications related to the overall program objectives to the various interest groups may have been deficient”.
  - Auditors found that various industry interest groups had a different understanding of the TTP's objectives.



## Findings to be followed-up

- AAFC will write to the Tobacco Board, the Ontario Farm Products Marketing Commission and the Ontario Ministry of Agriculture, Food and Rural Affairs
  - AAFC will share a copy of the final audit report.
  - The Board will be asked to implement the four recommendations and to follow-up on the five business arrangements which appear not to be at FMV and take appropriate corrective measures if findings are confirmed.
  
- AAFC decided to expand and extend the audit :
  - audit the three licensees in the original sample who did not provide information to the audit on time.
  - audit additional 2009 arrangements, audit 2010 arrangements and help to determine the FMV for 2010.
    - Over the next 6 months the auditor will audit an additional 100 business arrangements.
    - Information on tax statements for 2009 will be available.
    - Information on 2010 will help AAFC and the auditor confirm expected trends for FMV.
    - Will allow for the establishment of 2010 FMV.
  
- AAFC needs to communicate on findings and actions taken



# Communications approach

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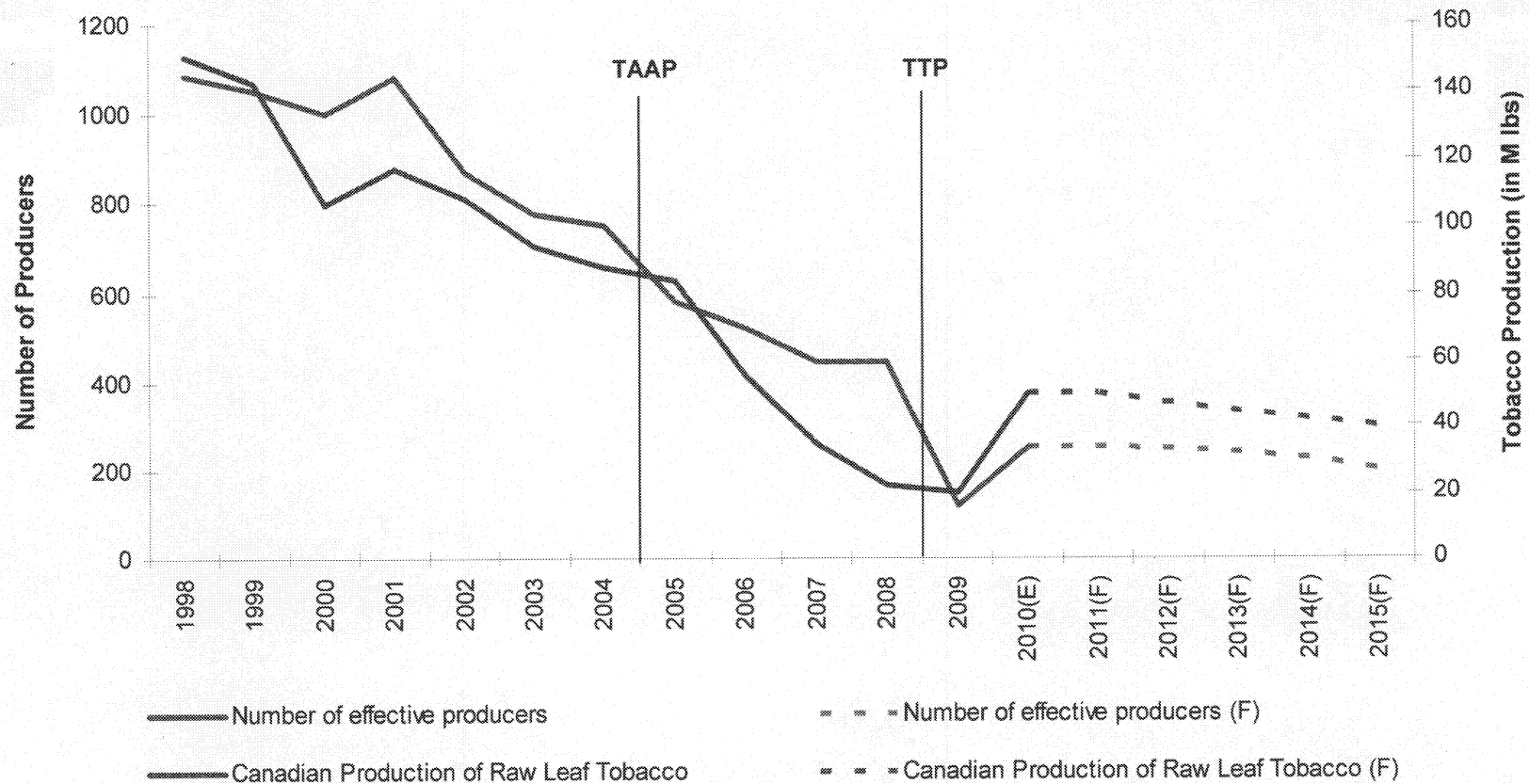
- Continue responsive, low-key approach
- Highlight positive findings in audit report and follow-up actions in communications products (Media Lines, QP Card)
- Draft letter for elected officials to respond to constituents
- Draft Letter to the Editor to respond to possible media stories
- Prep departmental spokesperson

# ANNEX - Results

<b>Quota holders who participated in the TTP in 2008</b>	1,044	Payment: \$284,229,440.69 (\$1.05 per lbs of quota retired). The TTP retired 270,478,113 lbs of quota (about 99.6% of the quota) All quota disappeared with the implementation of the provincial licensing system. All TTP participants received their payment by May 1st, 2009.		
<b>Active producers in 2008</b>	446	11 who held quota and did not participate in the TTP 7 were share-growers and did not hold quota		
<b>Active producers in 2009</b>	118	18 remaining producers (see above) 100 new producers		
<b>Number of licenses in 2009</b>	123			
<b>Number of known business arrangements in 2009</b> <small>(based on auditors findings)</small>	145 <small>(101 were audited)</small>	8% with non-TTP participants		
		92% with TTP participants	53% with relatives	37% between parents & non-dependent children
			39% with non-relatives	

# ANNEX - Production Trends

- Canadian producers are now capturing a larger share of the declining Canadian market.



(E) Estimated based on 2010 licenses issued.

(F) Forecast based on The Ontario Flue-Cured Tobacco Growers' Marketing Board statement on the state of the industry and the 10-year average downward trend in Canadian sales of cigarettes and fine-cuts calculated based on Health Canada's Canadian Tobacco Use Monitoring Survey (CTUMS) 2008.