

# Notes to the Consolidated Financial Statements

December 31, 2007

(\$ millions except where otherwise indicated)

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and are reported in Canadian dollars.

### Basis of Consolidation

The consolidated financial statements include the accounts of George Weston Limited (“Weston”) and its subsidiaries (collectively referred to as the “Company”) with provision for minority interest. Weston’s interest in the voting share capital of its subsidiaries is 100% except for Loblaw Companies Limited (“Loblaw”), which is 61.9% (2006 – 61.9%). In addition, the Company consolidates variable interest entities (“VIEs”) pursuant to the Canadian Institute of Chartered Accountants (“CICA”) Accounting Guideline 15, “Consolidation of Variable Interest Entities”, (“AcG 15”), that are subject to control by Loblaw on a basis other than through ownership of a majority of voting interest. AcG 15 defines a variable interest entity as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest. AcG 15 requires the primary beneficiary to consolidate VIEs and considers an entity to be the primary beneficiary of a VIE if it holds variable interests that expose it to a majority of the VIE’s expected losses or that entitle it to receive a majority of the VIE’s expected residual returns or both.

### Fiscal Year

The Company’s year end is December 31. Activities are reported on a fiscal year ending on the Saturday closest to December 31. As a result, the Company’s fiscal year is usually 52 weeks in duration but does include a 53rd week every five to six years. Each of the years ended December 31, 2007 and December 31, 2006 contained 52 weeks.

### Revenue Recognition

Weston Foods recognizes sales upon delivery of its products to customers and acceptance of its products by customers net of provisions for returns, discounts and allowances. Loblaw sales include revenues, net of estimated returns, from customers through corporate stores operated by Loblaw and independent franchisee stores that are consolidated by Loblaw pursuant to AcG 15. In addition, sales include sales to and service fees from associated stores and independent account customers and franchised stores excluding VIE stores net of sales incentives offered by Loblaw. Loblaw recognizes revenue at the time the sale is made to its customers.

### Earnings per Share (“EPS”)

Basic EPS is calculated by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted EPS is calculated using the treasury stock method, which assumes that all outstanding stock options with an exercise price below the average market price during the year are exercised and the assumed proceeds are used to purchase Weston’s common shares at the average market price during the year.

### Cash, Cash Equivalents and Bank Indebtedness

Cash equivalents consist primarily of highly liquid marketable investments with a maturity of 90 days or less. The Company has the ability and intent to offset cash balances to reduce reported bank indebtedness, except for VIEs consolidated by the Company. Commencing January 1, 2007, cash equivalents are either designated as held-for-trading financial assets or are classified as available-for-sale financial assets, and carried at quoted market value. See note 2 for more information.

Prior to January 1, 2007, cash equivalents were carried at the lower of cost or quoted market value.

### Short Term Investments

Short term investments consist primarily of government treasury bills and treasury notes, government-sponsored debt securities, corporate commercial paper and bank term deposits. Commencing January 1, 2007, short term investments are either designated as held-for-trading financial assets or are classified as available-for-sale financial assets, and carried at quoted market value. See note 2 for more information.

Prior to January 1, 2007, short term investments were carried at the lower of cost or quoted market value.

## Notes to the Consolidated Financial Statements

### Credit Card Receivables

The Company, through *President's Choice Bank* ("PC Bank"), a wholly owned subsidiary of Loblaw, has credit card receivables that are stated net of an allowance for credit losses. Any credit card receivable with a payment that is contractually 180 days in arrears, or where the likelihood of collection is considered remote, is written off. Interest income on credit card receivables is recorded on an accrual basis and is recognized in operating income.

### Allowance for Credit Losses

PC Bank maintains an allowance for probable credit losses on aggregate exposures for which losses cannot be determined on an item-by-item basis. The allowance is based upon a statistical analysis of past and current performance, the level of allowance already in place and management's judgment. The allowance for credit losses is deducted from the credit card receivables balance. The net credit loss experience for the year is recognized in operating income.

### Securitization

PC Bank securitizes credit card receivables through the sale of a portion of the total interest in these receivables to independent trusts and does not exercise any control over the trusts' management or assets. PC Bank does retain certain servicing and administrative responsibilities. The credit card receivables are removed from the consolidated balance sheet when PC Bank has surrendered control and are considered sold for accounting purposes pursuant to Accounting Guideline 12, "Transfers of Receivables". When PC Bank sells credit card receivables in a securitization transaction, it has a retained interest in the securitized receivables represented by the rights to future cash flows after obligations to investors have been met. Although PC Bank remains responsible for servicing all credit card receivables, it does not receive additional compensation for servicing those credit card receivables sold to the trusts and accordingly a service liability is recorded. The service liability is recorded at fair value. In the absence of quoted market rates for servicing securitized assets, fees payable to a replacement servicer, in the event that a replacement servicer was to be appointed, formed the basis of determination of fair value of the servicing liability. Gains or losses on the sale of these receivables depends, in part, on the previous carrying amount of receivables involved in the securitization, allocated between the receivables sold and the retained interest, based on their relative fair values at the date of securitization. The fair value is determined as the best estimate of the net present value of expected future cash flows using management's best estimates of key assumptions such as monthly payment rates, weighted average life, expected annual credit losses and discount rates. Any gain or loss on a sale is recognized in operating income at the time of the securitization. Commencing January 1, 2007, retained interests are designated as held-for-trading financial assets (see note 2) and are recorded at fair value on the consolidated balance sheet. Prior to January 1, 2007, the carrying value of retained interests was periodically reviewed and when a decline in value was identified as other than temporary, the carrying value was written down to fair value.

### Vendor Allowances

The Company receives allowances from certain of its vendors whose products it purchases. These allowances are received for a variety of buying and/or merchandising activities, including vendor programs such as volume purchase allowances, purchase discounts, listing fees and exclusivity allowances. Consideration received from a vendor is a reduction in the cost of the vendor's products or services and is recognized as a reduction in the cost of sales, selling and administrative expenses and the related inventory when recognized in the consolidated statement of earnings and the consolidated balance sheet. Certain exceptions apply if the consideration is a payment for assets or services delivered to the vendor or for reimbursement of selling costs incurred to promote the vendor's products, provided that these costs are separate, incremental and identifiable.

### Inventories (principally finished products)

The Company utilizes the retail method for retail store inventories which are stated at the lower of cost and estimated net realizable value less normal gross profit margin. Distribution centre inventories, seasonal general merchandise and other inventories are stated at the lower of cost and estimated net realizable value. Cost is determined substantially using the first-in, first-out method.

### Fixed Assets

Fixed assets are recorded at cost including capitalized interest. Depreciation commences when the assets are put into use and is recognized on a straight-line basis to depreciate the cost of these assets over their estimated useful lives. Estimated useful lives range from 10 to 40 years for buildings, 10 years for building improvements and from 3 to 16 years for equipment and fixtures. Leasehold improvements are depreciated over their estimated useful life and may include renewal options when an improvement is made after inception of the lease, to a maximum of 25 years, which approximates economic life. Equipment under capital leases is depreciated over the term of the lease.

Fixed assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value exceeds the sum of the undiscounted future cash flows expected from use and eventual disposal. These events or changes in circumstances include a commitment to retire or transfer manufacturing assets for Weston Foods and to close a Loblaw store or distribution centre or to relocate or convert a Loblaw store. Fixed assets are also reviewed for impairment annually. For purposes of annually reviewing assets for impairment, asset groups are reviewed at the lowest level for which identifiable cash flows are largely independent of cash flows of other assets and liabilities. Therefore, Weston Foods manufacturing asset net cash flows are grouped together by major production categories, where cash flows are largely dependent on each other. Loblaw's store net cash flows are grouped together by primary market areas, where cash flows are largely dependent on each other. Primary markets are regional areas where a number of store formats operate within close proximity to one another. If an indicator of impairment exists, such as sustained negative operating cash flows of the respective asset group, then an estimate of undiscounted future cash flows of each such major production category for Weston Foods, or each such store for Loblaw, within this group is prepared and compared to its carrying value. For purposes of annually reviewing Loblaw's distribution centre assets for impairment, distribution centre net cash flows are grouped with the respective net cash flows of the stores they service. An impairment in the Loblaw store network serviced by the distribution centre would indicate an impairment in the distribution centre assets as well. If Weston Foods or Loblaw's assets are determined to be impaired, the impairment loss is measured as the excess of the carrying value over fair value. In addition, the carrying value of fixed assets is evaluated whenever events or changes in circumstances indicate that the carrying value of fixed assets may not be recoverable. For Loblaw, these events or changes in circumstances include a commitment to close a store or distribution centre or to relocate or convert a store where the carrying value of its assets is greater than the expected undiscounted future cash flows.

#### **Deferred Charges**

Deferred charges are amortized over the related assets' estimated useful lives, to a maximum of 15 years.

#### **Goodwill and Intangible Assets**

Goodwill represents the excess of the purchase price of a business acquired over the fair value of the underlying net assets acquired at the date of acquisition. Other intangible assets are recorded at fair value at the date of acquisition. Goodwill is not amortized and is assessed for impairment at the reporting unit level at least annually. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting unit exceeds its fair value, a more detailed goodwill impairment assessment must be undertaken. A goodwill impairment charge is recognized to the extent that, at the reporting unit level, the carrying value of goodwill exceeds the implied fair value.

The Company determines the fair value of its reporting units using a discounted cash flow model corroborated by other valuation techniques such as market multiples. The process of determining these fair values requires management to make estimates and assumptions of a long term nature including, but not limited to, projected future sales, earnings and capital investment, discount rates and terminal growth rates. Projected future sales, earnings and capital investment are consistent with strategic plans presented to the Company's Board of Directors. Discount rates are based on an industry weighted average cost of capital. These estimates and assumptions may change in the future due to uncertain competitive and economic market conditions or changes in business strategies.

Intangible assets with an indefinite life are not subject to amortization and are tested at least annually for impairment. Any potential intangible asset impairment is identified by comparing the fair value of the indefinite life intangible asset to its carrying value. If the fair value of the intangible asset exceeds its carrying value, the intangible asset is considered not to be impaired. If the carrying value of the intangible asset exceeds its fair value, impairment is identified as the difference between the fair value and the carrying value and will result in a reduction in the carrying value of the intangible assets on the consolidated balance sheet and the recognition of a non-cash impairment charge.

The Company determines the fair value of its trademarks and brand names by using the "Relief from Royalty Method", a discounted cash flow model. The process of determining the fair values requires management to make assumptions of a long term nature regarding projected future sales, terminal growth rates, royalty rates and discount rates. Projected future sales are consistent with strategic plans presented to Weston's Board and discount rates are based on an industry after-tax cost of equity. These estimates and assumptions may change in the future due to uncertain competitive and economic market conditions or changes in business strategies. Intangible assets with a finite life are amortized over their estimated useful lives, ranging from 5 to 30 years.

Any impairment in the carrying value of goodwill or intangible assets is recognized in operating income. Additional disclosure regarding the results of the annual goodwill and indefinite life intangible assets impairment tests is provided in note 3.

## Notes to the Consolidated Financial Statements

### Foreign Currency Translation

#### *Self-Sustaining Foreign Operations*

Assets and liabilities of self-sustaining foreign operations denominated in foreign currencies are translated into Canadian dollars at the foreign currency exchange rate in effect at the balance sheet date. The resulting exchange gains or losses on translation are recognized as part of shareholders' equity in accumulated other comprehensive loss. When there is a reduction in the Company's net investment in self-sustaining foreign operations, the proportionate amount of accumulated other comprehensive loss is recognized in net earnings from continuing operations. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the weighted average foreign currency exchange rate for the year.

#### *Other including Loblaw Foreign Operations*

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the foreign currency exchange rate in effect at each balance sheet date. Commencing January 1, 2007, exchange gains or losses arising from the translation of these balances denominated in foreign currencies are recognized in operating income, except for Loblaw's cross currency basis swaps and available-for-sale cash equivalents and short term investments denominated in United States dollars which are designated in a cash flow hedge and are deferred in accumulated other comprehensive loss and reclassified to net earnings when realized. Prior to January 1, 2007, all exchange gains and losses arising from the translation of these assets and liabilities denominated in foreign currencies were recognized in operating income. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the average foreign currency exchange rate for the year.

### Derivative Instruments

The Company uses derivative instruments in the form of cross currency basis swaps, interest rate swaps and equity swaps and forwards to manage its current and anticipated exposure to fluctuations in foreign currency exchange rates, interest rates, and the market prices of Weston and Loblaw common shares. The Company uses financial and non-financial derivative instruments in the form of futures contracts, option contracts and forward contracts to manage its current and anticipated exposure to fluctuations in commodity prices. The Company does not enter into derivative agreements for trading or speculative purposes.

Commencing January 1, 2007, all financial derivative instruments are recorded at fair value on the consolidated balance sheet in accordance with CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement" ("Section 3855").

Non-financial derivative instruments are recorded at fair value on the consolidated balance sheet unless they are exempt from this treatment based upon expected purchase, sale or usage requirements. Embedded derivative instruments are separated from their host contract and recorded on the consolidated balance sheet at fair value. Fair values are based on quoted market prices where available from active markets, otherwise fair values are estimated using valuation methodologies, primarily discounted cash flow analysis. Derivative instruments are recorded in current or non-current assets and liabilities based on their remaining terms to maturity. All changes in fair value of the derivative instruments are recorded in net earnings unless cash flow hedge accounting is applied.

The Company formally identifies, designates and documents the relationships between hedging instruments and hedged items including: Loblaw's cross currency basis swaps and interest rate swaps as cash flow hedges against its exposure to fluctuations in the foreign currency exchange rate and variable interest rates on a portion of its United States dollar denominated cash equivalents and short term investments; and certain commodity futures as a cash flow hedge of anticipated future purchases. The Company assesses whether each derivative instrument continues to be highly effective in offsetting the change in the cash flows of hedged items. If and when a derivative instrument is no longer expected to be highly effective, hedge accounting is discontinued. Hedge ineffectiveness, if any, is included in current year net earnings.

Prior to January 1, 2007, all financial derivative instruments were recorded at fair value on the consolidated balance sheet with the exception of Loblaw's interest rate swaps which were designated in cash flow hedging relationships. These interest rate swaps were not recorded on the comparative consolidated balance sheet. Embedded derivative instruments and certain non-financial derivative instruments were also not recorded on the comparative consolidated balance sheet.

### Exchangeable Debentures

Commencing January 1, 2007, Weston's 3% Exchangeable Debentures ("Debentures") are re-measured at each balance sheet date based on the market price of the underlying shares with any change in value recognized in operating income. These debentures, which were previously designated as a hedge of the anticipated disposal of the Domtar (Canada) Paper Inc. investment, are no longer eligible for hedge accounting as a result of the implementation of CICA Handbook Section 3865, "Hedges" ("Section 3865") (see note 2). Prior to January 1, 2007, hedge accounting was applied and the changes in fair value were deferred on the consolidated balance sheet.

### **Income Taxes**

The asset and liability method of accounting is used for income taxes. Under the asset and liability method, future income tax assets and liabilities are recognized for the future income tax consequences attributable to temporary differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in income tax rates is recognized in income tax expense when enacted or substantively enacted. Future income tax assets are evaluated and a valuation allowance, if required, is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

### **Employee Future Benefits**

The Company sponsors a number of pension plans, including funded defined benefit pension plans, defined contribution pension plans and supplemental unfunded arrangements providing pension benefits in excess of statutory limits. The Company also offers certain employee post-retirement and post-employment benefit plans and long term disability benefit plans. Post-retirement and post-employment benefit plans are generally not funded, are mainly non-contributory and include health care, life insurance and dental benefits. The Company also contributes to various multi-employer pension plans which provide pension benefits.

#### ***Defined Benefit Plans***

The cost and accrued benefit plan obligations of the Company's defined benefit pension plans and other benefit plans, including post-retirement, post-employment and long term disability benefits, are based on actuarial valuations. The actuarial valuations for the defined benefit plans are determined using the projected benefit method prorated on service and management's best estimate of the discount rate, the expected long term rate of return on plan assets, the expected growth rate of health care costs, the rate of compensation increase, retirement ages, termination rates and mortality rates. Actuarial valuations are performed using a September 30 measurement date for accounting purposes. Market values used to value benefit plan assets are as at the measurement date. The discount rate used to value the accrued benefit plan obligation is based on market interest rates as at the measurement date, assuming a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations.

Past service costs arising from plan amendments are amortized over the expected average remaining service period of the active employees. The unamortized net actuarial gain or loss that exceeds 10% of the greater of the accrued benefit plan obligation or the fair value of the benefit plan assets at the beginning of the year is amortized over the expected average remaining service period of the active employees for defined benefit pension and post-retirement benefit plans. The unamortized net actuarial gain or loss for post-employment and long term disability benefits is amortized over periods not exceeding three years. The expected average remaining service period of the active employees covered by the defined benefit pension plans ranges from 6 to 17 years, with a weighted average of 12 years. The expected average remaining service period of the employees covered by the post-retirement benefit plans ranges from 6 to 22 years, with a weighted average of 16 years.

The net accrued benefit plan asset or liability represents the cumulative difference between the cost and the funding contributions and is recorded in other assets and other liabilities.

#### ***Defined Contribution and Multi-Employer Pension Plans***

The costs of pension benefits for defined contribution pension plans and multi-employer pension plans are expensed as contributions are due.

### **Stock Option Plan and Share Appreciation Rights**

The Company recognizes a compensation cost in operating income related to employee stock option grants that will be settled by issuing its common shares. The compensation cost is the fair value of the stock option on the grant date using an option pricing model and is recognized in operating income on a prescribed vesting basis. On the exercise of this type of stock option, the consideration paid by the employee and the related fair value accrual are credited to common share capital. Each stock option granted before 2003 that will be settled by issuing common shares will be accounted for as a capital transaction and no compensation cost is recognized. Consideration paid by employees on the exercise of this type of stock option is credited to common share capital.

## Notes to the Consolidated Financial Statements

The Company recognizes a compensation cost in operating income on a prescribed vesting basis and a liability related to employee stock option grants that allow for settlement in shares or in the share appreciation value in cash at the option of the employee and employee share appreciation right grants that will be settled in cash, using the intrinsic value method. Under the intrinsic value method, the stock-based compensation liability is the amount by which the market price of the common shares at the balance sheet date exceeds the exercise price of the stock options. A year-over-year change in the stock-based compensation liability is recognized in operating income on a prescribed vesting basis.

### Restricted Share Unit (“RSU”) Plan

The Company recognizes a compensation cost in operating income on a prescribed vesting basis for each RSU granted equal to the market value of a Weston or Loblaw common share at the date on which RSUs are awarded to each participant prorated over the performance period and adjusts for changes in the market value until the end of the performance date. The cumulative effect of the changes in market value is recognized in operating income in the period of the change.

### Deferred Share Unit (“DSU”) Plan

Members of Weston’s and Loblaw’s Boards of Directors, who are not management of the Company, may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of DSUs. The DSU obligation is accounted for using the intrinsic value method. Under the intrinsic value method, the DSU compensation liability is the amount by which the market price of the common shares at the balance sheet date exceeds the initial value of the DSU. The year-over-year change in the DSU compensation liability is recognized in operating income.

### Employee Share Ownership Plan

Weston and Loblaw maintain Employee Share Ownership Plans for their employees, which allow employees to acquire Weston’s and Loblaw’s common shares through payroll deductions of up to 5% of their gross regular earnings. Weston and Loblaw contribute an additional 25% of each employee’s contribution to their respective plans, which is recognized in operating income as a compensation cost when the contribution is made.

### Use of Estimates and Assumptions

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts and disclosures made in the consolidated financial statements and accompanying notes. These estimates and assumptions are based on management’s historical experience, best knowledge of current events and conditions and activities that may be undertaken in the future. Actual results could differ from these estimates.

Certain estimates, such as those related to valuation of inventories, goodwill, indefinite life intangible assets, income taxes, Goods and Services Tax (“GST”) and provincial sales taxes (“PST”), employee future benefits and impairment of fixed assets, depend upon subjective or complex judgments about matters that may be uncertain, and changes in those estimates could materially impact the consolidated financial statements.

### Future Accounting Standards

#### *Capital Disclosures and Financial Instruments – Disclosure and Presentation*

In December 2006, the CICA issued three new accounting standards: Section 1535, “Capital Disclosures” (“Section 1535”), Section 3862, “Financial Instruments – Disclosures” (“Section 3862”) and Section 3863, “Financial Instruments – Presentation” (“Section 3863”).

Section 1535 establishes guidelines for the disclosure of information regarding a company’s capital and how it is managed. The standard requires enhanced disclosures with respect to (i) an entity’s objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; and (iii) whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance.

Section 3862 and Section 3863 replace Section 3861, “Financial Instruments – Disclosure and Presentation”. Section 3862 requires increased disclosures regarding the risks associated with financial instruments such as credit risk, liquidity risk and market risks and the techniques used to identify, monitor and manage these risks. Section 3863 carries forward standards for the presentation of financial instruments and non-financial derivative instruments and provides additional guidance for the classification of financial instruments, from the perspective of the issuer, between liabilities and equity.

These standards are effective for fiscal years beginning on or after October 1, 2007 and therefore the Company will implement them in the first quarter of 2008.

### ***Inventories***

In June 2007, the CICA issued Section 3031, "Inventories", that will replace the existing Section 3030 of the same title. The new standard requires inventories to be measured at the lower of cost and net realizable value with more specific guidance of costs to include in the cost of inventory. Costs such as storage costs and administrative overhead that do not contribute to bringing inventories to their present location and condition are specifically excluded from the cost of inventories and expensed in the period incurred. Reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories is now required. The cost of the inventories should be based on a first-in, first-out or a weighted average cost formula. Techniques used for the measurement of cost of inventories, such as the retail method, may be used for convenience if the results approximate cost. The new standard also requires additional disclosures, including the accounting policies used in measuring inventories, the carrying amount of the inventories, amounts recognized as an expense during the period, write-downs and the amount of any reversal of any write-downs recognized as a reduction in expenses.

This standard is effective for fiscal years beginning on or after January 1, 2008 and will be implemented by the Company in the first quarter of 2008 to the opening inventory for the period with an adjustment to opening retained earnings, net of income taxes and applicable minority interest, for the difference in measurement of the opening inventory with no prior periods restated. Loblaw expects to record, upon implementation of this standard, a decrease in the measurement of its opening inventory of less than 4% of its inventory value with a corresponding decrease of less than \$31 to opening retained earnings net of income taxes and minority interest on the consolidated balance sheet. The impact of the Weston Foods adjustment to inventory and retained earnings is not expected to be material to the consolidated balance sheet.

In addition to the changes in the cost of inventory, the Company is reviewing the additional presentation and disclosure requirements which will be required in the consolidated financial statements and/or in the accompanying notes.

### ***Goodwill and Intangible Assets***

In November 2007, the CICA issued amendments to Section 1000, "Financial Statement Concepts", and Accounting Guideline 11, "Enterprises in the Development Stage", issued a new Section 3064, "Goodwill and Intangible Assets" ("Section 3064") to replace Section 3062, "Goodwill and Other Intangible Assets", withdrew Section 3450, "Research and Development Costs" and amended Emerging Issues Committee Abstract 27, "Revenues and Expenditures During the Pre-operating Period" to not apply to entities that have adopted Section 3064. These amendments provide guidance for the recognition of internally developed intangible assets, including assets developed from research and development activities, ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. The amendments are effective for annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008 and therefore the Company will implement them in the first quarter of 2009, retroactively with restatement of the comparative periods for the current and prior years. The impact of implementing these amendments on the Company's financial statements is currently being assessed.

### ***International Financial Reporting Standards ("IFRS")***

The Canadian Accounting Standards Board will require all public companies to adopt IFRS for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Companies will be required to provide IFRS comparative information for the previous fiscal year. The transition from Canadian GAAP to IFRS will be applicable for the Company for the first quarter of 2011 when the Company will prepare both the current and comparative financial information using IFRS. The Company expects the transition to IFRS to impact financial reporting, business processes and information systems. The Company will assess the impact of the transition to IFRS and will continue to invest in training and resources throughout the transition period to facilitate a timely conversion.

### ***Comparative Information***

Certain prior year's information was reclassified to conform with the current year's presentation.

## Notes to the Consolidated Financial Statements

### 2. IMPLEMENTATION OF NEW ACCOUNTING STANDARDS

#### Accounting Standards Implemented in 2007

On January 1, 2007, the Company implemented the CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement" ("Section 3855"), Section 3865, "Hedges", Section 1530, "Comprehensive Income", Section 3251, "Equity" and Section 3861, "Financial Instruments – Disclosure and Presentation". These standards have been applied without restatement of prior periods, with the exception of the reclassification of unrealized foreign currency translation losses on net investments in self-sustaining foreign operations to accumulated other comprehensive loss. All other transitional adjustments resulting from these standards are recognized in the opening balances of retained earnings and accumulated other comprehensive loss.

Section 3855 establishes guidance for recognizing and measuring financial assets, financial liabilities and non-financial derivative instruments. All financial instruments must be classified into a defined category, namely, held-for-trading financial assets or financial liabilities, held-to-maturity investments, loans and receivables, available-for-sale financial assets, or other financial liabilities. The standard requires that financial instruments within scope, including derivative instruments, be included on the Company's balance sheet and measured at fair value, with the exception of loans and receivables, held-to-maturity financial assets and other financial liabilities which are measured at cost or amortized cost. Gains and losses on held-for-trading financial assets and financial liabilities are recognized in net earnings in the period in which they arise. Unrealized gains and losses, including changes in foreign exchange rates on available-for-sale financial assets, are recognized in other comprehensive income until the financial asset is derecognized or impaired, at which time any unrealized gains or losses are recorded in net earnings. Transaction costs, other than those related to financial instruments classified as held-for-trading, which are expensed as incurred, are amortized using the effective interest method.

Section 3855 allows management to elect to measure financial instruments that would not otherwise be accounted for at fair value as held-for-trading instruments with changes in fair value recorded in net earnings provided they meet certain criteria. Financial instruments must have been designated when the standard was implemented or when the new financial instrument was acquired and the designation is irrevocable.

Fair values are based on quoted market prices where available from active markets, otherwise fair values are estimated using valuation methodologies, primarily discounted cash flow analysis.

As a result of the implementation of Section 3855, the following classifications were assumed:

- Cash and cash equivalents and short term investments are designated as held-for-trading with the exception of certain Loblaw United States dollar denominated cash equivalents and short term investments designated in a cash flow hedging relationship, which are classified as available-for-sale financial assets.
- Accounts receivable and other receivables are classified as loans and receivables.
- Investments in equity instruments are classified as available-for-sale, with the exception of Weston's investment in exchangeable shares of Domtar (Canada) Paper Inc., which is designated as held-for-trading.
- Bank indebtedness, commercial paper, accounts payable and certain accrued liabilities, short term bank loans, long term debt and capital lease obligations are classified as other financial liabilities.
- Weston's Debentures, which may be exchanged for common shares of Domtar Corporation, are re-measured at each balance sheet date based on the market price of the underlying shares. Prior to the implementation of Section 3855, the Debentures were accounted for in a hedging relationship, and the changes in fair value were deferred on the consolidated balance sheet. As the Debentures are no longer eligible for hedge accounting under the new standards, gains and losses resulting from the re-measurement are recognized in operating income.

The Company has not classified any financial assets as held-to-maturity.

The above classifications resulted in the following re-measurement impacts:

- The re-measurement of financial assets classified as available-for-sale at fair value resulted in an increase in other assets of \$9, with a corresponding decrease in accumulated other comprehensive loss of \$4 net of income taxes and minority interest.
- As a result of classifying certain Loblaw United States dollar denominated cash equivalents and short term investments designated in a cash flow hedging relationship as available-for-sale, the net unrealized gain previously recognized in retained earnings was reclassified to accumulated other comprehensive loss for an amount of \$9 net of income taxes and minority interest.

- The investment in common shares of Domtar Inc. (“Domtar”, held by the Company prior to the March 7, 2007 transaction concerning Domtar Inc. as more fully described in note 18) and the retained interest held by *PC* Bank in securitized receivables have been designated as held-for-trading and have resulted in a decrease in other assets of \$9 and a corresponding decrease in retained earnings of \$8 net of income taxes and minority interest.
- The re-measurement of financial assets classified as loans and receivables and financial liabilities classified as other liabilities at amortized cost was insignificant, with the exception of the impact of the Debentures. Under the accounting treatment as described above, a transitional adjustment resulted in a decrease of \$11 in long term debt, and a corresponding increase in opening retained earnings of \$7, net of income taxes.

Non-financial derivative instruments must be recorded at fair value on the consolidated balance sheet unless they are exempt from derivative instrument treatment based upon expected purchase, sale or usage requirements. All changes in their fair value are recorded in net earnings unless cash flow hedge accounting is applied, in which case changes in fair value are recorded in other comprehensive income for the effective portion of the hedge. As a result of Loblaw re-measuring a non-financial derivative instrument at fair value, an increase in other assets of \$7 and an increase in opening retained earnings of \$3 net of income taxes and minority interest were recognized. The standard requires embedded derivative instruments to be separated from their host contract and fair valued if certain criteria are met. Under an election provided for by the standard, January 1, 2003 was elected as the transition date to apply this accounting treatment to embedded derivative instruments. The impact of this change in accounting treatment related to embedded derivative instruments was not significant.

Section 3855 also requires that obligations undertaken in issuing a guarantee that meets the definition of a guarantee pursuant to Accounting Guideline 14, “Disclosure of Guarantees” be recognized at fair value at inception. No subsequent re-measurement at fair value is required unless the financial guarantee qualifies as a derivative instrument. As a result, a liability of \$7 related to the fair value of the standby letter of credit issued by a major Canadian chartered bank for the benefit of an independent funding trust which provides loans to Loblaw’s independent franchisees was recognized with a corresponding decrease of \$4 net of income taxes and minority interest to opening retained earnings.

Section 3865 replaces Accounting Guideline 13, “Hedging Relationships”. The requirements for identification, designation, documentation and assessment of effectiveness of hedging relationships remain substantially unchanged. Section 3865 addresses the accounting treatment of qualifying hedging relationships and the necessary disclosures and also requires all derivative instruments in hedging relationships to be recorded at fair value.

Upon implementation of these requirements with respect to cash flow hedges, an increase in other assets of \$17 and an increase in other liabilities of \$34 related to the fair value of the Loblaw interest rate swaps not previously recognized on the consolidated balance sheet and a decrease in accumulated other comprehensive loss of \$6 net of income taxes and minority interest were recorded. A decrease of \$9 in opening retained earnings net of income taxes and minority interest, resulting from the financing element of off-market Loblaw interest rate swaps, was also recorded. In addition, an increase in accumulated other comprehensive loss of \$9 net of income taxes and minority interest was recorded related to the effective portion of the unrealized gains and losses on the Loblaw cross currency basis swaps previously recognized in retained earnings. A loss of \$1, net of income taxes, was reclassified from accounts payable and accrued liabilities to accumulated other comprehensive loss representing the effective portion of the Company’s commodity hedges. Also on transition, the deferred loss of \$125 on Weston’s forward sale agreement for 9.6 million Loblaw common shares, which was deferred in other assets, was reclassified to opening retained earnings, resulting in a decrease of \$89 net of income taxes. The ineffective portion of the gains or losses on the derivative instruments within the hedging relationships was insignificant.

Section 1530, “Comprehensive Income” introduces a statement of comprehensive income, which is comprised of net earnings and other comprehensive income. Other comprehensive income represents the change in shareholders’ equity resulting from transactions and other events from non-owner sources and includes unrealized foreign currency translation gains or losses arising from self-sustaining foreign operations, unrealized gains and losses on financial assets that are classified as available-for-sale, and changes in the fair value of the effective portion of cash flow hedging instruments. The Company has included in the consolidated financial statements a new consolidated statement of comprehensive income for the changes in these items, while the cumulative changes in other comprehensive income or loss are included in accumulated other comprehensive loss, which is presented as a new category of shareholders’ equity on the consolidated balance sheet. See note 22 for further details of the accumulated other comprehensive loss balance. Implementation of the new standards resulted in the reclassification of \$503 previously recorded in the cumulative foreign currency translation adjustment, to accumulated other comprehensive loss. Due to the transitional provisions of the standards, this reclassification was accounted for retroactively, with restatement of the comparative year.

## Notes to the Consolidated Financial Statements

Section 3251, "Equity", which replaced Section 3250, "Surplus", establishes standards for the presentation of equity and changes in equity during the reporting period and requires the Company to present separately equity components and changes in equity arising from i) net earnings; ii) other comprehensive income; iii) other changes in retained earnings; iv) changes in contributed surplus; v) changes in share capital; and vi) changes in reserves. New consolidated statements of changes in shareholders' equity are included in the consolidated financial statements.

Section 3861, "Financial Instruments – Disclosure and Presentation", which replaces Section 3860, of the same title, establishes standards for the presentation of financial instruments and non-financial derivative instruments, and identifies the information that should be disclosed about them.

The following tables summarize the transitional adjustments recorded to the affected balance sheet accounts upon implementation:

	Balance as Reported, Dec. 31, 2006	Transitional Adjustments	Opening Balance Jan. 1, 2007
Other assets	\$ 1,459	\$ (101)	\$ 1,358
Accounts payable and accrued liabilities	\$ 3,176	\$ 1	\$ 3,177
Long term debt	\$ 5,918	\$ (11)	\$ 5,907
Future income taxes	\$ 366	\$ (41)	\$ 325
Other liabilities	\$ 688	\$ 41	\$ 729
Retained earnings	\$ 4,506	\$ (100)	\$ 4,406
Accumulated other comprehensive loss	\$ (503)	\$ 9	\$ (494)

	Retained Earnings		Accumulated Other Comprehensive Income/(Loss)	
	Gross	Net of Income Taxes and Minority Interest	Gross	Net of Income Taxes and Minority Interest
Classification of financial assets as available-for-sale	\$ (14)	\$ (9)	\$ 23	\$ 13
Classification of financial assets as held-for-trading	(9)	(8)		
Exchangeable Debentures	11	7		
Non-financial derivative instrument	7	3		
Guarantees	(7)	(4)		
Cash flow hedges	(9)		(9)	(4)
Reversal of deferred loss on Weston's forward sale agreement	(125)	(89)		
	\$ (146)	\$ (100)	\$ 14	\$ 9

### Accounting Standards Implemented in 2006

Effective January 1, 2006, the Company implemented Emerging Issues Committee Abstract 156, "Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Products)" ("EIC 156"), issued by the CICA in September 2005. EIC 156 addresses cash consideration, including sales incentives, given by a vendor to a customer. This consideration is presumed to be a reduction of the selling price of the vendor's products and should therefore be classified as a reduction of sales in the vendor's statement of earnings.

### 3. GOODWILL AND INTANGIBLE ASSETS

Changes in the carrying value of goodwill and intangible assets were as follows:

	2007			2006		
	Weston Foods	Loblaws	Total	Weston Foods	Loblaws	Total
Goodwill, beginning of year	\$ 1,121	\$ 934	\$ 2,055	\$ 1,159	\$ 1,727	\$ 2,886
Goodwill acquired during the year		8	8		7	7
Adjusted purchase price allocation <sup>(1)</sup>	(67)		(67)	(42)		(42)
Goodwill impairment					(800)	(800)
Other		4	4			
Impact of foreign currency translation	(167)		(167)	4		4
Goodwill, end of year	887	946	1,833	1,121	934	2,055
Trademarks and brand names <sup>(2)</sup>	394		394	466		466
Other intangible assets	13		13	15		15
Goodwill and intangible assets	\$ 1,294	\$ 946	\$ 2,240	\$ 1,602	\$ 934	\$ 2,536

- (1) The 2007 Weston Foods adjusted purchase price allocation relates to the reversal of certain valuation allowances recorded as part of the Bestfoods Baking purchase equation. The 2006 Weston Foods adjusted purchase price allocation relates primarily to the reversal of accruals (net of tax) related to the Bestfoods Baking purchase equation.
- (2) Year end 2007 balance includes the negative impact of foreign currency translation of \$71 (2006 – positive impact of \$2) and amortization of \$1 (2006 – \$1).

The Weston Foods intangible assets primarily relate to trademarks and brand names, of which \$380 (2006 – \$451) have an indefinite useful life and, accordingly, are not being amortized. The remaining trademarks and brand names and other intangible assets are being amortized over their estimated useful life ranging from 5 to 30 years.

During the fourth quarter of 2007, the Company performed its annual goodwill impairment test and determined that there was no impairment of the carrying value of goodwill.

In 2006, the annual goodwill impairment test was performed and it was determined that the carrying value of the goodwill established on the acquisition of Provigo Inc. in 1998 exceeded its respective fair value. As a result, in 2006, Loblaws recorded in operating income a non-cash impairment charge of \$800 relating to this goodwill. The determination that the fair value of goodwill was less than its carrying value resulted from a decline in market multiples, both from an industry and Loblaws perspective, and a reduction of fair value as determined using the discounted cash flow methodology, incorporating both current Loblaws and market assumptions, which in combination resulted in the goodwill impairment. In the second quarter of 2007, Loblaws completed its work and finalized the non-cash goodwill impairment charge of \$800 that was recorded in 2006.

During the fourth quarters of 2007 and 2006, the Company performed the annual indefinite life intangible assets impairment tests and determined that there was no impairment of the carrying values of indefinite life intangible assets.

Goodwill acquired during 2007 includes \$8 (2006 – \$7) related to Loblaws acquisition of franchise stores (see note 7). The consolidated balance sheet as at year end 2007 includes goodwill of independent franchisees that were consolidated by the Company pursuant to the requirements of AcG 15.

## Notes to the Consolidated Financial Statements

### 4. RESTRUCTURING AND OTHER CHARGES

The following table summarizes the restructuring and other charges:

	2007			2006		
	Weston Foods	Loblaw	Total	Weston Foods	Loblaw	Total
Fixed asset impairment				\$ 4	\$ 25	\$ 29
Accelerated depreciation	\$ 6		\$ 6	15	2	17
(Gain) loss on sale of fixed assets	(14)		(14)	1		1
Employee termination benefits	6	\$ 145	151	9	13	22
Site closing and other exit costs	7	77	84	17	4	21
Restructuring and other charges	\$ 5	\$ 222	\$ 227	\$ 46	\$ 44	\$ 90

#### Weston Foods

Weston Foods management continues to undertake a series of cost reduction initiatives with the objective of ensuring a low cost operating structure. Certain of these initiatives are in progress, are nearing completion or have been completed. Individual actions will be initiated as plans are finalized and approved.

#### *Manufacturing Assets Restructuring*

During 2007, Weston Foods approved and completed a plan to transfer two manufacturing lines for certain private label English muffins in the United States to third-party producers or other Weston Foods manufacturing lines already in place. As a result of this decision, Weston Foods recognized \$2 of accelerated depreciation during 2007.

During 2007, Weston Foods approved and completed a plan to exit certain bread and roll manufacturing lines in the Southeastern United States. All production associated with these lines will be transferred to third-party producers or other Weston Foods manufacturing facilities. As a result of this decision, Weston Foods recognized \$4 of accelerated depreciation and \$1 of employee termination benefits and other exit related costs during 2007.

During 2006, Weston Foods approved a restructuring plan to downsize its fresh-baked sweet goods facility in Bay Shore, New York. The plan involves the transfer of full-size dessert cake and cookie production to other existing Weston Foods facilities. Once the downsizing is complete, the Bay Shore location will be a more focused facility producing primarily danish and pie products. This restructuring is expected to be completed by the third quarter of 2008. As a result of this restructuring, Weston Foods recognized a total fixed asset impairment charge of \$4 and a total charge of \$5 for employee termination benefits and other exit related costs during 2006.

During 2006, Weston Foods approved a plan to close a frozen bagel plant in Nebraska, which was completed in that year. As a result of this restructuring, Weston Foods recognized total accelerated depreciation of \$5 and \$2 of employee termination benefits and other exit related costs during 2006. During 2007, Weston Foods completed the sale of this facility for proceeds of \$1 and recognized a loss on sale of fixed assets of \$1.

During 2006, Weston Foods approved a plan to close an ice-cream cone baking facility in Los Angeles, California and transfer the production to other existing Weston Foods facilities. This restructuring was completed in the first quarter of 2007. As a result of this restructuring, Weston Foods recognized total accelerated depreciation of \$3 and \$2 of employee termination benefits and other exit related costs during 2006. During 2007, Weston Foods completed the sale of this facility for proceeds of \$11 and recognized a gain on sale of fixed assets of \$9.

During 2006, Weston Foods approved and completed a plan to close a fresh bakery manufacturing facility in Quebec. During 2006, Weston Foods recognized \$1 of accelerated depreciation and \$1 of employee termination benefits and other exit related costs.

During 2005, Weston Foods approved a plan to restructure its United States biscuit operations. This plan included the closure of two biscuit facilities located in Elizabeth, New Jersey and Richmond, Virginia by the end of 2006 with the majority of the production relocated to a new facility in Virginia and an existing Weston Foods facility already operating in South Dakota. The sales of these two facilities were completed in 2005. All manufacturing activities ceased in the Elizabeth, New Jersey and Richmond, Virginia facilities by the end of 2006. During 2007, Weston Foods vacated the Elizabeth, New Jersey facility in accordance with the terms and conditions of the sale lease-back arrangement and accordingly, recognized the previously deferred gain on the sale of fixed assets of \$6. In addition, during 2007, Weston Foods recognized nil (2006 – \$6) of accelerated depreciation and \$2 (2006 – \$10) of employee termination benefits and other exit related costs. By the end of 2007, total charges of \$21 of accelerated depreciation and \$40 of employee termination benefits and other exit related costs had been recognized on a cumulative basis related to this restructuring plan, which is now complete.

#### ***Distribution Network Restructuring***

During 2007, Weston Foods approved plans to restructure its Ontario frozen bakery distribution operations, to further restructure its Quebec fresh bakery distribution operations and to restructure the dairy distribution network. These plans involve the closure and/or consolidation of certain warehouses, outsourcing certain warehousing and distribution functions to third-party warehousing service providers and certain route restructurings. As a result of these restructuring plans, Weston Foods recognized \$3 of employee termination benefits and other exit related costs during 2007 and expects to record an additional \$1 related to other exit costs in 2008 when these plans are expected to be substantially completed.

During 2007, Weston Foods approved a restructuring plan to exit and transfer certain distribution and transportation activities in the mid-Western United States to third-party logistic providers, which is expected to be completed by the end of the second quarter of 2008. As a result of this plan, Weston Foods recognized \$2 of employee termination benefits during 2007.

During 2006, Weston Foods approved a plan to restructure a portion of its distribution network in Quebec. During 2007, Weston Foods recognized \$2 (2006 – \$6) of employee termination benefits and other exit related costs pursuant to this plan, which is expected to be substantially completed in 2008.

#### ***Administrative Restructuring and Consolidation of Offices***

During 2007, Weston Foods approved plans to consolidate, relocate and restructure certain sales and administrative functions in the United States. These plans will be completed by the second quarter of 2008. As a result of this decision, Weston Foods recognized \$3 of employee termination benefits and other exit related costs during 2007 and no additional restructuring and other charges are anticipated.

#### ***Completion of Other Prior Year Plans***

During 2006, Weston Foods recognized a loss on the sale of fixed assets of \$1 related to a restructuring plan approved prior to 2006.

In 2007, employee termination benefits and other exit related costs of approximately \$23 (2006 – \$33) was paid related to all Weston Foods restructuring activities. As at year end 2007, the accrued liabilities related to all of these restructuring activities were \$9 (2006 – \$19).

#### **Loblaw**

##### ***Project Simplify***

During 2007, Loblaw approved and announced the restructuring of its merchandising and store operations into more streamlined functions as part of Project Simplify. In 2007, Loblaw recognized \$197 of restructuring costs resulting from this plan, comprised of \$139 for employee termination benefits including severance, additional pension costs resulting from the termination of employees and retention costs; and \$58 of other costs, primarily consulting directly associated with the restructuring. The total restructuring costs under this plan, comprised primarily of severance costs, are estimated to be approximately \$200, with the remaining costs to be expensed in 2008.

## Notes to the Consolidated Financial Statements

### **Store Operations**

During 2007, Loblaw completed the previously announced restructuring of its store operations. The total restructuring costs under these plans were \$51 compared to the original estimate of \$54. Of the \$51 total costs, approximately \$8 was attributable to employee termination benefits which included severance resulting from the termination of employees, \$25 to fixed asset impairment and accelerated depreciation of assets relating to these restructuring activities and \$18 to site closing and other costs including lease obligations. In 2007, Loblaw recognized \$16 (2006 – \$35) of these restructuring costs, which relates to site closing and other costs including lease obligations. The components of the store operations restructuring plan are described below.

As part of a review of the Quebec store operations, Loblaw approved and communicated a plan in 2006 to close 19 underperforming stores, mainly within the *Provigo* banner. During 2007, Loblaw concluded that 16 stores, 3 less than originally planned, would close under this initiative. The closure of these 16 stores was completed in 2007. The total restructuring cost under this initiative was \$37 compared to the original estimate of \$40, of which \$9 (2006 – \$28) was recognized in 2007.

Based on Loblaw's review of the impact on the Cash & Carry and wholesale club network of the loss in tobacco sales following the decision by a major tobacco supplier to sell directly to certain customers of Loblaw, Loblaw approved and communicated a plan in 2006 to close 24 wholesale outlets which were impacted most significantly by this change. The total restructuring cost under this initiative was \$12 compared to the original estimate of \$10, of which \$6 (2006 – \$6) was recognized in 2007.

As part of a review of the Atlantic store operations, Loblaw approved and communicated a plan in 2006 to close 8 stores in the Atlantic region. The total restructuring cost under this initiative was \$2 compared to the original estimate of \$4, of which \$1 (2006 – \$1) was recognized in 2007.

### **Supply Chain Network**

During 2005, Loblaw approved a comprehensive plan to restructure its supply chain operations nationally. The restructuring plan is expected to be completed by the first quarter of 2009 and the total restructuring costs under this plan is estimated to be approximately \$90. Of the \$90 total estimated costs, approximately \$57 is attributable to employee termination benefits which include severance and additional pension costs resulting from the termination of employees, \$13 to fixed asset impairment and accelerated depreciation of assets relating to this restructuring activity and \$20 to site closing and other costs directly attributable to the restructuring plan. In 2007, Loblaw recognized \$9 (2006 – \$8) of restructuring costs resulting from this plan which is composed of \$7 (2006 – \$4) for employee termination benefits resulting from planned involuntary terminations, nil (2006 – \$2) for fixed asset impairment and accelerated depreciation and \$2 (2006 – \$2) for other costs directly associated with those initiatives. At the end of the year, \$11 in estimated costs remain to be incurred and will be recognized as appropriate criteria are met.

### **Office Move and Reorganization of the Operation Support Functions**

In 2005, Loblaw consolidated several administrative and operating offices from across southern Ontario into a new national head office in Brampton, Ontario and reorganized the merchandising, procurement and operations groups which included the transfer of the general merchandise operations from Calgary, Alberta to the new office. All of the expected \$25 of costs related to these initiatives had been recognized by the end of 2006.

In 2007, severance and other cash exit costs of approximately \$176 (2006 – \$9) was paid related to all Loblaw restructuring activities. Accrued liabilities and other liabilities related to all of these restructuring activities were \$50 (2006 – \$19) and \$21 (2006 – \$21), respectively.

## 5. COLLECTIVE AGREEMENT

During 2006, members of certain Ontario locals of the United Food and Commercial Workers union ratified a new four-year collective agreement with Loblaw. The new agreement enables Loblaw to convert 44 stores in Ontario to the *Real Canadian Superstore* banner or food stores with equivalent labour economics, and the flexibility to invest in additional store labour where appropriate. As a result of securing this agreement, Loblaw recognized a one-time charge in 2006 of \$84 in operating income, including a \$36 amount due to a multi-employer pension plan which was paid in 2007 (see note 16) and a payment of \$38 which was paid to employees in 2006 upon ratification.

## 6. INTEREST EXPENSE AND OTHER FINANCING CHARGES

	2007	2006
Interest on long term debt	\$ 386	\$ 393
Interest expense on financial derivative instruments (note 24)	21	15
Other financing charges <sup>(1)</sup>	(167)	(96)
Net short term interest income (note 11)	(53)	(38)
Capitalized to fixed assets	(22)	(21)
Interest expense and other financing charges	\$ 165	\$ 253

(1) Other financing charges for 2007 include non-cash income of \$141 (2006 – \$73) related to the fair value adjustment of Weston's forward sale agreement for 9.6 million Loblaw common shares which was entered into during 2001 and matures in 2031.

The fair value adjustment of the forward contract is a non-cash item resulting from fluctuations in the market price of the underlying Loblaw shares that Weston owns. Weston does not record any change in the market price associated with the Loblaw shares it owns. Any cash paid under the forward contract could be offset by the sale of Loblaw common shares. Also included in other financing charges is forward accretion income of \$42 (2006 – \$40) net of the forward fee of \$16 (2006 – \$17) associated with Weston's forward sale agreement.

During 2007, net interest expense of \$362 was recorded related to the financial assets and financial liabilities not classified as held-for-trading. In addition, \$86 (2006 – \$74) of income from cash, cash equivalents and short term investments, the majority of which are denominated in United States dollars and are held or managed by Glenhuron Bank Limited ("Glenhuron"), a wholly owned subsidiary of Loblaw in Barbados, was recognized in net short term interest income.

Interest paid in 2007 was \$554 (2006 – \$566), and interest received in 2007 was \$186 (2006 – \$169).

## 7. BUSINESS ACQUISITIONS

In the normal course of business, Loblaw may acquire from time to time franchisee stores and convert them to corporate stores. In 2007, Loblaw acquired 4 franchisee businesses (2006 – 7 franchisee businesses). The acquisitions were accounted for using the purchase method of accounting with the results of the businesses acquired included in the consolidated financial statements from the date of acquisition. The fair value of the net assets acquired consisted of fixed assets of \$3 (2006 – \$2), other assets principally inventory of \$1 (2006 – \$2) and goodwill of \$8 (2006 – \$7) for cash consideration of \$9 (2006 – \$9), net of accounts receivable due from the franchisees of \$3 (2006 – \$2).

## Notes to the Consolidated Financial Statements

### 8. INCOME TAXES

The effective income tax rate in the consolidated statements of earnings is reported at a rate different than the weighted average basic Canadian federal and provincial statutory income tax rate for the following reasons:

	2007	2006
Weighted average basic Canadian federal and provincial statutory income tax rate	<b>32.6%</b>	32.6%
Net decrease resulting from:		
Earnings in jurisdictions taxed at rates different from the Canadian statutory income tax rates	<b>(4.4)</b>	(5.2)
Non-taxable amounts (including capital gains/losses and dividends)		(0.7)
Impact of statutory income tax rate changes on future income tax balances	<b>(2.5)</b>	(2.2)
Impact of resolution of certain income tax matters from a previous year and other	<b>(0.3)</b>	(0.9)
Effective income tax rate before impact of non-deductible goodwill impairment charge	<b>25.4%</b>	23.6%
Non-deductible goodwill impairment charge		66.5
Effective income tax rate	<b>25.4%</b>	90.1%

Net income taxes paid in 2007 were \$222 (2006 – \$310).

The cumulative effects of changes in Canadian federal and certain provincial statutory income tax rates on future income tax assets and liabilities are included in the consolidated financial statements at the time of substantive enactment. Accordingly, in each of 2007 and 2006, a \$24 net reduction to the future income tax expense was recognized as a result of changes in the Canadian federal and certain provincial statutory income tax rates.

The income tax effects of temporary differences that gave rise to significant portions of the future income tax assets (liabilities) were as follows:

	2007	2006
Accounts payable and accrued liabilities	<b>\$ 105</b>	\$ 109
Other liabilities	<b>170</b>	172
Losses carried forward (expiring 2008 to 2027)	<b>208</b>	169
Valuation allowances	<b>(28)</b>	(54)
Fixed assets	<b>(278)</b>	(301)
Goodwill and intangible assets	<b>(75)</b>	(63)
Other assets	<b>(210)</b>	(230)
Other	<b>27</b>	51
Net future income tax liabilities	<b>\$ (81)</b>	\$ (147)

	2007	2006
Recorded in the consolidated balance sheets as follows:		
<b>Future income tax assets</b>		
Current	\$ 121	\$ 151
Non-current	91	68
<b>Future income tax liabilities</b>	212	219
	(293)	(366)
Net future income tax liabilities	\$ (81)	\$ (147)

#### 9. BASIC AND DILUTED NET EARNINGS PER COMMON SHARE FROM CONTINUING OPERATIONS

	2007	2006
Net earnings from continuing operations	\$ 563	\$ 110
Prescribed dividends on preferred shares	(57)	(54)
Net earnings from continuing operations available to common shareholders	\$ 506	\$ 56
Weighted average common shares outstanding (in millions) (note 21)	129.1	129.0
Dilutive effect of stock-based compensation (in millions) <sup>(1)</sup>		
Diluted weighted average common shares outstanding (in millions)	129.1	129.0
Basic and diluted net earnings per common share from continuing operations (\$)	\$ 3.92	\$ 0.43

(1) The following stock options were outstanding but were not recognized in the computation of diluted net earnings per common share from continuing operations as the exercise prices for these options were greater than the average market prices for the year of the common shares as follows:

Option exercise price	2007	2006
\$72.21	687,892	
\$75.62	4,135	
\$78.85	81,168	
\$93.35	506,426	544,891
\$95.88	30,130	100,130
\$100.00	129,400	169,400
\$111.02	503,170	533,711

## Notes to the Consolidated Financial Statements

### 10. DISCONTINUED OPERATIONS

During 2006, income from discontinued operations of \$11 (net of \$2 of income taxes) was recorded. This income was primarily related to final adjustments to the proceeds in 2006 associated with the previously completed 2005 sale of the remaining discontinued Fisheries operations.

The current liabilities of discontinued operations were as follows as at year end:

	2007	2006
Accounts payable and accrued liabilities	\$ 3	\$ 4

The cash flows (used in) from discontinued operations were as follows:

	2007	2006
Cash flows used in operations	\$ (1)	\$ (5)
Cash flows from investing		16
Cash flows (used in) from discontinued operations	\$ (1)	\$ 11

During 2006, \$19 of cash was received, primarily related to deferred proceeds and final adjustments to the proceeds associated with the 2005 sale of the remaining discontinued Fisheries operations.

During 2006, the Company reached an agreement to settle claims against it relating to certain alleged misrepresentations and warranties arising from the sale of the Company's Forest Products business in 1998, including tax related representations and warranties dealing with years prior to 1998. The Company did not admit any wrongdoing or liability in connection with the settlement. The Company had previously accrued for certain of these tax related claims in prior years. The net impact of this settlement agreement was reflected in the 2005 loss from discontinued operations. A payment of \$7 was made during 2006 as a result of this settlement.

### 11. CASH AND CASH EQUIVALENTS

The components of cash and cash equivalents as at December 31, 2007 and December 31, 2006 were as follows:

	2007	2006
Cash	\$ 110	\$ 150
Cash equivalents – short term investments with a maturity date of 90 days or less:		
Bank term deposits	119	69
Government treasury bills and treasury notes	629	372
Government-sponsored debt securities	281	395
Corporate commercial paper	214	168
Bank-sponsored asset-backed commercial paper		65
Cash and cash equivalents	\$ 1,353	\$ 1,219

The Company recognized an unrealized foreign currency exchange loss of \$303 (2006 – gain of \$9) as a result of translating its United States dollar denominated cash, cash equivalents and short term investments, \$195 (2006 – gain of \$1) of which related to cash and cash equivalents. Loblaw recognized an unrealized foreign currency exchange loss of \$155 (2006 – gain of \$2) as a result of translating its United States dollar denominated cash, cash equivalents and short term investments, of which a loss of \$97 (2006 – gain of \$1) related to cash and cash equivalents. The resulting Loblaw loss or gain on cash, cash equivalents and short term investments is offset in operating income and accumulated other comprehensive loss by the unrealized foreign currency exchange gain or loss on Loblaw's cross currency basis swaps as described in note 24. The remaining foreign currency exchange loss of \$148 (2006 – gain of \$7), of which \$98 (2006 – gain of nil) relates to the translation of cash and cash equivalents held by Weston's self-sustaining foreign operations, is recognized in accumulated other comprehensive loss.

## 12. ACCOUNTS RECEIVABLE

	2007	2006
Credit card receivables	\$ 2,023	\$ 1,571
Amount securitized	(1,475)	(1,250)
Net credit card receivables	548	321
Other receivables	593	686
Accounts receivable	\$ 1,141	\$ 1,007

The Company, through *PC Bank*, securitizes certain credit card receivables by selling them to independent special purpose entities or trusts that issue interest bearing securities. When *PC Bank* sells credit card receivables, it retains servicing responsibilities, certain administrative responsibilities and the right to future cash flows after obligations to investors have been met. Commencing January 1, 2007, these retained interests have been designated as held-for-trading upon the implementation of Section 3855 and are carried at their fair value in other assets. The fair value of these retained interests was estimated using management's best estimate of the net present value of expected future cash flows using key assumptions. Prior to January 1, 2007, these retained interests were carried at their original carrying amount that was periodically reviewed and written down to fair value when there was an other than temporary decline in value. Although *PC Bank* remains responsible for servicing all credit card receivables, it does not receive additional compensation for servicing those credit card receivables sold to the trusts.

During 2007, \$225 (2006 – \$240) of credit card receivables were securitized through the sale of a portion of the total interest in these receivables to independent trusts, yielding a \$1 gain (2006 – nominal net loss) on the initial sale inclusive of nil (2006 – nil) servicing liability. During 2007, *PC Bank* received income of \$141 (2006 – \$114) in securitization revenue from the independent trusts relating to the securitized credit card receivables. An increase in servicing liability of \$2 (2006 – nil) was recognized during the year on securitization and the fair value at year end of recognized servicing liabilities was \$10 (2006 – \$8). The trusts' recourse to *PC Bank's* assets is limited to *PC Bank's* retained interests and is further supported by Loblaw through a standby letter of credit for 9% (2006 – 9%) on a portion of the securitized amount (see note 25).

Net credit loss experience of \$11 (2006 – \$9) includes \$57 (2006 – \$45) of credit losses on the total portfolio of credit card receivables net of credit losses of \$46 (2006 – \$36) relating to securitized credit card receivables.

The following table displays the sensitivity of the current fair value of retained interests to an immediate 10% and 20% adverse change in the 2007 key economic assumptions. The sensitivity analysis provided in the table is hypothetical and should be used with caution. The sensitivities of each key assumption have been calculated independently of any changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce the impact of such assumptions.

	2007	Change in Assumptions	
		10%	20%
Carrying value of retained interests	\$ 8		
Payment rate (monthly)	43.0%		
Weighted average life (years)	0.7		
Expected credit losses (annual)	3.25%	\$ (0.9)	\$ (1.8)
Discount rate applied to residual cash flows (annual)	15.21%	\$ (0.02)	\$ (0.05)

The details on the cash flows from securitization are as follows:

	2007	2006
Proceeds from new securitizations	\$ 225	\$ 240
Net cash flows received on retained interests	\$ 143	\$ 116

## Notes to the Consolidated Financial Statements

### 13. INVENTORY LIQUIDATION

During 2007, Loblaw recognized a charge of \$15 in operating income, comprising mainly storage and shipping costs related to certain excess inventory, primarily general merchandise as a result of its decision in 2006 to proceed with the liquidation of this inventory. In 2006, Loblaw recognized a charge of \$68 to adjust inventory identified for liquidation to the lower of cost and net realizable value. The charge reflected the write-down of inventory to recovery values and the associated costs of facilitating the disposition incurred to the end of 2007. The excess inventory liquidation was completed in 2007.

### 14. FIXED ASSETS

	2007			2006		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Properties held for development	\$ 525		\$ 525	\$ 500		\$ 500
Properties under development	89		89	226		226
Land	1,786		1,786	1,790		1,790
Buildings	5,690	\$ 1,392	4,298	5,400	\$ 1,151	4,249
Equipment and fixtures	5,442	3,584	1,858	5,217	3,214	2,003
Buildings and leasehold improvements	591	249	342	696	280	416
	14,123	5,225	8,898	13,829	4,645	9,184
Capital leases – buildings and equipment	165	103	62	133	98	35
Fixed assets	\$ 14,288	\$ 5,328	\$ 8,960	\$ 13,962	\$ 4,743	\$ 9,219

The following items were recognized in operating income during 2007: fixed asset impairment charge of \$33 (2006 – \$27), accelerated depreciation charge of \$6 (2006 – \$5) and restructuring and other charges of \$6 (2006 – \$46) (see note 4).

### 15. OTHER ASSETS

	2007	2006
Domtar (Canada) Paper Inc. investment (note 18)	\$ 157	\$ 215
Franchise investments and other receivables	298	324
Accrued benefit plan asset (note 16)	242	246
Unrealized cross currency basis swaps receivable (note 24)	270	165
Unrealized equity forward receivable (note 24)	365	181
Deferred loss on equity forward sale (note 2)		125
Deferred charges and other	235	203
Other assets	\$ 1,567	\$ 1,459

Commencing January 1, 2007, the Domtar (Canada) Paper Inc. investment was designated as held-for-trading upon the implementation of Section 3855 and is therefore carried at fair value. The fair value of this investment is based on the market price of common shares of Domtar (Canada) Paper Inc. During 2007, a transitional adjustment of \$11 was recorded and a fair value loss of \$44 was recorded in operating income, as a result of implementing Section 3855 (see note 2). In addition, the investment decreased by \$3 due to the delivery of common shares of Domtar prior to March 7, 2007 (see note 18) or Domtar (Canada) Paper Inc. upon redemption of the related Debentures. Prior to January 1, 2007, this investment was carried at the lower of cost or quoted market value.

Included in deferred charges and other above are \$9 (2006 – nil) of unrealized interest rate swap receivable and \$5 (2006 – nil) related to an electricity forward contract (see note 24).

## 16. EMPLOYEE FUTURE BENEFITS

### Pension and Other Benefit Plans

The Company sponsors a number of pension plans, including funded defined benefit pension plans, defined contribution pension plans and supplemental unfunded arrangements providing pension benefits in excess of statutory limits. Certain obligations of the Company to these supplemental pension arrangements are secured by standby letters of credit issued by a major Canadian chartered bank. The Company's defined benefit pension plans are predominantly non-contributory and these benefits are, in general, based on career average earnings.

During 2007, Loblaw approved and announced the restructuring of its merchandising and store operations into more streamlined functions as part of Project Simplify, resulting in contractual and special termination benefits recognized in restructuring and other charges (see note 4). Also in Canada, a new national defined contribution pension plan for salaried employees was introduced by the Company during 2006. All eligible salaried employees were given the option to join this new plan and convert their past accrued pension benefits or to remain in their existing defined benefit pension plans. All new salaried employees participate only in the new national defined contribution pension plan.

In the United States, certain defined benefit pension plans were frozen for Weston Foods salaried employees during 2007, triggering a curtailment at the time of the announcement. The curtailment had a nominal impact on the net defined benefit plan cost. Effective January 1, 2008, all salaried employees will participate in a new defined contribution pension plan.

The Company also offers certain employee post-retirement and post-employment benefit plans and long term disability benefit plans. Post-retirement and post-employment benefit plans are generally not funded, are mainly non-contributory and include health care, life insurance and dental benefits. Employees eligible for post-retirement benefits are those who retire at certain retirement ages and employees eligible for post-employment benefits are those on long term disability leave. The majority of post-retirement health care plans for current and future retirees include a limit on the total benefits payable by the Company.

In the United States, certain post-retirement benefit plans were amended, effective January 1, 2008. For one of these plans, the amendment resulted in a significant reduction in the number of future years of service for plan members, thereby triggering a curtailment at the time of the announcement in 2007. Accordingly, a \$7 pro rata portion of the unamortized past service gain from a previous plan amendment was recognized as a curtailment gain and included in the net defined benefit plan cost.

The Company also contributes to various multi-employer pension plans that provide pension benefits.

The accrued benefit plan obligations and the fair value of the benefit plan assets were determined using a September 30 measurement date for accounting purposes.

### Funding of Pension and Other Benefit Plans

The most recent actuarial valuations of the Canadian defined benefit pension plans for funding purposes ("funding valuations") were performed as at December 31, 2006 for all plans, except for two plans for which funding valuations were last performed as at December 31, 2004 and which will be performed as at December 31, 2007. The Company is required to file Canadian funding valuations at least every three years; accordingly, the next required funding valuations for the above mentioned plans will be performed no later than December 31, 2009 and 2010, respectively. The most recent funding valuations of the United States defined benefit pension plans were as at January 1, 2007. The Company is required to file United States funding valuations every year; accordingly, the next required funding valuations will be as at January 1, 2008.

Total cash payments made by the Company during 2007, consisting of contributions to funded defined benefit pension plans, defined contribution pension plans, multi-employer pension plans, long term disability benefit plans and benefits paid directly to beneficiaries of the unfunded defined benefit pension plans and other benefit plans, were \$260 (2006 – \$267). In 2006, the Company accrued \$36 relating to a one-time contribution to a multi-employer pension plan which was paid in 2007 (see note 5).

During 2008, the Company expects to contribute approximately \$86 to its funded defined benefit pension plans. This estimate may vary subject to the completion of actuarial valuations, market performance and regulatory requirements. The Company also expects to make contributions in 2008 to defined contribution pension plans and multi-employer pension plans as well as benefit payments to the beneficiaries of the unfunded defined benefit pension plans and other benefit plans.

## Notes to the Consolidated Financial Statements

### Pension and Other Benefit Plans Status

Information on the Company's defined benefit pension plans and other benefit plans, in aggregate, was as follows:

	2007			2006		
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Total	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Total
<b>Benefit Plan Assets</b>						
Fair value, beginning of year	\$ 1,629	\$ 50	\$ 1,679	\$ 1,480	\$ 45	\$ 1,525
Actual return (loss)						
on plan assets	152	1	153	115	(1)	114
Employer contributions	93	17	110	129	29	158
Employee contributions	4	2	6	4		4
Benefits paid	(102)	(32)	(134)	(100)	(23)	(123)
Other, including impact of foreign currency translation	(61)	(1)	(62)	1		1
Fair value, end of year	\$ 1,715	\$ 37	\$ 1,752	\$ 1,629	\$ 50	\$ 1,679
<b>Accrued Benefit Plan Obligations</b>						
Balance, beginning of year	\$ 1,957	\$ 475	\$ 2,432	\$ 1,840	\$ 377	\$ 2,217
Current service cost	70	50	120	70	14	84
Interest cost	100	25	125	98	20	118
Benefits paid	(102)	(32)	(134)	(100)	(23)	(123)
Actuarial (gain) loss	(98)	(35)	(133)	50	86	136
Past service costs		(7)	(7)			
Contractual termination benefits <sup>(2)</sup>	7		7			
Special termination benefits <sup>(2)</sup>	6		6			
Curtailment gain <sup>(3)</sup>	(26)	(3)	(29)			
Other, including impact of foreign currency translation	(69)	(23)	(92)	(1)	1	
Balance, end of year	\$ 1,845	\$ 450	\$ 2,295	\$ 1,957	\$ 475	\$ 2,432
<b>Deficit of Plan Assets Versus Plan Obligations</b>						
Unamortized past service costs	4	(29)	(25)	6	(38)	(32)
Unamortized net actuarial loss	281	184	465	462	244	706
Net accrued benefit plan asset (liability)	\$ 155	\$ (258)	\$ (103)	\$ 140	\$ (219)	\$ (79)
<b>Recorded in the consolidated balance sheets as follows:</b>						
Other assets (note 15)	\$ 230	\$ 12	\$ 242	\$ 207	\$ 39	\$ 246
Other liabilities (note 19)	(75)	(270)	(345)	(67)	(258)	(325)
Net accrued benefit plan asset (liability)	\$ 155	\$ (258)	\$ (103)	\$ 140	\$ (219)	\$ (79)

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Contractual and special termination benefits resulted from the Loblaw 2007 Project Simplify to restructure and streamline its merchandising and store operations, and were recorded in restructuring and other charges in 2007 (see note 4).

(3) Certain defined benefit plans and other benefit plans affected by Loblaw's 2007 Project Simplify to restructure and streamline its merchandising and store operations, the 2007 freezing of certain defined benefit pension plan benefits of Weston Foods United States salaried employees and the 2007 amendment of a post-retirement benefit plan for certain Weston Foods United States salaried employees were remeasured as at March 31, 2007, March 31, 2007 and August 31, 2007, respectively. For these plans, costs subsequent to these dates were determined using discount rates of 5.0%, 5.75% and 6.0%, respectively. A portion of the resulting curtailment gains were offset against unamortized net actuarial losses for some of those plans, with the remainder being recorded in income.

### Funded Status of Plans in Deficit

Included in the accrued benefit plan obligations and the fair value of benefit plan assets at year end are the following amounts in respect of plans with accrued benefit plan obligations in excess of benefit plan assets:

	2007		2006	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Fair Value of Benefit Plan Assets	\$ 684	\$ 37	\$ 1,629	\$ 50
Accrued Benefit Plan Obligations	(856)	(450)	(1,957)	(475)
Deficit of Plan Assets versus Plan Obligations	\$ (172)	\$ (413)	\$ (328)	\$ (425)

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

### Asset Allocations

The benefit plan assets are held in trust and at September 30 consisted of the following asset categories:

Percentage of Plan Assets	2007		2006	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Asset Category				
Equity securities	63%		62%	
Debt securities	35%	91%	35%	93%
Cash and cash equivalents	2%	9%	3%	7%
Total	100%	100%	100%	100%

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

Pension benefit plan assets include securities issued by Weston and by Loblaw having a fair value of \$6 and \$1 (2006 – \$3 and nil), respectively, as at September 30. Other benefit plan assets do not include any Weston or Loblaw securities.

## Notes to the Consolidated Financial Statements

### Pension and Other Benefit Plans Cost

The total net cost for the Company's benefit plans and multi-employer pension plans was as follows:

	2007		2006	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Current service cost, net of employee contributions	\$ 66	\$ 48	\$ 66	\$ 14
Interest cost on plan obligations	100	25	98	20
Actual (return) loss on plan assets	(152)	(1)	(115)	1
Actuarial (gain) loss	(98)	(35)	50	86
Past service costs		(7)		
Contractual termination benefits <sup>(2)</sup>	7			
Special termination benefits <sup>(2)</sup>	6			
Curtailement loss (gain) <sup>(2,3)</sup>	2	(7)		
Defined benefit plan (income) cost, before adjustments to recognize the long term nature of employee future benefit costs	(69)	23	99	121
Excess (shortfall) of actual return over expected return on plan assets	27	(1)	(1)	(4)
Excess (shortfall) of amortized net actuarial loss over actual actuarial (gain) loss on accrued benefit obligation	115	50	(29)	(61)
Excess (shortfall) of amortized past service costs over actual past service costs	1	2	1	(4)
Net defined benefit plan cost	74	74	70	52
Defined contribution plan cost	25		21	
Multi-employer pension plan cost <sup>(4)</sup>	89		124	
Net benefit plan cost	\$ 188	\$ 74	\$ 215	\$ 52
<b>Recognized in the consolidated statements of earnings as follows:</b>				
Pension and other benefit plan costs	\$ 173	\$ 74	\$ 215	\$ 52
Restructuring and other charges <sup>(2)</sup>	15			
Net benefit plan cost	\$ 188	\$ 74	\$ 215	\$ 52

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Contractual and special termination benefits and curtailment losses resulted from Loblaw's 2007 Project Simplify to restructure and streamline its merchandising and store operations, and were recorded in restructuring and other charges in 2007 (see note 4).

(3) Certain defined benefit plans and other benefit plans affected by Loblaw's 2007 Project Simplify to restructure and streamline its merchandising and store operations, the 2007 freezing of certain defined benefit pension plan benefits of Weston Foods United States salaried employees and the 2007 amendment of a post-retirement benefit plan for certain Weston Foods United States salaried employees were remeasured as at March 31, 2007, March 31, 2007 and August 31, 2007, respectively. For these plans, costs subsequent to these dates were determined using discount rates of 5.0%, 5.75% and 6.0%, respectively. A portion of the resulting curtailment gains were offset against unamortized net actuarial losses for some of those plans, with the remainder being recorded in income.

(4) Included in 2006 is a \$36 amount relating to a one-time contribution to a multi-employer pension plan which was paid in 2007 (see note 5).

## Plan Assumptions

The significant annual weighted average actuarial assumptions used in calculating the Company's accrued benefit plan obligations as at the measurement date of September 30 and the net defined benefit plan cost for the year were as follows:

	2007		2006	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
<b>Accrued Benefit Plan Obligations</b>				
Discount rate	5.6%	5.6%	5.2%	5.3%
Rate of compensation increase	3.5%		3.5%	
<b>Net Defined Benefit Plan Cost</b>				
Discount rate <sup>(2)</sup>	5.1%	5.1%	5.3%	5.3%
Expected long term rate of return on plan assets	7.8%	5.0%	8.0%	5.0%
Rate of compensation increase	3.5%		3.5%	

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Certain defined benefit plans and other benefit plans affected by Loblaw's 2007 Project Simplify to restructure and streamline its merchandise and store operations, the 2007 freezing of certain defined benefit pension plan benefits of Weston Foods United States salaried employees and the 2007 amendment of a post-retirement benefit plan for certain Weston Foods United States salaried employees were remeasured as at March 31, 2007, March 31, 2007 and August 31, 2007, respectively. For these plans, costs subsequent to these dates were determined using discount rates of 5.0%, 5.75% and 6.0%, respectively. A portion of the resulting curtailment gains were offset against unamortized net actuarial losses for some of those plans, with the remainder being recorded in income.

The growth rate of health care costs, primarily drug and other medical costs for other benefit plans, was estimated at 10.0% (2006 – 10.0%) and is assumed to gradually decrease to 5.0% by 2015 (2006 – 5.0% by 2014), remaining at that level thereafter.

## Notes to the Consolidated Financial Statements

### Sensitivity of Key Assumptions

The following table outlines the key assumptions for 2007 and the sensitivity of a 1% change in each of these assumptions on the accrued benefit plan obligations and on the benefit plan cost for defined benefit pension plans and other benefit plans. The table reflects the impact on the current service and interest cost components for the discount rate and expected growth rate of health care costs assumptions.

The sensitivity analysis provided in the table is hypothetical and should be used with caution. The sensitivities of each key assumption have been calculated independently of any changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce the impact of such assumptions.

	Pension Benefit Plans		Other Benefit Plans <sup>(1)</sup>	
	Accrued Benefit Plan Obligations	Benefit Plan Cost <sup>(2)</sup>	Accrued Benefit Plan Obligations	Benefit Plan Cost <sup>(2)</sup>
Expected long term rate of return on plan assets		7.8%		5.0%
Impact of: 1% increase	n/a	\$ (16)	n/a	\$ –
1% decrease	n/a	\$ 16	n/a	\$ –
Discount rate	5.6%	5.1%	5.6%	5.1%
Impact of: 1% increase	\$ (241)	\$ (8)	\$ (49)	\$ (4)
1% decrease	\$ 285	\$ 8	\$ 57	\$ 4
Expected growth rate of health care costs <sup>(3)</sup>			10.0%	10.0%
Impact of: 1% increase	n/a	n/a	\$ 45	\$ 7
1% decrease	n/a	n/a	\$ (39)	\$ (6)

n/a – not applicable

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Discount rate and expected growth rate of health care costs sensitivity is for current service and interest costs only.

(3) Gradually decreasing to 5.0% by 2015 for the accrued benefit plan obligation and the benefit plan cost, remaining at that level thereafter.

### 17. SHORT TERM BANK LOANS

During 2007, Weston renewed its 364-day revolving committed credit facility of \$300, which matures in May 2008. At year end 2007, \$30 was drawn on this facility.

During 2007, Loblaw entered into a 364-day revolving committed credit facility of \$500, which matures in March 2008. At year end 2007, nil was drawn on this facility. Subsequent to year end, Loblaw obtained a 60-day extension of the facility extending the maturity date to May 2008.

Neither credit facility has financial covenants and borrowings are based on short term floating interest rates.

Also included in short term bank loans are Weston's Series B debentures, due on demand, of \$220 (2006 – \$178) (see note 18).

**18. LONG TERM DEBT**

	2007	2006
<b>George Weston Limited</b>		
Debtures		
Series B, current rate 5.18%, due on demand <sup>(i)</sup>	\$ 220	\$ 178
Series A, 7.00%, due 2031 <sup>(i)</sup>	466	466
Exchangeable Debtures, 3.00%, due 2023, redeemable in 2005 <sup>(ii)</sup>		
Carrying amount	157	202
Deferred amount		18
Notes		
5.90%, due 2009	250	250
6.45%, due 2011	300	300
5.05%, due 2014	200	200
12.70%, due 2030		
Principal	150	150
Effect of coupon repurchase	(131)	(131)
7.10%, due 2032	150	150
6.69%, due 2033	100	100
Other		1
<b>Loblaw Companies Limited</b>		
Notes		
6.00%, due 2008	390	390
5.75%, due 2009	125	125
7.10%, due 2010	300	300
6.50%, due 2011	350	350
5.40%, due 2013	200	200
6.00%, due 2014	100	100
7.10%, due 2016	300	300
6.65%, due 2027	100	100
6.45%, due 2028	200	200
6.50%, due 2029	175	175
11.40%, due 2031		
Principal	151	151
Effect of coupon repurchase	(44)	(34)
6.85%, due 2032	200	200
6.54%, due 2033	200	200
8.75%, due 2033	200	200
6.05%, due 2034	200	200
6.15%, due 2035	200	200
5.90%, due 2036	300	300
6.45%, due 2039	200	200
7.00%, due 2040	150	150
5.86%, due 2043	55	55
Other at a weighted average interest rate of 9.57%, due 2008 to 2043	17	21
VIE loans payable <sup>(iii)</sup> (note 28)	153	124
Capital lease obligations <sup>(iii)</sup> (note 20)	62	32
<b>Total long term debt</b>	<b>6,146</b>	<b>6,123</b>
Less – amount due within one year	(432)	(27)
– amount due on demand (note 17)	(220)	(178)
	<b>\$ 5,494</b>	<b>\$ 5,918</b>

## Notes to the Consolidated Financial Statements

The schedule of repayment of long term debt, inclusive of VIE and other debt, based on maturity, excluding the Debentures and the amount due on demand, is as follows: 2008 – \$432; 2009 – \$399; 2010 – \$326; 2011 – \$676; 2012 – \$24; thereafter – \$3,912.

(i) During 2007, Weston issued \$42 (2006 – \$40) of Series B Debentures due on demand, which are at a current weighted average interest rate of 5.18%. The Series A, 7.00% and Series B Debentures are secured by a pledge of 9.6 million Loblaw common shares.

(ii) In 1998, Weston sold its Forest Products business to Domtar for proceeds of \$803, consisting of \$435 of cash and \$368 of Domtar common shares. The Domtar common share investment was recorded in other assets (see note 15). Weston subsequently issued \$375 of 3% Exchangeable Debentures due June 30, 2023. On March 7, 2007, pursuant to a transaction whereby Domtar was combined with the fine paper business of Weyerhaeuser Inc., Domtar common shares were exchanged for an equal number of either non-voting exchangeable shares of Domtar (Canada) Paper Inc. or common shares of Domtar Corporation (“New Domtar”). The Company elected to receive exchangeable shares of Domtar (Canada) Paper Inc. in exchange for its Domtar common shares. See note 25 for further implications of this transaction to the Company.

Each one thousand dollar principal amount of the Debentures is exchangeable at the option of the holder for 95.2381 New Domtar common shares. The Debentures became redeemable at the option of Weston after June 30, 2005. Upon notice of redemption by Weston or within 30 days prior to the maturity date, the holder has the option to exchange each one thousand dollar principal amount for 95.2381 New Domtar common shares plus accrued interest payable in cash.

Weston's obligation on the exchange or redemption of the Debentures can be satisfied by delivery of a cash amount equivalent to the current market price of the common shares of New Domtar at such time, the common shares of New Domtar or any combination thereof. Upon maturity, Weston at its option may deliver cash, the New Domtar common shares or any combination thereof equal to 95.2381 New Domtar common shares for each one thousand dollar principal amount of these Debentures. During a transitional period, during 2007, whereby New Domtar was awaiting certain regulatory approvals regarding the delivery of New Domtar shares in exchange for exchangeable shares of Domtar (Canada) Paper Inc., Weston offered on the exchange or redemption of these Debentures, the exchangeable shares of Domtar (Canada) Paper Inc. On June 25, 2007, regulatory approval was received.

During 2007, \$3 (2006 – \$5) of the 3% Exchangeable Debentures were exchanged for the underlying shares. A corresponding reduction in the investment in Domtar (Canada) Paper Inc. was recorded.

Commencing January 1, 2007, the carrying amount of the Debentures is based on the market price of the underlying common shares. During 2007, a gain of \$44 was recorded in operating income related to the Debentures. Prior to January 1, 2007, the carrying amount of the Debentures was based on their market price and any fair value gain or loss was deferred on the consolidated balance sheet as the Debentures were part of a designated hedging relationship.

(iii) Pursuant to the requirements of AcG 15, the consolidated balance sheet as at December 31, 2007 includes \$183 (2006 – \$156) of loans payable and capital lease obligations of VIEs consolidated by the Company, \$32 (2006 – \$23) of which is due within one year.

The VIE loans payable of \$153 (2006 – \$124) represent financing obtained by eligible Loblaw independent franchisees through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixtures and equipment. The loans payable, which have an average term to maturity of 7 years (2006 – 8 years), are due and payable on demand under certain predetermined circumstances and are secured through a general security agreement made by the independent franchisees in favour of the independent funding trust. Interest is charged on a floating rate basis and prepayment of the loans may be made without penalty. The independent funding trust within the structure finances its activities through the issuance of short term asset-backed commercial paper (“ABCP”) to third-party investors. The independent funding trust has a global style liquidity agreement from a major Canadian chartered bank in the event that it is unable to issue short term ABCP. As disclosed in note 25, a standby letter of credit has been provided by a major Canadian chartered bank for the benefit of the independent funding trust equal to approximately 10% of the total principal amount of the loans outstanding at any point in time. Loblaw has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. In the event of a default by an independent franchisee and Loblaw has not, within a specified time period assumed the loan, or the default is not otherwise remedied, the independent funding trust shall assign the loan to Loblaw and draw upon the standby letter of credit. See note 28 for a further discussion on the independent funding trust financing.

During 2006, Weston repaid its \$200 of 5.25% Medium Term Notes (“MTN”) as they matured. In addition, during 2006, Loblaw repaid its \$125 of 8.70% Series 1996 Provigo Inc. Debenture as it matured.

The fair value of long term debt issues at year end 2007 is \$6,090 (2006 – \$6,791). The fair value of long term debt issues excluding the Debentures was estimated based on the discounted cash flows of the debt at the Company's estimated incremental borrowing rates for debt of the same remaining maturities. The fair value of the Debentures was estimated based on the market price at the reporting date.

## 19. OTHER LIABILITIES

	2007	2006
Accrued benefit plan liability (note 16)	\$ 345	\$ 325
Accrued insurance liabilities	122	138
Asset retirement obligation	19	20
Goods and Services Tax and provincial sales taxes	23	14
Restructuring and other charges (note 4)	21	21
Stock-based compensation liability (note 23)	17	28
Unrealized equity swaps and forwards liability (note 24)	174	60
Unrealized interest rate swap liability (note 24)	28	
Other	82	82
Other liabilities	\$ 831	\$ 688

Total accrued insurance liabilities are \$165 (2006 – \$188), of which \$122 (2006 – \$138) is included in other liabilities and \$43 (2006 – \$50) in accounts payable and accrued liabilities. Included in total accrued insurance liabilities of \$165 (2006 – \$188) are \$112 (2006 – \$132) of United States workers' compensation liabilities. The related cost and accrued workers' compensation liabilities are based on actuarial valuations which are dependent on assumptions determined by management. The discount rate used in determining the 2007 workers' compensation cost and liability was 5.0% (2006 – 6.0%). The total workers' compensation liability is equal to the ultimate actuarial loss estimate less any actual losses paid to date. Any change in the workers' compensation liability is recognized immediately in operating income.

The United States workers' compensation cost associated with the workers' compensation liability was \$34 in 2007 (2006 – \$43).

## 20. LEASES

### As Lessee

Future minimum lease payments relating to the Company's operating leases are as follows:

	Payments due by year						2007 Total	2006 Total
	2008	2009	2010	2011	2012	Thereafter to 2046		
Operating lease payments	\$ 222	\$ 194	\$ 168	\$ 144	\$ 121	\$ 718	\$ 1,567	\$ 1,643
Expected sub-lease income	(40)	(34)	(29)	(23)	(19)	(84)	(229)	(252)
Net operating lease payments	\$ 182	\$ 160	\$ 139	\$ 121	\$ 102	\$ 634	\$ 1,338	\$ 1,391

### Capital Leases

Capital lease obligations of \$62 (2006 – \$32) are included in the consolidated balance sheet as at year end (see note 18). These Loblaw capital lease obligations are related primarily to equipment of the third-party VIE that provides distribution and warehousing services. The amount due within one year is \$9 (2006 – \$4).

## Notes to the Consolidated Financial Statements

### Sale-Leaseback

In 2007, Loblaw completed a sale-leaseback transaction of property and a partially constructed building ("Property") for a total purchase price of \$109, subject to a vendor take back mortgage of \$27 which bears interest at 6% due in 2009. There was no gain or loss recorded on the sale of the Property. Loblaw has leased back the Property for a term of 20 years, with options to renew for an additional 20 years, and in turn subleased the Property to a third-party logistics provider. The leaseback was accounted for as an operating lease and commences in 2008. Loblaw also entered into a warehousing and distribution agreement with the third-party logistics provider, which will use this Property to provide services to Loblaw.

### 21. SHARE CAPITAL

	2007	2006
Common share capital	\$ 133	\$ 133
Preferred shares, Series I	228	228
Preferred shares, Series II	260	260
Preferred shares, Series III	196	196
Preferred shares, Series IV	197	197
Preferred shares, Series V	196	196
Share capital	\$ 1,210	\$ 1,210

### Common Share Capital (authorized – unlimited)

The changes in the common shares issued and outstanding during the year were as follows:

	2007		2006	
	Number of Common Shares	Common Share Capital	Number of Common Shares	Common Share Capital
Issued and outstanding, beginning of year	129,074,526	\$ 133	129,038,226	\$ 131
Issued from treasury <sup>(1)</sup>			36,300	2
Issued and outstanding, end of year	129,074,526	\$ 133	129,074,526	\$ 133
Weighted average outstanding	129,074,526		129,042,005	

(1) 2006 share capital includes \$2 issued for stock options exercised (see note 23).

### Preferred Shares, Series I (authorized – unlimited) (\$)

Weston has 9.4 million 5.80% Preferred Shares, Series I outstanding, which entitle the holder to a fixed cumulative preferred cash dividend of \$1.45 per share per annum. Weston may, at its option, redeem for cash, in whole or in part, these outstanding preferred shares as follows:

- On or after December 15, 2006 at \$26.00 per share
- On or after December 15, 2007 at \$25.75 per share
- On or after December 15, 2008 at \$25.50 per share
- On or after December 15, 2009 at \$25.25 per share
- On or after December 15, 2010 at \$25.00 per share

At any time after issuance, Weston may, at its option, give the holders of these preferred shares the right, at the option of the holder, to convert their preferred shares into preferred shares of a further series designated by Weston on a share-for-share basis on a date specified by Weston.

**Preferred Shares, Series II (authorized – unlimited) (\$)**

Weston has 10.6 million 5.15% Preferred Shares, Series II outstanding, which entitle the holder to a fixed cumulative preferred cash dividend of \$1.2875 per share per annum. On or after April 1, 2009, Weston may, at its option, redeem for cash, in whole or in part, these outstanding preferred shares at \$25.00 per share. On and after July 1, 2009, these outstanding preferred shares are convertible, at the option of the holder, into a number of Weston's common shares determined by dividing \$25.00 by the greater of \$2.00 and 95% of the then current market price of Weston's common shares. At any time after issuance, Weston may, at its option, give the holders of these preferred shares the right, at the option of the holder, to convert their preferred shares into preferred shares of a further series designated by Weston on a share-for-share basis on a date specified by Weston.

**Preferred Shares, Series III (authorized – unlimited) (\$)**

Weston has 8.0 million 5.20% Preferred Shares, Series III outstanding, which entitle the holder to a fixed cumulative preferred cash dividend of \$1.30 per share per annum. Weston may, at its option, redeem for cash, in whole or in part, these outstanding preferred shares as follows:

On or after July 1, 2010 at \$26.00 per share

On or after July 1, 2011 at \$25.75 per share

On or after July 1, 2012 at \$25.50 per share

On or after July 1, 2013 at \$25.25 per share

On or after July 1, 2014 at \$25.00 per share

At any time after issuance, Weston may, at its option, give the holders of these preferred shares the right, at the option of the holder, to convert their preferred shares into preferred shares of a further series designated by Weston on a share-for-share basis on a date specified by Weston.

**Preferred Shares, Series IV (authorized – unlimited) (\$)**

Weston has 8.0 million 5.20% Preferred Shares, Series IV outstanding, which entitle the holder to a fixed cumulative preferred cash dividend of \$1.30 per share per annum. Weston may, at its option, redeem for cash, in whole or in part, these outstanding preferred shares as follows:

On or after October 1, 2010 at \$26.00 per share

On or after October 1, 2011 at \$25.75 per share

On or after October 1, 2012 at \$25.50 per share

On or after October 1, 2013 at \$25.25 per share

On or after October 1, 2014 at \$25.00 per share

At any time after issuance, Weston may, at its option, give the holders of these preferred shares the right, at the option of the holder, to convert their preferred shares into preferred shares of a further series designated by Weston on a share-for-share basis on a date specified by Weston.

**Preferred Shares, Series V (authorized – unlimited) (\$)**

During 2006, Weston issued 8.0 million 4.75% Preferred Shares, Series V for \$25.00 per share for net proceeds of \$194 million, which entitle the holder to a fixed cumulative preferred cash dividend of \$1.1875 per share per annum. In addition, included in share capital is a future tax benefit of \$2 million related to the deductibility of the issuance costs. Weston may, at its option, redeem for cash, in whole or in part, these outstanding preferred shares as follows:

On or after July 1, 2011 at \$26.00 per share

On or after July 1, 2012 at \$25.75 per share

On or after July 1, 2013 at \$25.50 per share

On or after July 1, 2014 at \$25.25 per share

On or after July 1, 2015 at \$25.00 per share

At any time after issuance, Weston may, at its option, give the holders of these preferred shares the right, at the option of the holder, to convert their preferred shares into preferred shares of a further series designated by Weston on a share-for-share basis on a date specified by Weston.

## Notes to the Consolidated Financial Statements

### Normal Course Issuer Bid ("NCIB") (\$)

Weston intends to file a NCIB to purchase on the Toronto Stock Exchange or enter into equity derivatives to purchase up to 5% of each class of its common and preferred shares outstanding. Weston, in accordance with the rules and by-laws of the Toronto Stock Exchange, may purchase its common and preferred shares at the then market price of such shares. Weston did not purchase any common shares under its NCIB during 2007 or 2006.

### 22. ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table provides further detail regarding the composition of accumulated other comprehensive loss for the year ended December 31, 2007:

	Foreign Currency Translation Adjustment	Cash Flow Hedges	Available-for- Sale Assets	Total
Balance, beginning of year	\$ (503)			\$ (503)
Cumulative impact of implementing new accounting standards <sup>(1)</sup> (note 2)		\$ (4)	\$ 13	9
Foreign currency translation adjustment	(508)			(508)
Net unrealized loss on available-for-sale financial assets <sup>(2)</sup>			(35)	(35)
Reclassification of loss on available-for-sale financial assets <sup>(3)</sup>			20	20
Net gain on derivative instruments designated as cash flow hedges <sup>(4)</sup>		36		36
Reclassification of gain on derivative instruments designated as cash flow hedges <sup>(5)</sup>		(18)		(18)
Balance, end of year	\$ (1,011)	\$ 14	\$ (2)	\$ (999)

(1) Net of income taxes of \$1 and minority interest of \$6.

(2) Net of income taxes of \$5 and minority interest of \$21.

(3) Net of income taxes of nil and minority interest of \$13.

(4) Net of income taxes of \$2 and minority interest of \$22.

(5) Net of income taxes of \$2 and minority interest of \$12.

An estimated net gain of \$12, net of income taxes and minority interest, recorded in accumulated other comprehensive loss related to the cash flow hedges as at December 31, 2007, is expected to be reclassified to net earnings during the next 12 months. This will be offset by the estimated loss on available-for-sale financial assets that are hedged. Remaining amounts will be reclassified to net earnings over periods up to 4 years.

During 2007, the change in the cumulative foreign currency translation adjustment increased accumulated other comprehensive loss by \$508 (2006 – decreased accumulated other comprehensive loss by \$15). This change was due to the negative (2006 – positive) impact of translating the Company's net investment in self-sustaining foreign operations due to the appreciation (2006 – depreciation) of the Canadian dollar relative to the United States dollar.

### 23. STOCK-BASED COMPENSATION (\$ except table)

The Company maintains five types of stock-based compensation plans, which are described below.

#### Stock Option Plans

Weston maintains a stock option plan for certain employees. Under this plan, Weston may grant options for up to seven million of its common shares; however, Weston has set a guideline which limits the number of stock option grants to a maximum of 5% of outstanding common shares at any time. Stock options have up to a seven-year term, vest 20% cumulatively on each anniversary of the date of the grant and are exercisable at the designated common share price, which is 100% of the market price of Weston's common shares on the last trading day prior to the effective date of the grant. Each stock option is exercisable into one common share of Weston at the price specified in the terms of the option agreement, or option holders may elect to receive in cash the share appreciation value equal to the excess of the market price at the date of exercise over the specified option price.

During 2007, Weston granted 693,327 (2006 – nil) stock options with a weighted average exercise price of \$72.23 (2006 – nil) per common share under its existing stock option plan, which allows for settlement in shares or in the share appreciation value in cash at the option of the employee.

During 2007, the share appreciation value of \$0.5 million (2006 – \$1 million) was paid on the exercise of 21,965 (2006 – 58,550) stock options and 180,306 (2006 – 91,792) stock options were forfeited or cancelled. In 2006, Weston issued 36,300 common shares on the exercise of stock options and received cash consideration of \$2 million, for which it had recorded a stock-based compensation liability of nil.

Loblaw maintains a stock option plan for certain employees. Under this plan, Loblaw may grant options for up to 20.4 million of its common shares; however, Loblaw has set a guideline which limits the number of stock option grants to a maximum of 5% of outstanding common shares at any time. Stock options have up to a seven-year term, vest 20% cumulatively on each anniversary date of the grant and are exercisable at the designated common share price, which is 100% of the market price of Loblaw's common shares on the last trading day prior to the effective date of the grant. Each stock option is exercisable into one common share of Loblaw at the price specified in the terms of the option agreement, or option holders may elect to receive in cash the share appreciation value equal to the excess of the market price at the date of exercise over the specified option price.

During 2007, Loblaw granted 4,368,980 (2006 – 189,354) stock options with a weighted average exercise price of \$47.28 (2006 – \$55.30) per common share under its existing stock option plan, which allows for settlement in shares or in the share appreciation value in cash at the option of the employee.

During 2007, the share appreciation value of a nominal amount (2006 – \$11 million) was paid by Loblaw on the exercise of 108,000 (2006 – 815,403) stock options. Loblaw issued nil (2006 – 118,750) common shares on the exercise of stock options and received cash consideration of nil (2006 – \$4 million), for which it had recorded a stock-based compensation liability of nil (2006 – \$0.1 million).

#### Share Appreciation Right Plan

Weston maintains a share appreciation right plan for certain senior United States employees. Share appreciation rights have up to a seven-year term, vest 20% cumulatively on each anniversary date of the grant and are exercisable at the designated common share price, which is 100% of the market price of Weston's common shares on the last trading day prior to the effective date of the grant.

When they are exercised, the employee will receive in cash the share appreciation value equal to the excess of the market price at the date of exercise over the specified right price.

In 2007, 125,400 (2006 – 10,400) share appreciation rights were forfeited or cancelled.

#### Restricted Share Unit (“RSU”) Plans

Weston and Loblaw maintain a RSU plan for certain senior employees. The RSUs entitle employees to a cash payment after the end of each performance period, of up to 3 years, following the date of the award. The RSU payment will be an amount equal to the weighted average price of a Weston or Loblaw common share for a prescribed period preceding the end of the performance period for the RSUs multiplied by the number of RSUs held by the employee.

During 2007, Weston granted 36,099 (2006 – 148,049) RSUs to 40 (2006 – 100) employees, 27,833 (2006 – 6,396) RSUs were cancelled and 16,818 (2006 – 2,643) were paid out in the amount of \$1 million (2006 – nominal). In addition, during 2007, Loblaw granted 335,056 (2006 – 691,001) RSUs to 349 (2006 – 238) employees, 161,621 (2006 – 211,526) RSUs were cancelled and 154,700 (2006 – 112,707) were paid out in the amount of \$8 million (2006 – \$6 million). At year end, a total of 290,359 (2006 – 298,911) Weston and 768,687 (2006 – 749,952) Loblaw RSUs were outstanding.

The following table summarizes the Company's cost recognized in operating income related to its stock-based compensation plans, related equity swaps and forwards and restricted share unit plans:

(\$ millions)	2007	2006
Stock option plans/share appreciation right plan income		\$ (11)
Equity swaps and forwards loss (note 24)	\$ 100	48
Restricted share unit plan expense	9	23
Net stock-based compensation cost	\$ 109	\$ 60

## Notes to the Consolidated Financial Statements

### Deferred Share Unit (“DSU”) Plans

Members of Weston's and Loblaw's Boards of Directors, who are not management of the Company, may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of DSUs, the value of which is determined by the market price of Weston's or Loblaw's common shares at the time the director's annual retainer(s) or fees are earned. Upon termination of Board service, the common shares due to the director, as represented by the DSUs, will be purchased on the open market on the director's behalf. At year end, Weston had 41,023 (2006 – 28,303) and Loblaw had 56,082 (2006 – 44,397) DSUs outstanding. The year-over-year change in the DSU compensation liability was minimal and was recognized in operating income.

### Employee Share Ownership Plans (“ESOPs”)

Weston and Loblaw maintain ESOPs for their employees which allow employees to acquire Weston's and Loblaw's common shares through regular payroll deductions of up to 5% of their gross regular earnings. Weston and Loblaw contribute an additional 25% (2006 – 25%) of each employee's contribution to its plan. The ESOPs are administered through a trust which purchases Weston's and Loblaw's common shares on the open market on behalf of employees. A compensation cost of \$7 million (2006 – \$7 million) related to these plans was recognized in operating income.

Weston's stock option and share appreciation right transactions were as follows:

	2007		2006	
	Options/ Rights (number of shares)	Weighted Average Exercise Price/Share	Options/ Rights (number of shares)	Weighted Average Exercise Price/Share
Outstanding options/rights, beginning of year	1,934,258	\$ 99.84	2,131,300	\$ 97.68
Granted	693,327	\$ 72.23		
Exercised	(21,965)	\$ 53.70	(94,850)	\$ 49.70
Forfeited/cancelled	(305,706)	\$ 99.19	(102,192)	\$ 101.41
Outstanding options/rights, end of year <sup>(1,2)</sup>	2,299,914	\$ 92.05	1,934,258	\$ 99.84
Options/rights exercisable, end of year <sup>(2)</sup>	1,062,847	\$ 97.82	911,515	\$ 95.55

(1) Options/rights outstanding represented approximately 1.8% (2006 – 1.5%) of the Company's issued and outstanding common shares, which was within the Company's guideline of 5%.

(2) Included in the outstanding balance are 357,593 (2006 – 482,993) share appreciation rights at a weighted average exercise price of \$101.64 (2006 – \$101.20). Included in the exercisable balance are 240,671 (2006 – 236,393) share appreciation rights at a weighted average exercise price of \$99.49 (2006 – \$98.54).

The following table summarizes information about Weston's stock option and share appreciation rights outstanding:

	2007				
	Outstanding Options/Rights			Exercisable Options/Rights	
Range of Exercise Prices (\$)	Number of Options/ Rights Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price/Share	Number of Exercisable Options/ Rights	Weighted Average Exercise Price/Share
\$72.21 – \$ 78.85	773,195	6	\$ 72.93	81,168	\$ 78.85
\$93.35 – \$111.02 <sup>(1)</sup>	1,526,719	3	\$ 101.73	981,679	\$ 99.39

(1) Included in the outstanding balance are 357,593 share appreciation rights with a weighted average remaining contractual life of 3 years and a weighted average exercise price of \$101.64. Included in the exercisable balance are 240,671 share appreciation rights with a weighted average exercise price of \$99.49.

## 24. FINANCIAL INSTRUMENTS

A summary of Weston's and Loblaw's outstanding derivative instruments is as follows:

### Notional Amounts

	Notional Amounts Maturing in						2007 Total	2006 Total
	2008	2009	2010	2011	2012	Thereafter		
Cross currency basis swaps	\$ 140	\$ 31	\$ 174	\$ 56	\$ 166	\$ 533	\$ 1,100	\$ 1,060
Interest rate swaps receivable	\$ 240	\$ 140	\$ 50	\$ 200			\$ 630	\$ 630
Interest rate swaps payable						\$ 150	\$ 150	\$ 150
Equity swaps and forwards associated with stock-based compensation			\$ 206	\$ 35	\$ 25	\$ 162	\$ 428	\$ 421
Equity forward associated with the forward sale of Loblaw common shares						\$ 692	\$ 692	\$ 649
Electricity forward contract	\$ 9	\$ 8	\$ 8	\$ 8			\$ 33	\$ 42

Notional amounts do not represent assets or liabilities and are therefore not recorded on the consolidated balance sheet. The notional amounts are used in order to calculate the payments to be exchanged under the contracts.

### Cross Currency Basis Swaps

Loblaw enters into cross currency basis swaps to manage its exposure to fluctuations in the foreign currency exchange rate on a portion of its United States dollar denominated cash, cash equivalents and short term investments.

Loblaw entered into cross currency basis swaps to exchange United States dollars for \$1.1 billion (2006 – \$1.1 billion) Canadian dollars, which mature by 2017. Cross currency basis swaps totalling \$590 are designated in a cash flow hedge and the remaining undesignated \$510 are classified as held-for-trading financial assets. Currency adjustments receivable or payable arising from these swaps are settled in cash on maturity. At year end, a cumulative unrealized foreign currency exchange rate receivable of \$270 (2006 – \$165) was recorded in other assets (see note 15).

### Interest Rate Swaps

Loblaw enters into interest rate swaps to manage a portion of its exposure to fluctuations in interest rates. Loblaw's interest rate swaps convert a notional \$630 (2006 – \$630) of its floating rate available-for-sale cash equivalents and short term investments to average fixed rate investments at 5.60% (2006 – 5.60%), which mature by 2011. At year end, the fair value of these interest rate swaps of \$9 was recorded in other assets (see note 15) and the unrealized fair value gain of \$6, net of income taxes and minority interest, was deferred in accumulated other comprehensive loss, related to these interest rate swaps. When realized, these unrealized gains are reclassified to net earnings. Prior to January 1, 2007, these unrealized gains or losses were not recognized on the consolidated balance sheet.

During 2007, Loblaw terminated hedge accounting for its interest rate swaps previously designated as a cash flow hedge of the variable interest rate exposure on commercial paper. These interest rate swaps converted a notional \$150 (2006 – \$150) of floating rate commercial paper debt to an average fixed rate debt of 8.37% (2006 – 8.37%) which matures by 2013. As a result of this termination, the cumulative loss of \$1, net of income taxes and minority interest, in accumulated other comprehensive loss was reclassified to net earnings. At year end, the fair value of these interest rate swaps of \$28 was recorded in other liabilities (see note 19). Prior to January 1, 2007, these unrealized gains or losses were not recognized on the consolidated balance sheet.

## Notes to the Consolidated Financial Statements

### Equity Swaps and Forwards (\$, except where otherwise indicated)

In 2007, Weston had cumulative outstanding equity swaps in its common shares of 1,686,700 (2006 – 1,686,700) at an average forward price of \$103.17 (2006 – \$103.17). In 2007, Loblaw had cumulative outstanding equity forwards in its common shares of 4.8 million (2006 – 4.8 million), at a cumulative average forward price of \$53.14 (2006 – \$51.43) including \$8.27 (2006 – \$6.56) per common share of interest expense net of dividends that has been recognized in net earnings from continuing operations and will be paid at termination. These swaps and forwards allow for several methods of settlement including net cash settlement. These equity swaps and forwards change in value as the market prices of the underlying common shares change and provide a partial offset to fluctuations in Weston's and Loblaw's stock-based compensation costs, including RSU plan expense. The partial offset between the Company's stock-based compensation costs, including RSU plan expense, and the equity derivatives is effective when the market prices of Weston and Loblaw common shares exceed the exercise price of the related employee stock options. When the market prices of Weston and Loblaw common shares are lower than the exercise price of the related employee stock options, these equity derivatives will provide a partial offset only to RSU plan expenses. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised stock options and RSUs and their vesting schedules relative to the number of underlying common shares on the equity derivatives and the level of and fluctuations in the market prices of the respective underlying common shares. At year end, the fair value of these Weston swaps of \$83 million (2006 – \$47 million) was recorded in other liabilities and the fair value, interest and dividends of these Loblaw forwards of \$91 million (2006 – \$13 million) was also recorded in other liabilities (see note 19). During 2007, a fair value loss of \$100 million (2006 – \$48 million) was recorded in operating income related to these equity swaps and forwards (see note 23).

In 2001, Weston entered into an equity forward sale agreement based on 9.6 million Loblaw common shares at an original forward price of \$48.50 per Loblaw common share which, under the terms of the agreement, had increased to a forward price of \$72.06 (2006 – \$67.64) per Loblaw common share as at December 31, 2007. The forward matures in 2031 and will be settled in cash as follows: Weston will receive the forward price and will pay the market value of the underlying Loblaw common shares at maturity. The obligation of Weston under this forward is secured by the underlying Loblaw common shares. Weston entered into this forward to partially offset any repayment risk associated with its Series A, 7.00% and Series B Debentures. Further, if the market value of the underlying Loblaw common shares exceeds the obligation of Weston under this forward, a portion of the proceeds from a future sale of these shares may be used to satisfy the obligation under this forward contract upon termination or maturity. Weston recognizes a non-cash charge or income, which is included in consolidated interest expense and other financing charges, representing the fair value adjustment of Weston's forward sale agreement for 9.6 million Loblaw common shares. The fair value adjustment of the forward contract is a non-cash item resulting from fluctuations in the market price of the underlying Loblaw common shares that Weston owns. Weston does not record any change in the market price associated with the Loblaw common shares that it owns. At maturity, if the forward price is greater than the market price, Weston will receive a cash amount equal to the difference. If the forward price is less than the market price, Weston will pay a cash amount equal to the difference. Any cash paid under the forward contract could be offset by the sale of Loblaw common shares. At year end, the fair value of this equity forward sale agreement based on 9.6 million Loblaw common shares of \$365 million (2006 – \$181 million) was recorded in other assets (see note 15). During 2007, a fair value gain of \$141 million (2006 – \$73 million) was recorded in interest expense and other financing charges related to this forward (see note 6).

### Electricity Forward Contract

Loblaw entered into an electricity forward contract to minimize price volatility and to maintain a portion of its electricity costs in Alberta, Canada at approximately 2006 rates. This electricity forward contract has an initial term of five years and expires in December 2011. Commencing January 1, 2007, Loblaw is required to measure its electricity forward contract at fair value in accordance with Section 3855. At year end, the fair value of this Loblaw forward contract of \$5 was recorded in other assets (see note 15). During 2007, a loss in value of \$2 was recorded in operating income. Prior to January 1, 2007, this non-financial derivative instrument was not recognized on the comparative consolidated balance sheet and therefore gains and losses due to fair value changes in the contract were also not recognized in the consolidated statement of earnings.

### Commodity Derivatives

The Company uses commodity futures and options to manage its anticipated exposure to fluctuations in commodity prices. At year end, the fair value of the commodity futures of \$21 (2006 – \$1) was recorded in accounts receivable. During 2007, a fair value gain of \$19 (2006 – nil) was recorded in operating income relating to futures which were not designated in a cash flow hedge while a fair value gain of \$1 was deferred in accumulated other comprehensive loss relating to futures which were designated in a cash flow hedge. At year end, the fair value of the commodity options was not significant nor was the 2007 fair value gain related to these options.

### Fair Value of Derivative Instruments

The fair value of derivative instruments is the estimated amount that the Company would receive or pay to terminate the instrument agreement at the reporting date. The fair values have been determined by reference to prices available from the markets on which the instruments trade and prices provided by counterparties. Commencing January 1, 2007, the fair value of all derivative instruments approximated their carrying value and are recorded on the consolidated balance sheet. Prior to January 1, 2007, the interest rate swaps were not recorded on the comparative consolidated balance sheet. The fair value of the unrecorded unrealized interest rate swap receivable was \$17 at December 31, 2006.

The following table summarizes the change in fair value of financial assets and financial liabilities, including non-financial derivatives, classified as held-for-trading, recognized in 2007 in net earnings, before income taxes and minority interest.

	2007	
	Designated as held-for-trading	Required to be classified as held-for-trading
Cash equivalents and short term investments	\$ 76	
Electricity forward		\$ 2
Interest rate swaps		5
Cross currency basis swaps		(79)
Commodity futures fair value adjustment		(19)
Equity forward sale agreement based on 9.6 million Loblaw common shares		(183)
Equity swaps and forwards associated with stock-based compensation		112
Exchangeable shares of Domtar (Canada) Paper Inc. <sup>(1)</sup>	44	
Fair value loss (gain)	\$ 120	\$ (162)

(1) The impact of this fair value adjustment on operating income is substantially offset by the re-measurement of the Debentures, as discussed previously.

### Fair Value of Other Financial Instruments

The fair values of accounts receivable, bank indebtedness, commercial paper, accounts payable and accrued liabilities and short term bank loans approximate their carrying values given their short term maturities. See note 18 for the carrying values and fair values of long term debt.

The equity investment in Loblaw franchises is measured at cost because there are no quoted market prices in an active market and these investments are classified as available-for-sale.

### Foreign Currency Exchange Rate Risk

At year end, the Company had \$1.4 billion (2006 – \$1.2 billion) in cash and cash equivalents and \$603 (2006 – \$610) in short term investments, the majority of which are denominated in United States dollars and are held or managed by Glenhuron.

Loblaw is exposed to foreign currency exchange rate variability on its cash, cash equivalents and short term investments. To manage this risk, Loblaw designates a portion of its cross currency basis swaps in a cash flow hedge of the exposure to fluctuations in the foreign currency exchange rate on a portion of its United States dollar denominated cash equivalents and short term investments. The remaining undesignated cross currency basis swaps economically hedge exposure to fluctuations in the foreign currency exchange rate on the remaining United States dollar denominated cash, cash equivalents and short term investments.

During 2007, the unrealized foreign currency exchange loss of \$79 before income taxes and minority interest, related to the cash equivalents and short term investments classified as available-for-sale was recognized in accumulated other comprehensive loss and was partially offset by the unrealized foreign currency exchange rate gain of \$72 before income taxes and minority interest relating to the designated cross currency basis swaps also deferred in accumulated other comprehensive loss. The unrealized foreign currency exchange loss of \$76 on the designated held-for-trading cash, cash equivalents and short term investments is partially offset in operating income by the unrealized foreign currency exchange rate gain of \$79 relating to the cross currency basis swaps which are not designated in a cash flow hedge. During 2007, Loblaw realized a foreign currency exchange gain of \$46 relating to cross currency basis swaps that matured or were terminated.

## Notes to the Consolidated Financial Statements

The Company's consolidated financial statements are expressed in Canadian dollars but a significant portion of its Weston Foods business occurs in United States dollars through its net investment in self-sustaining foreign operations, primarily in the United States ("U.S. net investment"). The U.S. net investment is translated into Canadian dollars at the foreign currency exchange rate in effect at each balance sheet date. As a result, the Company is exposed to exchange rate gains and losses which are recorded in other comprehensive loss with the offset in the reported Canadian dollar value of the related assets and liabilities included in the U.S. net investment. During 2007, the Canadian dollar appreciated relative to the United States dollar, resulting in a reduction of the Company's U.S. net investment and a corresponding increase in other comprehensive loss of \$508. In addition, revenues and expenses of these self-sustaining foreign operations are translated into Canadian dollars at the average foreign currency exchange rate for the year. An appreciating Canadian dollar relative to the United States dollar will negatively impact the year-over-year change in reported sales, operating income and net earnings, while a depreciating Canadian dollar relative to the United States dollar will have the opposite impact.

### Credit Risk

The Company is exposed to credit risk resulting from the possibility that counterparties may default on their financial obligations, or if there is a concentration of transactions carried out with the same counterparty or of financial obligations which have similar economic characteristics such that they could be similarly affected by changes in economic conditions. Exposure to credit risk relates to derivative instruments, cash equivalents and short term investments, amounts receivable from Weston Foods customers and suppliers, PC Bank's credit card receivables and accounts receivable from independent franchisees, associates and independent accounts.

The Company may be exposed to losses should any counterparty to the Company's financial or non-financial derivative agreements fail to fulfill its obligations. The Company has sought to minimize potential counterparty risk and losses by conducting transactions for its derivative agreements with counterparties that have at minimum a long term "A" credit rating from a recognized credit rating agency and by placing risk adjusted limits on its exposure to any single counterparty for its financial derivative agreements.

The Company has internal policies, controls and reporting processes, which require ongoing assessment and corrective action, if necessary, with respect to its derivative transactions. In addition, principal amounts on cross currency basis swaps and equity swaps and forwards are each netted by agreement and there is no exposure to loss of the original notional principal amounts on the interest rate swaps and equity swaps and forwards.

Credit risk associated with the Company's cash equivalents and short term investments results from the possibility that a counterparty may default on the repayment of a security. The Company attempts to mitigate this risk through policies and guidelines that require issuers of permissible investments to have at minimum a long term "A" credit rating from a recognized credit rating agency, that specify minimum and maximum exposures to specific issuers, and that specify the type of instruments to be held by the Company.

Weston Foods performs ongoing credit evaluations to assess the financial condition of its new and existing suppliers and customers for amounts receivable from these counterparties.

Loblaw's exposure to credit risk from PC Bank's credit card receivables and receivables from independent franchisees, associates and independent accounts results from the possibility that customers may default on their payment obligation. PC Bank manages the credit card receivable risk by employing stringent credit scoring techniques, actively monitoring its credit card portfolio and reviewing techniques and technology that can improve the effectiveness of the collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers. Loblaw accounts receivable from independent franchisees, associates and independent accounts are actively monitored on an ongoing basis and settled on a frequent basis in accordance with the terms specified in the applicable agreements.

## 25. CONTINGENCIES, COMMITMENTS AND GUARANTEES

The Company is involved in, and potentially subject to, various claims by third parties arising out of the normal course and conduct of its business including, but not limited to, product liability, labour and employment, regulatory and environmental claims. In addition, the Company is involved in and potentially subject to regular audits from federal, provincial and state tax authorities relating to income, capital and commodity taxes and as a result of these audits, may receive assessments and reassessments. Although such matters cannot be predicted with certainty, management currently considers the Company's exposure to such claims and litigation, to the extent not covered by the Company's insurance policies or otherwise provided for, not to be material to these consolidated financial statements, with the exception of the items disclosed in the Legal Proceedings section below.

At year end, the Company has committed approximately \$114 (2006 – \$161) with respect to capital investment projects such as the construction, expansion and renovation of buildings and the purchase of real property.

The Company establishes standby letters of credit used in connection with certain obligations mainly related to real estate transactions and benefit programs. The aggregate gross potential liability related to these standby letters of credit is approximately \$398 (2006 – \$440), a portion of which is recorded on the consolidated balance sheet. Other standby letters of credit related to the financing program for Loblaw's independent franchisees and securitization of *PC Bank's* credit card receivables have been identified as guarantees and are discussed further in the Guarantees section below.

### Guarantees

The Company has provided to third parties the following significant guarantees as defined pursuant to Accounting Guideline 14, "Disclosure of Guarantees":

#### *Independent Funding Trust*

Certain independent franchisees of Loblaw may obtain financing through a structure involving independent trusts which were created to provide loans to the independent franchisees to facilitate their purchase of inventory and fixed assets, consisting mainly of fixtures and equipment. These trusts are administered by a major Canadian chartered bank. The independent funding trust within the structure finances its activities through the issuance of short term ABCP to third-party investors. The independent funding trust has a global style liquidity agreement from a major Canadian chartered bank in the event that it is unable to issue short term ABCP. The gross principal amount of loans issued to Loblaw's independent franchisees outstanding as of year end 2007 was \$418 (2006 – \$419) including \$153 (2006 – \$124) of loans payable by VIEs consolidated by the Company in 2007 (see note 28). Based on a formula, Loblaw has agreed to provide credit enhancement, in the form of a standby letter of credit for the benefit of the independent funding trust equal to approximately 10% of the principal amount of the loans outstanding at any point in time, \$44 (2006 – \$44) as of year end 2007 (see note 28). This credit enhancement allows the independent funding trust to provide favourable financing terms to Loblaw's independent franchisees. As well, each independent franchisee provides security to the independent funding trust for its obligations by way of a general security agreement. In the event that an independent franchisee defaults on its loan and Loblaw has not, within a specified time period, assumed the loan, or the default is not otherwise remedied, the independent funding trust shall assign the loan to Loblaw and draw upon this standby letter of credit. Loblaw has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. As a result of implementing Section 3855 (see note 2), a liability of \$7 related to the fair value of this standby letter of credit was recognized.

Neither the independent funding trust nor Loblaw can voluntarily terminate the agreement prior to December 2009, and following that date only upon six months' prior notice. Automatic termination of the agreement can only occur if specific, predetermined events occur and are not remedied within the time periods required including downgrades of Loblaw below a long term credit rating of "A (low)" or a short term credit rating of "R-1 (low)" as issued by Dominion Bond Rating Service ("DBRS"). On February 7, 2008, DBRS downgraded Loblaw's long term credit rating to "BBB (high)" from "A (low)" and also lowered Loblaw's short term credit rating to "R-2 (high)" from "R-1 (low)". Subsequent to the DBRS downgrades, Loblaw was notified that an Event of Termination of the independent funding trust agreement for Loblaw's franchisees had occurred as a result of the credit downgrades. The \$44 standby letter of credit provided to the independent funding trust by Loblaw has not been drawn upon. If such an event were to occur, long term debt in the amount of \$126 would need to be reclassified to short term liabilities. This amount relates to certain franchisees that are VIEs that Loblaw currently consolidates. Loblaw is currently in the process of securing alternative financing with a syndicate of banks in the form of a 364-day committed credit facility for the benefit of its franchisees to address this issue. Any new alternative financing structure which might be implemented would need to be reviewed to determine if there are any implications with respect to the consolidation of VIEs. In accordance with Canadian GAAP, the financial statements of the independent funding trust are not consolidated with those of the Company.

## Notes to the Consolidated Financial Statements

### **Standby Letter of Credit**

A standby letter of credit for the benefit of an independent trust with respect to the credit card receivables securitization program of PC Bank has been issued by a major Canadian chartered bank. This standby letter of credit could be drawn upon in the event of a major decline in the income flow from or in the value of the securitized credit card receivables. Loblaw has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. The aggregate gross potential liability under this arrangement, which represents 9% (2006 – 9%) on a portion of the securitized credit card receivables amount, is approximately \$89 (2006 – \$68) (see note 12).

### **Lease Obligations**

In connection with historical dispositions of certain of its assets, the Company has assigned leases to third parties. The Company remains contingently liable for these lease obligations in the event any of the assignees are in default of their lease obligations.

The estimated amount for minimum rent, which does not include other lease related expenses such as property tax and common area maintenance charges, is in aggregate \$79 (2006 – \$111).

### **Indemnification Provisions**

The Company from time to time enters into agreements in the normal course of its business, such as service and outsourcing arrangements and leases, and in connection with business or asset acquisitions or dispositions. These agreements by their nature may provide for indemnification of counterparties. These indemnification provisions may be in connection with breaches of representations and warranties or with future claims for certain liabilities, including liabilities related to tax and environmental matters. The terms of these indemnification provisions vary in duration and may extend for an unlimited period of time. The Company is unable to reasonably estimate its total maximum potential liability as certain indemnification provisions do not provide for a maximum potential amount and the amounts are dependent on the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. Historically, the Company has not made any significant payments in connection with these indemnification provisions.

### **Legal Proceedings**

During 2007, Weston and Loblaw were two of 17 defendants served with an action brought in the Superior Court of Ontario by certain beneficiaries of a multi-employer pension plan in which Loblaw's employees and those of its independent franchisees participate. In their claim against the employers and the trustees of the multi-employer pension plan, the plaintiffs claim that assets of the multi-employer pension plan have been mismanaged and are seeking, among other demands, damages of \$1 billion. The action is framed as a representative action on behalf of all the beneficiaries of the multi-employer pension plan. The Company has received notice from counsel for the plaintiffs indicating that he has received instructions from his client to discontinue the action against the employers, including the Company. The action against the trustees is ongoing and one of the trustees, an officer of Loblaw, may be entitled to indemnification from Loblaw.

On March 7, 2007, pursuant to a transaction whereby Domtar was combined with the fine paper business of Weyerhaeuser Inc., Domtar common shares were exchanged for an equal number of either exchangeable shares of Domtar (Canada) Paper Inc. or common shares of New Domtar. The Company elected to receive exchangeable shares of Domtar (Canada) Paper Inc. in exchange for its Domtar common shares. See note 18 for a further discussion on the exchangeable shares.

The Share Purchase Agreement governing the June 1998 sale by Weston of E.B. Eddy Paper, Inc. to Domtar (the "SPA") contains a price adjustment clause. The SPA provides, subject to certain limited exceptions, that if any person subsequently acquired more than 50% of the outstanding voting shares of Domtar, the price adjustment clause applies. Weston believes that a price adjustment in the amount of \$110 is payable to it by Domtar and Weston has demanded payment of such amount from Domtar. Domtar's position is that the purchase price adjustment does not apply because of the application of an exception contained in the SPA. Weston has commenced an action against Domtar for \$110. The parties have exchanged legal pleadings.

In addition to the claim described above, the Company is the subject of various legal proceedings and claims that arise in the ordinary course of business. The outcome of all of these proceedings is uncertain. However, based on information currently available, these claims, individually and in the aggregate, are not expected to have a material impact on the Company.

## **26. VARIABLE INTEREST ENTITIES (“VIEs”)**

Pursuant to AcG 15, Loblaw consolidates all VIEs for which it is the primary beneficiary. AcG 15 defines a VIE as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest. AcG 15 requires the primary beneficiary to consolidate VIEs and considers an entity to be the primary beneficiary of a VIE if it holds variable interests that expose it to a majority of the VIE’s expected losses or that entitle it to receive a majority of the VIE’s expected residual returns or both. Loblaw has identified the following significant VIEs:

### ***Independent Franchisees***

Loblaw enters into various forms of franchise agreements that generally require the independent franchisee to purchase inventory from Loblaw and pay certain fees in exchange for services provided by Loblaw and for the right to use certain trademarks and licenses owned by Loblaw. Independent franchisees generally lease the land and building from Loblaw, and when eligible, may obtain financing through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixtures and equipment. These trusts are administered by a major Canadian chartered bank. Under the terms of certain franchise agreements, Loblaw may also lease equipment to independent franchisees. Independent franchisees may also obtain financing through operating lines of credit with traditional financial institutions or through issuing preferred shares or notes payable to Loblaw. Loblaw monitors the financial condition of its independent franchisees and provides for estimated losses or write-downs on its accounts and notes receivable or investments when appropriate.

As at year end 2007, 137 (2006 – 123) of Loblaw’s independent franchise stores met the criteria for a VIE and were consolidated pursuant to AcG 15.

### ***Warehouse and Distribution Agreement***

Loblaw has warehouse and distribution agreements with third-party entities to provide to Loblaw distribution and warehousing services from dedicated facilities. Loblaw has no equity interest in these third-party entities; however, the terms of the agreement with the third-party entities are such that Loblaw has determined that the third-party entities meet the criteria for a VIE that requires consolidation by Loblaw. The impact of the consolidation of the warehouse and distribution entities was not material.

Accordingly, the Company has included the results of these independent franchisees and these third-party entities that provide distribution and warehousing services in its consolidated financial statements. The consolidation of these VIEs by the Company does not result in any change to its tax, legal or credit risks, nor does it result in the Company assuming any obligations of these third parties.

### ***Independent Trust***

Loblaw has also identified that it holds a variable interest, by way of a standby letter of credit, in an independent trust which is used to securitize credit card receivables for PC Bank. In these securitizations, PC Bank sells a portion of its credit card receivables to the independent trust in exchange for cash. Although this independent trust has been identified as a VIE, it was determined that Loblaw is not the primary beneficiary and therefore this VIE is not subject to consolidation by the Company. The Company’s maximum exposure to loss as a result of its involvement with this independent trust is disclosed in notes 12 and 25.

During 2006, PC Bank restructured its credit card securitization program. Eagle Credit Card Trust (“Eagle”), a previously established independent trust, issued \$500 of five year senior notes and subordinated notes due in 2011 at a weighted average rate of 4.5% to finance the purchase of credit card receivables previously securitized by PC Bank through an independent trust. The subordinated notes provide credit support to those notes which are more senior. PC Bank will continue to service the credit card receivables on behalf of Eagle, but will not receive any fee for its servicing obligations and has a retained interest in the securitized receivables represented by the right to future cash flows after obligations to investors have been met. In accordance with Canadian GAAP, the financial statements of Eagle are not consolidated with those of the Company. The restructuring of the portfolio yielded a nominal net loss.

## Notes to the Consolidated Financial Statements

### 27. RELATED PARTY TRANSACTIONS

The Company's majority shareholder, Wittington Investments, Limited ("Wittington"), and its affiliates are related parties. The Company, in the normal course of business, has routine transactions with these related parties, including the rental of office space at market prices from Wittington. Rental payments to Wittington amounted to approximately \$3 (2006 – \$6) in 2007. During 2006, Loblaw purchased from Wittington a property designated for future development for consideration of \$8, which was prepaid in accordance with a former ground lease between the parties. It is the Company's policy to conduct all transactions and settle balances with related parties on market terms and conditions.

From time to time, the Company and Wittington may make elections that are permitted or required under applicable income tax legislation with respect to affiliated corporations and, as a result, may enter into agreements in that regard. These elections and any accompanying agreements do not have any material impact on the Company.

### 28. SUBSEQUENT EVENTS

On February 7, 2008, Loblaw's Medium Term Notes, other notes and debentures and commercial paper ratings were downgraded by DBRS and Standard & Poor's ("S&P"). DBRS downgraded Loblaw's long term credit rating to "BBB (high)" from "A (low)" and also lowered Loblaw's short term credit rating to "R-2 (high)" from "R-1 (low)". In addition, S&P downgraded the Loblaw commercial paper rating to "A-2" from "A-1 (low)". As a result of the DBRS downgrade of the short term credit rating, Loblaw has limited access to commercial paper. Loblaw has entered into discussions, which have not yet been finalized, with a syndicate of banks to secure short term funding to replace its existing 364-day revolving committed credit facility of \$500, as described in note 17, with a new, longer term committed credit facility of a higher amount.

Subsequent to the DBRS downgrades, Loblaw was notified that an Event of Termination of the independent funding trust agreement for the Loblaw's franchisees had occurred as a result of the credit rating downgrades. The \$44 standby letter of credit provided to the independent funding trust by Loblaw has not been drawn upon. If such an event were to occur, long term debt in the amount of \$126 would need to be reclassified to short term liabilities. This amount relates to certain franchisees that are VIEs that Loblaw currently consolidates. The gross principal amount of the franchisee loans outstanding at the end of 2007 was \$418 (2006 – \$419), including \$153 (2006 – \$124) of loans payable of VIEs consolidated by Loblaw in 2007. Loblaw is currently in the process of securing alternative financing with a syndicate of banks, in the form of a 364-day committed credit facility for the benefit of its franchisees to address this issue. Any new alternative financing structure which may be implemented would need to be reviewed to determine if there are any implications with respect to the consolidation of VIEs.

On February 12, 2008, DBRS downgraded the Company's long term credit rating to "BBB" from "BBB (high)", the short term credit rating to "R-2 (high)" from "R-1 (low)", the Debentures to "BBB (low)" from "BBB" and the preferred shares to "Pfd-3" from "Pfd-3 (high)", all with a stable trend. As a result of the DBRS downgrade of Weston's commercial paper credit rating, Weston has limited access to commercial paper. Weston has entered into discussions, which have not yet been finalized, with a syndicate of banks to secure short term funding to replace its existing committed credit facility of \$300, as described in note 17, with a new, longer term committed credit facility.

### 29. SEGMENT INFORMATION

The Company has two reportable operating segments: Weston Foods and Loblaw. The Weston Foods segment is primarily engaged in the baking and dairy industries within North America. The Loblaw segment, which is operated by Loblaw Companies Limited and its subsidiaries, focuses on merchandising, which includes primarily food as well as general merchandise and drugstore products and services.

The accounting policies of the reportable operating segments are the same as those described in the Company's summary of significant accounting policies. The Company measures each reportable operating segment's performance based on operating income. Neither reportable operating segment is reliant on any single external customer.

	2007	2006
<b>Sales</b>		
Weston Foods	\$ 4,296	\$ 4,350
Loblaw	29,384	28,640
Intersegment	(865)	(823)
Consolidated	\$ 32,815	\$ 32,167
<b>Operating Income<sup>(1)</sup></b>		
Weston Foods	\$ 366	\$ 256
Loblaw	728	281
Consolidated	\$ 1,094	\$ 537
<b>Depreciation and Amortization</b>		
Weston Foods	\$ 116	\$ 115
Loblaw	588	590
Consolidated	\$ 704	\$ 705
<b>Total Assets</b>		
Weston Foods <sup>(2)</sup>	\$ 4,574	\$ 4,969
Loblaw	13,814	13,626
Consolidated	\$ 18,388	\$ 18,595
<b>Fixed Assets and Goodwill Purchases</b>		
Weston Foods	\$ 109	\$ 184
Loblaw	621	944
Consolidated	\$ 730	\$ 1,128

(1) 2007 includes restructuring and other charges of \$227 (2006 – \$90) comprised of a \$5 (2006 – \$46) charge recognized by Weston Foods and a \$222 (2006 – \$44) charge recognized by Loblaw (see note 4). In addition, 2006 includes the Loblaw goodwill impairment charge of \$800.

(2) Includes the \$157 (2006 – \$215) investment in Domtar (Canada) Paper Inc. common shares, which is economically hedged as a result of Weston issuing the 3% Exchangeable Debentures (see note 18).

The Company operates primarily in Canada and the United States.

	2007	2006
<b>Sales (excluding intersegment)</b>		
Canada	\$ 30,028	\$ 29,269
United States	2,787	2,898
Consolidated	\$ 32,815	\$ 32,167
<b>Fixed Assets and Goodwill</b>		
Canada	\$ 9,243	\$ 9,339
United States	1,550	1,935
Consolidated	\$ 10,793	\$ 11,274