

#### **14. CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures made in the consolidated financial statements and accompanying notes. Management continually evaluates the estimates and assumptions it uses. These estimates and assumptions are based on management's historical experience, best knowledge of current events and conditions and activities that the Company may undertake in the future. Actual results could differ from these estimates.

The estimates and assumptions described in this section depend upon subjective or complex judgments about matters that may be uncertain and changes in these estimates and assumptions could materially impact the consolidated financial statements. Illiquid credit markets, volatile equity, foreign currency and energy markets and declines in consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

##### ***Inventories***

The Company's inventories are stated at the lower of cost and estimated net realizable value. For its retail store inventories, Loblaw is required to make estimation or judgment in the determination of (i) discount factors used to convert inventory to cost after a physical count at retail has been completed and (ii) estimated inventory losses, or shrinkage, occurring between the last physical inventory count and the balance sheet date.

Inventories counted at retail are converted to cost by applying a discount factor to retail selling prices. This discount factor is determined at the category level, is calculated in relation to historical gross margins and is reviewed on a regular basis for reasonableness. Inventory shrinkage, which is calculated as a percentage of sales, is evaluated throughout the year and provides for estimated inventory shortages from the last physical count to the balance sheet date. To the extent that actual losses experienced vary from those estimated, both inventories and operating income will be impacted. Changes or differences in these estimates may result in changes to inventories on the consolidated balance sheet and a charge or credit to operating income in the consolidated statement of earnings.

## Management's Discussion and Analysis

In the first quarter of 2008, the Company implemented Section 3031, "Inventories" ("Section 3031"), which replaced Section 3030 of the same title. Section 3031 provides guidance with respect to the determination of cost and requires inventories to be measured at the lower of cost and net realizable value.

Additional information on inventories is provided in notes 2 and 14 to the consolidated financial statements.

### ***Employee Future Benefits***

The cost and accrued benefit plan obligations of the Company's defined benefit pension plans and other benefit plans are accrued based on actuarial valuations which are dependent on assumptions determined by management. These assumptions include 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. These assumptions are reviewed annually by management and the Company's actuaries.

The discount rate, the expected long term rate of return on plan assets and the expected growth rate in health care costs are the three most significant assumptions.

The discount rates are based on market interest rates, as at the Company's measurement date of September 30 on a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations. The discount rates used to determine the 2008 net cost for defined benefit pension and other benefit plans were 5.5% and 5.4%, respectively, on a weighted average basis, compared to 5.1% and 5.1%, respectively, in 2007. The discount rates used to determine the net 2009 defined benefit pension and other benefit plans costs increased to 6.0% and 5.7%, respectively, in Canada and increased to 7.0% and 7.0%, respectively, in the United States.

The expected long term rate of return on plan assets is based on current market conditions, the asset mix, the active management of defined benefit pension plan assets and on historical returns. The Company reduced the expected long term rate of return on plan assets in Canada to 7.25% and 7.75% on plan assets in the United States in calculating its defined benefit pension plans cost for 2009. The Company's defined benefit pension plan assets had a 10-year annualized return of 6.3% as at the 2008 measurement date. The actual annual returns within this 10-year period varied with market conditions.

The expected growth rate in health care costs for 2008 was based on external data and the Company's historical trends for health care costs. In 2009, the growth rate of health care costs is estimated at 9.5% and is assumed to gradually decrease to 5.0% by 2015, remaining at that level thereafter.

Since the three key assumptions discussed above are forward-looking and long term in nature, they are subject to uncertainty and actual results may differ. In accordance with Canadian GAAP, differences between actual experience and the assumptions, as well as the impact of changes in the assumptions, are accumulated as unamortized net actuarial gains and losses and amortized over future periods, affecting the recognized cost of defined benefit pension plans and other benefit plans and the accrued benefit plan obligation in future periods. While the Company believes that its assumptions are appropriate, significant differences in actual experience or significant changes in the Company's assumptions may materially affect its defined benefit pension plans and other benefit plans accrued benefit plan obligations and future costs.

Additional information regarding the Company's pension and other benefit plans, including a sensitivity analysis for changes in key assumptions, is provided in note 17 to the consolidated financial statements and in the Employee Future Benefit Contributions discussion in the Operating Risks and Risk Management section of this MD&A.

### ***Goodwill and Indefinite Life Intangible Assets***

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. Any goodwill impairment will result in a reduction in the carrying value of goodwill on the consolidated balance sheet and in the recognition of a non-cash impairment charge in operating income in the consolidated statement of earnings.

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 Board. 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.

During the fourth quarter of 2008, the Company performed its annual goodwill impairment test and determined that there was no impairment of the carrying value of goodwill. Subsequent to year end, Weston Foods reorganized its operations as a result of the disposition of the U.S. fresh bakery business. The reorganization changed the composition of Weston Foods' reporting units for the purpose of goodwill impairment testing. As a result of this change, Weston Foods expects to record a write-down of a portion of the remaining goodwill related to the biscuits, cookies, cones and wafers business in an amount of up to USD \$60 million in the first quarter of 2009.

Intangible assets with indefinite useful lives, primarily consisting of certain Weston Foods trademarks and brand names, are assessed for impairment at least annually. 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 asset on the consolidated balance sheet and the recognition of a non-cash impairment charge in operating income in the consolidated statement of earnings.

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 GWL'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.

During the fourth quarters of 2008 and 2007, 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.

### ***Income Taxes***

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 assets and liabilities and their respective income tax bases. Future income tax assets or 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 calculation of current and future income taxes requires management to make estimates and assumptions and to exercise judgment regarding the financial statement carrying values of assets and liabilities which are subject to accounting estimates inherent in those balances, the interpretation of income tax legislation across various jurisdictions, expectations about future operating results, the timing of reversal of temporary differences and possible audits of income tax filings by the regulatory authorities. Management believes it has adequately provided for income taxes based on currently available information.

At each balance sheet date, future income tax assets are reviewed to determine whether a valuation allowance is required. Such an allowance is required when it is deemed unlikely that projected future taxable income will be sufficient to realize the future income tax benefits.

Changes or differences in the underlying estimates or assumptions may result in changes to the current or future income tax balances on the consolidated balance sheet, a charge or credit to income tax expense in the consolidated statement of earnings and may result in cash payments or receipts.

### ***Fixed Assets***

Fixed assets to be held and used are reviewed for impairment annually and when events or circumstances indicate that their carrying value exceeds the sum of the undiscounted cash flows expected from their use and eventual disposition. An impairment loss is measured as the amount by which the fixed assets' carrying value exceeds their fair value. As discussed in note 15 to the consolidated financial statements, the Company reviewed certain fixed assets for impairment in the Weston Foods and Loblaw operating segments due to circumstances that indicated that their carrying values may not be recovered. The factor that most significantly influences the impairment assessments and calculations is estimates of future cash flows. The Company uses its internal plans in estimating future cash flows. These plans reflect the Company's current best estimate of future cash flows but may change in the future due to uncertain competitive and economic market conditions or changes in business strategies. Changes or differences in these estimates may result in changes to fixed assets on the consolidated balance sheet and a charge to operating income on the statement of earnings.

## **Management's Discussion and Analysis**

### ***Goods and Services Tax and Provincial Sales Taxes***

During 2005, Loblaw recorded a charge relating to an audit and proposed assessment by the Canada Revenue Agency relating to GST on certain products sold on which GST was not appropriately charged and remitted. In light of this proposed assessment, the Company assessed and estimated the potential liabilities for GST and PST in other areas of its operations for various periods. The ultimate remaining amount paid will depend on the outcome of audits performed by or settlements reached with the various tax authorities, and therefore may differ from this estimate. Management will continue to assess the remaining accrual as progress towards resolution with the various tax authorities is made and will adjust the remaining accrual accordingly. Changes in this accrual may result in a charge or credit to operating income in the consolidated statement of earnings.