

2. IMPLEMENTATION OF NEW ACCOUNTING STANDARDS

Accounting Standards Implemented in 2008

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 external capital requirements, and if it has not complied, the consequences of such non-compliance. For new disclosures, refer to note 24. The adoption of Section 1535 did not have an impact on the Company’s results of operations or financial condition.

Section 3862 and Section 3863 replaced Section 3861, “Financial Instruments – Disclosure and Presentation”. Section 3862 requires increased disclosures regarding the risks associated with financial instruments such as credit risks, liquidity risks 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. For new disclosures, refer to notes 28 and 29. Comparative information about the nature and extent of risks arising from financial instruments is not required in the year Section 3862 is adopted. The adoption of Section 3862 and Section 3863 did not have an impact on the Company’s results of operations or financial condition.

Notes to the Consolidated Financial Statements

Inventories

Effective January 1, 2008, the Company implemented Section 3031, "Inventories" ("Section 3031"), issued by the CICA in June 2007, which replaces Section 3030 of the same title. Section 3031 requires inventories to be measured at the lower of cost and net realizable value. 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 inventories should be based on a first-in, first-out or weighted average cost formula. Techniques used for the measurement of cost of inventories, such as the retail method, may be used 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 below cost to net realizable value for inventories recorded at period end and the amount of any reversal of any write-downs recognized as a reduction in expenses.

The Company values inventories at the lower of cost and net realizable value. Costs include the costs of purchase net of vendor allowances plus other costs, such as transportation, that are directly incurred to bring inventories to their present location and condition. Loblaw's seasonal general merchandise, Loblaw's inventories at distribution centres and Weston Foods inventories are measured at weighted average cost. Loblaw uses the retail method to measure the cost of certain retail store inventories. The Company estimates net realizable value as the amount that inventories are expected to be sold less estimated costs necessary to make the sale. In addition, Loblaw estimates net realizable value by taking into consideration fluctuations in retail prices due to seasonality. Inventories are written down to net realizable value when the cost of inventories is estimated to be unrecoverable due to obsolescence, damage or declining selling prices. When circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in retail selling prices, the amount of the write-down previously recorded is reversed. Storage costs, indirect administrative overhead and certain selling costs related to inventories are expensed in the period these costs are incurred.

The transitional adjustments resulting from the implementation of Section 3031 are recognized in the 2008 opening balance of retained earnings and prior periods have not been restated. Upon implementation of these requirements, a decrease in opening inventories of \$67 and a corresponding decrease of \$27 to opening retained earnings net of income taxes of \$25 and minority interest of \$15 were recorded on the consolidated balance sheet resulting mainly from the application by Loblaw of a consistent cost formula for all inventories having a similar nature and use.

In addition to the disclosure of accounting policies used in measuring inventories, Section 3031 also requires additional disclosures. See note 14 for the amount of inventories recognized as an expense in the period, the amount of inventories written down below cost to net realizable value for inventories recorded at period end and the amount of any reversal of any previously recognized write-downs.

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 GWL's investment in exchangeable shares of Domtar (Canada) Paper Inc. prior to its sale in 2008, 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.
- GWL'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 19) 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" ("AcG 14"), 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.

Notes to the Consolidated Financial Statements

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 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 GWL'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 26 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.

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.

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 GWL's forward sale agreement	(125)	(89)		
	\$ (146)	\$ (100)	\$ 14	\$ 9