

Critical Accounting Estimates

The Notes to BMO's October 31, 2008 Consolidated Financial Statements outline our significant accounting estimates. The following accounting estimates are considered particularly important, as they require significant judgments by management. Management has established detailed policies and control procedures that are intended to ensure these judgments are well controlled, independently reviewed and consistently applied from period to period. We believe that our estimates of the value of BMO's assets and liabilities are appropriate.

Allowance for Credit Losses

The allowance for credit losses adjusts the value of credit assets to reflect their estimated realizable value. In assessing their estimated realizable value, we must rely on estimates and exercise judgment regarding matters for which the ultimate outcome is unknown. These include economic factors, developments affecting companies in particular industries and specific issues with respect to single borrowers. Changes in circumstances may cause future assessments of credit risk to be materially different from current assessments, which could require an increase or decrease in the allowance for credit losses.

One of our key performance measures is the provision for credit losses as a percentage of average net loans and acceptances (including securities borrowed or purchased under resale agreements). Over the past 10 years, the ratio has ranged from a high of 0.66% in 2001 to a low of (0.07%) in 2004. This ratio varies with changes in the economy and credit conditions. If we applied these high and low ratios to average net loans and acceptances (including securities borrowed or purchased under resale agreements) in 2008, our provision for credit losses would range from a provision of \$1,387 million to a net recovery of \$147 million. Our provision for credit losses in 2008 was \$1,330 million.

Additional information on the process and methodology for determining the allowance for credit losses can be found in the discussion of credit risk on page 76 as well as in Note 4 on page 113 of the financial statements.

Financial Instruments Measured at Fair Value

BMO records securities and derivatives at their fair value. Fair value represents our estimate of the proceeds we would receive, or would have to pay in the case of a derivative liability, in a current transaction between willing parties. We employ a fair value hierarchy to categorize the inputs we use in valuation techniques to measure fair value. The extent of our use of quoted market prices (Level 1), internal models using observable market information (Level 2) and internal models without observable market information (Level 3) in the valuation of securities, derivative assets and derivative liabilities as at October 31, 2008 was as follows:

(%)	Trading securities	Available-for-sale securities	Fair value liabilities	Derivative instruments	
				Asset	Liability
Valued using quoted market prices	99	28	95	6	3
Valued using internal models (with observable inputs)	–	67	5	91	96
Valued using internal models (without observable inputs)	1	5	–	3	1
Total	100	100	100	100	100

The sensitivity analysis on our Level 3 assets is included in Note 3 on page 110 of the financial statements.

Valuation models use general assumptions and market data and therefore do not reflect the specific risks and other factors that would affect a particular instrument's fair value. As a result, we incorporate certain adjustments when using internal models to establish fair values. These fair value adjustments take into account the estimated impact

of credit risk, liquidity risk, valuation considerations, administrative costs and closeout costs. For example, the credit risk adjustment incorporates credit risk into our determination of fair values by taking into account factors such as the counterparty's credit rating, the duration of the instrument and changes in credit spreads.

Valuation Product Control (VPC), a group independent of the trading lines of business, verifies the fair values at which financial instruments are recorded. For instruments that are valued using models, VPC identifies situations where adjustments must be made to the model estimates to arrive at fair value. In 2007, we changed our valuation process to incorporate a more appropriate market-based valuation methodology for the commodities portfolio.

The methodologies used for calculating these adjustments are reviewed on an ongoing basis to ensure that they remain appropriate. Significant changes in methodologies are rare and are made only when we feel that the change will result in better estimates of fair value.

Valuation Adjustments

As at October 31 (\$ millions)	2008	2007
Credit risk	153	50
Liquidity risk	39	20
Administrative costs	7	7
Other	30	2
	229	79

The increase in the adjustment for credit risk was due to wider relative credit spreads between our counterparties and BMO. The increase in the adjustment for liquidity risk was due to widening bid/ask spreads as liquidity in the market decreased in late 2008. Illiquid markets at the end of 2008 also caused the increase in the other adjustments.

Accounting for Securitizations

When loans are securitized, we record a gain or loss on sale. In determining the gain or loss, management must estimate the net present value of expected future cash flows by relying on estimates of the amount of interest and fees that will be collected on the securitized assets, the yield to be paid to investors, the portion of the securitized assets that will be repaid before their scheduled maturity, credit losses, the fair value cost of servicing and the rate at which to discount these estimated future cash flows. Actual cash flows may differ significantly from those estimated by management. If management's estimate of future cash flows were different, our gain on securitization recognized in income would also be different. The interest rate used to discount expected future cash flows is the estimate that most affects the gain on securitization. A 10% decrease in the interest rate would have resulted in a decrease of approximately \$53 million in the amount of the deferred purchase price recorded in available-for-sale securities and in securitization revenues.

Additional information concerning accounting for securitizations, including sensitivity analysis for key assumptions, is included in Note 8 on page 118 of the financial statements.

Accounting for Variable Interest Entities

In the normal course of business, BMO enters into arrangements with variable interest entities (VIEs). VIEs include entities with equity that is considered insufficient to finance the entity's activities or in which the equity holders do not have a controlling financial interest. We are required to consolidate VIEs if the investments we hold in these entities and/or the relationships we have with them result in us being exposed to the majority of their expected losses, being able to benefit from a majority of their expected residual returns, or both, based on a calculation determined by accounting standard setters.

We use a qualitative estimation process to determine whether an entity is a VIE and whether BMO holds a variable interest in that VIE. We also use a variety of complex estimation processes involving qualitative and quantitative factors to calculate and analyze a VIE's expected losses and its expected residual returns. These processes involve estimating the future cash flows and performance of the VIE, analyzing the variability of those cash flows and allocating the losses and returns among the identified parties holding variable interests. These processes enable us to identify the party that is exposed to the majority of the VIE's expected losses, expected residual returns, or both, and thus which party should consolidate the entity.

We are required to reconsider if consolidation is required when our obligation to absorb expected losses or residual returns increases. If there is a change in events that leads to BMO absorbing the majority of the expected losses or residual returns BMO would be required to consolidate the VIE as of the date of the change.

With respect to Apex, reconsideration events would include BMO purchasing additional Notes, granting additional liquidity facilities, an increase to the loan amount extended by BMO beyond what is contemplated under the existing credit lending facilities, or guaranteeing repayment on Notes held by third parties. Each of these reconsideration events could result in BMO absorbing additional expected losses or residual returns. It is not expected that such reconsideration events will occur in the near future. The issuance of an expected loss note by Apex would also be considered a reconsideration event but would not likely result in BMO absorbing additional expected losses or residual returns. If the total return swap held by a third party is terminated, another third party would have to be found to absorb the exposure to the underlying Notes, otherwise BMO would be required to consolidate Apex.

With respect to Links and Parkland, reconsideration events include a purchase or sale by BMO of capital notes, provision of additional lending facilities, an increase to the loan amount extended by BMO beyond what is contemplated under the existing credit lending facilities, asset for capital note exchanges and provision of a guarantee by BMO to compensate note holders for realized losses. The reconsideration event that is most likely to occur is an increase in our lending facilities. If we were to provide an increase in our lending facilities prior to July 2009, we would not expect to consolidate at that time based on our current assessment of our exposure to expected losses.

A reconsideration event for our Canadian multi-seller conduits includes the purchase or sale by BMO of asset-backed commercial paper (ABCP) issued by the conduits and the granting of additional liquidity facilities or credit enhancement. Since BMO regularly purchases and sells ABCP issued by our Canadian multi-seller conduits, we continually monitor expected losses to ensure they do not approach consolidation thresholds.

A reconsideration event for our U.S. multi-seller conduit includes the purchase or sale by BMO of ABCP issued by the conduit, the addition of new programs and the granting of additional liquidity facilities or credit enhancement. Repayment of the expected loss note would also be a reconsideration event and a third party would have to be found to absorb the majority of the expected losses otherwise BMO would be required to consolidate. We monitor BMO's exposure to expected losses as reconsideration events occur and increase the expected loss note so that consolidation is not required.

Additional information concerning BMO's involvement with variable interest entities is included on pages 63 to 66 as well as in Note 9 on page 120 of the financial statements.

Pensions and Other Employee Future Benefits

BMO's pensions and other employee future benefits expense is calculated by our actuaries using assumptions determined by management. If actual experience differs from the assumptions used, pension and other employee future benefits expense could increase or decrease in future years. The expected rate of return on plan assets is the management estimate that most affects the calculation of pension expense. Our expected rate of return on plan assets is determined using the plan's target asset allocation and estimated rates of return for each asset class. Estimated rates of return are based on expected returns from fixed income securities, which take into consideration bond yields. An equity risk premium is then applied to estimate expected equity returns. Expected returns from other asset classes are established to reflect the risks of these asset classes relative to fixed income and equity assets. With all other assumptions held constant, a 1 percentage point decline in the expected rate of return on plan assets would result in an increase in pension expense for 2009 of approximately \$45 million. The impact of changes in expected rates of return on plan assets is not significant for our other employee future benefits expense since only small amounts of assets are held in these plans.

Pension and other employee future benefits expense and obligations are also sensitive to changes in discount rates. For our Canadian plans, which currently represent 82% of BMO's pension obligations, we determine a discount rate at each year-end using market rates applicable to high-quality debt instruments with cash flows that match the timing and amount of expected benefit payments.

Additional information regarding our accounting for pensions and other employee future benefits, including sensitivity analysis for key assumptions, is included in Note 24 on page 139 of the financial statements.

Other Than Temporary Impairment

We review available-for-sale and other securities at each quarter-end reporting period to identify and evaluate investments that show indications of possible impairment. An investment is considered impaired if its unrealized losses represent impairment that is considered to be other than temporary. In making this assessment, we consider such factors as the type of investment, the length of time and extent to which the fair value has been below the cost, the financial condition and near-term prospects of the issuer, and our intent and ability to hold the investment long enough to allow for any anticipated recovery. The decision to record a write-down, its amount and the period in which it is recorded could change if management's assessment of those factors were different. We do not record impairment write-downs on debt securities when impairment is due to changes in market interest rates, since we expect to realize the full value of these investments by holding them until they recover in value or to maturity.

We also have investments in securities issued or guaranteed by Canadian or U.S. governments, corporate debt and equity securities, mortgage-backed securities and collateralized mortgage obligations. Quoted market value is considered to be fair value for actively traded securities. At the end of 2008, there were total unrealized losses of \$352 million on securities on which the cost exceeded fair value and an impairment write-down had not been recorded. Of this amount, \$7 million related to securities for which the cost had exceeded fair value for 12 months or more. These unrealized losses resulted from increases in market interest rates and not from deterioration in the creditworthiness of the issuer.

Additional information regarding our accounting for available-for-sale securities and other securities and the determination of fair value is included in Note 3 on page 109 of the financial statements.

Customer Loyalty Program

During the year ended October 31, 2008, we settled the liability associated with our credit card customer loyalty rewards program. We are no longer required to estimate and accrue a liability associated with the future redemption of rewards issued to our customers under the new agreement. The ongoing costs of our credit card loyalty program are recorded as a reduction in non-interest revenue, card fees in our Consolidated Statement of Income.

Additional information regarding our accounting for our customer loyalty program is included in Note 16 on page 131 of the financial statements.

Income Taxes

The provision for income taxes is calculated based on the expected tax treatment of transactions recorded in our Consolidated Statements of Income or Changes in Shareholders' Equity. In determining the provision for income taxes, we interpret tax legislation in a variety of jurisdictions and make assumptions about the expected timing of the reversal of future tax assets and liabilities. If our interpretations differ from those of tax authorities or if the timing of reversals is not as anticipated, our provision for income taxes could increase or decrease in future periods. The amount of any such increase or decrease cannot be reasonably estimated.

Additional information regarding our accounting for income taxes is included in Note 25 on page 142 of the financial statements.

Goodwill and Intangible Assets

Goodwill is assessed for impairment at least annually. This assessment includes a comparison of the carrying value and the fair value of each group of businesses to ensure that the fair value of the group is greater than its carrying value. If the carrying value exceeds the fair value of the group, a more detailed goodwill impairment assessment would have to be undertaken. In determining fair value, we employ internally generated valuation models consistent with those used when we are acquiring businesses. Valuation models used to determine fair value

include discounted cash flows, comparable acquisitions and industry multiples. These models are dependent on assumptions related to revenue growth, discount rates, synergies achieved on acquisitions, and the availability of comparable acquisition data. Changes in each of these assumptions will impact the determination of fair value for each of the business units in a different manner. Management must exercise judgment and make assumptions in determining fair value, and differences in judgments and assumptions could affect the determination of fair value and any resulting impairment write-down. At October 31, 2008, the estimated fair value of each of our groups of businesses was greater than its carrying value.

Intangible assets are amortized to income on either a straight-line or an accelerated basis over a period not exceeding 15 years, depending upon the nature of the asset. There are no intangible assets with indefinite lives. We test intangible assets for impairment when circumstances indicate the carrying value may not be recoverable. No such impairment has been identified for the years ended October 31, 2008, 2007 and 2006.

Additional information regarding the composition of goodwill and intangible assets is included in Note 13 on page 129 of the financial statements.

Contingent Liabilities

BMO and its subsidiaries are involved in various legal actions in the ordinary course of business.

Contingent litigation loss provisions are recorded when it becomes likely that BMO will incur a loss and the amount can be reasonably estimated. BMO's management and internal and external experts are involved in assessing any likelihood and in estimating any amounts involved. The actual costs of resolving these claims may be substantially higher or lower than the amounts provided. Additional information regarding contingent liabilities is included in Note 29 on page 146 of the financial statements.

Changes in Accounting Policies in 2008

Transfer of Financial Assets

On August 1, 2008, we adopted the CICA's new accounting guidance permitting the transfer of certain financial assets out of trading portfolios into available-for-sale. For details of the specific accounting change and related impacts, refer to Note 3 on page 109 of the financial statements.

Financial Disclosures

New disclosures that resulted from changes by Canadian standard setters in the current year are disclosed as follows: financial instruments disclosures – Notes 3, 4, 15, 29 and 30; capital management – Note 22; and risk management – Note 6.

Future Changes in Accounting Policies

Goodwill and Intangibles

Effective November 1, 2008, BMO adopted the CICA's new handbook section "Goodwill and Intangible Assets" with effect for the 2009 fiscal year. This section clarifies the recognition and measurement criteria for intangible assets and, in particular, for intangible assets that are generated internally. The impact of implementation of this standard will not be material to our results of operations or financial position.

Transition to International Financial Reporting Standards

Canadian public companies will be required to prepare their financial statements in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board, for financial years beginning on or after January 1, 2011. Effective November 1, 2011, we will adopt IFRS as the basis for preparing our consolidated financial statements. We will issue our

financial results for the quarter ended January 31, 2012 prepared on an IFRS basis. We will also provide comparative data on an IFRS basis, including an opening balance sheet as at November 1, 2010.

In order to meet the requirement to transition to IFRS, we have established an enterprise-wide project and formed an executive steering committee. We are following a transition plan comprised of three phases: IFRS diagnostic assessment, implementation and education, and completion of all integration system and process changes. We are on track, having completed the diagnostic phase of our project, and we have entered the early stages of the implementation and education phase of our plan. Due to anticipated changes in International Accounting Standards prior to our transition to IFRS, we are not in a position to determine the impact on our financial results.

Management's Annual Report on Disclosure Controls and Procedures and Internal Control over Financial Reporting

Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the President & Chief Executive Officer (CEO) and the Interim Chief Financial Officer (Interim CFO), on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures was conducted as of October 31, 2008 by BMO Financial Group's management under the supervision of the CEO and the Interim CFO. Based on this evaluation, the CEO and the Interim CFO have concluded that, as of October 31, 2008, our disclosure controls and procedures, as defined in Canada by National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, and in the United States by Rule 13a-15(e) under the *Securities Exchange Act of 1934* (the Exchange Act), are effective to ensure that information required to be disclosed in reports that we file or submit under Canadian securities legislation and the Exchange Act is recorded, processed, summarized and reported within the time periods specified therein.

Internal Control over Financial Reporting

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian generally accepted accounting principles and the requirements of the Securities and Exchange Commission in the United States, as applicable. Management is responsible for establishing and maintaining adequate internal control over financial reporting for BMO Financial Group.

BMO's internal control over financial reporting includes policies and procedures that: pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions

of the assets of BMO; provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with Canadian generally accepted accounting principles and the requirements of the Securities and Exchange Commission in the United States, as applicable, and that receipts and expenditures of BMO are being made only in accordance with authorizations of management and directors of BMO; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of BMO's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

BMO Financial Group's management, under the supervision of the CEO and the Interim CFO, has evaluated the effectiveness of our internal control over financial reporting using the framework and criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that internal control over financial reporting was effective as of October 31, 2008.

BMO Financial Group's auditors, KPMG LLP (Shareholders' Auditors), an independent registered public accounting firm, has issued an audit report on our internal control over financial reporting. This audit report appears on page 103.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting in fiscal 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Pre-Approval of Shareholders' Auditors' Services and Fees

Pre-approval Policies and Procedures

As part of BMO Financial Group's corporate governance practices, the Board ensures the strict application of BMO's corporate policy limiting the services provided by the Shareholders' Auditors that are not related to their role as auditors. All services provided by the Shareholders' Auditors are pre-approved by the Audit Committee as they arise, or through an annual pre-approval of amounts for specific types of services. All services comply with our Auditor Independence Policy, as well as professional standards and securities regulations governing auditor independence.

Shareholders' Auditors' Service Fees

Aggregate fees paid to the Shareholders' Auditors during the fiscal years ended October 31, 2008 and 2007 were as follows:

Fees (\$ millions) (1)	2008	2007
Audit fees	11.6	12.0
Audit-related fees (2)	0.1	0.1
Tax fees	–	–
All other fees (3)	0.1	0.1
Total	11.8	12.2

- (1) The classification of fees is based on applicable Canadian securities laws and United States Securities and Exchange Commission definitions.
- (2) Audit-related fees for 2008 relate to fees paid for accounting advice, specified procedures on our Proxy Circular and other specified procedures. Audit-related fees for 2007 relate to fees paid for accounting advice and specified procedures on the Proxy Circular.
- (3) All other fees for 2008 and 2007 relate primarily to fees paid for reviews of compliance with regulatory requirements for financial information and reports on internal controls over services provided by various BMO Financial Group businesses. Also included in 2008 were corporate recovery services grandfathered under BMO's Auditor Independence Policy.