AIR CANADA

Consolidated Financial Statements and Notes
2007

Consolidated Statement of Operations

For the year ended December 31 (Canadian dollars in millions except per share figures)		2007*	2006
			(note 3)
Operating revenues			
Passenger		$ 9,329	$ 8,887
Cargo		550	629
Other		720	651
		10,599	10,167
Special charge for Aeroplan Miles	note 22	-	(102)
		10,599	10,065
Operating expenses			
Wages, salaries and benefits		2,059	2,127
Aircraft fuel		2,553	2,545
Aircraft rent		323	441
Airport and navigation fees		1,021	982
Aircraft maintenance, materials and supplies		799	855
Communications and information technology		277	278
Food, beverages and supplies		319	335
Depreciation, amortization and obsolescence	notes 4, 6 & 15	557	514
Commissions		201	237
Capacity purchase with Jazz	note 19	537	-
Special charge for labour restructuring	note 11	-	20
Other		1,458	1,472
		10,104	9,806
Operating income		**495**	**259**
Non-operating income (expense)			
Interest income		94	87
Interest expense		(351)	(321)
Interest capitalized		108	61
Gain (loss) on disposal of assets	note 4	19	(6)
Gain (loss) on financial instruments recorded at fair value	note 17	26	(18)
Other		(18)	1
		(122)	(196)
Income before the following items		**373**	**63**
Non-controlling interest		(71)	(152)
Foreign exchange gain		317	12
Recovery of (provision for) income taxes			
Current	note 9	(16)	-
Future	note 9	(174)	3
Income (loss) for the year		**$ 429**	**$ (74)**
Earnings (loss) per share			
Basic	note 14	$ 4.29	$ (0.83)
Diluted	note 14	$ 4.27	$ (0.83)

** Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*
The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Financial Position

As at December 31		2007*	2006
(Canadian dollars in millions)			
ASSETS			
Current			
Cash and cash equivalents	note 2P	$ 527	$ 1,447
Short-term investments	note 2Q	712	798
		1,239	2,245
Restricted cash	note 2R	124	109
Accounts receivable	note 19	750	688
Spare parts, materials and supplies		112	148
Prepaid expenses and other current assets	note 19	253	124
Prepaid maintenance to ACTS	note 3	-	535
Future income taxes	note 9	-	345
		2,478	4,194
Property and equipment	note 4	7,919	5,946
Deferred charges	note 5	51	103
Intangible assets	note 6	952	1,194
Deposits and other assets	note 7	437	312
		$ 11,837	**$ 11,749**
LIABILITIES			
Current			
Accounts payable and accrued liabilities	note 19	$ 1,243	$ 1,521
Advance ticket sales		1,245	1,019
Aeroplan miles obligation	note 22	55	58
Current portion of long-term debt and capital leases	note 8	413	367
Note payable to ACTS	note 3	-	535
Current taxes payable	note 9	-	345
		2,956	3,845
Long-term debt and capital leases	note 8	4,006	3,196
Future income taxes	note 9	88	134
Pension and other benefit liabilities	note 10	1,824	1,876
Other long-term liabilities	note 11	336	472
		9,210	9,523
Non-controlling interest		184	374
SHAREHOLDERS' EQUITY			
Share capital	note 13	274	274
Contributed surplus		1,791	1,693
Retained earnings (deficit)		322	(115)
Accumulated other comprehensive income	note 2M	56	-
		2,443	1,852
		$ 11,837	**$ 11,749**

** Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*
The accompanying notes are an integral part of the consolidated financial statements.
Commitments (Note 16); Contingencies, Guarantees and Indemnities (Note 18)

On behalf of the Board of Directors:

Signed
David I. Richardson
Chairman

Signed
Robert G. Long
Chair of the Audit, Finance and Risk Committee

Consolidated Statement of Changes in Shareholders' Equity

For the year ended December 31 (Canadian dollars in millions)		2007	2006
			(note 3)
Common shares			
Beginning of year		$ 562	$ -
Issue of common shares, net	note 3	-	187
Conversion of Special common shares and Preferred shares into Common shares	note 3	-	375
End of year		562	562
Special common shares			
Beginning of year		-	325
Conversion of Special common shares into Common shares	note 3	-	(325)
End of year		-	-
Adjustment to shareholders' equity	note 13	(288)	(288)
Total share capital		274	274
Contributed surplus			
Balance, beginning of year		1,693	1,037
Fair value of stock options issued to Corporation employees recognized as compensation expense	note 12	15	6
Contribution from ACE on transfer of investments	note 3	-	1,156
Allocation of corporate costs	note 3	-	11
Allocation of reduction to intangible assets	note 9	-	(340)
Utilization of future income tax assets	note 9	-	(177)
Purchase of Air Canada Vacations and other assets from parent	notes 1 & 19	(14)	-
Proceeds from Repair Schemes and Non-Compete Agreement with ACTS	note 20	15	-
Deconsolidation of Jazz	note 1	82	-
Total contributed surplus		1,791	1,693
Retained earnings (deficit)			
Balance, beginning of year		(115)	(41)
Cumulative effect of adopting new accounting policies	note 2M	8	-
		(107)	(41)
Net income (loss) for the year		429	(74)
Retained earnings		322	(115)
Accumulated other comprehensive income (loss)			
Balance, beginning of year		-	-
Cumulative effect of adopting new accounting policies	note 2M	(26)	-
Other comprehensive income		82	-
Total accumulated other comprehensive income		56	-
Total retained earnings and accumulated other comprehensive income		378	(115)
Total shareholders' equity		**$ 2,443**	**$ 1,852**

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Comprehensive Income

For the year ended December 31 (Canadian dollars in millions)		2007*	2006
Comprehensive income (loss)			
Net income (loss) for the year		$ 429	$ (74)
Other comprehensive income, net of taxes:			
Unrealized period change in fair value of fuel derivatives under hedge accounting (net of taxes of (29))	note 17	88	-
Reclassification of net realized losses (gains) on fuel derivatives to income (net of taxes of 1)	note 17	(6)	-
		82	-
Total comprehensive income (loss)		**$ 511**	**$ (74)**

** Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*
The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Cash Flow

For the year ended December 31 (Canadian dollars in millions)		2007*	2006
			(note 3)
Cash flows from (used for)			
Operating			
Net income for the year		$ 429	$ (74)
Adjustments to reconcile to net cash from operations			
Depreciation, amortization and obsolescence		557	514
Loss (gain) on disposal of assets		(19)	6
Foreign exchange loss (gain)		(387)	6
Future income taxes		174	(3)
Excess of employee future benefit funding over expense		(205)	(228)
Decrease in Aeroplan miles obligation		(79)	(108)
Non-controlling interest		71	152
Special charge for Aeroplan miles	note 22	-	102
Allocation of corporate expenses	note 3	-	11
Aircraft lease payments in excess of rent expense		(14)	(16)
Capitalized interest		(108)	(61)
Changes in non-cash working capital balances		(6)	83
Other		16	9
		429	**393**
Financing			
Issue by Air Canada of share capital	note 3	-	187
Issue of Jazz units	note 21	-	218
Transfer of ACTS investment to ACE	note 3	-	673
Transfer of Jazz investment to ACE	note 3	-	483
Promissory note paid by Jazz to ACE	note 21	-	(424)
Jazz – Credit facility borrowings	note 8	-	113
Aircraft and facility related borrowings	note 8	1,914	397
Settlement of notes payable to ACE	note 3	-	(140)
Distributions paid to non-controlling interest		(54)	(86)
Reduction of long-term debt and capital lease obligations		(504)	(278)
Other	note 8 & 20	(16)	(1)
		1,340	**1,142**
Investing			
Short-term investments		86	(496)
Additions to capital assets		(2,606)	(888)
Reduction of note receivable from ACE		-	186
Proceeds from sale of assets	note 4	119	40
Deconsolidation of Jazz cash	note 1	(138)	-
Cash management with related parties	note 19	(1)	32
Funding of ACTS Aero letter of credit	note 20	(101)	-
Purchase of Air Canada Vacations	note 1	(10)	-
Other	note 17	(38)	4
		(2,689)	**(1,122)**
Increase (decrease) in cash and cash equivalents		**(920)**	**413**
Cash and cash equivalents, beginning of year		1,447	1,034
Cash and cash equivalents, end of year		**$ 527**	**$ 1,447**

** Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*

Cash and cash equivalents exclude Short-term investments of $712 as at December 31, 2007 ($798 as at December 31, 2006).
The accompanying notes are an integral part of the consolidated financial statements.

For the years ended December 31, 2007 and 2006
(currencies in millions – Canadian dollars)

1. BASIS OF PRESENTATION AND NATURE OF OPERATIONS

The accompanying consolidated financial statements are of Air Canada (the "Corporation"), a majority-owned subsidiary of ACE Aviation Holdings Inc. ("ACE"). The term "Corporation" refers to, as the context may require, Air Canada and / or one or more of Air Canada's subsidiaries.

A) INITIAL PUBLIC OFFERING

In November 2006 Air Canada completed an initial public offering (the "Air Canada IPO") of an aggregate of 9,523,810 variable voting shares and voting shares for gross proceeds of $200 ($187 net of offering costs of $13) and a secondary offering by ACE of an aggregate of 15,476,190 variable voting shares and voting shares for gross proceeds of $325 ($304 net of offering costs of $21). Refer to Note 3 for additional information.

B) BASIS OF PRESENTATION

These consolidated financial statements include the financial position, results of operations and cash flows of:

- Air Canada, which provides transportation services;
- AC Cargo Limited Partnership ("Air Canada Cargo"), a wholly owned subsidiary of Air Canada, which, along with Air Canada, provides cargo services;
- ACGHS Limited Partnership ("Air Canada Ground Handling Services" or "ACGHS"), a wholly owned subsidiary of Air Canada, which provides ground handling services;
- Touram Limited Partnership ("Air Canada Vacations"), which provides tour operator services and leisure vacation packages. The Corporation purchased from ACE its 49% interest in Air Canada Vacations causing Air Canada Vacations to be wholly owned by the Corporation. Consideration for the interest was $10 and was accounted for within contributed surplus. Refer to Note 19;
- Air Canada Capital Ltd., a wholly owned subsidiary of Air Canada, which owns and leases certain aircraft which are leased or subleased to Air Canada, Jazz and unrelated third parties;
- Simco Leasing Ltd., a wholly owned subsidiary of Air Canada, which owns certain flight equipment which is leased to Air Canada;
- Jazz Air LP ("Jazz") for the period up to May 24, 2007. Jazz provides both domestic and transborder services for Air Canada under a capacity purchase agreement, which is consolidated within Air Canada for the period up to May 24, 2007. (refer below for additional information on the accounting for Jazz); and
- Certain aircraft and engine leasing entities and fuel facility corporations, which are consolidated under Accounting Guideline of the CICA Handbook, Consolidation of Variable Interest Entities ("AcG-15"), as Air Canada has been determined to be the primary beneficiary.

The activities of these operations are described further below in part C) Nature of Operations. These consolidated financial statements also include certain limited partnerships that are holding companies of the limited partnerships and the general partners of the limited partnerships described above; these entities do not carry on any active business.

Prior to the deconsolidation of Jazz, as described below, Air Canada had two business segments: Air Canada Services and Jazz. Subsequent to the deconsolidation of Jazz, Air Canada has one reportable segment. Air Canada Services is now referred to as Air Canada or the Air Canada Segment.

These consolidated financial statements are expressed in millions of Canadian dollars and are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada.

In accordance with the Canadian Institute of Chartered Accountants' Emerging Issue Committee Abstract No. 89, Exchange of Ownership Interests between Enterprises under Common Control – Wholly and Partially-Owned Subsidiaries, the 2006 comparative financial statements of Air Canada combine the assets and liabilities, results of operations and cash flows of Air Canada and all of the affiliates combined with Air Canada as noted above as if they had been combined from September 30, 2004, the date Air Canada and the affiliates emerged from proceedings under the Companies' Creditors Arrangement Act (the "CCAA"). The shareholders' equity reflects the shareholders' equity of Air Canada adjusted for the above transactions, as applicable. Refer to Note 3 for additional information.

Accounting for Jazz

Air Canada is party to a capacity purchase agreement with Jazz (the "Jazz CPA") as described in Note 19. Under the Jazz CPA, the Corporation provides a minimum daily utilization guarantee and a minimum capacity guarantee to Jazz, pays certain variable costs of operating Jazz aircraft and is obligated to cover the costs of certain aircraft return obligations related to Jazz aircraft covered under the Jazz CPA. The Corporation does not hold any partnership units of Jazz. Due to the terms of the Jazz CPA, Jazz is deemed to be a variable interest entity. The Corporation was deemed to be the primary beneficiary of Jazz up until May 24, 2007. As a result, the consolidated financial statements of the Corporation include the results of Jazz up until that date, as a business segment of Air Canada.

As a result of ACE's distribution of units of Jazz Air Income Fund on May 24, 2007 ACE's ownership interest in Jazz Air Income Fund was reported to be reduced from 58.8% to 49.0%. This ownership interest was, as reported, further reduced to 20.1% on October 16, 2007 and to 9.5% on January 24, 2008. Jazz Air Income Fund holds all of the outstanding units of Jazz. The May 24, 2007 distribution by ACE gave rise to a reconsideration of who should consolidate Jazz, and as a result, Jazz Air Income Fund was deemed to be the primary beneficiary of Jazz under AcG-15 Consolidation of Variable Interest Entities. As of the May 24, 2007 distribution date, the Corporation therefore no longer consolidates Jazz. Prospective from the date of deconsolidation, the Corporation has one reportable segment.

The Consolidated statement of financial position as at December 31, 2007 does not include the financial position of Jazz. The comparative December 31, 2006 Consolidated statement of financial position included the following items related to Jazz:

- Cash and cash equivalents of $135 and Other current assets of $109;
- Long-lived assets of $239;
- Current liabilities of $213;
- Long-term debt of $115;
- Non-controlling interest of $162; and
- Other long-term liabilities of $71.

As a result of the deconsolidation of Jazz, the Corporation recorded an adjustment of $82 as a credit to contributed surplus. This credit consists of the Corporation's initial negative investment in Jazz of $78, which had not previously reversed as none of the income of Jazz is distributed to Air Canada, and a future income tax credit of $4.

The cash flow impact during 2007 of the Corporation's deconsolidation of Jazz of $138 reflects the Jazz cash being removed from the Consolidated statement of financial position of the Corporation and classified as a cash outflow from investing activities.

Notwithstanding that the Corporation is no longer the primary beneficiary of Jazz effective May 24, 2007, Air Canada continues to hold a significant variable interest in Jazz through the contractual arrangements with Jazz as described in Note 16 (Commitments) and Note 19 (Related Party Transactions).

C) NATURE OF OPERATIONS

Air Canada is Canada's largest domestic and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-US transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-US transborder routes are provided by Jazz through the Jazz CPA. Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance network. In addition, Air Canada provides certain charter services.

Air Canada and Air Canada Cargo provide air cargo services on domestic, US transborder and international flights. Air Canada Cargo is a major domestic and US transborder air cargo carrier and uses the entire cargo capacity on aircraft operated by Air Canada and Jazz on domestic and transborder routes. Air Canada offers cargo services on its international flights and currently uses one chartered all freighter aircraft to supplement Canada-Europe services.

Air Canada Ground Handling Services provides passenger handling services to Air Canada, Jazz and other airlines with a primary focus on Canadian stations. Services covered include passenger check-in, gate management, baggage and cargo handling and processing, cabin cleaning, de-icing as well as aircraft ramp services.

Air Canada Vacations is one of Canada's leading tour operators. Based in Montreal and Toronto, Air Canada Vacations is a 100% subsidiary of Air Canada and operates its business in the outgoing leisure travel market (Caribbean, Mexico, Europe, South America and USA) through developing, marketing and distributing vacation travel packages and services through a network of independent travel agencies in Canada as well as Air Canada Vacations website, aircanadavacations.com.

Jazz is the largest regional airline and the second largest airline in Canada, after Air Canada, based on fleet size and number of routes operated. Pursuant to the Jazz CPA, Jazz provides service to Air Canada's customers in lower density markets and in higher density markets at off-peak times throughout Canada and to certain destinations in the United States. Jazz focuses on flight operations and customer service and Air Canada is responsible for scheduling, marketing, pricing and related commercial activities of the regional operations. Under the Jazz CPA, Air Canada records expenses based upon fees relating to flight operations performed, passengers carried and other items covered by the agreement. Prior to May 24, 2007 these inter-company transactions were eliminated in these consolidated financial statements. The segment previously referred to as the "Air Canada Services" segment recorded the revenue on flights operated under the Jazz CPA in Passenger revenue. However, since all distributions from Jazz are made to Jazz Air Income Fund, all income from Jazz was allocated to the non-controlling interest in the Consolidated statement of operations. Distributions for the period ended May 24, 2007 of $54 are reflected as a reduction of the non-controlling interest on the balance sheet. As noted above under B), effective May 24, 2007, the results and financial position of Jazz are no longer consolidated within Air Canada.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) BASIS OF VALUATION

In accordance with Section 1625 of the CICA Handbook, Comprehensive Revaluation of Assets and Liabilities ("CICA 1625"), Air Canada adopted fresh start reporting on September 30, 2004. As a result of the financial reorganization under CCAA, the assets and liabilities of the consolidated entity, excluding goodwill, were comprehensively revalued to fair values and a revaluation adjustment of $4,234 was recorded as a credit to share capital.

As described in Note 3, for the periods prior to the initial public offering of shares of the Corporation, which closed on November 24, 2006 (the "Air Canada IPO"), the financial statements of the Corporation are combined to include the financial position, results of operations and cash flows of a number of entities that subsequently became subsidiaries of the Corporation in conjunction with the Air Canada IPO.

B) PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of the operations described in Note 1B above, with adjustments for non-controlling interests. The consolidated financial statements of the Corporation include the accounts of variable interest entities for which the Corporation is the primary beneficiary. All inter-company balances and transactions are eliminated.

C) USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

D) PASSENGER AND CARGO REVENUES

Airline passenger and cargo advance sales are deferred and included in current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan, a related party that provides loyalty program services to Air Canada and purchases seats from Air Canada under the Commercial Participation and Services Agreement ("CPSA" — refer to Note 2F). Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. The Corporation has formed alliances with other airlines encompassing loyalty program participation, code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided.

The Corporation performs regular evaluations on the deferred revenue liability which may result in adjustments being recognized as revenue. Due to the complex pricing structures; the complex nature of interline and other commercial agreements used throughout the industry; historical experience over a period of many years; and other factors including refunds, exchanges and unused tickets, certain relatively small amounts are recognized as revenue based on estimates. Events and circumstances may result in actual results that are different from estimates; however these differences have historically not been material.

E) CAPACITY PURCHASE AGREEMENTS – JAZZ & TIER III CARRIERS

Air Canada has capacity purchase agreements with certain unaffiliated regional carriers, which are referred to as Tier III carriers, operating aircraft of 18 seats or less. Air Canada also has a capacity purchase agreement with Jazz, a related party to the Corporation (refer to Note 19 for additional information). Under these agreements, Air Canada is responsible for the marketing, ticketing and commercial arrangements relating to these flights and records the revenue it earns under passenger revenue. Operating expenses under capacity purchase agreements include the capacity purchase fees and pass-through costs, which are non-marked-up costs charged to the Corporation, which include fuel, airport and user fees and other; these expenses are recorded in the applicable category within the operating expenses.

For the year ended December 31, 2007, passenger revenues under capacity purchase agreements with Tier III carriers amounted to $71 ($68 - 2006). Refer to Note 19 for related party transaction amounts with Jazz.

F) AEROPLAN LOYALTY PROGRAM

Air Canada is an Aeroplan partner providing certain of Air Canada's customers with Aeroplan Miles, which can be redeemed by customers for air travel or other rewards acquired by Aeroplan.

Under the Commercial Participation and Services Agreement ("CPSA") between the Corporation and Aeroplan, Aeroplan purchases passenger tickets from Air Canada to meet its obligation for the redemption of Aeroplan Miles for air travel. The proceeds from the sale of passenger tickets to Aeroplan are included in Advance ticket sales. Revenue related to these passenger tickets is recorded in passenger revenues when transportation is provided.

For Aeroplan Miles earned by Air Canada customers, Air Canada purchases Miles from Aeroplan in accordance with the terms of the CPSA. The cost of purchasing Aeroplan Miles from Aeroplan is accounted for as a sales incentive and charged against passenger revenues when the points are issued, which is upon the qualifying air travel being provided to the customer.

Under the CPSA, for a specified number of Aeroplan Miles issued prior to January 1, 2002, the Corporation is responsible for providing air travel rewards at no charge to Aeroplan. Upon implementation of the Corporation's plan of arrangement under the Companies' Creditors Arrangement Act (the "Plan"), this obligation was recorded at the estimated fair value of air travel rewards expected to be issued to the Aeroplan members and was adjusted in 2006 (Note 22). On redemption of these Aeroplan Miles, a proportion of the liability is transferred to Advance ticket sales with revenue recorded in passenger revenues when the transportation is provided.

G) OTHER REVENUES

Other revenue includes revenues from the sale of the ground portion of vacation packages, ground handling services and other airline related services. Vacation package revenue is recognized as services are provided over the period of the vacation. Other airline related service revenues are recognized as the products are sold to passengers or the services are provided.

Other revenue also includes revenue related to the lease or sublease of aircraft to third parties. Lease or sublease revenues are recognized on a straight line basis over the term of the lease or sublease.

The Corporation provides certain services to related parties consisting principally of administrative services in relation to information technology, human resources, finance and accounting, treasury and tax services, corporate real estate, environmental affairs and legal services. Administrative service revenues are recognized as services are provided. Real estate rental revenues are recognized on a straight line basis over the term of the lease.

H) EMPLOYEE FUTURE BENEFITS

The cost of pensions, other post-retirement and post-employment benefits earned by employees is actuarially determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

A market-related valuation method is used to value plan assets for the purpose of calculating the expected return on plan assets. Under the selected method, the differences between investment returns during a given year and the expected investment returns are amortized on a straight line basis over 4 years.

Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. This period does not exceed the average remaining service period of such employees up to the full eligibility date. The average remaining service life of active employees (or average remaining life expectancy of former members for plan with no active members) is between 7 and 16 years for pension plans and between 10 and 11 years for post retirement and post employment benefit plans.

Cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the projected benefit obligation or market-related value of plan assets at the beginning of the year are amortized over the remaining service life of active employees.

As described in Note 10, some of the Corporation's employees perform work for ACE, and others are contractually assigned to ACTS Aero Technical Support & Services Inc. ("ACTS Aero") or Aeroplan Limited

Partnership ("Aeroplan"). These employees are members of the Corporation's sponsored defined benefit pension plans and also participate in the Corporation's sponsored health, life and disability future benefit plans. These consolidated financial statements include all of the assets and liabilities of all sponsored plans of the Corporation. Pension expenses are recorded net of costs recovered from related parties pertaining to employees assigned by the Corporation to the related parties based on an agreed upon formula. The cost recovery reduces the Corporation's benefit cost with an offset to related party receivables.

I) EMPLOYEE PROFIT SHARING PLAN

The Corporation has an employee profit sharing plan. Payments are calculated annually on full calendar year results and recorded throughout the year as a charge to salary and wage expense based on the estimated annual payment under the plan.

J) STOCK-BASED COMPENSATION PLANS

Certain employees of the Corporation, for the relevant periods, participate in ACE, Air Canada and/or Jazz stock based compensation plans, as described in Note 12.

The fair value of stock options or units granted to Corporation employees is recognized as compensation expense and a credit to contributed surplus on a straight line basis over the applicable vesting period. For a stock option or unit award attributable to an employee who is eligible to retire at the grant date, the fair value of the stock option or unit award is expensed on the grant date. For a stock option or unit award attributable to an employee who will become eligible to retire during the vesting period, the fair value of the stock option or unit award is recognized over the period from the grant date to the date the employee becomes eligible to retire. The amount of compensation cost recognized at any date at least equals the value of the vested portion of the options at that date. Refer to Note 12 for a discussion of the accelerated vesting of ACE options.

ACE, Air Canada, and Jazz also maintain employee share and unit purchase plans for shares and units. Under these plans, contributions by the Corporation's employees are matched to a specific percentage by the Corporation. These contributions are included in salaries, wages and benefits expense. Upon the closing of the Air Canada IPO described in Note 3, Air Canada employees are limited to participating in the Air Canada plan and not the ACE plan.

K) MAINTENANCE AND REPAIRS

Maintenance and repair costs for both leased and owned aircraft, including line maintenance, component overhaul and repair, and maintenance checks, are charged to operating expenses as incurred, with the exception of maintenance and repair costs related to return conditions on short-term aircraft leases, which are accrued over the term of the lease. Line maintenance consists of routine daily and weekly scheduled maintenance inspections and checks, overhaul and repair involves the inspection or replacements of major parts, and maintenance checks consist of more complex inspections and servicing of the aircraft.

L) OTHER OPERATING EXPENSES

Included in other operating expenses are expenses related to building rent and maintenance, terminal handling, professional fees and services, crew meals and hotels, advertising and promotion, insurance costs, credit card fees, ground costs for Air Canada Vacations packages, and other expenses. Expenses are recognized as incurred.

M) FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Under the Corporation's risk management policy derivative financial instruments are used only for risk management purposes and not for generating trading profits.

On January 1, 2007, the Corporation adopted CICA accounting handbook section 3855, *Financial Instruments – Recognition and Measurement*, section 3861, *Financial Instruments – Disclosure and Presentation,* section 3865, *Hedges*, section 1530, *Comprehensive Income*, and section 3251, *Equity.*

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated statement of financial position when the Corporation becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods is dependent upon the classification of the financial instrument as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The held-for-trading classification is applied when an entity is "trading" in an instrument or alternatively the standard permits that any financial instrument be irrevocably designated as held-for-trading. The held-to-maturity classification is applied only if the asset has specified characteristics and the entity has the ability and intent to hold the asset until maturity. For financial instruments classified as other than held-for-trading, transaction costs are added to the initial fair value of the related financial instrument. Transaction costs related to the revolving line of credit which are not drawn are deferred and amortized straight line over the term of the credit facility.

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with changes in those fair values recognized in non-operating income (expense). Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are measured at amortized cost using the effective interest method of amortization. Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses, including changes in foreign exchange rates, being recognized in Other Comprehensive Income ("OCI"), as described below.

Derivative instruments are recorded on the consolidated statement of financial position at fair value, including those derivatives that are embedded in financial or non-financial contracts. Changes in the fair values of derivative instruments are recognized in non-operating income (expense) with the exception of foreign exchange risk management contracts and derivatives designated as effective cash flow hedges, as further described below.

For financial instruments measured at amortized cost, transaction costs or fees, premiums or discounts earned or incurred are recorded, at inception, net against the fair value of the financial instrument. Interest expense is recorded using the effective interest method. For any guarantee issued that meets the definition of a guarantee pursuant to Accounting Guideline 14, *Disclosure of Guarantees*, the inception fair value of the obligation relating to the guarantee is recognized and amortized over the term of the guarantee. It is the Corporation's policy to not re-measure the fair value of the financial guarantee unless it qualifies as a derivative.

The Corporation has implemented the following classifications:

- Cash and cash equivalents are classified as held-for-trading and any period change in fair value is recorded through net income.
- Aircraft related deposits are classified as held-to-maturity investments and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.
- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.
- Accounts payable, credit facilities, and bank loans are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.

Changes in the fair value of foreign currency forward contracts, option agreements and currency swap agreements used for foreign exchange risk management but not designated as hedges for accounting purposes, are recorded in foreign exchange gain (loss). These contracts are included in the consolidated statement of financial position at fair value in Prepaid expenses and other current assets, Deposits and other assets, Accounts payable and accrued liabilities, or Other long-term liabilities as appropriate.

The Corporation from time to time enters into interest rate swaps to manage the risks associated with interest rate movement on US and Canadian floating rate debt, including anticipated debt transactions. Changes in the fair value of these swap agreements, which are not designated as hedges for accounting purposes, are recognized in income in Other non-operating income. These contracts are included in the consolidated statement of financial position at fair value in Prepaid expenses and other current assets, Deposits and other assets, Accounts payable and accrued liabilities, or Other long-term liabilities as appropriate.

<u>Fuel Derivatives Under Hedge Accounting</u>

The Corporation has designated certain of its fuel derivatives as cash flow hedges. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in OCI while the ineffective portion is recognized in non-operating income (expense). Upon maturity of the fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in fuel expense. The derivatives are recorded on the consolidated statement of financial position in Prepaid expenses and other current assets, Deposits and other assets, Accounts payable and accrued liabilities, or Other long-term liabilities as appropriate.

Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item. The amounts previously recognized in AOCI are reclassified to fuel expense during the periods when the derivative matures. If the derivative is sold prior to its maturity, the amounts previously recognized in AOCI are reclassified to non-operating income (expense). The Corporation does not have a practice of selling fuel derivatives prior to maturity. Refer to Note 17.

Comprehensive Income

OCI represents changes in Shareholders' equity during a period arising from transactions and other events with non-owner sources that are recognized in Comprehensive income, but excluded from net income. Period changes in the fair value of the effective portion of cash flow hedging instruments are recorded in OCI. Commencing in the first quarter of 2007 interim consolidated financial statements include the consolidated statement of comprehensive income; items affecting OCI are recorded prospectively commencing from January 1, 2007, including the transition adjustments. Cumulative changes in OCI are included in AOCI, which is presented as a new category within Shareholders' equity on the consolidated statement of financial position. OCI and AOCI are presented net of tax.

Impact Upon Adoption of CICA accounting handbook sections 3855, 3861, 3865, 1530, and 3251

In accordance with the transitional provisions of the standards, prior periods have not been restated for the adoption of CICA Sections 3855, *Financial Instruments – Recognition and Measurement*, 3861, *Financial Instruments – Disclosure and Presentation,* section 3865 – *Hedges,* section 1530, *Comprehensive Income,* and 3251 – *Equity.*

The transition adjustments attributable to the re-measurement of financial assets and financial liabilities at fair value, other than financial assets classified as available-for-sale and hedging instruments designated as cash flow hedges, were recognized in the opening Deficit of the Corporation as at January 1, 2007.

For the Corporation's fuel-hedging relationship classified as a cash flow hedge, which qualifies for hedge accounting under the new standard, the effective portion of any gain or loss on the hedging instruments was recognized in AOCI and the cumulative ineffective portion was included in the opening Deficit of the Corporation as at January 1, 2007.

Upon adoption the Corporation recorded the following adjustments to the Consolidated statement of financial position:

Increase (decrease)	
Deferred charges	$ (14)
Future income taxes ($6, net of valuation allowance $6)	-
Accounts payable and accrued liabilities	18
Long-term debt and capital leases	(14)
Deficit, net of nil tax	(8)
Accumulated other comprehensive income (loss), net of nil tax	(26)

N) FOREIGN CURRENCY TRANSLATION

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the consolidated statement of financial position. Non-monetary assets, non-monetary liabilities, revenues and expenses arising from transactions denominated in foreign currencies, are translated at rates of exchange in effect, which are based on averages for the month. Adjustments to the Canadian dollar equivalent of foreign denominated monetary assets and liabilities due to the impact of exchange rate changes are classified on the consolidated statement of operations as a foreign exchange gain or loss.

O) INCOME TAXES

The Corporation utilizes the liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax basis of assets and liabilities. Future income tax assets and liabilities are measured using substantively enacted tax rates in effect for the year 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 tax rates is recognized in earnings in the period when the change is substantively enacted. Future income tax assets are recognized to the extent that realization is considered more likely than not. The benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, will be recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to shareholders' equity. The benefit of future income tax assets that arise after fresh start will be recognized in the income statement.

As the income of excluded inter-company investments held by Air Canada (Note 3) has been excluded from these consolidated financial statements, the future income tax expense resulting from the utilization of the losses accumulated prior to the date of the Air Canada IPO has been allocated to Shareholders' Equity.

P) CASH AND CASH EQUIVALENTS

Cash includes $411 pertaining to investments with original maturities of three months or less at December 31, 2007 (2006 - $1,330). Investments include bankers' acceptances, bankers discount notes, and commercial paper, which may be liquidated promptly and have original maturities of three months or less. The weighted average interest rate on investments as at December 31, 2007 is 4.68 % (2006 - 4.31%). Refer to Note 7 for a discussion of non-bank sponsored Asset-Backed Commercial Paper ("ABCP") reclassified to Deposits and other assets as it is not expected that these amounts are collectible within one year.

Q) SHORT-TERM INVESTMENTS

Short-term investments, comprised of bankers' acceptances and bankers' discount notes, have original maturities over three months, but not more than one year. The weighted average interest rate on short-term investments as at December 31, 2007 is 4.61% (2006 - 4.38%).

R) RESTRICTED CASH

The Corporation has recorded $124 (2006 - $109) in restricted cash, under current assets, representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance ticket sales, recorded under current liabilities, for certain travel related activities.

Restricted cash with maturities greater than one year from the balance sheet date is recorded in Deposits and other assets.

S) SPARE PARTS, MATERIALS AND SUPPLIES

Spare parts, materials and supplies includes repairable and expendable spare parts and fuel inventories and are valued at the lower of average cost and net realizable value.

T) PROPERTY AND EQUIPMENT

Property and equipment is initially recorded at cost. Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments.

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Property and equipment under capital leases and variable interest entities are depreciated to estimated residual values over the life of the lease. Aircraft and flight equipment, including spare engines and related parts ("rotables") are depreciated over 20 to 25 years, with 10% to 20% estimated residual values. Aircraft reconfiguration costs are amortized over 3-5 years. Betterments to owned aircraft are capitalized and amortized over the remaining service life of the aircraft. Betterments to aircraft on operating leases are amortized over the term of the lease.

Buildings are depreciated over their useful lives not exceeding 40 to 50 years on a straight line basis. An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease. Leasehold improvements are amortized over the lesser of the lease term or 5 years. Ground and other equipment is depreciated over 3 to 25 years.

U) INTEREST CAPITALIZED

Interest on funds used to finance the acquisition of new flight equipment and other property and equipment is capitalized for periods preceding the dates that the assets are available for service. Capitalized interest related to the acquisition of new flight equipment and other property and equipment is included in purchase deposits within Property and equipment (refer to Note 4). Capitalized interest also includes financing costs charged by the manufacturer on capital commitments as described in Note 16.

V) INTANGIBLE ASSETS

As a result of the application of fresh start reporting, intangible assets were recorded at their estimated fair values at September 30, 2004. For periods subsequent to September 30, 2004, intangible assets are initially recorded at cost. Indefinite life assets are not amortized while assets with finite lives are amortized on a straight line basis to nil over their estimated useful lives.

	Estimated Useful Life
International route rights and slots	Indefinite
Air Canada trade name	Indefinite
Other marketing based trade names	Indefinite
Star Alliance membership	25 years
Other contract and customer based intangible assets	10 to 15 years
Technology based intangible assets	1 to 5 years

W) IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are tested for impairment whenever circumstances indicate that the carrying value may not be recoverable. When events or circumstances indicate that the carrying amount of long-lived assets, other than indefinite life intangibles, are not recoverable, the long-lived assets are tested for impairment by comparing the estimate of future expected cash flows to the carrying amount of the assets or groups of assets. If the carrying value is not recoverable from future expected cash flows, any loss is measured as the amount by which the asset's carrying value exceeds fair value and recorded in the period. Recoverability is assessed relative to undiscounted cash flows from the direct use and disposition of the asset or group of assets.

Indefinite life intangible assets are subjected to impairment tests on an annual basis or when events or circumstances indicate a potential impairment. If the carrying value of such assets exceeds the fair values, the assets are written down to fair value.

X) AIRCRAFT LEASE PAYMENTS IN EXCESS OF OR LESS THAN RENT EXPENSE

Total aircraft operating lease rentals over the lease term are amortized to operating expense on a straight-line basis. Included in deferred charges and long-term liabilities is the difference between the straight line aircraft rent expense and the payments as stipulated under the lease agreement.

Y) ASSET RETIREMENT OBLIGATIONS

The Corporation records an asset and related liability for the costs associated with the retirement of long-lived tangible assets when a legal liability to retire such assets exists. The fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and then amortized over its estimated useful life. In subsequent periods, the asset retirement obligation is adjusted for the passage of time through charges to income and any changes in the amount of the underlying cash flows through increases or decreases to the asset retirement obligation and related asset. A gain or loss may be incurred upon settlement of the liability.

Z) RELATED PARTY TRANSACTIONS

Related party transactions not in the normal course of operations are measured at the exchange amount when the change in ownership interest in the item transferred is substantive and the exchange amount is supported by independent evidence; otherwise it is recorded at the carrying amount. Related party transactions in the normal course of operations are measured at the exchange amount.

AA) VARIABLE INTEREST ENTITIES

Aircraft and Engine Leasing Transactions

The Corporation has aircraft and engine leasing transactions with a number of special purpose entities that are variable interest entities (a "VIE") under Accounting Guideline 15 of the CICA Handbook, Variable Interest Entities ("AcG-15"). As a result of the Corporation being the primary beneficiary of these VIEs, the Corporation consolidates leasing entities covering 44 aircraft and 22 engines.

Fuel Facilities Arrangements

The Corporation participates in fuel facilities arrangements operated through fuel facility corporations (the "Fuel Facility Corporations"), along with other airlines to contract for fuel services at various major Canadian airports. The Fuel Facility Corporations are organizations incorporated under federal or provincial business corporations acts in order to acquire, finance and lease assets used in connection with the fuelling of aircraft and ground support equipment. The Fuel Facilities Corporations operate on a cost recovery basis.

Under AcG-15, the Corporation is the primary beneficiary of three of the Fuel Facilities Corporations in Canada. Five of the Fuel Facility Corporations in which Air Canada participates in Canada that have not been consolidated have assets of approximately $141 and debt of approximately $119, which is the Corporation's maximum exposure to loss without taking into consideration any cost sharing and asset retirement obligations that would occur amongst the other contracting airlines. The Corporation considers this loss potential as remote.

BB) FUTURE ACCOUNTING STANDARD CHANGES

The following is an overview of accounting standard changes that the Corporation will be required to adopt in future years:

Capital Disclosures and Financial Instruments – Presentation and Disclosure

The CICA issued three new accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments – Disclosures*, and section 3863, *Financial Instruments – Presentation*. These new standards will be effective for fiscal years beginning on or after October 1, 2007 and the Corporation will adopt them on January 1, 2008. The Corporation is in the process of evaluating the disclosure and presentation requirements of the new standards.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 will replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections will place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

Inventories

The CICA issued section 3031, *Inventories*, which will replace section 3030, *Inventories*. This new standard is effective for fiscal years beginning on or after July 1, 2007, and the Corporation will adopt this section on January 1, 2008. Section 3031 provides more extensive guidance on measurement, and expands disclosure requirements to increase transparency. The Corporation's accounting policy for inventories is consistent with measurement requirements in the new standard and therefore it is not anticipated that the results of the Corporation will be impacted; however, additional disclosures will be required in relation to inventories carried at net realizable value, the amount of inventories recognized as an expense, and the amount of any write downs of inventories.

CC) COMPARATIVES

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

3. INITIAL PUBLIC OFFERING

The Air Canada IPO consisted of an offering by Air Canada of an aggregate of 9,523,810 variable voting shares and voting shares for gross proceeds of $200 ($187 net of offering costs of $13) and a secondary offering by ACE of an aggregate of 15,476,190 variable voting shares and voting shares for gross proceeds to ACE of $325 ($304 net of offering costs of $21). The offering costs incurred were allocated between ACE and Air Canada on a pro rata basis in relation to size of the aggregate offering. Air Canada did not receive any proceeds from the secondary offering from ACE.

Other transactions in conjunction with the Air Canada IPO, which closed on November 24, 2006, are as follows:

- Prior to the Air Canada IPO and in connection with internal planning by the ACE group of entities, Air Canada prepaid an amount of approximately $595 to ACTS, for the estimated equivalent of 12 months of service to be rendered by ACTS starting on November 1, 2006.

  The amount of such prepayment was immediately loaned back by ACTS to Air Canada through a non-interest bearing loan. The loan was repayable in instalments equal to the amount that would otherwise be payable by Air Canada to ACTS for services to be rendered, starting on November 1, 2006. This is considered to be a non-cash transaction in substance and has been excluded from the Consolidated statement of cash flows. This amount was repaid by the Corporation during the year ended December 31, 2007.

- ACE transferred to Air Canada all of its interests in Air Canada Ground Handling, all of its interests in Air Canada Cargo and 51% of its interests in Air Canada Vacations in consideration for the issuance to ACE of additional common shares of Air Canada. In addition, ACE exchanged all the preferred shares it held in Air Canada for common shares of Air Canada at an exchange ratio equal to the price of shares sold in the Air Canada IPO resulting in the issuance of additional common shares. No effect is given to this transaction in the 2006 comparative consolidated financial statements as the preferred shares would be classified as equity. Following these transactions, ACE held 90,476,190 common shares in the restructured Air Canada immediately prior to the offering.

- For consideration of $673, special investments in ACTS were transferred to ACE from Air Canada and were recorded in Contributed surplus (refer to Excluded Inter-company Investments section below).

- Inter-company accounts between ACE and Air Canada were settled that resulted in an increase to Cash and cash equivalents of $170, a reduction to Deposits and other assets of $269 (consisting of an advance of $186 and a note receivable on the transfer of the Jazz investment of $83), a reduction to Accounts receivable of $41 and a reduction of Long-term debt of $140.

Allocation of Corporate Expenses

For the period prior to November 24, 2006, the consolidated financial statements include an allocation of the general corporate expenses incurred by ACE based upon the proportion of the Corporation's consolidated revenues compared to ACE's consolidated revenues. The allocation of general corporate expenses to the Corporation includes its proportionate share of such general corporate expenses incurred by ACE, including executive management, legal, investor relations, treasury, finance, financial reporting, tax, internal audit and human resources services as well as costs of governance, professional fees and regulatory filings, all of which amounted to $11 for the year ended December 31, 2006. This allocation of corporate expenses was recorded within what was then referred to as the “Air Canada Services” segment and as a credit to Contributed surplus. The allocation of general corporate expenses ceased on November 24, 2006.

For the period prior to November 24, 2006, the consolidated financial statements do not include an allocation of additional interest expense on corporate debt issued by ACE which had a weighted average effective interest rate of 12% for the period ended November 24, 2006. In conjunction with the Air Canada IPO, as described above, the Corporation settled the outstanding loans due to ACE and its affiliates of $140. The weighted average effective interest rates on these inter-company loans amounted to 9.36% for the period ended November 24, 2006. Management of the Corporation believes that the inter-company debt and the rates thereon were appropriate in the circumstances.

Excluded Inter-company Investments

Prior to the Air Canada IPO, Air Canada held, for tax planning purposes, certain investments in limited partnerships of which ACE owned directly or indirectly all of the limited partner units. These investments and related income and income tax effects have been excluded from these consolidated statements of financial positions and operations of the Corporation, as these activities did not relate to the operations of the Corporation. These investments were transferred to ACE during 2005 and 2006 in exchange for cash and a note receivable. For purposes of these consolidated financial statements, these exchanges of the investments for cash and a note receivable were recorded as related party transactions resulting in a contribution of cash and notes receivable to the Corporation. These contributions of cash have been reflected as financing activities in the Consolidated statement of cash flows. During 2006 the Corporation received cash from ACE of $673 for the investments in ACTS and $483 for the investments in Jazz.

During 2006, Jazz settled a Note payable outstanding to a subsidiary of ACE of $200 in connection with the initial public offering of Jazz Air Income Fund (Note 21).

Income Taxes

As part of a tax loss utilization strategy that was planned in conjunction with the Air Canada IPO and corporate restructuring, a current tax payable of $345 was created in 2006. This tax payable arose upon a transaction to transfer tax assets from the Corporation to ACE. This tax payable was recoverable from future income tax assets of the Corporation and was settled during the first quarter of 2007. The Corporation recorded interest expense of $6, which was due on the tax balance prior to its recovery in current income taxes on the Consolidated statement of operations.

4. PROPERTY AND EQUIPMENT

	2007	2006
Cost		
Flight equipment, including spare engines (a)	$ 5,433	$ 3,666
Assets under capital leases (b)	1,899	1,813
Buildings, including leasehold improvements	603	662
Ground and other equipment	136	122
	8,071	6,263
Accumulated depreciation and amortization		
Flight equipment, including spare engines (a)	685	476
Assets under capital leases (b)	438	285
Buildings, including leasehold improvements	118	95
Ground and other equipment	35	24
	1,276	880
	6,795	**5,383**
Purchase deposits, including capitalized interest (c)	1,124	563
Property and equipment at net book value (d)	**$ 7,919**	**$ 5,946**

(a) Included in flight equipment as at December 31, 2007 are rotable parts, including spare engines with a cost of $560 (2006 - $450) less accumulated depreciation of $121 (2006 - $70) for a net book value of $439 (2006 - $380). Also included in flight equipment are 33 aircraft which are leased to Jazz (Note 16) and third parties with a cost of $753 (2006 - $763) less accumulated depreciation of $152 (2006 - $100) for a net book value of $601 (2006 - $663).

(b) Included in capital leases as at December 31, 2007 are 39 aircraft (2006 - 37) with a cost of $1,825 (2006 - $1,739) less accumulated depreciation of $409 (2006 - $265) for a net book value of $1,416 (2006 - $1,474), computer equipment with a cost of $28 (2006 - $28) less accumulated depreciation of $23 (2006 - $16) for a net book value of $5 (2006 - $12) and facilities with a cost of $46 (2006 - $46) less accumulated depreciation $6 (2006 - $4) for a net book value of $40 (2006 - $42).

(c) Includes $867 (2006 - $287) for Boeing B777/787 aircraft, $26 (2006 - $66) for Empresa Brasileira de Aeronautica S.A. ("Embraer") aircraft, $205 (2006 - $175) for the aircraft interior refurbishment program and $26 (2006 - $35) for equipment purchases and internal projects. Refer to Note 8(c) relating to the financing of Boeing predelivery payments.

(d) Net book value of Property and equipment includes $973 (2006 - $1,137) consolidated for aircraft and engine leasing entities, $123 (2006 - $111) consolidated for fuel facility corporations, and nil (2006 - $199) consolidated for Jazz; all of which are consolidated under AcG-15 (Jazz ceased to be consolidated effective May 24, 2007 as described in Note 1).

As at December 31, 2007, flight equipment included 12 aircraft (2006 - 28), that are retired from active service with a net carrying value of $5 (2006 - $5), which approximates fair value.

Interest capitalized during 2007 amounted to $108 (2006 - $61) with $63 at an interest rate of 3 month US LIBOR plus 3.0%, $5 at an interest rate of 30 day LIBOR plus 1.14%, and $40 at an interest rate of 8.34%.

During 2007:

- The Corporation sold an in-service aircraft for proceeds of $23 with a book value of $21, resulting in a gain on sale of $2 (loss of $2 net of tax).
- The Corporation sold a building to ACTS Aero for proceeds of $28 which was equal to the carrying value of the asset (refer to Note 20).
- A CRJ-100 aircraft owned by Air Canada and leased to Jazz was damaged beyond repair. As a result of insurance proceeds of $21, Air Canada recorded a gain on disposal of $14 ($10 net of tax).
- The Corporation sold one of its commercial real estate properties for net proceeds of $42 with a carrying value of $37, resulting in a gain on sale of $5 ($4 net of tax).
- The Corporation sold 18 parked aircraft for proceeds of $2 with a nil book value, resulting in a gain on sale of $2 ($1 net of tax).

During 2006:

- The Corporation sold one of its buildings with a carrying value of $35, for proceeds of $40 resulting in a gain on sale of $5.
- The Corporation recorded an impairment loss of $7 on one of its buildings being held for sale, which was sold to ACTS Aero in 2007 (refer to Note 20).

5. DEFERRED CHARGES

		2007	2006
Aircraft lease payments in excess of rent expense - Air Canada	Note 2X	$ 47	$ 55
Financing costs - Air Canada		4	18
Aircraft lease payments in excess of rent expense - Jazz	Note 2X	-	28
Financing costs - Jazz		-	2
		$ 51	**$ 103**

6. INTANGIBLE ASSETS

	2007	2006
Indefinite life assets		
International route rights and slots	$ 327	$ 430
Air Canada trade name	298	393
Other marketing based trade names	31	50
	656	**873**
Finite life assets		
Star Alliance membership	131	158
Other contract and customer based	144	157
Technology based	186	130
	461	445
Accumulated depreciation and amortization		
Star Alliance membership	(27)	(22)
Other contract and customer based	(81)	(65)
Technology based	(57)	(37)
	(165)	(124)
Finite life assets, net	**296**	**321**
	$ 952	**$ 1,194**

As a result of recognizing the benefit during the year ended December 31, 2007 of future income tax assets that existed at fresh start, and for which a valuation allowance was recorded intangible assets were reduced on a pro-rata basis by $252 (2006 - $554). In addition, amortization of intangible assets amounted to $41 (2006 - $54)

The carrying value of intangible assets includes nil (2006 - $5) related to Jazz, which ceased to be consolidated under AcG-15 effective May 24, 2007.

7. DEPOSITS AND OTHER ASSETS

		2007	2006
Aircraft related deposits (a)		$ 150	$ 168
Restricted cash (b)		84	83
Deposit related to the Pension and Benefits Agreement	note 20	101	-
Asset-backed commercial paper (c)		29	-
Other deposits		56	50
Other		17	11
		$ 437	**$ 312**

(a) The amount of deposits with lessors for the lease of aircraft and flight simulators.

(b) Restricted cash relates to funds on deposit with various financial institutions as collateral for letters of credit and other items.

(c) The Corporation has $37 ($29 net of a fair value adjustment) in non-bank sponsored ABCP which has been recorded in Deposits and other assets. These investments, which were scheduled to mature during the third quarter 2007, were previously recorded in Cash and cash-equivalents and the transfer to Deposits and other assets is reflected as an investing activity on the Consolidated statement of cash flows. An agreement in principle to restructure the ABCP investments was approved by the Pan-Canadian Committee for Third Party Structured ABCP ("Committee") on December 23, 2007. The approval of the restructuring, subject to a vote by all investors, is anticipated to occur by March 2008. Under the terms of the restructuring, all of the ABCP would be exchanged for longer-term notes that will match the maturity of the underlying assets in the proposed structure. Air Canada is not accruing interest on these investments.

During 2007, Air Canada recorded a charge of $8 ($5 after tax) in non-operating income (expense). The charge is based on a number of assumptions as to the fair value of the investments including factors such as estimated cash flow scenarios and risk adjusted discount rates. The assumptions used in estimating the fair value of the investments are subject to change, which may result in further adjustments to non-operating results in the future.

8. LONG-TERM DEBT AND CAPITAL LEASES

	Final Maturity	Stated Interest Rate	2007	2006
Embraer aircraft financing (a)	2017-2021	6.61-8.49	$ 1,138	$ 776
Boeing aircraft financing (b)	2019	5.13-5.69	647	-
Predelivery financing (c)	2008-2013	6.16	521	-
Conditional sales agreements (d)	2019	7.74-7.97	149	184
Lufthansa cooperation agreement (e)	2009	6.50	25	44
GE loan (f)	2015	10.58	38	48
Revolving credit facility (g)			-	-
Canadian Regional Jet (h)	2012	6.43	33	-
Other			-	5
Direct Corporation debt			**2,551**	**1,057**
Jazz - senior syndicated credit facility (i)			-	115
Aircraft and engine leasing entities - debt (j)			771	1,051
Fuel facility corporations - debt (k)			125	59
Debt consolidated under AcG-15			**896**	**1,225**
Capital lease obligations (l)			**972**	**1,281**
Total debt and capital leases			**4,419**	**3,563**
Current portion			(413)	(367)
Long-term debt and capital leases			**$ 4,006**	**$ 3,196**

The Stated Interest Rate in the table above is the rate as of December 31, 2007

Principal repayment requirements as at December 31, 2007 on long-term debt and capital lease obligations, and aircraft, engine and fuel facility debt consolidated as variable interest entities under AcG-15 are as follows:

	2008	2009	2010	2011	2012	Thereafter	Total
Direct Corporation debt	$ 160	$ 152	$ 141	$ 153	$ 166	$ 1,779	$ 2,551
Debt consolidated under AcG-15	105	51	100	288	73	279	896
Capital lease principal obligation	148	80	83	84	132	445	972
Total	**$ 413**	**$ 283**	**$ 324**	**$ 525**	**$ 371**	**$ 2,503**	**$ 4,419**

(a) Embraer aircraft financing amounts to US$1,151 as at December 31, 2007 (US$666 as at December 31, 2006). Principal and interest is repaid quarterly until maturity. The loan is secured by the 57 delivered Embraer aircraft, including 2005 to 2007 deliveries, with a carrying value of $1,651.

(b) Boeing aircraft financing amounts to US$655 as at December 31, 2007, which is financed under loan guarantee support provided by the Export-Import Bank of the United States ("EXIM"), as described below. Principal and interest is repaid quarterly until maturity. The loan is secured by the 7 delivered aircraft with a carrying value of $992.

On April 19, 2007, the Corporation received a final commitment for loan guarantee support, subject to the fulfillment of certain terms and conditions, from EXIM covering seven Boeing 777 aircraft under the Corporation's purchase agreement with Boeing (the "Boeing Purchase Agreement"), to be delivered in 2007. During 2007, the Corporation took delivery of eight Boeing 777 aircraft, seven of which were acquired under the Boeing Purchase Agreement and financed under the loan guarantee support provided by EXIM, the other one being subject to an operating lease agreement with International Lease Finance Corporation ("ILFC").

(c) On October 30, 2007, the Corporation entered into an agreement with a syndicate of banks for the financing of pre-delivery payments ("PDP") for 10 of the 16 Boeing B777 aircraft contemplated in the Boeing Purchase Agreement. The PDP financing is a series of loans that are aircraft specific with a maximum aggregate commitment of up to $568 (US$575). The PDP loans have a term of five years, but may be prepaid upon the delivery of the aircraft without penalty. The Corporation drew $533 (US$540) in October 2007. The Corporation prepaid in November 2007, the PDP loan of $64 (US$65) on the first Boeing 777 delivered under the PDP financing agreement. In addition, the Corporation has served notice to the PDP syndicate that it will be repaying the PDP loans on delivery of the second through eighth aircraft. Air Canada's intent is to prepay all PDP loans upon delivery of the relevant aircraft, using the committed long-term aircraft financing for the aircraft to be delivered. The last aircraft in this PDP financing is currently scheduled for delivery in November 2008, at which time, Air Canada expects to have fully repaid the PDP loans. At year-end 2007, the balance outstanding on the PDP loans was $521 (US$528), which includes two additional draws of $26 (US$26) each. The long-term financing is included within Long-term debt and capital leases within the Consolidated statement of financial position. The year to date capitalized interest relating to this financing is $5 at an interest rate of 30 day LIBOR plus 1.14% (6.16% as at December 31, 2007). As the loans are not due until 2013, the principal repayment is shown in the thereafter amount in the table above.

(d) US$151 principal outstanding on acquisitions of two A340-500 aircraft financed through conditional sales agreements. Principal and interest is paid quarterly until maturity in 2019. The purchase price instalments bear interest at a three month LIBOR rate plus 2.9% (7.74% - 7.97% as at December 31, 2007 and 8.27% as at December 31, 2006). The carrying value of the two A340-500 aircraft provided as security under the conditional sales agreements is $265 as at December 31, 2007.

(e) US$25 principal outstanding to mature in 2009, with semi-annual repayments, at a fixed interest rate of 4.50% plus an annual 2.0% guarantee fee.

(f) US$38 principal outstanding to mature in 2015, with quarterly repayments, at a floating interest rate equal to the six month LIBOR rate plus 5.75% pre-payable on any interest payment date after December 23, 2007. The next interest payment date is March 20, 2008. The debt is secured by certain flight training equipment with a current carrying value of $47.

(g) The revolving credit facility is a $400 senior secured revolving credit facility (the "Credit Facility"). The Credit Facility has a three year term that can be extended at Air Canada's option for additional one-year periods on each anniversary of the closing of the Air Canada IPO, subject to prior approval of Lenders holding no less than two thirds of the total commitments under the Credit Facility. The total amount available for borrowing under the Credit Facility is subject to a borrowing base restriction based on certain percentages of the values of eligible accounts receivable and eligible real estate. The Credit Facility is secured by a first priority security interest and hypothec over the present and after-acquired personal property of Air Canada, subject to certain exclusions and permitted liens, and by a first priority charge and hypothec over certain owned and leased real property of Air Canada. Air Canada's obligations are guaranteed by 1209265 Alberta Ltd., a subsidiary of Air Canada, which provides a first priority security interest over its present and after-acquired personal property, subject to certain exclusions and permitted liens, as security for its guarantee obligations. The Credit Facility contains customary representations and warranties and is subject to customary terms and conditions (including negative covenants, financial covenants and events of default). The interest rate margin ranges from LIBOR plus 2.25% to 3.25% or prime plus 1.25% to 2.25% (based on Air Canada's earnings before interest, taxes, depreciation, amortization and obsolescence and aircraft rent). As at December 31, 2007, no amount was drawn under this facility.

(h) During 2007, the Corporation refinanced five Canadair Regional Jet ("CRJ") aircraft. The refinancing included a payment of other obligations under the leasing arrangement to third parties of $36. During 2007 the debt of $9 relating to one of the CRJ aircraft was repaid. As at December 31, 2007, the principal outstanding is $33 on the four CRJ aircraft. Principal and interest are paid quarterly to maturity in 2012. The financing bears interest at a floating rate of the 3 month Canadian Banker's Acceptance rate plus 1.7%. The loan is secured by the five delivered aircraft with a carrying value of $29.

(i) At December 31, 2006, Jazz reported senior secured syndicated credit facility in the amount of $150. On closing of the Jazz IPO, $115 was drawn under the credit facility ($113 net of fees). The facility bears interest at floating rates and had a three year term maturing in 2009. The outstanding credit facility was secured by substantially all the present and future assets of Jazz. Jazz had entered into swap agreements with third parties with a notional value of $115 to receive floating rates and pay fixed rates of 7.09%. Subsequent to December 31, 2006, the original term of this facility was extended to 2010. Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (refer to Note 1).

(j) The Corporation has entered into aircraft and engine lease transactions with several special purpose entities that qualify as VIEs. The debt has a weighted average effective interest rate of approximately 8% (2006 - 8%). These aircraft and engines have a carrying value of $973 and are charged as collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to the Corporation, as lessee, in the event of default or early termination of the lease. Aircraft related debt amounting to US$780 ($771) [2006 - US$902 ($1,051)] is summarized as follows:

	Final Maturity	2007	2006
Canadian Regional Jet	2010-2011	$ 218	$ 316
Boeing 767-300	2011-2016	163	211
Engines	2008	54	71
Airbus 319	2011-2014	215	304
Airbus 321	2017	121	149
Total		**$ 771**	**$ 1,051**

(k) Under AcG-15, the Corporation is the primary beneficiary of certain of the Fuel Facility Corporations in Canada. The debt is comprised of bankers' acceptances with interest rates ranging from 5.72% - 6.93%, bank loans at prime plus 0.25% to prime plus 1.5%, and bonds payable with an interest rate of 5.09%. $110 of debt is due in 2032 with equal semi-annual payments of principal and interest. The remaining debt has varying maturities. The debt is secured by a general security agreement covering all assets of the Fuel Facility Corporations. The carrying value of the fuel facilities debt is $123 as at December 31, 2007.

(l) Capital lease obligations, related to computer equipment, facilities and 39 aircraft, total $972 ($71 and US$912) [2006 total $1,281 ($80 and US$1,030)]. The debt has a weighted average effective interest rate of approximately 8% and final maturities range from 2008 to 2027. During 2007, the Corporation recorded interest expense on capital lease obligations of $96 (2006 - $101).

Certain aircraft lease agreements contain a fair value test, beginning on July 1, 2009, and annually thereafter until lease expiry. This test relates to 26 aircraft under lease of which 23 are accounted for as capital leases. Under the test, the Corporation may be required to prepay certain lease amounts, based on aircraft fair values, as of the date of the test. Any amounts prepaid would be recorded as a reduction of the lease obligation. The Corporation contracts with certain third parties to provide residual value support for certain aircraft. If the Corporation is required under the loan to value test to prepay lease obligations, these amounts are recoverable from the third party residual value support provider upon lease expiry to the extent that the adjusted obligation taking into account prepayments is less than the residual value support. The maximum amount payable on July 1, 2009, assuming the related aircraft are worth nil, is $722 (US$731). This amount declines over time to nil upon lease expiry. As the Corporation does not expect to have to prepay any amounts based upon expectations of aircraft fair values into the future, the amortized cost of these capital lease obligations reflects the scheduled payments over the term to final maturity.

As at December 31, 2007, obligations under capital leases for future minimum lease payments are as follows:

2008	$ 223
2009	147
2010	142
2011	136
2012	177
Thereafter	569
Total minimum lease payments	1,394
Less amount representing interest	(422)
Total obligation under capital leases	**$ 972**

The above minimum lease payments include residual value guarantees, except for those for which the Corporation has obtained residual value support.

Interest paid on long-term debt and capital lease obligations in 2007 by the Corporation was $263 (2006 - $251).

9. FUTURE INCOME TAXES

The following income tax related amounts appear in the Corporation's Consolidated statement of financial position:

	2007	2006
Future income tax asset recorded in current assets (a)	$ -	$ 345
Current tax payable (a)	$ -	$ (345)
Long-term tax payable (a)	$ (10)	$ -
Future income tax liability (c)	$ (88)	$ (134)

a) Current Taxes Payable

As part of a tax loss utilization strategy that was planned in conjunction with the initial public offering of Air Canada and corporate restructuring, a current tax payable of $345 was created in 2006. This tax payable arose upon a transaction to transfer tax assets from Air Canada to ACE. This tax payable was recoverable from future income tax assets of Air Canada and was settled in 2007. The Corporation recorded current tax expense of $6 in 2007, which was related to the interest on the tax balance prior to its recovery.

During 2007, Air Canada recorded a current income tax expense of $10 resulting from the Federal and Ontario harmonization of corporate taxes. Air Canada will have a cash tax payable of $10 that will be payable over a five year period beginning in 2009. This amount is included in Other long-term liabilities.

b) Valuation Allowance

The Corporation has determined that it is more likely than not that future income tax assets of $843 are not recoverable and have been offset by a valuation allowance. However, the future tax deductions underlying the future tax assets remain available for use in the future to reduce taxable income.

Subsequent to the completion of the Air Canada IPO in 2006, the future income tax accounting of Air Canada is independent from ACE, and as such, Air Canada's intangible assets and shareholders' equity are not affected by ACE accounting events. For periods subsequent to the Air Canada IPO, the benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, is recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting. The benefit of future income tax assets that arise after fresh start are recognized in the income statement.

Prior to the completion of the Air Canada IPO in 2006, it was determined that a portion of valuation allowance recorded by ACE should be reversed as it was more likely than not that certain future income tax assets of $504, which a valuation allowance had been recorded against at the time of fresh start reporting, would be realized. Consistent with the income tax accounting policy of Air Canada while it was wholly owned by ACE, the reversal of the valuation allowance by ACE resulted in a reduction of Air Canada's intangible assets (on a pro-rata basis) of $374 in 2006.

For periods when Air Canada was wholly owned by ACE, the benefit of future income tax assets that existed at fresh start, including the benefit recognized by affiliates of the Corporation, and for which the valuation allowance has been reversed, are recognized on a pro rata basis as a reduction of intangible assets of the Corporation and a debit or credit to shareholders' equity. The pro rata allocation of the reversal of the valuation allowance was based on the aggregate carrying value of intangible assets of the Corporation and other entities of ACE on the basis that under the plan of arrangement under the Companies' Creditors Arrangement Act, these intangible assets were transferred to the other entities from Air Canada. The accumulated debit to shareholders' equity as at December 31, 2006 was $291.

As described in Note 3, the income of certain inter-company investments held by Air Canada is excluded from these consolidated financial statements. The income from these investments resulted in the utilization of non-capital losses carried forward of Air Canada and, as a result, the related future income tax expense was charged to shareholders' equity. The accumulated debit to shareholders' equity as at December 31, 2006 was $282.

c) Future Income Tax Liability

It has been assumed that certain intangibles and other assets with nominal tax cost and a carrying value of approximately $661, have indefinite lives and accordingly, the associated future income tax liability is not expected to reverse until the assets are disposed of or become amortizable, resulting in the reporting of a future income tax liability of $88.

	2007	2006
Future tax assets		
Loss carry forwards	$ 52	$ 27
Post-employment obligations	556	685
Accounting provisions not currently deductible for tax	129	180
Tax basis of capital assets over book basis	187	278
Eligible capital expenditures	2	10
Unearned revenues	13	393
Other	60	50
Total future tax assets	**999**	**1,623**
Future tax liabilities		
Intangible assets	135	210
Other	109	33
Total future tax liabilities	**244**	**243**
Net future tax assets	755	1,380
Less valuation allowance (b)	843	1,169
Net recorded future income tax asset (liability) (1)	**$ (88)**	**$ 211**

(1) As at December 31, 2007, the future income tax liability of $88 is recorded in long-term liabilities. As at December 31, 2006 the net recorded future income tax asset is comprised of a future income tax asset of $345 recorded in current assets (refer to (a) above) and a future income tax liability of $134 recorded in long-term liabilities.

The reconciliation of income tax attributable to continuing operations, computed at the statutory tax rates, to income tax expense (recovery) is as follows:

	2007	2006
Provision (recovery) based on combined federal and provincial rates	$ 206	$ (25)
Non-taxable portion of capital gains	(32)	1
Non-deductible expenses	17	14
Effect of tax rate changes on future income taxes	(3)	2
Effect of statutory tax rates substantively enacted during the year	67	64
Other	11	2
	266	**58**
Valuation allowance	(76)	(61)
Provision for (recovery of) income taxes	**$ 190**	**$ (3)**

Significant components of the provision for income taxes attributable to continuing operations are as follows:

	2007	2006
Current tax expense	$ 16	$ -
Future income tax expense (recovery) relating to changes in temporary differences	183	(6)
Future income tax expense from tax rate changes	67	64
Valuation allowance	(76)	(61)
Provision for (recovery of) income taxes	**$ 190**	**$ (3)**

In addition to the above items impacting the provision for income taxes, a future income tax expense of $5 was recorded in contributed surplus related to the proceeds from repair schemes and non-compete agreement with ACTS (refer to Note 20). Refer to Note 17 for future income taxes recorded in other comprehensive income related to fuel derivatives designated under fuel hedge accounting.

Income taxes paid in 2007 by the Corporation were $6. No income taxes were paid in 2006 by the Corporation.

The balances of tax attributes as at December 31, 2007, namely the balances of non-capital loss carry forwards, vary amongst different taxing jurisdictions. The following are the Federal tax loss expiry dates:

	Tax Losses
2010	$ 8
2014	16
2027	90
	$ 114

There are $61 of net capital losses that have no expiry date.

10. PENSION AND OTHER BENEFIT LIABILITIES

The Corporation maintains several defined benefit and defined contribution plans providing pension, other post-retirement and post-employment benefits to its employees, including those employees of the Corporation who are contractually assigned to ACTS Aero and Aeroplan.

The Corporation is the administrator and sponsoring employer of ten Domestic Registered Plans ("Domestic Registered Plans") under the Pension Benefits Standard Act, 1985 (Canada). The US plan, UK plan and Japan plan are international plans covering employees in those countries. In addition, the Corporation maintains a number of supplementary pension plans, which are not registered. The defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and final average earnings for a specified period.

The other employee benefits consist of health, life and disability. These benefits consist of both post-employment and post-retirement benefits. The post-employment benefits relate to disability benefits available to eligible active employees, while the post-retirement benefits are comprised of health care and life insurance benefits available to eligible retired employees.

Certain Corporation employees perform work for ACE and others are contractually assigned to ACTS Aero or Aeroplan. These employees are members of Corporation-sponsored defined benefit pension plans and also participate in Corporation-sponsored health, life and disability future benefit plans. These consolidated financial statements include all of the assets and liabilities of all Corporation-sponsored plans. The employee benefit expense in these consolidated financial statements includes the expenses for all employees participating in the plans less a cost recovery which is charged to the related parties for those employees assigned. The cost recovery includes current service costs for pensions along with their portion of post-employment and post-retirement benefits, based on the actuarial calculation for their specific employee group. This cost recovery amounted to $40 for the year ended December 31, 2007 (2006 - $56).

The measurement date used for financial reporting on the pension and other benefit obligations is November 30.

As described in Note 20, Air Canada and ACTS Aero are parties to a Pension and Benefits Agreement covering the future transfer of certain pension and benefit assets and obligations to ACTS Aero.

Benefit Obligation and Plan Assets

The following tables present financial information related to the changes in the pension and other post-employment benefits plans:

	Pension Benefits		Other Employee Future Benefits	
	2007	**2006**	**2007**	**2006**
Change in benefit obligation				
Benefit obligation at beginning of year	$ 13,235	$ 12,921	$ 966	$ 940
Current service cost	254	254	69	77
Interest cost	649	640	49	48
Employees' contributions	88	89	-	-
Benefits paid	(648)	(627)	(51)	(60)
Other benefits	2	-	-	-
Actuarial (gain) loss	(1,278)	(74)	(119)	(38)
Deconsolidation of Jazz	(100)	-	-	-
Foreign exchange	(52)	32	(15)	(1)
	12,150	13,235	899	966
Change in plan assets				
Fair value of plan assets at beginning of year	11,858	10,421	8	14
Actual return on plan assets	197	1,493	-	1
Employer contributions	382	455	43	47
Employees' contributions	88	89	-	-
Benefits paid	(648)	(627)	(51)	(54)
Deconsolidation of Jazz	(81)	-	-	-
Foreign exchange	(49)	27	-	-
	11,747	11,858	-	8
Deficit at end of year	**403**	**1,377**	**899**	**958**
Employer contributions after measurement date	(7)	(7)	(5)	(6)
Unrecognized net actuarial gain (loss)	497	(221)	149	46
Valuation allowance against accrued benefit	1	-	-	-
Net benefit obligation	**$ 894**	**$ 1,149**	**$ 1,043**	**$ 998**
Weighted average assumptions used to determine the accrued benefit liability				
Discount rate	5.75%	5.00%	5.75 - 6.00%	5.00 - 5.50%
Rate of compensation increase (a)	2.50%	2.50%		

(a) As a result of pay awards during 2006, a rate of compensation increase of 1.75% was used for years 2006 to 2008 in determining the net benefit obligation for the pension plan and 2.5% for the remaining years.

Under the terms of the domestic registered and supplementary plans, there is no indexation provided after January 1, 2007.

The pension benefit deficit of only those plans that are not fully funded at the end of the year is as follows:

	2007	**2006**
Domestic registered plans (a)	$ 35	$ 556
US, UK, and Japan	17	55
Supplementary plans	665	766
	$ 717	**$ 1,377**

(a) Includes nil (2006 - $19) related to Jazz, which was consolidated until May 24, 2007 under AcG-15.

The net deficit, on an accounting basis, at December 31, 2007 for pension benefits was $403 compared to $1,377 at December 31, 2006. The decrease in the accounting deficit is mainly the result of an increase in the discount rate and funding of past service employer contributions of $134, offset by a negligible return on plan assets.

The net benefit obligation is recorded in the statement of financial position is as follows:

	2007	2006
Pension benefits	$ 894	$ 1,149
Other employee future benefits	1,043	998
Net benefit obligation	**1,937**	**2,147**
Current portion	(113)	(271)
Pension and other benefits liability	**$ 1,824**	**$ 1,876**

The current portion of Pension benefits represents past service contributions for the Domestic Registered Plans, scheduled to be paid during 2008 while the current portion of Other employee future benefits is an estimate of the claims to be incurred during 2008. The current portion is included in Accounts payable and accrued liabilities.

Total cash payments for 2007, consisting of cash contributed by the Corporation to its defined benefit plans, cash payments to beneficiaries for post-employment and post-retirement plans, and cash contributed to its defined contribution plans were $428 (2006 - $520).

Pension and Other Employee Future Benefit Expense

The Corporation has recorded net defined benefit pension and other employee future benefits expense as follows:

	Pension Benefits		Other Employee Future Benefits	
	2007	2006	2007	2006
Components of Net Periodic Pension Cost				
Current service cost	$ 254	$ 254	$ 69	$ 77
Interest cost	649	640	49	48
Actual return on plan assets	(148)	(1,515)	-	(1)
Actuarial (gain) loss	(1,278)	(47)	(119)	(43)
Other benefits	2	-	-	-
Costs arising in the year	**(521)**	**(668)**	**(1)**	**81**
Differences between costs arising in the year and costs recognized in the year in respect of:				
Return on plan assets	(622)	774	-	-
Actuarial loss (gain)	1,285	65	103	26
Increase (decrease) in valuation allowance provided against accrued benefit asset	1	-	-	-
Net periodic benefit cost of plans	**143**	**171**	**102**	**107**
Amount charged to affiliates	(23)	(33)	(17)	(23)
Net defined benefit pension and other employee benefits expense (a)	**$ 120**	**$ 138**	**$ 85**	**$ 84**
Weighted average assumptions used to determine the accrued benefit cost				
Discount rate	5.00%	5.00%	5.00 - 5.50%	5.00 - 5.50%
Expected long-term rate of return on plan assets	7.15%	7.50%	n/a	7.50%
Rate of compensation increase (b)	2.50%	4.00%		

a) Includes $4 of Pension Benefits related to Jazz (2006 - $10), which was consolidated until May 24, 2007 under AcG-15.

b) A rate of compensation increase of 2% in 2006 and 2% in 2007 was used in determining the net benefit pension expense and 4% for the remaining years.

Other Benefits — Sensitivity Analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 9.25% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2007 (2006 - 9.75%). The rate is assumed to decrease gradually to 5% by 2013. A one percentage point increase in assumed health care trend rates would have increased the service and interest costs by $1 and the obligation by $16. A one percentage point decrease in assumed health care trend rates would have decreased the service and interest costs by $1 and the obligation by $16.

Pension Plan Cash Funding Obligations

As at December 31, 2007 and based on the January 1, 2007 solvency valuation, the table below provides projections for the Corporation's cash pension plan funding obligations for 2008. The final funding obligation for 2008 will be determined based on the January 1, 2008 valuation.

	2008
Past service domestic registered plans	$ 91
Current service domestic registered plans	166
Other pension arrangements	86
	$ 343

The most recent actuarial valuation is as at January 1, 2007 and the effective date of the next required actuarial valuation is January 1, 2008. For domestic registered pension plans, the funding requirements are based on the minimum past service contributions disclosed in the January 1, 2007 actuarial valuations plus a projection of the current service contributions based upon the January 1, 2007 actuarial valuation used for the purpose. Based on a funding outlook, employer contributions determined in accordance with regulations are expected to increase by approximately $90 in 2008.

On August 9, 2004, the Government of Canada adopted the Air Canada Pension Plan Solvency Deficiency Funding Regulations (the "Pension Regulations"). The Pension Regulations allow Air Canada to fund the solvency deficiencies in its Domestic Registered Plans as of January 1, 2004 over ten years, rather than the five years required under the ordinary rules, and to pay down such deficiencies by way of an agreed schedule of variable annual contributions rather than by way of equal annual contributions as required under the ordinary rules. The Pension Regulations came into force upon Air Canada's emergence from CCAA protection on September 30, 2004, on which date Air Canada issued subordinated secured promissory Notes in an aggregate amount of approximately $347 in favour of the pension plan trustee. Such Notes will be reduced as the principal amount of the solvency deficiencies is paid down, and will only be called on the occurrence of certain specified events of default. The amount of secured promissory Notes outstanding as at December 31, 2007 is $89 (2006 - $219. The effect of the issuance of the subordinated security promissory Notes is included within the value of the obligation for pension benefits as reflected in the Corporation's balance sheet. The funding of the notes is included, on a discounted basis, in all future expected cash flows required to fund the benefit obligation.

The composition of the Domestic Registered Plan assets and the target allocation consist of the following:

	2007	2006	Target Allocation
Equity securities	58.9%	59.1%	59.0%
Bonds and mortgages	36.1%	34.7%	41.0%
Cash and temporary investments	5.0%	6.2%	0.0%
	100.0%	**100.0%**	**100.0%**

Domestic Registered Plans

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Master Trust Fund. The investment return objective of the fund is to achieve a total annualized rate of return that exceeds inflation by at least 3.75% over the long term.

In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes:

- Equity investments can include convertible securities, and are required to be diversified among industries and economic sectors. Foreign equities can comprise 37% to 43% of the total market value of the trust. Limitations are placed on the overall allocation to any individual security at both cost and market value. Derivatives are permitted to the extent they are not used for speculative purposes or to create leverage.

- Bond and Mortgage investments are oriented toward risk averse, long term, investment grade securities rated "A" or higher. With the exception of Government of Canada securities or a province thereof, in which the plan may invest the entire fixed income allocation, these investments are required to be diversified among individual securities and sectors. The target return is comprised of 40% of the total return of the Scotia Capital Universe Bond Index and 60% of the total return of the Scotia Capital Long Term Bond Index.

Similar investment policies are established for the other pension plans sponsored by the Corporation.

The Corporation's expected long-term rate of return on assets assumption is selected based on the facts and circumstances that exist as of the measurement date, and the specific portfolio mix of plan assets. Management reviewed anticipated future long-term performance of individual asset categories and considered the asset allocation strategy adopted by the Corporation, including the longer duration in its bond portfolio in comparison to other pension plans. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. While the review considers recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate.

Defined Contribution Plans

The Corporation's management, administrative and certain unionized employees may participate in defined contribution plans. Contributions range from 3% to 6% for those employees in Canada and 3% - 7% for those participants in the United Kingdom. The Corporation contributes an equal amount. The Corporation’s expense for defined contribution plans amounted to $4 for the year ended December 31, 2007 (2006 - $7).

11. OTHER LONG-TERM LIABILITIES

		2007	2006
Aeroplan miles obligations (a)		$ 29	$ 105
Unfavourable contract liability on aircraft leases (b)		54	77
Aircraft rent in excess of lease payments (c)	Note 2X	54	121
Long-term employee liabilities (d)		47	54
Workplace safety and insurance board liabilities		45	45
Other (e)		107	70
		$ 336	**$ 472**

(a) Air Canada has a liability related to Aeroplan Miles which were issued by Air Canada prior to January 1, 2002. Refer to Note 22 for a description of the Special charge for Aeroplan Miles in 2006. As of December 31, 2007 a liability for approximately 7 billion miles, or $84, remains in Air Canada, of which $55 is included in current liabilities (total liability of 15 billion Miles, or $163, as at December 31, 2006). The amount of the additional liability was determined by valuing the incremental Miles at the current fair value.

(b) The unfavourable contract liability on aircraft leases represents the net present value of lease payments in excess of estimated market rents related to lease arrangements that existed on fresh start reporting.

(c) Included in this balance is nil as at December 31, 2007 (2006 - $59) related to Jazz, which was consolidated under AcG-15 until May 24, 2007.

(d) The following table outlines the changes to labour related provisions which are included in long-term employee liabilities for balances that existed upon the implementation of fresh start reporting on September 30, 2004:

	2007	2006
Beginning of year	$ 77	$ 121
Interest accretion	5	8
Amounts disbursed	(38)	(52)
Deconsolidation of Jazz	(4)	-
End of year	40	77
Current portion	(6)	(32)
	$ 34	**$ 45**

The following table outlines the changes to labour related provisions which are included in long-term employee liabilities for balances that have been created subsequent to the implementation of fresh start reporting on September 30, 2004 (current portion included in Accounts payable and accrued liabilities):

	2007	2006
Beginning of year	$ 29	$ 13
Special charge for labour restructuring	-	20
Charges recorded in wages, salaries, and benefits	14	7
Amounts disbursed	(17)	(11)
End of year	26	29
Current portion	(13)	(20)
	$ 13	**$ 9**

The Corporation offers certain severance programs to certain employees from time to time. The cost of these programs is recorded within operating expenses.

During 2006 a workforce reduction plan was announced to reduce non-unionized employee levels by 20 percent. A special charge of $20 was recorded in 2006 relating to this program.

e) Other includes asset retirement obligations of the Corporation. Under the terms of their respective land leases, each Fuel Facility Corporation has an obligation to restore the land to vacant condition at the end of the lease and to rectify any environmental damage for which it is responsible. If it were found that the Fuel Facility Corporations had to contribute to any remediation costs, each contracting airline would share pro rata, based on system usage, in the costs. For all Fuel Facility Corporations in Canada in which the Corporation participates, the Corporation has recorded an obligation of $7 ($44 undiscounted) representing the present value of the estimated decommissioning and remediation obligations at the end of the lease using an 8% discount rate, with lease term expiry dates ranging from 2032 to 2039. This estimate is based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches. The estimated fair value of the obligation is nil.

12. STOCK-BASED COMPENSATION

ACE Stock Option Plan

Certain of the Corporation's employees participate in the ACE stock option plan. Plan participation is limited to employees holding positions that, in ACE Board's view (or a committee selected by the ACE Board), have a significant impact on ACE's long term results. The stock option plan provides that the options will have an exercise price of not less than 100% of the market price of the underlying shares at the time of grant. Under the terms of the stock option plan, fifty percent of all options vest over four years. The remaining options vest upon performance conditions that are based on net income targets established by the ACE Board over the same time period. All options expire after seven years. The terms of ACE's stock option plan specify that upon the retirement of the employee, options granted to that employee may be exercised as the options vest within three years of such retirement.

In compliance with the terms of the ACE stock option plan, in November 2007, the Board of ACE resolved to immediately vest all remaining unvested ACE stock options. This resulted in the immediate expense recognition of all deferred stock based compensation on outstanding ACE options granted to Air Canada employees, less amounts previously recognized as compensation expense. This expense of $6 is included in the amount below in 2007. As a result of this immediate vesting of all ACE options granted to Air Canada employees, no further stock based compensation expense is expected to be recorded related to the ACE stock option plan.

The number of ACE stock options granted to employees, the related compensation expense recorded and the assumptions used to determine stock-based compensation expense, using the Black-Scholes option valuation model were as follows:

	2007	2006
Compensation expense ($millions)	$ 9	$ 3
Number of stock options granted to Air Canada employees	-	186,006
Weighted average fair value per option granted ($)	$ -	$ 10.39
Aggregated fair value of options granted ($ millions)	$ -	$ 2
Weighted average assumptions:		
Risk-free interest rate	-	4.02%
Expected volatility	-	35%
Dividend yield	-	0%
Expected option life (years)	-	4.50

A summary of the activity related to Air Canada employees participating in the ACE stock option plan is as follows:

	2007		2006	
	Options (000)	Weighted Average Exercise Price/Share	Options (000)	Weighted Average Exercise Price/Share
Beginning of year	1,610	$ 24.42	1,550	$ 24.37
Granted	-	-	26	34.78
Exercised	(20)	18.70	(80)	20.00
Forfeited	-	-	(30)	20.00
Outstanding options, prior to special distribution January 10, 2007 (March 3, 2006)	1,590	24.49	1,466	24.88
Adjustment - ACE special distribution (a)	386	-	101	
Outstanding options, after special distribution (a)	1,976	19.71	1,567	23.26
Granted	-	-	160	32.08
Exercised	(410)	17.15	(96)	19.07
Forfeited	(2)	26.16	(21)	20.73
Outstanding options, prior to special distribution March 14, 2007	1,564	20.37	1,610	24.42
Adjustment - ACE special distribution (a)	272	-	-	-
Outstanding options, after special distribution (a)	1,836	17.35	1,610	24.42
Granted	-	-	-	-
Exercised	(10)	18.53	-	-
Forfeited	(123)	26.00	-	-
Outstanding options, prior to special distribution May 24, 2007	1,703	16.73	1,610	24.42
Adjustment - ACE special distribution (a)	270	-	-	-
Outstanding options, after special distribution (a)	1,973	14.43	1,610	24.42
Granted	-	-	-	-
Exercised	(1,433)	13.12	-	-
Forfeited	(216)	20.95	-	-
Outstanding options, end of year	**324**	**$ 15.90**	**1,610**	**$ 24.42**
Options exercisable, end of year	**324**	**$ 15.90**	**291**	**$ 24.27**

(a) In accordance with the terms of the ACE stock option plan, each distribution of Aeroplan and Jazz units by ACE during 2007 and 2006 triggered an adjustment to the weighted average exercise price and the number of options outstanding. Effective on the applicable dates of the distributions, the adjustments were applied to all unexercised ACE stock options held by Air Canada employees, whether vested or not.

		2007 Outstanding Options			2007 Exercisable Options	
Range of Exercise Prices	**Expiry Dates**	**Number of Options Outstanding**	**Weighted Average Remaining Life (Years)**	**Weighted Average Exercise Price/Share**	**Number of Exercisable Options**	**Weighted Average Exercise Price/Share**
$11.05	2011	129,077	4	$ 11.05	129,077	$ 11.05
$19.10 - $20.04	2013	194,677	6	19.12	194,677	19.12
		323,754		**$ 15.90**	**323,754**	**$ 15.90**

		2006 Outstanding Options			2006 Exercisable Options	
Range of Exercise Prices	**Expiry Dates**	**Number of Options Outstanding**	**Weighted Average Remaining Life (Years)**	**Weighted Average Exercise Price/Share**	**Number of Exercisable Options**	**Weighted Average Exercise Price/Share**
$18.70	2011	1,085,803	5	$ 18.70	210,742	$ 18.70
$31.89 - $38.91	2012	339,604	6	38.52	80,220	38.91
$30.61 - $33.89	2013	184,734	7	32.14	-	-
		1,610,141		**$ 24.42**	**290,962**	**$ 24.27**

Air Canada Long-Term Incentive Plan

As approved by the Board of Directors, concurrent with the Air Canada IPO described in Note 3, certain of the Corporation's employees participate in the Air Canada Long-term Incentive Plan (the "Long-term Incentive Plan") administered by the Board of Directors of Air Canada. The Long-term Incentive Plan provides for the grant of options and performance share units to senior management and officers of Air Canada.

The options to purchase shares granted under the Long-term Incentive Plan have a maximum term of 10 years and an exercise price based on the fair market value of the shares at the time of the grant of the options. Options granted under the Long-term Incentive Plan will vest over four years and will incorporate performance vesting features. The performance vesting conditions are based on operating margin (operating income over operating revenues) and net income targets established by the Air Canada Board over the same time period. The terms of the Long-term Incentive Plan specify that upon the retirement of the employee, options granted may be exercised as the rights to exercise accrue within three years from the retirement date.

The number of Air Canada stock options granted to employees, the related compensation expense recorded and the assumptions used to determine stock-based compensation expense, using the Black-Scholes option valuation model were as follows:

	2007	2006
Compensation expense ($millions)	$ 4	$ 3
Number of stock options granted	482,870	1,699,678
Weighted average fair value per option granted ($)	$ 4.32	$ 5.40
Aggregated fair value of options granted ($ millions)	$ 2	$ 9
Weighted average assumptions:		
Risk-free interest rate	3.94% - 4.43%	4.07%
Expected volatility	34% - 35%	35%
Dividend yield	0%	0%
Expected option life (years)	4.50	4.50

A summary of the activity related to Corporation employees participating in the Air Canada Long-term Incentive Plan is as follows:

	2007		2006	
	Options (000)	Weighted Average Exercise Price/Share (b)	Options (000)	Weighted Average Exercise Price/Share
Beginning of year	1,700	$ 21.00	-	$ -
Granted	483	14.74	1,700	21.00
Exercised	-	-	-	-
Forfeited	(463)	21.00	-	-
Outstanding options, end of year	**1,720**	**$ 19.24**	**1,700**	**$ 21.00**
Options exercisable end of year	**155**	**$ 21.00**	**-**	**$ -**

		2007 Outstanding Options			2007 Exercisable Options	
Range of Exercise Prices	**Expiry Dates**	**Number of Options Outstanding**	**Weighted Average Remaining Life (Years)**	**Weighted Average Exercise Price/Share**	**Number of Exercisable Options**	**Weighted Average Exercise Price/Share**
$21.00	2013	1,237,222	6	$ 21.00	154,653	$ 21.00
$11.08 - 18.60	2014	482,870	7	14.74	-	-
		1,720,092		**$ 19.24**	**154,653**	**$ 21.00**

		2006 Outstanding Options			2006 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$21.00	2013	1,699,678	7	$ 21.00	-	$ -

Performance Share Units

The Long-term Incentive Plan also includes Performance Share Units ("PSUs"). The value of the PSUs is based on the fair market value of the shares at the time of the grant. The vesting term of PSUs is three years, generally commencing on January 1 of the year following granting, and incorporate performance vesting features based upon achieving the average Earnings Per Share target established over the vesting period. Subject to vesting and other conditions, each PSU shall entitle the employee to receive a payment in the form of one common share, cash in the amount equal to market value of one common share, or a combination thereof, at the discretion of the Board of Directors. The terms of the plan specify that upon the retirement of an employee, the number of PSUs that vest will be prorated based on the total number of completed months of active service during the PSU vesting term.

The number of PSUs granted to employees and the related compensation expense were as follows:

	2007	2006
Compensation expense ($millions)	$ 2	$ -
Number of PSUs granted	232,760	345,805
Weighted average fair value per PSU granted ($)	$ 16.46	$ 19.40
Aggregate fair value of PSUs granted	$ 4	$ 7

During the year 27,314 PSUs were forfeited (2006 – nil).

Jazz Long-Term Incentive Plan

Jazz provides certain of its employees with unit based compensation plans. The Jazz segment recorded compensation expense of $1 for the period ended May 24, 2007 (2006 - $2) related to this plan. The units under this plan relate to units in Jazz Air Income Fund. Effective May 24, 2007, Jazz is no longer consolidated.

Employee Ownership Plans

Employee ownership plans have been established for shares of ACE and Air Canada under which eligible employees are allowed to invest up to 6% of their base salary for the purchase of shares on the secondary market. Air Canada will match 33.3% of the investments made by the employee. During 2007, the Corporation recorded compensation expense of $1 (2006 - $2)

13. SHAREHOLDERS' EQUITY

Share capital (net of issue costs) consists of the following:

	2007	2006
Share Capital		
Common shares	$ 562	$ 562
Adjustment to shareholders' equity (a)	(288)	(288)
	$ 274	**$ 274**

(a) As a result of the financial reorganization under CCAA, the assets and liabilities of the consolidated entity, excluding goodwill, were comprehensively valued to fair values and a revaluation adjustment of $4,234 was recorded as a credit to share capital. GAAP does not permit goodwill to be recorded even if the fair value of net assets is less than the fair value of the enterprise as a whole.

Common Shares

As at December 31, 2007, the common shares issuable by Air Canada consist of an unlimited number of Class A Variable Voting Shares ("Variable Voting Shares") and an unlimited number of Class B Voting Shares ("Voting Shares"). The two classes of common shares have equivalent rights as common shareholders except for voting rights. Holders of Variable Voting Shares are entitled to one vote per share unless the aggregate number of Variable Voting Shares outstanding, as a percentage of the total number of votes attaching to all issued and outstanding voting shares of Air Canada exceeds 25% or the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If the 25% threshold would be surpassed, the votes attaching to the Variable Voting Shares would be proportionately reduced. Variable Voting Shares will be automatically converted to Voting Shares if the shares become held, beneficially owned and controlled, directly or indirectly, by a Canadian, as defined in the Canada Transportation Act. Voting Shares will be automatically converted to Variable Voting Shares if the shares become held, beneficially owned or controlled, directly or indirectly, by a party that is not a Canadian, as defined in the Canada Transportation Act.

The issued and outstanding common shares of Air Canada, along with the potential common shares, are as follows:

Outstanding common shares	2007	2006
Issued and outstanding		
Class A variable voting shares	16,654,049	18,343,095
Class B voting shares	83,345,951	81,656,905
Total issued and outstanding	100,000,000	100,000,000
Potential common shares		
Stock options	1,720,092	1,695,035
Performance share units	551,251	345,805

Accumulated Other Comprehensive Income

The following table outlines the components of Accumulated other comprehensive income:

(in millions)	2007	2006
Accumulated other comprehensive income		
Unrealized period change in fair value of derivatives (net of tax of $28)	$ 56	$ -
	$ 56	**$ -**

14. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted earnings per share:

(in millions, except per share amounts)	**2007**	**2006**
Numerator:		
Numerator for basic and diluted earnings per share:		
Income (loss) for the year	$ 429	$ (74)
Adjusted numerator for diluted earnings per share	**$ 429**	**$ (74)**
Denominator:		
Denominator for basic earnings per share:		
Weighted-average shares	100	89
Effect of potential dilutive securities:		
Performance share units	1	-
Adjusted denominator for diluted earnings per share	101	89
Basic earnings (loss) per share	**$ 4.29**	**$ (0.83)**
Diluted earnings (loss) per share	**$ 4.27**	**$ (0.83)**

The calculation of earnings per share is based on whole dollars and not on rounded millions.
As a result, the above amounts may not be recalculated to the per share amount disclosed above.

The dilutive effect of outstanding stock options on earnings per share is based on the application of the treasury stock method. Under this method, the proceeds from the exercise of such securities are assumed to be used to purchase Class B Voting Shares.

Excluded from the calculation of diluted earnings per share were 1,606,820 outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year (2006 - 1,699,678).

15. SEGMENT INFORMATION

A reconciliation of the total amounts reported by each business segment and geographic region to the applicable amounts in the consolidated statements is as follows:

	2007				2006			
	Air Canada Segment	Jazz	Elimination	Consolidated Total	Air Canada Segment	Jazz	Elimination	Consolidated Total
Passenger revenue	$ 9,329	$ -	$ -	$ 9,329	$ 8,887	$ -	$ -	$ 8,887
Cargo revenue	550	-	-	550	629	-	-	629
Other revenue	717	3	-	720	644	7	-	651
External revenue	10,596	3	-	10,599	10,160	7	-	10,167
Inter-segment revenue	50	610	(660)	-	106	1,374	(1,480)	-
	10,646	**613**	**(660)**	**10,599**	**10,266**	**1,381**	**(1,480)**	**10,167**
Special charge for Aeroplan miles	-	-	-	-	(102)	-	-	(102)
Total revenues	**10,646**	**613**	**(660)**	**10,599**	**10,164**	**1,381**	**(1,480)**	**10,065**
Wages, salaries and benefits	1,920	139	-	2,059	1,816	311	-	2,127
Aircraft fuel	2,552	125	(124)	2,553	2,544	285	(284)	2,545
Aircraft rent	282	57	(16)	323	341	134	(34)	441
Airport and navigation fees	1,022	80	(81)	1,021	982	178	(178)	982
Aircraft maintenance, materials and supplies	757	50	(8)	799	768	98	(11)	855
Communications and information technology	275	2	-	277	273	8	(3)	278
Food, beverages and supplies	313	6	-	319	322	15	(2)	335
Depreciation, amortization and obsolescence	548	9	-	557	493	21	-	514
Commissions	201	-	-	201	237	-	-	237
Capacity purchase with Jazz	923	-	(386)	537	871	-	(871)	-
Special charge for labour restructuring					20	-	-	20
Other operating expenses	1,420	83	(45)	1,458	1,383	187	(98)	1,472
Total operating expenses	**10,213**	**551**	**(660)**	**10,104**	**10,050**	**1,237**	**(1,481)**	**9,806**
Operating income	**433**	**62**	**-**	**495**	**114**	**144**	**1**	**259**
Interest income	92	2	-	94	82	6	(1)	87
Interest expense	(348)	(3)	-	(351)	(313)	(8)	-	(321)
Interest capitalized	108	-	-	108	62	(1)	-	61
Gain (loss) on sale of assets	19	-	-	19	(6)	-	-	(6)
Gain (loss) on financial instruments recorded at fair value	26	-	-	26	(18)	-	-	(18)
Other non-operating income (expense)	(19)	1	-	(18)	2	(1)	-	1
Non-controlling interest	(9)	-	(62)	(71)	(12)	-	(140)	(152)
Foreign exchange gain	317	-	-	317	12	-	-	12
Recovery of (provision) for income taxes	(190)	-	-	(190)	3	-	-	3
	(4)	-	(62)	(66)	(188)	(4)	(141)	(333)
Segment income (loss)	**$ 429**	**$ 62**	**$ (62)**	**$ 429**	**$ (74)**	**$ 140**	**$ (140)**	**$ (74)**

Included within Depreciation, amortization and obsolescence is depreciation of property and equipment for 2007 of $514 (2006 - $458). This is broken down by segment as follows: Air Canada $505 (2006 - $437) and Jazz $9 ($21).

Passenger revenues	2007	2006
Canada	$ 3,970	$ 3,680
US Transborder	1,884	1,825
Atlantic	1,806	1,795
Pacific	967	946
Other	702	641
	$ 9,329	**$ 8,887**

Cargo revenues	2007	2006
Canada	$ 108	$ 119
US Transborder	25	28
Atlantic	219	222
Pacific	159	218
Other	39	42
	$ 550	**$ 629**

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origin and destinations principally in Europe. Pacific refers to flights that cross the Pacific Ocean with origin and destinations principally in Asia. Other revenues are principally derived from customers located in Canada.

Segment Asset Information

As at December 31, 2007, the Corporation has one reportable segment. The following is the segment asset information for the Corporation's two reportable segments as at December 31, 2006.

				2006
	Air Canada Segment	**Jazz**	**Elimination**	**Consolidated Total**
Cash and cash equivalents	$ 1,312	$ 135	$ -	$ 1,447
Short-term investments	798	-	-	798
	$ 2,110	**$ 135**	**$ -**	**$ 2,245**
Additions to capital assets	$ 863	$ 25	$ -	$ 888
Total assets	**$ 11,388**	**$ 483**	**$ (122)**	**$ 11,749**

The Corporation is a domestic and international carrier and for the purposes of segment reporting, flight equipment is attributed to Canada. As a result, substantially all of the Corporation's property and equipment are related to operations in Canada.

The Air Canada segment is comprised of the passenger and cargo transportation services business operated by the Corporation and related ancillary services.

The Jazz segment, included up to May 24, 2007, is operating under the Jazz CPA with the Corporation. Effective May 24, 2007, the results of Jazz are not consolidated within Air Canada. Refer to note 1. Pass-through costs, which are non-marked-up costs charged to the Corporation from Jazz, include fuel, airport and user fees and other; these expenses are recorded in the applicable category within the operating expenses in the 2007 results of Air Canada.

Also refer to Note 19 *Related Party Transactions*.

16. COMMITMENTS

In 2004, the Corporation signed definitive purchase agreements with Embraer for the acquisition of regional jet aircraft. In November 2005, the Corporation also concluded agreements with The Boeing Company ("Boeing") for the acquisition of Boeing 777 and Boeing 787 aircraft.

Boeing

In November 2005, the Corporation concluded agreements with Boeing for the acquisition of up to 36 Boeing 777 aircraft and up to 60 Boeing 787 Dreamliners. The initial order for the 36 Boeing 777 aircraft was comprised of firm orders for 18 aircraft plus purchase rights for 18 more. The initial order for the Boeing 787 aircraft was comprised of firm orders for 14 aircraft plus purchase rights, options and rolling options for 46 aircraft. In conjunction with the initial agreements, the Corporation received financing commitments from Boeing and the engine manufacturer for all firm aircraft orders covering up to 90% of the capital expenditure. This available financing is based on a floating or fixed rate equivalent and was at 8.70% at December 31, 2007. The term to maturity is 15 years with principal payments made on a mortgage style basis resulting in equal instalment payments of principal and interest over the term to maturity.

During 2007, the Corporation amended agreements with Boeing to cancel orders for two Boeing 777 aircraft scheduled for delivery in 2009. In addition, the Corporation increased its order for Boeing 787 aircraft by 23, bringing its total firm orders to 37 Boeing 787 aircraft. The first delivery of the Boeing 787 firm aircraft is scheduled for 2010 and deliveries of all 37 firm aircraft are scheduled to be completed by 2014. As at December 31, 2007, 18 purchase rights for Boeing 777 aircraft and 23 options for Boeing 787 aircraft remained exercisable. In January, 2008, Boeing announced a delay in the production of its first Boeing 787 aircraft from the end of the first quarter of 2008 to the end of the second quarter of 2008 due to production delays. The Corporation has not been notified that its Boeing 787 deliveries have been affected, however, the Corporation expects to receive an update towards the end of the first quarter of 2008.

In conjunction with the amended agreements, the Corporation received additional financing commitments from Boeing for seven of the additional Boeing 787 aircraft (21 Boeing 787 aircraft in total) on the same terms and conditions as described above. Should the Corporation not utilize any of the financing commitments on the Boeing 777 aircraft, the financing commitments for the Boeing 787 aircraft will be increased to 31 aircraft of which the terms for 28 aircraft would be revised to cover 80% of the aircraft delivery price and the term to maturity would be reduced to 12 years with straight-line principal repayments over the term to maturity.

As at December 31, 2007, seven of the Boeing 777 firm aircraft have been delivered with the remaining nine firm deliveries expected to be delivered by end of year 2008. The first seven aircraft were financed under loan guarantee support from EXIM. All of the nine Boeing 777 firm aircraft deliveries expected in 2008 have commitments for loan guarantee support to be provided by EXIM which was signed in January, 2008. The loan guarantee, subject to certain conditions, covers a 12-year loan term for 85 percent of the capital expenditure at an interest rate based on a floating rate. This loan guarantee from EXIM is expected to be used instead of the financing commitments provided by Boeing and the engine manufacturer described above. As a result, it is not expected that any of Boeing's and the engine manufacturer's financing commitments for the Boeing 777 aircraft will be utilized. The firm commitment financing on capital purchase commitments disclosed below reflects this guarantee support for only five aircraft in 2008, given that the Corporation expects to sell and lease back the other four aircraft (see below).

In January 2008, the Corporation signed letters of intent for the sale and lease back of four of the nine Boeing 777 deliveries scheduled for delivery in 2008. The lease term for two of the Boeing 777 aircraft is 12 years. The other two Boeing 777 aircraft each have 10.5 year lease terms and the Corporation has options to extend each for an additional 18 months. All four leases are at market lease rates. This replaces an equivalent number of aircraft loan guarantee support commitments provided by EXIM. As a result, the capital expenditure forecast in the table below does not include expenditures relating to these aircraft. These four aircraft deliveries are included in the operating lease commitments table below. The impact of these leases results in a significant reduction in capital expenditures from what was previously disclosed. Operating lease commitments have increased as a result of this change.

Embraer

The agreement with Embraer covers firm orders for 45 Embraer 190 series aircraft. The purchase agreement also contains rights to exercise options for up to 60 additional Embraer 190 series aircraft as well as providing for conversion rights to other Embraer models. As of December 31, 2007, 31 options remain exercisable.

The Embraer 190 series deliveries commenced in December 2005. As at December 31, 2007, 42 of the Embraer 190 series firm aircraft orders have been completed and an additional aircraft was delivered in January 2008. The final two Embraer 190 series firm aircraft are scheduled for delivery in the first quarter of 2008.

The Corporation has received loan commitments from third parties for the remaining three firm aircraft covering approximately 80% of the capital expenditure to be repaid in quarterly instalments for a 12-year term. Two of these aircraft will be based on floating rates at the 90-day US LIBOR plus 1.90% and one will be based at the fixed rate equivalent of the 90-day US LIBOR plus 1.70%.

Aircraft Interior Refurbishment Program

In addition to acquiring new aircraft, the Corporation commenced a major refurbishment of the interior of its existing aircraft in April 2006. The Corporation has completed the refurbishment of 26 Airbus A319 aircraft, 30 Airbus A320 aircraft, 10 Airbus A321 aircraft and 15 Boeing 767-300 aircraft to date, for a total of 81 aircraft. The Embraer and Boeing 777 aircraft are being delivered with the new seats and entertainment systems already installed. The capital expenditures associated with this program, which are committed, are amortized over a five-year period. A significant portion of the remaining capital expenditures relating to this program are included in the capital commitments table below.

Capital Commitments

The estimated aggregate cost of the future firm deliveries, and other capital purchase commitments as at December 31, 2007 including the impact of the sale and lease back transaction described above and the loan guarantee support signed in January 2008, approximates $4,739 (of which $2,698 is subject to committed financing, subject to the fulfillment of certain terms and conditions). US dollar amounts are converted using the December 31, 2007 noon day rate of CDN$0.9881. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day US LIBOR rate at December 31, 2007.

Year ending December 31, 2008	$ 555
Year ending December 31, 2009	102
Year ending December 31, 2010	760
Year ending December 31, 2011	891
Year ending December 31, 2012	692
Thereafter	1,739
	$ 4,739

Operating Lease Commitments

As at December 31, 2007 the future minimum lease payments under existing operating leases of aircraft and other property amount to $2,108 (December 31, 2006 - $2,957) using year end exchange rates. This also includes payments for aircraft contemplated by letters of intent signed in January 2008 for the sale and lease back of four Boeing 777 aircraft as described above.

			Operating lease commitments
	Aircraft	Other Property	Total
Year ending December 31, 2008	$ 280	$ 59	$ 339
Year ending December 31, 2009	271	42	313
Year ending December 31, 2010	255	36	291
Year ending December 31, 2011	197	33	230
Year ending December 31, 2012	180	32	212
Thereafter	602	121	723
	$ 1,785	**$ 323**	**$ 2,108**

As described in Note 19, the Corporation subleases certain aircraft to Jazz on a flow through basis, which are reported net on the statement of operations. These subleases relate to 33 Bombardier CRJ-200 aircraft and 15 Bombardier CRJ-705 aircraft. The operating lease commitments under these aircraft, which are recovered from Jazz, are not included in the aircraft operating lease commitments table above but are summarized as follows:

Year ending December 31, 2008	$ 84
Year ending December 31, 2009	84
Year ending December 31, 2010	76
Year ending December 31, 2011	75
Year ending December 31, 2012	75
Thereafter	673
	$ 1,067

The subleases with Jazz have the same terms and maturity as the Corporation's corresponding lease commitments to the lessors.

Lease payments for aircraft classified as capital leases and variable interest entities for accounting purposes are disclosed in Note 8.

As at December 31, 2007, the future minimum non-cancellable commitments for the next 12 months under the capacity purchase agreements with Jazz is approximately $650 and with unaffiliated regional carriers is $20. As described in Note 19, the initial term of the Jazz CPA expires December 31, 2015 with two automatic renewal periods of five years each, subject to either party's right not to renew by notice at least one year prior to the expiration of the then applicable term. As the rates under the Jazz CPA are subject to adjustments beginning in 2009, it is not possible to determine the minimum non-cancellable commitments beyond 2008; however they are not expected to change significantly from the 2008 amount.

17. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Under its risk management policy, the Corporation manages its currency risk, interest rate risk, and market risk through the use of various foreign exchange, interest rate, and fuel derivative financial instruments. The Corporation uses derivative financial instruments only for risk management purposes, not for generating trading profit.

Interest Rate Risk Management

The Corporation enters into forward interest rate agreements to manage the risks associated with interest rate movement on US dollar and Canadian dollar floating rate debt and investments. During 2006 the Corporation entered into 19 interest rate swaps with a notional value of US$414 to receive floating rates and pay a weighted average fixed rate of 5.81% for the debt to be arranged in relation to the financing of Embraer 190 aircraft between June 2006 and February 2008. The swaps have 15 year terms from the expected delivery date of the aircraft and their maturities range from June 2021 to December 2022. The Corporation has been settling the interest rate swaps upon delivery of the related aircraft. The Corporation did not apply hedge accounting to these derivative instruments. As at December 31, 2007, one contract remains outstanding with a fair value of $2 in favour of the counterparty. (December 31, 2006 - $13 in favour of the counterparty for 12 contracts outstanding) During 2007, 11 contracts settled at a net loss of $10.

The Corporation has entered into interest rate swap agreements with a term to January 2024 which convert lease payments related to two B767 aircraft leases consolidated under AcG-15 from fixed to floating rates. These have not been designated as hedges for accounting purposes. As at December 31, 2007 these two swaps have a fair value of $7 in favour of the Corporation ($4 in favour of the Corporation as at December 31, 2006). The notional amount under these two swaps is $103 (US$104) as at December 31, 2007 (December 31, 2006 - $131 (US$112)).

Foreign Exchange Risk Management

The Corporation enters into certain foreign exchange forward contracts or currency swaps to manage the risks associated with foreign currency exchange rates. As at December 31, 2007, the Corporation had entered into foreign currency forward contracts and option agreements on $2,132 (US$2,158) and $26 (EUR$18) of future purchases in 2008 and 2009. The fair value of these foreign currency contracts as at December 31, 2007 is $124 in favour of third parties (December 31, 2006 - $25 in favour of the Corporation on $586 (US$503) of future purchases in 2007). These derivative instruments have not been designated as hedges for accounting purposes.

The Corporation has entered into currency swap agreements for 16 CRJ aircraft operating leases until lease terminations between 2007 and 2011. During 2007 five currency swaps were settled with a fair value of $10 (which was equal to carrying value) (December 31, 2006 - $10 in favour of the counterparties). The Corporation has 11 currency swap agreements remaining. These currency swaps with third parties have a nominal fair value in favour of the Corporation as at December 31, 2007 (December 31, 2006 - $3 in favour of the Corporation). The notional amount under these swaps is $78 (US$79) as at December 31, 2007 (December 31, 2006 - $103 (US$88)). These have not been designated as hedges for hedge accounting purposes.

Fuel Price Risk Management

The financial results of the Corporation are impacted by changes in jet fuel prices as a result of the Corporation's inherent dependence on energy for its operations. To manage its exposure to jet fuel prices, the Corporation enters into derivative contracts with financial intermediaries for the purpose of managing volatility in operating cash flows. The Corporation uses derivative contracts on jet fuel and also on other crude oil based commodities, such as heating oil and crude oil, due to the relative limited liquidity of jet fuel derivative instruments on a medium to longer term horizon, since jet fuel is not traded on an organized futures exchange. The Corporation does not purchase or hold any derivative financial instruments for trading purposes.

As of December 31, 2007, approximately 20% of the Corporation's anticipated purchases of jet fuel for 2008 are hedged. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2008 period comprised of jet fuel, heating oil and crude-oil based contract. The Corporation also hedged approximately 3% of its 2009 anticipated jet fuel purchase in heating oil based contracts and 2% of its 2010 anticipated jet fuel purchase in crude oil based contracts.

The following table outlines the notional volumes per barrel along with the weighted average floor and ceiling price for each year currently hedged. These average contract prices represent the equivalent price in West Texas Intermediate ("WTI") using the forward prices for WTI, heating oil, and jet oil as at December 31, 2007:

Notional Volumes (bbl)	Term	WTI-equivalent Average Floor Price (USD$/bbl)	WTI-equivalent Average Ceiling Price (USD$/bbl)
4,890,000	2008	$ 77.97	$ 81.58
840,000	2009	$ 76.03	$ 80.92
480,000	2010	$ 84.20	$ 88.00

The Corporation designates certain of its fuel derivatives as cash flow hedges and applies hedge accounting as prescribed under CICA section 3865, Hedges. Designated hedging items under cash flow hedges result in all period changes in the fair value of the hedging item that are considered effective being recorded in AOCI until the underlying jet fuel is consumed. Upon maturity of the hedging item, the effective gains and losses are recorded in fuel expense. The ineffective component of the change in fair value is recorded in Non-operating income (expense) when it occurs.

Effectiveness is defined as the extent to which changes in the fair value of a hedged item relating to a risk being hedged is offset by changes in the fair value of the corresponding hedging item. The Corporation's accounting policy measures effectiveness based on the change in the intrinsic value of fuel derivatives compared to the change in the intrinsic value of the anticipated jet fuel purchase (based on the Corporation's weighted average price). As the Corporation's current policy does not take into account variables affecting fair value such as volatility and time value of money, a significant component of the change in fair value of outstanding fuel derivatives may be recorded as ineffective under the current policy.

Ineffectiveness is inherent in hedging diversified jet fuel purchases with derivative positions in crude oil and related commodities and in the differences between intrinsic values and fair market values of the derivative instruments, especially given the magnitude of volatility observed in oil market prices. As a result the Corporation is unable to predict the amount of ineffectiveness for each period. This may result, and has resulted, in increased volatility in the accounting results of the Corporation, but has no impact on the underlying cash flows.

If the hedge ceases to qualify for hedge accounting, any period change in fair value of the fuel derivative instrument is recorded in Non-operating income (expense). For those fuel derivatives that do not qualify for hedge accounting, the period changes in fair value of the fuel derivative is recorded in Non-operating income (expense).

During 2007 hedge accounting was discontinued for certain fuel hedge contracts where the hedging relationship ceased to satisfy the conditions for hedge accounting. The value of the AOCI balance recognized in connection with these derivatives will be taken into fuel expense upon the maturity of the contracts. The Corporation still continues to hold these derivatives as it believes they continue to be good economic hedges in managing its exposure to jet fuel prices.

The following information summarizes the financial statement impact of derivatives designated under fuel hedge accounting, before the impact of tax:

- The fair value of outstanding fuel derivatives under hedge accounting at December 31, 2007 is $67 in favour of the Corporation.
- The 2007 benefit to Fuel expense for the year ended December 31, 2007 is $31.
- The Non-operating income (loss) for the year ended December 31, 2007 is $12. The amount in Non-operating income (loss) represents the ineffective portion of the fair value change in items under hedge accounting.
- The effective change in the fair value of derivatives recorded in OCI for the period is $110 before tax expense of $28. OCI amounts for the year ended December 31, 2007 are presented net of this tax expense in the Consolidated statement of comprehensive income.

The estimated net amount of existing gains and losses reported in AOCI that is expected to be reclassified to net income during 2008 is $68.

The following information summarizes the financial statement impact of derivatives not designated under fuel hedge accounting, but held as economic hedges, before the impact of tax:

- The fair value of outstanding fuel derivatives not under hedge accounting at December 31, 2007 is $10 in favour of the Corporation.
- The Non-operating gain for the year ended December 31, 2007 is $26. The amount in Non-operating income (loss) represents the change in fair value of these contracts (realized and unrealized) for the current year.

Concentration of Credit Risk

The Corporation does not believe it is subject to any significant concentration of credit risk. Cash and short-term investments are in place with major financial institutions, Canadian governments and major corporations. Accounts receivable are generally the result of sales of tickets to individuals, often through the use of major credit cards, through geographically dispersed travel agents, corporate outlets, or other airlines, often through the use of major credit cards. Refer to Note 7 for a description of ABCP held by the Corporation.

Financial Instrument Fair Values in the Statement of Consolidated Financial Position

The carrying amounts reported in the Consolidated statement of financial position for short term financial assets and liabilities, which includes cash and short-term investments, accounts receivable and accounts payable approximate fair values due to the immediate or short-term maturities of these financial instruments. Cash equivalents and short-term investments are classified as held for trading and therefore are recorded at fair value.

The carrying amounts of foreign currency and interest rate swaps and fuel derivatives is equal to the fair value, which is based on the amount at which they could be settled based on estimated current market rates.

The following is a comparison of fair value versus carrying value of the Corporation's long-term debt and capital lease obligations, as at December 31, 2007, which was estimated using valuation techniques based on current market rates of interest for similar financial liabilities:

	Carrying Value	Estimated Fair Value
Direct Corporation debt	$ 2,551	$ 2,611
Debt consolidated under AcG-15	896	933
Capital lease obligations	972	1,127
	$ 4,419	**$ 4,671**

18. CONTINGENCIES, GUARANTEES AND INDEMNITIES

Contingencies

Investigation by Competition Authorities Relating to Cargo

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among other competition authorities, are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including the Corporation, a number of whom, including the Corporation, have received a statement of objections from the European Commission that sets out the European Commission's preliminary assessment in relation to such matter. Competition authorities have sought or requested information from the Corporation as part of their investigations. The Corporation is cooperating with these investigations which are likely to lead to proceedings against the Corporation and a number of airlines and other cargo operators in certain jurisdictions. The Corporation is also named as a defendant in a number of class action lawsuits that have been filed before the United States District Court and in Canada in connection with these allegations. Management has determined it is not possible at this time to predict with any degree of certainty the outcome of these proceedings, but these proceedings may result in a material liability to the Corporation.

Porter Airlines Inc.

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against Porter Airlines Inc. ("Porter") and other defendants (collectively the "Porter Defendants") after Jazz became aware that it would be excluded from operating flights from Toronto City Centre (Island) Airport (the "TCCA"). On October 26, 2007, the Porter Defendants counter-claimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming $850 in damages. Concurrently with the Ontario Superior Court of Justice proceedings, Jazz commenced judicial review proceedings against the Toronto Port Authority ("TPA") before the Federal Court of Canada relating to Jazz' access to the TCCA. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, Porter filed a defence and counterclaim against Jazz and Air Canada making allegations and seeking conclusions similar to those in the Ontario Superior Court counterclaim. Management views Porter's counterclaims in both jurisdictions as being without merit.

Pay Equity

The Canadian Union of Public Employees ("CUPE"), which represents the Corporation's flight attendant, has a complaint before the Canadian Human Rights Commission where it alleges gender-based wage discrimination. CUPE claims the predominantly female flight attendant group should be paid the same as the predominantly male pilot and mechanics groups because their work is of equal value. The complaint dates from 1991 but has not been investigated on the merits because of a legal dispute over whether the three groups work in the same "establishment" within the meaning of the Canadian Human Rights Act. On January 26, 2006, the Supreme Court of Canada ruled that they do work in the same "establishment" and sent the case back to the Canadian Human Rights Commission, which may now proceed to assess the merits of CUPE's complaint. On March 16, 2007, the Canadian Human Rights Commission referred the complaint against the Corporation for investigation. The Corporation considers that any investigation will show that it is complying with the equal pay provisions of the Canadian Human Rights Act; however, management has determined it is not possible at this time to predict with any degree of certainty the final outcome of the Commission's investigation.

Claim by the Air Canada Pilots Association

In October 2006, ACPA commenced proceedings before the Ontario Superior Court of Justice against Air Canada, ACE and certain members of the board of directors of Air Canada alleging that certain past and future actions are oppressive to it. A variety of remedies were sought against the parties including an injunction to impose, among other things, limits on corporate distributions including those contemplated under the ACE plan of arrangement which became effective on October 10, 2006. Following a hearing in December, 2006, Mr. Justice Cumming of the Ontario Superior Court of Justice dismissed ACPA's application for an injunction and granted respondents' cross-motion to dismiss ACPA's claim. ACPA has not appealed the dismissal of the injunction application but has appealed the order dismissing its claim and the appeal is scheduled to be heard by the Ontario Court of Appeal in March 2008. Management is of the view that the ACPA claim is without merit.

Other Contingencies

Various other lawsuits and claims, including claims filed by various labour groups of Air Canada are pending by and against the Corporation and provisions have been recorded where appropriate. It is the opinion of management that final determination of these claims will not have a significant material adverse effect on the financial position or the results of the Corporation.

With respect to 45 aircraft leases, the difference between the amended rents as a result of the implementation of the Plan of Reorganization, Compromise and Arrangement (the "Plan") under the Companies' Creditors Arrangement Act ("CCAA") on September 30, 2004 and amounts due under the original lease contracts will be forgiven at the expiry date of the leases if no material defaults have occurred. If a material default occurs, this difference plus interest will become due and payable and all future rent will be based on the original contracted rates. Rent expense is being recorded on the renegotiated lease agreements and any liability would be recorded only at the time management believes the amount is likely to occur.

Guarantees

Guarantees in Fuel Facilities Arrangements

The Corporation participates in fuel facility arrangements operated through fuel facility corporations ("Fuel Facility Corporations"), along with other airlines that contract for fuel services at various major airports in Canada. The Fuel Facility Corporations operate on a cost recovery basis. The purpose of the Fuel Facility Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the Land Rights under the land lease. The aggregate debt of the five Fuel Facility Corporations in Canada that have not been consolidated by the Corporation under AcG-15 is approximately $119 as at December 31, 2007 (2006 - $108), which is the Corporation's maximum exposure to loss without taking into consideration any cost sharing that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote. Each contracting airline participating in a Fuel Facility Corporation shares pro rata, based on system usage, in the guarantee of this debt.

Indemnification Agreements

The Corporation enters into real estate leases or operating agreements, which grant a license to the Corporation to use certain premises, in substantially all cities that it serves. It is common in such commercial lease transactions for the Corporation as the lessee to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to the Corporation's use or occupancy of the leased or licensed premises. Exceptionally, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross negligence or willful misconduct. Additionally, the Corporation typically indemnifies such parties for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

In aircraft financing or leasing agreements, the Corporation typically indemnifies the financing parties, trustees acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or willful misconduct. In addition, in aircraft financing or leasing transactions, including those structured as leveraged leases, the Corporation typically provides indemnities in respect of various tax consequences including in relation to the leased or financed aircraft, the use, possession, operation maintenance, leasing, subleasing, repair, insurance, delivery, import, export of such aircraft, the lease or finance arrangements entered in connection therewith, changes of law and certain income, commodity and withholding tax consequences.

When the Corporation, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, the Corporation has from time to time agreed to indemnify the service provider against liabilities that arise from third party claims, whether or not these liabilities arise out of or relate to the negligence of the service provider, but excluding liabilities that arise from the service provider's gross negligence or willful misconduct.

Under its general by-laws, the Corporation has indemnification obligations to its directors and officers. Pursuant to such obligations, the Corporation indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to the Corporation.

The maximum amount payable under the foregoing indemnities cannot be reasonably estimated. The Corporation expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities described above.

19. RELATED PARTY TRANSACTIONS

At December 31, 2007, ACE has a 75% ownership interest in Air Canada. Air Canada has various related party transactions with ACE and other ACE-related entities, including Aeroplan, Jazz and ACTS Aero. ACTS Aero conducts the business operated by ACTS LP prior to the sale of ACTS LP announced by ACE and completed on October 16, 2007 (refer to Note 20). Also refer to Note 3 for certain related party transactions completed during the Air Canada IPO.

Related party trade balances, as outlined below, mainly arise from the provision of services, including the allocation of employee related costs, as further described in Note 10, the allocation of corporate expenses, as described in Note 3, and centralized cash management activities as described below. Trade balances between the related parties have trade terms which generally require payment 30 days after receipt of invoice.

The related party balances resulting from the application of the related party agreements were as follows:

	2007*	2006
Accounts receivable		
ACE	$ 9	$ -
Aeroplan	20	6
ACTS / ACTS Aero	75	97
Jazz	85	-
	$ 189	**$ 103**
Prepaid Maintenance		
ACTS Aero	$ 24	$ -
	$ 24	**$ -**
Accounts payable and accrued liabilities		
ACE	$ -	$ 12
ACTS / ACTS Aero	88	111
Jazz	71	-
	$ 159	**$ 123**

**Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*

Revenues and expenses with related parties are summarized as follows:

	2007*	2006
Revenues		
Passenger revenues from Aeroplan related to Aeroplan rewards, net of purchase of Aeroplan miles	$ 154	$ 115
Property rental revenues from related parties	46	46
Revenues from information technology services to related parties	28	27
Revenues from corporate services and other	25	14
Aircraft sublease revenues from Jazz	14	-
Air Canada Ground Handling revenues from related parties	33	-
Cargo revenues from related parties	3	4
	$ 303	**$ 206**
Expenses		
Maintenance expense for services from ACTS / ACTS Aero	$ 631	$ 614
Expense from CPA with Jazz	537	-
Pass through fuel expense from Jazz	197	-
Pass through airport expense from Jazz	120	-
Pass through other expense from Jazz	17	-
Other expenses	12	49
Recovery of wages, salary and benefit expense for employees assigned to related parties	(412)	(413)
	$ 1,102	**$ 250**
Net interest expense (income) from related parties	**$ (1)**	**$ 6**

**Effective May 24, 2007, the results and financial position of Jazz are not consolidated within Air Canada (Note 1).*

In addition to the above revenues and expenses with Jazz, the Corporation transfers fuel inventory and sub leases certain aircraft to Jazz on a flow through basis, which are reported net on the statement of operations.

The Corporation held certain investments in Aeroplan, Jazz and ACTS. As described in Note 3, certain cash payments and notes received from ACE on transfer of these investments to ACE have been included in these consolidated financial statements as a contribution from ACE to Shareholders' Equity.

Summary of significant related party agreements

The Relationship between the Corporation and Aeroplan

ACE has reported holding a 20.1% ownership interest in Aeroplan Income Fund at December 31, 2007. Aeroplan operates a loyalty program which provides loyalty marketing services to its customers. The transactions between the Corporation and Aeroplan described below are recorded at the exchange amount and are settled by netting amounts payable against amounts receivable in accordance with the inter-company agreements with any outstanding balance paid in the subsequent period. Accordingly, at December 31, 2007 and December 31, 2006, the amounts have been presented on a net basis as the parties intend to settle on a net basis.

Aeroplan Commercial Participation and Services Agreement (Aeroplan CPSA)

Air Canada and Aeroplan are parties to the Aeroplan CPSA dated June 9, 2004. Pursuant to the Aeroplan CPSA, the Corporation allocates 8% of the seat capacity to Aeroplan on the flights operated by Air Canada and Jazz and certain other air carriers under the Air Canada code (collectively, the "AC Flights") at a fixed redemption cost. In 2007, the rates charged for such seat capacity were renegotiated in accordance with the Aeroplan CPSA for the period January 1, 2008 through to December 31, 2010. Aeroplan may also purchase an unlimited number of available seats based on published fares with a variable discount depending on the fare product. Any adjustment to this variable discount is based on an identified set of parameters. The Aeroplan CPSA also provides that Aeroplan will be charged the lowest fares charged to any other loyalty program taking into account Aeroplan's volume purchase of the Corporation's seat inventory. The Aeroplan CPSA expires June 29, 2020 with four automatic renewals of five year each, unless either party provides notice of its intention not to renew at least twelve months prior to the expiry of the applicable term.

Air Canada is one of Aeroplan's leading partners and it pays a fee to participate in the Aeroplan program, which fee is based on the Aeroplan miles awarded to Aeroplan members who are Air Canada customers traveling on AC Flights. Aeroplan is required to purchase a minimum number of reward travel seats on AC Flights annually, 2007 - $171 (2006 - $170), which number is a function of Aeroplan's consumption of seats in the three preceding calendar years. Moreover, the Corporation is required to purchase a minimum number of Aeroplan miles annually.

The Aeroplan CPSA also provides that Aeroplan shall, in return for a service fee, manage the Corporation's frequent flyer tier membership program for Air Canada Super Elite™, Elite™ and Prestige™ customers, as well as perform certain marketing and promotion services for the Corporation, including call centre services for the frequent flyer tier membership program.

Aeroplan Master Services Agreement (Aeroplan MSA)

Air Canada and Aeroplan are parties to the Aeroplan MSA effective January 1, 2005 pursuant to which, the Corporation provides certain services to Aeroplan in return for a fee based on the Corporation's fully allocated cost of providing such services to Aeroplan plus a mark-up to reflect overhead and administrative costs. Pursuant to the Aeroplan MSA, the Corporation provides Aeroplan with infrastructure support which is mostly administrative in nature, including information technology, human resources, finance and accounting, and legal services. Amounts related to the MSA are included in the table summarizing related party revenues and expenses under Revenues from corporate services and other.

Aeroplan General Services Agreement (Aeroplan GSA)

Air Canada and Aeroplan are parties to the Aeroplan GSA effective January 1, 2005 pursuant to which the Corporation provides Aeroplan with the services of a group of call centre employees of the Corporation. Aeroplan must reimburse Air Canada for all costs, including salary and benefits, related to the call centre employees on a fully allocated basis. With regard to the shortfall in the pension plan maintained by the Corporation, which covers, among others, these call centre employees, Aeroplan has agreed to pay an amount not to exceed $11 over a six year period ending in 2013 to compensate the Corporation for call centre employees' share of the unfunded Air Canada pension liability. Either party may, subject to collective agreements of the employees assigned to Aeroplan, terminate the GSA upon six months notice.

Trademark License Agreement

Pursuant to a Trademark License Agreement effective May 13, 2005, Air Canada and Aeroplan have granted each other reciprocal royalty-free, non-exclusive, non-sublicensable, non-assignable rights to use certain of each other's trademarks around the world which incorporate their names or logos, solely in association with the Aeroplan Program. No fees were charged or earned under this agreement for 2007 and 2006.

The Relationship between the Corporation and Jazz

ACE reported a 20.1% ownership interest in Jazz Air Income Fund at December 31, 2007. On January 24, 2008, ACE's ownership interest in Jazz Air Income Fund was reported to have been reduced to 9.5%. Air Canada has no ownership interest in Jazz. Jazz is consolidated in these consolidated financial statements under AcG-15 up to May 24, 2007. Jazz is still considered to be a variable interest entity to the Corporation, however, is no longer the primary beneficiary under AcG-15 (refer to Note 1). The deconsolidation of Jazz does not impact any of the contractual arrangements between Air Canada and Jazz.

In addition to the agreements summarized below, Air Canada and Jazz are also parties to a number of lease agreements pursuant to which Jazz leases or subleases, from the Corporation, certain premises at airports across Canada. Refer to Note 16, Commitments for further details.

Jazz Capacity Purchase Agreement (Jazz CPA)

Air Canada and Jazz are parties to the Jazz CPA, effective January 1, 2006, pursuant to which the Corporation purchases substantially all of Jazz's fleet capacity based on predetermined rates, in addition to reimbursing Jazz, without mark-up, for certain pass-through costs as defined in the Jazz CPA which include fuel, airport and navigation fees. The fees include both a variable component that is dependent on Jazz aircraft utilization and a fixed component. The initial term of the Jazz CPA expires December 31, 2015. There are two automatic renewal periods of five years each, subject to either party's right not to renew by notice at least one year prior to the expiration of the then applicable term. The rates under the Jazz CPA are subject to periodic adjustment with the next adjustment scheduled for the start of 2009. Amounts related to the CPA are included on the Expense from CPA with Jazz line in the table above.

Jazz Master Services Agreement (Jazz MSA)

Air Canada and Jazz are parties to the Jazz MSA pursuant to which the Corporation provides certain services to Jazz in return for a fee based on the fair market value of the services provided by the Corporation to Jazz. Pursuant to the Jazz MSA, the Corporation provides Jazz with infrastructure support consisting principally of administrative services in relation with information technology, corporate real estate, environmental affairs and legal services. Jazz benefits from certain information technology services available to the Corporation from third parties and from the Corporation's internal information technology resources.

Either Air Canada or Jazz may elect to terminate any services under the Jazz MSA (without terminating the whole Jazz MSA) or the entire Jazz MSA upon one year's prior written notice. The Jazz MSA terminates upon the termination of the Jazz CPA.

Jazz Trademark License Agreements

Air Canada and Jazz are parties to the Jazz Trademark License Agreement pursuant to which the Corporation has granted Jazz a royalty-free, non-exclusive, non-sublicensable, non-assignable right to use certain trademarks owned or registered by the Corporation around the world including “Jazz” and certain trademarks which incorporate the Air Canada name, and/or Air Canada’s roundel design, solely in association with the Jazz business. The Jazz Trademark License Agreement can be terminated in the event that the Jazz CPA is terminated. However, Air Canada and Jazz have also entered into a Jazz Special Trademark Agreement which would grant all of the Corporation’s rights to the Jazz trademark to Jazz (and preclude the Corporation from using the Jazz trademark or licensing the Jazz trademark to third parties) upon the occurrence of certain events involving (i) the expiration or termination of the Jazz CPA if, at such time, Jazz is no longer an affiliate of the Corporation; (ii) the occurrence of a change of control pursuant to which Jazz ceases to be an affiliate of the Corporation if, at or prior to such time, the Jazz CPA has expired or has been terminated; or (iii) the sale or transfer of all or substantially all of the assets or business of Jazz to a third party that is not an affiliate of the Corporation if, at or prior to such time, the Jazz CPA has expired or has been terminated.

The Relationship between the Corporation and ACTS

As described in Note 20, on October 16, 2007, ACE announced the completion of the sale of ACTS LP pursuant to which ACTS LP sold substantially all of its assets, liabilities and business to ACTS Aero. ACTS Aero conducts the business previously operated by ACTS LP.

The ACTS Maintenance Agreements, the ACTS Master Services Agreement, the ACTS Trademark License Agreement, the Repair Schemes and Non-Compete Agreement and the ACTS General Services Agreements, all between Air Canada and ACTS LP and described below and in Note 20 were assigned from ACTS LP to ACTS Aero upon closing of the monetization of ACTS. On closing of the ACTS sale, Air Canada recorded proceeds of $28 for the sale of a building to ACTS Aero, $17 for the settlement of a intercompany note with ACTS LP, $20 pursuant to the transfer of repair schemes and the funding of a letter of credit in the amount of $101 related to a “Pension and Benefits Agreement” as described in Note 20. ACTS Aero is a related party to Air Canada due to ACE’s investment in both entities.

ACTS Maintenance Agreements

ACTS Aero and Air Canada are parties to a general terms and related services agreements effective October 1, 2006, pursuant to which ACTS Aero provides technical services to the Corporation including engine and auxiliary power unit maintenance services, aircraft heavy maintenance services (excluding line and cabin maintenance services which are provided by the Corporation), component maintenance services, paint services, training services and ancillary services. ACTS Aero serves as the Corporation's exclusive repair agency in respect of aircraft heavy maintenance, engine maintenance, auxiliary power unit maintenance services as well as for maintenance services relating to certain components. ACTS Aero serves as the Corporation's non-exclusive repair agency in respect of other services provided. Except for the services agreement relating to aircraft heavy maintenance services, which expires in October 2011, and the services agreement relating to paint services, which expires in October 2009, each of the agreements referred to above expires in October 2013.

ACTS Aero and Jazz are parties to a component maintenance agreement (the “ACTS-Jazz Agreement”) dated August 1, 2005, pursuant to which ACTS Aero provides selected maintenance, repair, overhaul and related services with respect to Jazz’s CRJ aircraft. Pursuant to the ACTS-Jazz Agreement, ACTS Aero serves as Jazz’s exclusive repair agency to provide component repair and overhaul work on parts which can be removed from the aircraft in respect of CRJ-100/200 and common CRJ-705 parts not performed internally by Jazz employees. The initial term of the ACTS-Jazz Agreement expires in August 2015 and it is renewable for three successive two-year periods. The amounts related to the ACTS Maintenance Agreements and other maintenance agreements with Jazz are recorded in the above table summarizing related party revenues and expenses under Maintenance expense from ACTS. Jazz amounts with ACTS are not reported for the period after deconsolidation on May 24, 2007.

ACTS Master Services Agreement (ACTS MSA)

ACTS Aero and Air Canada are parties to an amended and restated master services agreement (the "ACTS MSA"), effective January 1, 2007, pursuant to which the Corporation provides ACTS Aero with services including infrastructure support and services which are mostly administrative in nature, including information technology, human resources, finance and accounting, and claims services in return for fees paid by ACTS Aero to the Corporation. ACTS Aero may elect to terminate any services under the ACTS MSA or the entire ACTS MSA upon six months' prior written notice, with the exception of services relating to information technology which ACTS Aero cannot terminate prior to the expiry of the ACTS MSA. Air Canada may elect to terminate any services under the ACTS MSA or the entire ACTS MSA upon 18 months' prior written notice. These amounts are recorded in the above table summarizing related party revenues and expenses under Revenues from corporate services and other.

ACTS Trademark License Agreement

ACTS Aero and Air Canada are parties to a trademark license agreement (the "ACTS Trademark License Agreement"), effective September 30, 2004, pursuant to which the Corporation has granted ACTS Aero a royalty-free, non-exclusive, non-assignable right to use certain Air Canada trademarks which incorporate the Air Canada name, and Air Canada's roundel design, solely in association with the provision of heavy maintenance, component maintenance and supply chain business services in Canada and the United States. The ACTS Trademark License Agreement was amended on closing of the sale of ACTS LP to provide for the termination of the agreement on October 16, 2008.

ACTS General Services Agreements

ACTS Aero and Air Canada are parties to an amended and restated general services agreement (the "ACTS GSA"), effective as of June 22, 2007, pursuant to which the Corporation provides ACTS Aero with the services of a group of unionized employees for which the Corporation is reimbursed by ACTS Aero for all costs, including salary and benefits, on a fully allocated basis. The ACTS GSA may be terminated by either party at any time upon 30 days' prior written notice.

Real Estate Agreements

As part of the closing of the monetization of ACTS LP, Air Canada sold a building to ACTS Aero for proceeds of $28 effective as of October 16, 2007. In connection with the sale, Air Canada and ACTS Aero entered into a land sublease for certain land contiguous with the building and a service contract whereby the Corporation provides ACTS Aero certain services related to the operation of the building.

Loan and Prepayment Agreements between ACTS and Air Canada

Pursuant to a Prepayment Agreement dated October 26, 2006, Air Canada prepaid an amount of approximately $595 to ACTS LP (the predecessor to ACTS LP and ACTS Aero) under the ACTS Maintenance Agreements for the estimated equivalent of 12 months of service to be rendered by ACTS to Air Canada under the ACTS Maintenance Agreements starting on November 1, 2006. The amount of such prepayment was immediately loaned back by ACTS LP to Air Canada pursuant to a loan agreement dated October 26, 2006. Such loan was non-interest bearing and repayable in instalments starting on November 1, 2006. The amount of the instalments was equal to the amount that would otherwise have been payable by Air Canada under the ACTS Maintenance Agreements and became due and payable on the day on which the amount became payable under the ACTS Maintenance Agreements. Repayment of the entire amount of the loan was completed in 2007.

ACTS Aero and Air Canada are parties to a master lease agreement, effective as of October 1, 2006, pursuant to which ACTS Aero leases space from the Corporation at the Vancouver, Winnipeg, Toronto and Montreal airports.

As described in Note 20, the non unionized employees were transferred to ACTS on October 16, 2007. Post October 16, 2007, the non-unionized employees of ACTS are not covered under the GSA.

Cash Management System

Air Canada manages the cash for ACTS up to October 2007. All cash collected from billings and sources other than Air Canada is recorded by Air Canada on a daily basis. Any payments to pay obligations related to operating and financing costs and capital expenditures other than obligations to the Corporation and other ACE affiliates were made through the Air Canada cash management system. Inter-company accounts receivable and payable include any excess cash (cash proceeds greater than cash expenditures), cash deficiencies (cash expenditures greater than proceeds) or deferrals of receipts of payments. The Consolidated statement of cash flows reflects the receipt and repayment of excess cash as a financing activity and the disbursement and repayment of cash deficiencies as investing activities.

The Relationship between the Corporation and ACE

Master Services Agreement

Air Canada provides certain administrative services to ACE in return for a fee. Such services relate to finance and accounting, information technology, human resources and other administrative services.

Share Purchase Rights Sold by Air Canada to ACE

During 2007, Air Canada entered into an aircraft transaction with an unrelated third party whereby partial consideration was paid to the Corporation in the form of the right to acquire shares of the unrelated third party. The Corporation recorded the value of the share purchase rights at fair value of $1. The transaction related to the sale by the Corporation of two Airbus A319 aircraft and the sublease by the Corporation of an additional two Airbus A319 aircraft, all of which was completed in 2007 with the exception of one of the owned Airbus A319 aircraft, which was completed in 2008. The Corporation sold the right to acquire the shares received from the unrelated third party to ACE, for proceeds of $1.

Warrants purchased from ACE

On November 26, 2007, Air Canada purchased certain share warrants held by ACE for consideration of $4, which was paid during the year and recorded as a decrease to contributed surplus. These warrants are for the purchase of shares of an unrelated third party from which the Corporation purchases services. The equity of the unrelated third party is not quoted in an active market and therefore fair value is not reliably measurable. As such, the financial instrument is recorded at cost, being the carrying amount in ACE of nil.

Purchase of Air Canada Vacations

During 2007, Air Canada purchased from ACE its 49% interest in Air Canada Vacations causing Air Canada Vacations to be wholly owned by the Corporation. Consideration for the interest was $10. The consideration is accounted for on the Consolidated statement of financial position in contributed surplus. Air Canada Vacations remains consolidated within the results of the Corporation.

20. Sale of ACTS

On October 16, 2007, ACE announced the completion of the sale of ACTS LP, its wholly owned maintenance, repair and overhaul subsidiary, pursuant to which ACTS LP sold substantially all its assets, liabilities and business to ACTS Aero, a new entity established to purchase the assets of ACTS LP, with ACE retaining a 23% interest in ACTS Aero.

On closing of the ACTS Sale, the following transactions were recorded by Air Canada:

- Proceeds of $28 for the sale of a building to ACTS Aero (refer to Note 4).
- Proceeds of $17 for the settlement of a related party receivable with ACTS.
- Proceeds of $20 pursuant to the Repair Schemes and Non-Compete Agreement described below
- The funding of a letter of credit in the amount of $101 related to the "Pension and Benefits Agreement" as described below.

The ACTS Maintenance Agreements, the ACTS Master Services Agreement, the ACTS Trademark License Agreement, and the General Services Agreements, all between Air Canada and ACTS and as described in Note 19, and the Repair Schemes and Non-Compete Agreement described below were assigned from ACTS to ACTS Aero upon closing of the ACTS Sale.

Pension and Benefits Agreement

The Corporation, ACTS and ACTS Aero entered into a Pension and Benefits Agreement effective as of October 16, 2007 ("Pension and Benefits Agreement"), relating to pension and benefits arrangements pertaining to (i) the non-unionized employees of Air Canada who were previously assigned to the ACTS operation became employees of ACTS Aero on October 16, 2007 and (ii) unionized employees of Air Canada who were assigned to ACTS Aero operation pursuant to general services agreements between Air Canada and ACTS for the assignment of unionized employees from Air Canada to ACTS (these agreements were assigned to ACTS Aero upon closing of the ACTS Sale). New defined benefit and defined contribution pension plans as well as other employee and retiree benefit arrangements (including health, life and disability) are being established by ACTS Aero (the "ACTS Benefit Arrangements").

Upon receipt of regulatory approval where required and based upon valuations of the relevant pension and benefit arrangements of Air Canada (the "Air Canada Benefit Arrangements") as at October 16, 2007, the assets and obligations under the Air Canada Benefit Arrangements pertaining to the transferring non-unionized employees will be transferred to ACTS Aero or the ACTS Benefit Arrangements, as applicable. Amounts with a present value equal to the solvency deficiency in the defined benefit pension plans as at October 16, 2007 related to transferring non-unionized employees will be paid by Air Canada through quarterly payments to ACTS Aero until 2014. Amounts with a present value equal to the accounting liability as at October 16, 2007 in respect of retiree and disability benefits related to transferring non-unionized employees will be paid by Air Canada through quarterly payments to ACTS Aero until 2012. The present value of these quarterly payments is also referred to as the compensation amount. Until such future time as the assets and obligations under the Air Canada Benefit Arrangements pertaining to non-unionized employees may be transferred to ACTS Aero, the current service pension cost and the current service and interest costs for other employee benefits will be expensed by Air Canada with a full offset recorded as an amount charged to affiliates (ACTS Aero).

In addition, the Pension and Benefits Agreement contemplates similar asset and liability transfer and compensation arrangements in respect of unionized employees, which arrangements would take effect at such future time as those unionized employees may be transferred from Air Canada to ACTS Aero. However, the solvency deficiencies in respect of transferring unionized employees for which the future quarterly compensation payments would be made are determined as at October 16, 2007, subject to certain adjustments, and the discount rate used to compute the accounting liability for the unionized employees' retiree and disability benefits is fixed as at October 16, 2007. The compensation payments in respect of these solvency deficiencies and accounting liabilities would be made quarterly during the five years beginning after the unionized employees are transferred to ACTS Aero, but only if such a transfer occurs. Until such future time as the assets and obligations under the Air Canada Benefit Arrangement pertaining to unionized employees may be transferred to ACTS Aero, the current service pension cost and the current service and interest costs for other employee benefits in respect of Air Canada employees providing services to ACTS Aero are charged to ACTS Aero.

The Pension and Benefits Agreement also required that Air Canada provide letters of credit to ACTS Aero on October 16, 2007, to secure the above-described payment obligations in respect of the solvency deficiencies of the defined benefit pension plans and accounting liabilities for other retiree and disability benefit arrangements. The letters of credit total $101, subject to adjustment once the exact amounts of the relevant solvency deficiencies and accounting liabilities as at October 16, 2007 are determined by actuarial valuations. The face amount of the letter of credit in respect of the unionized solvency deficiency is also adjusted annually to recognize past service costs paid by Air Canada to the plan in respect of unionized employees assigned to ACTS Aero. The face amount of the letters of credit decreases as the related quarterly funding payments described above are made. ACTS Aero may call the letters of credit in whole or in part, in the event of a default as defined in the Pension and Benefits Agreement. Collateral equal to the amount of the letters of credit was paid in cash with the asset recorded in Deposits and other assets.

Non-Compete and Repair Schemes Transfer Agreement

ACTS Aero and Air Canada are parties to a non-compete and repair schemes transfer agreement, effective as of October 16, 2007 (the “Repair Schemes and Non-Compete Agreement”). Generally described, repair schemes are processes and methods which may be used in the maintenance and repair of aircraft and related equipment. The Repair Schemes and Non-Compete Agreement confirmed an arrangement and provides for the sale from Air Canada to ACTS Aero (as successor to ACTS LP) of an undivided joint ownership interest in repair schemes owned by Air Canada or approved under Air Canada’s airworthiness engineering organization as well as the sale from ACTS Aero to Air Canada of an undivided joint ownership interest in the repair schemes owned or developed by ACTS Aero and applicable to airframe heavy maintenance services provided by ACTS to Air Canada under the parties’ airframe heavy maintenance services agreement. However, in September 2004 as part of the implementation of the Corporation’s plan of arrangement under the Companies’ Creditors Arrangement Act, the Corporation had already granted ACTS full and exclusive right to these schemes on a royalty free basis.

The Repair Schemes and Non-Compete Agreement also restricts Air Canada’s ability to own any equity interest in an entity (other than entities in which Air Canada previously held interests), or to carry on a business activity, related to the following commercial maintenance, repair and overhaul services in the airline industry, namely, airframe heavy maintenance and paint services, engine and auxiliary power unit (“APU”) overhaul maintenance services, and component maintenance services. The applicable non-compete periods are as follows:

- With respect to airframe heavy maintenance services and paint services, the non-compete period ends one year after the current heavy maintenance services agreement is terminated or expires (the current term of the heavy maintenance services agreement expires October 1, 2011);
- With respect to engine and APU overhaul maintenance services, the non-compete period ends on October 1, 2015; and
- With respect to component maintenance services, the non-compete period ends on October 1, 2016;

The Repair Schemes and Non-compete Agreement does not restrict Air Canada from holding interests in any entities in which it held interests at the time of concluding the agreement nor does it limit Air Canada’s line maintenance activities which it continues to operate.

In consideration for the transfer of the repair schemes, Air Canada received $20. These proceeds were recorded in financing activities on the Consolidated statement of cash flows and a credit of $20 was recorded in contributed surplus ($15 after future income tax) as the transaction was recorded at the Corporation’s carrying amount of nil.

The Repair Schemes and Non-Compete Agreement was assigned to ACTS Aero upon closing of the ACTS Sale.

21. JAZZ IPO

On February 2, 2006, Jazz Air Income Fund completed an initial public offering of its fund units. The Jazz Fund is an unincorporated, open-ended trust. With the proceeds of the initial public offering, the Jazz Fund subscribed for 23.5 million units of Jazz at a price of $10.00 per unit for net proceeds of $218, net of offering costs of $17 that were paid during Quarter 1 2006. Concurrent with the closing of the initial public offering, Jazz received proceeds of $113, net of fees of $2, representing the drawing under a new term credit facility (refer to Note 8).

On February 27, 2006, following the exercise of the over-allotment option by the underwriters, the Jazz Air Income Fund issued an additional 1.5 million units at a price of $10.00 per unit for additional net proceeds of approximately $14. The proceeds of the over allotment were used to acquire 1,500,000 Jazz partnership units from ACE.

In connection with the initial public offering, Jazz Air Limited Partnership transferred substantially all of its assets and liabilities to the new Jazz Air LP that was wholly owned by ACE. In consideration ACE received 99,365,143 units of the Jazz Air LP partnership and an acquisition promissory note of $424. The acquisition promissory note was repaid by Jazz Air LP to ACE from proceeds it received from the offering, a drawdown under its new term credit facility (Note 8) and out of the working capital of Jazz Air LP.

22. SPECIAL CHARGE FOR AEROPLAN MILES

In 2001, Air Canada established Aeroplan Limited Partnership as a limited partnership wholly owned by Air Canada. The Aeroplan loyalty program was previously a division of Air Canada.

Under the Commercial Participation and Services Agreement (CPSA) between Air Canada and Aeroplan, Air Canada retained responsibility for the 103 billion Miles to be redeemed from accumulations up to December 31, 2001. Aeroplan assumed responsibility for all Miles issued beginning January 1, 2002. On December 31, 2001, there were 171 billion Miles outstanding of which, after considering breakage, management estimated that 103 billion Miles would be redeemed.

In 2006, management of Air Canada and Aeroplan re-estimated the number of Miles expected to be redeemed from accumulations up to December 31, 2001. As a result, management of Air Canada and Aeroplan concluded that they expected that 112 billion Miles would be redeemed compared to the original estimate of 103 billion. Pursuant to the terms of the CPSA, dated June 9, 2004, as amended, the management of Air Canada and Aeroplan agreed to further amend the terms of the CPSA. Effective October 13, 2006, by amendment, Air Canada assumed responsibility for the redemption of up to 112 billion Miles and, as a result, recorded a special charge of $102 for the incremental 9 billion Miles against Operating revenues in the year ended December 31, 2006 and increased Aeroplan deferred revenues. This amendment to the CPSA represented full and final settlement with Aeroplan of Air Canada's obligations for the redemption of pre-2002 Miles. Aeroplan is responsible for any redemption of Miles in excess of the re-estimated 112 billion Miles. The amount of the additional liability was determined by valuing the incremental Miles at fair value.