ACE AVIATION

Quarter 3 2006
Interim Unaudited Consolidated Financial Statements and Notes

November 9, 2006

Consolidated Statement of Operations and Retained Earnings

(in millions except per share figures - Canadian dollars) *(unaudited)*		Three Months Ended September 30 2006	2005	Nine Months Ended September 30 2006	2005
Operating revenues					
Passenger	note 11	**$ 2,564**	$ 2,461	**$ 6,873**	$ 6,300
Cargo	note 11	**157**	162	**460**	444
Other		**226**	210	**780**	724
		2,947	2,833	**8,113**	7,468
Special charge for Aeroplan miles	note 2	**(102)**	-	**(102)**	-
		2,845	2,833	**8,011**	7,468
Operating expenses					
Salaries, wages and benefits		**641**	635	**1,919**	1,870
Aircraft fuel		**762**	675	**1,962**	1,620
Aircraft rent		**108**	112	**334**	300
Airport and navigation fees		**275**	259	**750**	702
Aircraft maintenance, materials and supplies		**100**	80	**347**	263
Communications and information technology		**70**	75	**217**	230
Food, beverages and supplies		**93**	94	**255**	253
Depreciation, amortization and obsolescence		**145**	118	**419**	357
Commissions		**61**	68	**188**	206
Special charge for labour restructuring	note 7	**-**	-	**33**	-
Other		**387**	396	**1,265**	1,178
		2,642	2,512	**7,689**	6,979
Operating income		**203**	321	**322**	489
Non-operating income (expense)					
Interest income		**33**	20	**84**	47
Interest expense		**(94)**	(76)	**(273)**	(228)
Interest capitalized		**18**	2	**40**	8
Gain on sale of US Airways shares	note 4	**52**	-	**152**	-
Gain (loss) on sale of assets and provisions on assets		**(4)**	2	**-**	2
Dilution gain	note 9	**-**	-	**220**	190
Other	note 13	**(17)**	14	**(14)**	(16)
		(12)	(38)	**209**	3
Income before the following items		**191**	283	**531**	492
Non-controlling interest		**(19)**	(9)	**(53)**	(16)
Foreign exchange gain (loss)		**(3)**	125	**117**	57
Provision for income taxes		**(66)**	(128)	**(138)**	(170)
Income for the period		**$ 103**	**$ 271**	**$ 457**	**$ 363**
Retained earnings, beginning of period as originally reported		**756**	249	**415**	157
Adjustment related to change in accounting policy	note 1	**-**	(16)	**(13)**	(16)
Retained earnings, beginning of period as restated		**756**	233	**402**	141
Retained earnings, end of period		**$ 859**	**$ 504**	**$ 859**	**$ 504**
Earnings per share (restated)	note 1				
- Basic		**$ 1.01**	**$ 2.67**	**$ 4.49**	**$ 3.75**
- Diluted		**$ 0.95**	**$ 2.33**	**$ 4.11**	**$ 3.39**

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

Consolidated Statement of Financial Position

(in millions except per share figures - Canadian dollars) *(unaudited)*		September 30 2006	December 31, 2005
ASSETS			
Current			
Cash and cash equivalents		**$ 1,747**	$ 1,565
Short-term investments		**1,139**	616
		2,886	2,181
Restricted cash		**51**	86
Accounts receivable		**824**	637
Spare parts, materials and supplies		**269**	325
Prepaid expenses and other current assets		**97**	125
		4,127	3,354
Property and equipment		**5,822**	5,494
Deferred charges		**122**	145
Intangible assets	note 10	**2,193**	2,462
Investments and other assets		**329**	392
		$ 12,593	**$ 11,847**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		**$ 1,532**	$ 1,355
Advance ticket sales		**811**	711
Current portion of Aeroplan deferred revenues		**772**	680
Current portion of long-term debt and capital leases		**285**	265
		3,400	3,011
Long-term debt and capital leases	note 5	**3,643**	3,543
Convertible preferred shares		**161**	148
Future income taxes		**180**	221
Pension and other benefit liabilities		**2,006**	2,154
Aeroplan deferred revenues		**978**	953
Other long-term liabilities		**401**	446
		10,769	10,476
NON-CONTROLLING INTEREST		**225**	203
SHAREHOLDERS' EQUITY			
Share capital and other equity	note 8	**714**	747
Contributed surplus	note 1	**26**	19
Retained earnings	note 1	**859**	402
		1,599	1,168
		$ 12,593	**$ 11,847**

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

Contingencies are described in Note 14.

Consolidated Statement of Cash Flow

(in millions of Canadian dollars) *(unaudited)*		Three Months Ended September 30 2006	Three Months Ended September 30 2005	Nine Months Ended September 30 2006	Nine Months Ended September 30 2005
Cash flows from (used for)					
Operating					
Income for the period		**$ 103**	$ 271	**$ 457**	$ 363
Adjustments to reconcile to net cash provided by operations					
Depreciation, amortization and obsolescence		**145**	118	**419**	357
Gain on sale of US Airways shares	note 4	**(52)**	-	**(152)**	-
(Gain) loss on sale of assets		**4**	(2)	**-**	(2)
Dilution gain	note 9	**-**	-	**(220)**	(190)
Foreign exchange (gain) loss		**1**	(149)	**(129)**	(94)
Future income taxes		**66**	125	**138**	161
Employee future benefit funding more than expense		**(63)**	(33)	**(131)**	(47)
Decrease (increase) in accounts receivable		**(49)**	(131)	**(192)**	(330)
Decrease (increase) in spare parts, materials and supplies		**12**	3	**47**	(2)
Increase (decrease) in accounts payable and accrued liabilities		**120**	(7)	**175**	53
Increase (decrease) in advance ticket sales, net of restricted cash		**(239)**	(155)	**150**	345
Special charge for Aeroplan miles	note 2	**102**	-	**102**	-
Other		**9**	(52)	**62**	27
		159	(12)	**726**	641
Financing					
Issue of common shares		**-**	(1)	**3**	442
Issue of convertible notes		**-**	-	**-**	319
Issue of Aeroplan units		**-**	-	**-**	232
Issue of Jazz units	note 9	**-**	-	**218**	-
Credit facility borrowings - Aeroplan		**-**	(18)	**-**	300
Credit facility borrowings - Jazz	note 5	**-**	-	**113**	-
Aircraft related borrowings	note 5	**99**	213	**321**	213
Reduction of long-term debt and capital lease obligations		**(58)**	(67)	**(207)**	(834)
Distributions paid to non-controlling interests		**(14)**	(3)	**(36)**	(3)
Other		**-**	1	**-**	(4)
		27	125	**412**	665
Investing					
Short-term investments		**(372)**	136	**(523)**	(1,219)
Additions to capital assets		**(213)**	(316)	**(692)**	(411)
Proceeds from sale of assets		**40**	4	**40**	41
Investment in US Airways shares	note 4	**-**	(87)	**-**	(87)
Sale of US Airways shares	note 4	**74**	-	**232**	-
Proceeds from sale of Aeroplan units		**-**	-	**-**	35
Proceeds from sale of Jazz units	note 9	**-**	-	**14**	-
Cash collaterization of letters of credit		**(11)**	(15)	**(15)**	(35)
Other		**(12)**	-	**(12)**	-
		(494)	(278)	**(956)**	(1,676)
Increase (decrease) in cash and cash equivalents		**(308)**	(165)	**182**	(370)
Cash and cash equivalents, beginning of period		**2,055**	1,276	**1,565**	1,481
Cash and cash equivalents, end of period		**$ 1,747**	**$ 1,111**	**$ 1,747**	**$ 1,111**
Cash payments of interest		**$ 54**	**$ 54**	**$ 194**	**$ 163**
Cash payments of income taxes		**$ 3**	**$ 11**	**$ 9**	**$ 20**

Cash and cash equivalents exclude Short-term investments of $1,139 as at September 30, 2006 ($616 as at December 31, 2005)

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

For the period ended September 30, 2006 (unaudited)
(currencies in millions – Canadian dollars)

1. NATURE OF OPERATIONS AND ACCOUNTING POLICIES

ACE Aviation Holdings Inc. ("ACE") is the parent holding company of various transportation and other service companies and partnerships, which are operated through the following four reportable segments: Air Canada Services, Aeroplan Limited Partnership ("Aeroplan"), Jazz Air LP ("Jazz"), and ACTS Limited Partnership ("ACTS"). As at September 30, 2006, ACE holds a 100 percent ownership interest in the entities included in the Air Canada Services segment, a 75.3 percent direct ownership interest in Aeroplan, a 79.7 percent direct ownership interest in Jazz and a 100 percent ownership interest in ACTS.

The Air Canada Services segment includes the following principal operating companies and partnerships: Air Canada, ACGHS Limited Partnership ("ACGHS"), Touram Limited Partnership ("Air Canada Vacations") and AC Cargo Limited Partnership ("Air Canada Cargo"). The Air Canada Services segment is comprised of the entities previously included within the Transportation Services segment with the exception of the activities of the ACE stand-alone entity and certain consolidation adjustments that are now included within Corporate Items and Eliminations ("CIE"). As a result of these changes, the comparative segment disclosures have been restated to reflect the current reportable segment structure.

Reference to "Corporation" in the following notes to the consolidated financial statements refers, as the context may require, to ACE and its subsidiaries collectively, ACE and one or more of its subsidiaries, one or more of ACE's subsidiaries, or ACE itself.

The unaudited interim consolidated financial statements for the Corporation are based on the accounting policies consistent with those disclosed in Note 2 to the 2005 annual consolidated financial statements of ACE, with the exception of the policy on stock-based compensation for employees eligible to retire before the vesting period that is addressed below.

In accordance with Canadian generally accepted accounting principles ("GAAP"), these interim financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the 2005 annual consolidated financial statements of ACE. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim periods presented.

The Corporation has historically experienced considerably greater demand for its services in the second and third quarters of the calendar year and significantly lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months. The Corporation has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short-term.

EIC-162: Stock-Based Compensation for Employees Eligible to Retire Before the Vesting Date
On July 6, 2006, the Emerging Issues Committee of the Accounting Standards Board of Canada issued EIC-162 – Stock-based compensation for employees eligible to retire before the vesting date. EIC-162 requires that the compensation cost for a stock option award attributable to an employee who is eligible to retire at the grant date be recognized on the grant date, if the employee can retire from the entity at any point and the award's exercisability does not depend on continued service. It further requires that the compensation cost for a stock option award attributable to an employee who will become eligible to retire during the vesting period be recognized over the period from the grant date to the date the employee becomes eligible to retire. This accounting treatment should be applied retroactively, with restatement of prior periods, for financial statements ending on or after December 31, 2006. Earlier adoption is encouraged.

Prior to the adoption of EIC-162, the fair value of stock options granted was recognized as a charge to salaries and wages expense on a straight line basis over the applicable vesting period, without regard to when an employee was eligible to retire. EIC-162 is applicable to the Corporation as the terms of the Corporation's stock option plan specify that upon the retirement of the employee, options granted may be exercised as the rights to exercise accrue.

The Corporation adopted EIC-162 in Quarter 2 2006 with restatement of prior periods. The impact in these interim financial statements of adopting EIC-162 is a charge to retained earnings of $16 as at January 1, 2005 and $13 as at January 1, 2006, a decrease to Salaries, wages and benefits expense of $1 for the three month period ended September 30, 2005 ($2 for the nine month period ending September 30, 2005) and a nominal impact to Salaries, wages and benefits expense for the three month period ended September 30, 2006 (an increase of $1 to for the nine month period ended September 30, 2006) offset against Contributed Surplus.

The basic and diluted earnings per share increased by $0.01 for the three month period ended September 30, 2005 ($0.02 for the nine month period ended September 30, 2005) and had a nominal impact for the three month period ended September 30, 2006 (decreased by $0.02 for the nine months ended September 30, 2006).

Future Accounting Pronouncements

Financial Instruments, Comprehensive Income and Hedges
The Accounting Standards Board has issued three new standards dealing with financial instruments: (i) Financial Instruments – Recognition and Measurement, Disclosure and Presentation, (ii) Hedges and (iii) Comprehensive Income. The key principles under these standards are that all financial instruments, including derivatives, are to be included on a company's balance sheet and measured, initially at their fair values. Subsequent measurement depends on the classification of the instrument and is either at fair value or, in limited circumstances when fair value may not be considered most relevant, at cost or amortized cost. Financial instruments intended to be held-to-maturity should be measured at amortized cost. Existing requirements for hedge accounting are extended to specify how hedge accounting should be performed. Also, a new location for recognizing unrealized gains and losses of certain financial instruments on the balance sheet entitled other comprehensive income has been introduced. The new standards are effective for the Corporation beginning January 1, 2007. The standards do not permit restatement of prior years' financial statements, however, the standards have detailed transition provisions. The Corporation is in the process of evaluating all of the consequences of the new standards; which may have a material impact on the Corporation's financial statements.

2. 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 estimated 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.

With the assistance of independent actuaries, management of Air Canada and Aeroplan re-estimated the number of Miles expected to be redeemed from accumulations up to December 31, 2001. Management now expects that 112 billion Miles will 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 have agreed to further amend the terms of the CPSA. Effective October 13, 2006, by amendment, Air Canada has assumed responsibility for the redemption of up to 112 billion Miles and, as a result, recorded a special charge of $102 against Operating revenues in Quarter 3 2006 and increased Aeroplan deferred revenues. This amendment to the CPSA represents 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.

3. DISPOSAL OF PROPERTY

During Quarter 3 2006 the Corporation sold one of its commercial real estate properties for proceeds of $40 with a carrying value of $35. The gain on sale of $5 has been deferred in these consolidated financial statements as a result of the leaseback of a portion of the property by subsidiaries of the Corporation. The deferred gain will be amortized into consolidated net income on a weighted average basis over the term of the leaseback transaction, which will result in the gain being fully recognized by December 2008.

During Quarter 3 2006 the amortization of the gain was less than $1 and was recorded as an offset to building lease costs included in Other operating expenses. As of September 30, 2006 the remaining deferred gain on sale of $4 is included in Other long-term liabilities.

4. SALE OF US AIRWAYS SHARES

In Quarter 3 2005 the Corporation made an investment of $87 (US$75) in US Airways Group, Inc. ("US Airways") for 5 million shares.

On April 10, 2006, the Corporation disposed of 1.75 million shares of its holdings in US Airways to PAR Investment Partners LP. The proceeds from the sale transaction amounted to $78 (US$68). The Corporation recorded a pre-tax gain of $46 ($38 after tax) in Quarter 2 2006 as a result of this transaction.

Over the period from June 7, 2006 to July 6, 2006, the Corporation disposed of 2.75 million shares of its holdings in US Airways through a series of transactions on the open stock market at an average price of over US$50 per share.

- Prior to June 30, 2006, 1.5 million shares were sold at an average price of over US$47 per share for net proceeds of $80 (US$72). The Corporation recorded a pre-tax gain of $54 ($45 after tax) in Quarter 2 2006 as a result of these transactions.
- During Quarter 3 2006 the Corporation sold an additional 1.25 million shares at an average price of over US$53 per share for net proceeds of $74 (US$66). The Corporation recorded a pre-tax gain of $52 ($43 after tax) in Quarter 3 2006 as a result of these transactions.

As of November 9, 2006, ACE continues to hold 0.5 million shares in US Airways with a market value of US$25.

5. LONG-TERM DEBT AND CAPITAL LEASES

Embraer Aircraft Financing

The following table summarizes the loans that Air Canada drew to finance the acquisition of Embraer aircraft that are secured by the delivered aircraft:

	Number of Aircraft	Interest Rate	Maturity	Original US$ Loan Amount	Original CDN$ Loan Amount
Quarter 3 2006					
Embraer 190	4	8.13%	2021	$ 89	$ 99
Quarter 2 2006					
Embraer 190	4	8.39%	2021	$ 88	$ 98
Quarter 1 2006					
Embraer 175	1	7.34%	2018	$ 20	$ 23
Embraer 190	4	7.82%	2021	$ 87	$ 101
2005 Year					
Embraer 175	14	7.14%	2017	$ 277	$ 329
Embraer 190	3	7.80%	2020	$ 65	$ 75
Total				**$ 626**	**$ 725**

During Quarter 3 2006, the interest rate margins on outstanding financing relating to all EMB 175 aircraft (US$297) were re-priced from 3.25% down to 2.35% and eight loans that bear interest at a floating interest rate were converted to fixed interest rate loans. The Interest Rate above represents the weighted average fixed interest rates as at September 30, 2006 of the loans that Air Canada drew relating to the Embraer aircraft financing.

The following is the principal repayment requirements of the total Embraer aircraft financing in US$ as at September 30, 2006:

	Remainder of 2006	2007	2008	2009	2010	2011
Embraer aircraft financing US$	**$ 7**	**$ 29**	**$ 30**	**$ 31**	**$ 32**	**$ 44**

Revolving Credit Facilities

Air Canada
On March 31, 2006, Air Canada finalized amendments to its existing senior secured syndicated revolving credit facility, including reductions in interest rates and standby fees. The aggregate amount available was also amended to $250 (or the US dollar equivalent) from $300 (or the US dollar equivalent). Specifically, the interest rate margin has been adjusted downwards by 0.25% to rates ranging 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 September 30, 2006, no amount was drawn under this facility. Further amendments are to occur subsequent to September 30, 2006, refer to Note 15.

Jazz
During Quarter 1 2006, in connection with the initial public offering of the Jazz Air Income Fund (Note 9), Jazz arranged for a senior secured syndicated credit facility in the amount of $150. On closing of the offering, $115 was drawn under the credit facility ($113 net of fees). The facility bears interest at floating rates and has a three year term. The outstanding credit facility is secured by substantially all the present and future assets of Jazz. Jazz entered into swap agreements with third parties with a nominal value of $115 to receive floating rates and pay fixed rates of 7.09% (Note 13). During Quarter 1 2006, Jazz repaid term loans and credit facilities of $14.

ACE Convertible Senior Notes

In connection with the special distribution of units of Aeroplan Income Fund to the shareholders of ACE (Note 10), the conversion rate of the 4.25% Convertible Senior Notes due 2035 ("Convertible Notes") has been adjusted from 20.8333 to 22.2838 Class A variable voting shares (if the holder is not a Canadian) or Class B voting shares (if the holder is Canadian) per $1,000 principal amount of Convertible Notes. This adjustment was effective on March 22, 2006 and has been determined in accordance with the terms of indenture governing the Convertible Notes.

6. POST-EMPLOYMENT EXPENSES

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

	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
Pension benefit expense	**$ 47**	$ 39	**$ 138**	$ 117
Other employee future benefit expense	**28**	35	**83**	100
Total	**$ 75**	$ 74	**$ 221**	$ 217

7. LABOUR RELATED PROVISIONS

The following table outlines the changes to labour related provisions for balances that existed upon the implementation of fresh start reporting on September 30, 2004:

	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
Beginning of period	**$ 122**	$ 167	**$ 144**	$ 180
Charges recorded in Salaries, wages & benefits	**-**	-	**-**	5
Interest accretion	**2**	3	**7**	9
Adjustment (a)	**(23)**	-	**(23)**	-
Amounts disbursed	**(12)**	(13)	**(39)**	(37)
End of period	**89**	157	**89**	157
Current portion	**(32)**	(44)	**(32)**	(44)
Long-term employee liabilities	**$ 57**	$ 113	**$ 57**	$ 113

a) During Quarter 3 2006, as a result of a review of the outstanding provisions related to programs implemented prior to September 30, 2004, it was determined that a portion of the provision amounting to $23 would no longer be required. The amount reversed has been applied against Share capital as these amounts related to plans established before the application of fresh start reporting as described in Note 20 of the 2005 annual consolidated financial statements of ACE.

The following table outlines the changes to labour related provisions for balances that have been created subsequent to the implementation of fresh start reporting on September 30, 2004:

	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
Beginning of period	**$ 42**	$ 12	**$ 13**	$ 12
Special charge for labour restructuring	**-**	-	**33**	-
Charges recorded in Salaries, wages & benefits	**4**	5	**6**	5
Interest accretion	**-**	-	**-**	-
Amounts disbursed	**(4)**	(1)	**(10)**	(1)
End of period	**42**	16	**42**	16
Current portion	**(32)**	(11)	**(32)**	(11)
Long-term employee liabilities	**$ 10**	$ 5	**$ 10**	$ 5

The current portion of labour related provisions are included in Accounts payable and accrued liabilities. The long-term portion is included in Other long-term liabilities.

In February, 2006, the Corporation announced that certain ACE companies would proceed with the reduction of non-unionized staffing levels by 20%. A special charge of $33 was recorded during Quarter 1 2006 relating to staff reductions, with $28 recorded in Air Canada Services and $5 in ACTS.

8. SHARE INFORMATION

As at September 30, 2006, the issued and outstanding common shares of ACE, along with common shares potentially issuable, pursuant to convertible preferred shares, convertible notes and stock options were as follows:

		Number of shares (000)	
	Authorized	**September 30, 2006**	**December 31, 2005**
Issued and outstanding common shares			
Class A variable voting shares	unlimited	**80,142**	76,735
Class B voting shares	unlimited	**21,850**	25,059
Shares held in escrow		**-**	28
Total issued and outstanding common shares		**101,992**	101,822
Potential common shares			
Convertible preferred shares		**10,614**	10,228
Convertible notes		**7,354**	6,875
Stock options		**3,871**	3,187
Total potential common shares		**21,839**	20,290

The information presented in the table above reflects the changes in connection with the special distribution of Aeroplan units (Note 10).

Share capital and other equity summary as at September 30, 2006 (net of issue costs)

		September 30, 2006	**December 31, 2005**
Common shares	note 10	**$ 2,175**	$ 2,231
Convertible preferred shares		**117**	117
Convertible notes		**92**	92
Share capital before fresh start adjustment		**2,384**	2,440
Adjustment to shareholders' equity	note 7a	**(1,670)**	(1,693)
Share capital and other equity		**$ 714**	$ 747

9. DISPOSAL OF INTERESTS IN JAZZ

ACE completed an initial public offering of the Jazz Air Income Fund (“Jazz Fund”) on February 2, 2006. 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 (Note 5).

On February 27, 2006, following the exercise of the over-allotment option by the underwriters, the Jazz Fund issued an additional 1.5 million units at a price of $10.00 per unit for additional net proceeds of approximately $14. The Jazz Fund is an unincorporated, open-ended trust that indirectly holds 20.3% of the outstanding limited partnership units of Jazz. ACE holds the remaining 79.7% of the outstanding limited partnership units of Jazz.

Certain of the units held by the Corporation (the "Subordinated Units") representing 20% of the units issued and outstanding at the closing are subordinated. Distributions on the Subordinated Units are subordinated in favour of the non-subordinated units. Distributions (including in respect of accrued deficiencies in distributions) are only paid by Jazz on the Subordinated Units at the end of the fiscal quarter.

Under the terms of an investor liquidity agreement, the units held by ACE in Jazz, to the extent not subordinated, are exchangeable for Jazz Fund units on a one-to-one basis. The subordinated units of Jazz held by ACE will become exchangeable after December 31, 2006. The exchange right expires once all units of Jazz held by ACE have been exchanged. The investor liquidity agreement also provides for registration and other liquidity rights that enable it to require the Jazz Fund to file a prospectus and otherwise assist with a public offering subject to certain restrictions.

ACE recorded a dilution gain of $220 in Quarter 1 2006 and a non-controlling interest on the statement of financial position of $10 as a result of the dilution of its interests in Jazz. The dilution gain is the net proceeds of the offering in excess of ACE’s proportionate carrying value of its investment in Jazz. In addition, a future income tax expense of $10 was recorded in Quarter 1 2006.

10. SPECIAL DISTRIBUTION OF AEROPLAN UNITS

On February 16, 2006, ACE's Board of Directors declared a special distribution of units of the Aeroplan Income Fund to ACE's shareholders. The distribution of 0.18 Aeroplan unit per Class A variable voting share, Class B voting share, and preferred share (on an as converted basis) of ACE was made as a return of capital and represents in the aggregate approximately 10.1% of the units of Aeroplan Income Fund on a fully diluted basis. The record date for the purpose of the special distribution was March 3, 2006. Based on the closing price of the units of Aeroplan Income Fund on March 3, 2006, the fair value of the units distributed amounted to $251.

Units of Aeroplan could not be distributed to shareholders of ACE that were resident in the United States. A total of 7,085,111 units of Aeroplan Income Fund, representing those Aeroplan units that would have otherwise been delivered to shareholders of ACE that were resident in the United States, as well as those units of Aeroplan that would have otherwise been delivered to the registered shareholders of ACE holding less than 200 shares in the capital of ACE and any fractional interests in units of Aeroplan, were sold through an orderly sale process on the Toronto Stock Exchange and the net cash proceeds of such sale of units were remitted to shareholders. A total of 20,204,165 Aeroplan units were distributed as part of the special distribution to ACE shareholders, of which 13,119,054 units were delivered to ACE shareholders and the remaining 7,085,111 units were sold on the Toronto Stock Exchange. Following the completion of the distribution, and the funding of Aeroplan's Initial Long Term Incentive Plan as described below, ACE's direct interest in Aeroplan is 75.3% and Aeroplan Income Fund's interest is 24.7%.

The special distribution to Class A and Class B shareholders totaling 18,347,309 Aeroplan units is a non-monetary non-reciprocal transfer to owners. Non-monetary non-reciprocal transfers to owners are recorded at the carrying amount of the net assets transferred and do not give rise to a gain or loss. As Aeroplan is in a deficit position, in these consolidated financial statements, no amounts have been reflected for this element of the distribution, other than accounting entries relating to future income taxes described below.

The special distribution to preferred shareholders of ACE totaled 1,856,856 Aeroplan units. This transaction is considered a non-reciprocal transfer to non-owners since the holders of the Convertible Preferred Shares are not considered owners of the Corporation for accounting purposes. The transfer is measured at fair value at the date of distribution and results in net interest expense of $4 recorded in Quarter 1 2006 and a reduction to intangible assets of $4 as a result of the dilution of interests. The net interest expense of $4 is the fair value of the distribution of $23 less a gain recorded of $19, which is the fair value of the distribution in excess of the Corporation's proportionate carrying value of its investment in Aeroplan of $4 (including fair value adjustments recorded on consolidation).

The special distribution has no cash tax consequences. However, the distribution involves a use of loss carry forwards in ACE giving rise to a reduction in future income tax assets of $65. $59 relates to the distribution to the Class A and Class B shareholders which is recorded as a reduction in Share capital and Intangible assets in accordance with the Corporation's accounting policy on income taxes. The remaining $6 relating to the distribution to preferred shareholders is recorded as a future income tax expense in the statement of operations in Quarter 1 2006.

In accordance with the terms of the ACE Convertible Senior Notes, the special distribution and return of capital triggers a conversion rate adjustment (Note 5). This change in the conversion rate did not have any accounting consequences. Similarly, the Corporation's stock option plan provides for amendments to the option exercise price and the number of common shares to which participants are entitled to exercise. Effective March 22, 2006 the adjustment was applied to all unexercised ACE stock options as of March 1, 2006, whether vested or not. As at the adjustment date, the weighted average exercise price and number of options outstanding had been amended from $25.54 and 3,131,946 options to $23.87 and 3,350,193 options.

Initial Long Term Incentive Plan – Aeroplan

On March 31, 2006 ACE exchanged on a 1:1 basis 500,000 of its Aeroplan Limited Partnership units into Aeroplan Income Fund units ("Fund Units"). The Aeroplan Income Fund units were transferred to a trust for the purpose of funding the Initial Long Term Incentive Plan of Aeroplan. The transfer is recorded at the carrying amount of the net assets transferred and does not give rise to a gain or loss. Under the terms of the plan 50% of the Units granted are subject to vesting conditions based on performance and the remaining 50% based on time. Performance based Units vest at the end of each performance period if distributable income targets established by Aeroplan's board of directors for each of the periods ended December 31, 2005, 2006 and 2007 are met, or on a cumulative basis at the end of the following performance period if such targets are met in that following performance period. Time based Units vest at the end of the three year period ending on June 29, 2008. Forfeited units that do not meet the vesting conditions and accumulated distributions thereon accrue back to ACE.

11. SEGMENT INFORMATION

The Corporation revised its internal financial reporting structure during the period, which results in a change to the reportable segments. As a result of the change, the Corporation has four reportable segments: Air Canada Services, Aeroplan, Jazz, and ACTS. The Air Canada Services segment is comprised of the entities previously included within the Transportation Services segment with the exception that the activities of ACE and certain consolidation adjustments, are now included within CIE. As a result of these changes, the comparative segment disclosures have been restated to reflect the current reportable segment structure.

CIE includes the corporate, financing and investing activities of ACE. CIE also includes certain consolidation adjustments related to revenue recognition differences amongst the operating segments. These consolidation adjustments are related to the timing of recognition and the presentation of revenue related to Aeroplan redemptions and the timing of revenue recognition related to maintenance services provided by ACTS (completed contract for engine and component maintenance services) versus the expense recognition in Air Canada and Jazz, which is as the work is completed. CIE also records the non-controlling interest related to ACE's investment in Aeroplan and Jazz. Future income taxes are recorded within the applicable taxable entities and are not allocated to non-taxable entities.

The Aeroplan consolidation adjustments recorded within CIE relate mainly to the revenue recognition timing difference from when Aeroplan records revenues, which is at the time a Mile is redeemed for travel, to the consolidated accounting policy of revenue recognition at the time reward transportation is provided. In addition, Aeroplan records revenue from the redemption of Miles in Other revenue, whereas on the consolidated financial statements, Miles redeemed for travel on Air Canada and Jazz are recorded in Passenger revenue. This results in an elimination of certain Aeroplan Other revenue amounts within CIE to reflect the consolidated recognition of Aeroplan Miles redeemed for travel on Air Canada and Jazz within Passenger revenue. This also results in an adjustment to passenger revenue recorded within CIE. In the Aeroplan segment information, the cost to Aeroplan of purchasing rewards is recorded in other operating expenses.

For the nine months ended September 30, 2006, there have been no changes in accounting policies for each of these segments, with the exception of the policy on stock-based compensation for employees eligible to retire before the vesting period which is described in Note 1 to these interim financial statements. Segment financial information has been prepared consistent with how financial information is produced internally for the purposes of making operating decisions. Segments negotiate transactions between each other as if they were unrelated parties. A reconciliation of the total amounts reported by each segment to the applicable amounts in the consolidated financial statements follows:

	Three months ended September 30, 2006					
	Air Canada Services	Aeroplan	Jazz	ACTS	CIE	Consolidated Total
Passenger revenue	$ 2,552	$ -	$ -	$ -	$ 12	$ 2,564
Cargo revenue	157	-	-	-	-	157
Other revenue	104	176	1	63	(118)	226
External revenue	2,813	176	1	63	(106)	2,947
Inter-segment revenue	41	2	368	138	(549)	-
	2,854	178	369	201	(655)	2,947
Special charge for Aeroplan miles	(102)	-	-	-	-	(102)
Total revenues	**2,752**	**178**	**369**	**201**	**(655)**	**2,845**
Salaries, wages, and benefits	461	20	78	82	-	641
Aircraft fuel	762	-	85	-	(85)	762
Aircraft rent	74	-	35	-	(1)	108
Airport user fees	276	-	49	-	(50)	275
Aircraft maintenance materials and supplies	166	-	26	47	(139)	100
Depreciation of property and equipment	110	-	5	2	-	117
Amortization of intangible assets	14	3	-	3	5	25
Commissions	61	-	-	-	-	61
Capacity purchase fees paid to Jazz	226	-	-	-	(226)	-
Special charge for labour restructuring	-	-	-	-	-	-
Other operating expenses	472	122	52	62	(155)	553
Total operating expenses	**2,622**	**145**	**330**	**196**	**(651)**	**2,642**
Operating income (loss)	**130**	**33**	**39**	**5**	**(4)**	**203**
Interest income	21	5	2	-	5	33
Interest expense	(78)	(4)	(2)	(4)	(6)	(94)
Gain on sale of US Airways shares	-	-	-	-	52	52
Gain (loss) on disposal	1	-	-	-	(5)	(4)
Other non-operating income (expense)	3	-	-	-	(2)	1
Non-controlling interest	(1)	-	-	-	(18)	(19)
Foreign exchange gain (loss)	(3)	-	-	-	-	(3)
Recovery of (provision for) income taxes	(29)	-	-	-	(37)	(66)
Segment results / income (loss)	**$ 44**	**$ 34**	**$ 39**	**$ 1**	**$ (15)**	**$ 103**

	Three months ended September 30, 2005 (restated)					
	Air Canada Services	Aeroplan	Jazz	ACTS	CIE	Consolidated Total
Passenger revenue	$ 2,455	$ -	$ -	$ -	$ 6	$ 2,461
Cargo revenue	162	-	-	-	-	162
Other revenue	108	153	1	62	(114)	210
External revenue	2,725	153	1	62	(108)	2,833
Inter-segment revenue	32	3	273	136	(444)	-
Total revenues	**2,757**	**156**	**274**	**198**	**(552)**	**2,833**
Salaries, wages, and benefits	470	17	66	84	(2)	635
Aircraft fuel	675	-	52	-	(52)	675
Aircraft rent	90	-	22	-	-	112
Airport user fees	259	-	35	-	(35)	259
Aircraft maintenance materials and supplies	149	-	14	40	(123)	80
Depreciation of property and equipment	85	-	4	2	-	91
Amortization of intangible assets	15	2	-	3	4	24
Commissions	68	-	-	-	-	68
Capacity purchase fees paid to Jazz	183	-	-	-	(183)	-
Other operating expenses	491	116	43	54	(136)	568
Total operating expenses	**2,485**	**135**	**236**	**183**	**(527)**	**2,512**
Operating income (loss)	**272**	**21**	**38**	**15**	**(25)**	**321**
Interest income	15	3	-	-	2	20
Interest expense	(64)	(3)	(4)	(3)	(2)	(76)
Gain (loss) on disposal	(1)	-	3	-	-	2
Other non-operating income (expense)	18	(1)	-	-	(1)	16
Non-controlling interest	(3)	-	-	-	(6)	(9)
Foreign exchange gain (loss)	126	-	-	-	(1)	125
Recovery of (provision for) income taxes	(123)	-	-	-	(5)	(128)
Segment results / income (loss)	**$ 240**	**$ 20**	**$ 37**	**$ 12**	**$ (38)**	**$ 271**

	Nine months ended September 30, 2006					
	Air Canada Services	Aeroplan	Jazz	ACTS	CIE	Consolidated Total
Passenger revenue	$ 6,816	$ -	$ -	$ -	$ 57	$ 6,873
Cargo revenue	460	-	-	-	-	460
Other revenue	420	554	5	164	(363)	780
External revenue	7,696	554	5	164	(306)	8,113
Inter-segment revenue	128	7	1,024	463	(1,622)	-
	7,824	561	1,029	627	(1,928)	8,113
Special charge for Aeroplan miles	(102)	-	-	-	-	(102)
Total revenues	**7,722**	**561**	**1,029**	**627**	**(1,928)**	**8,011**
Salaries, wages, and benefits	1,373	58	229	246	13	1,919
Aircraft fuel	1,961	-	216	1	(216)	1,962
Aircraft rent	239	-	100	-	(5)	334
Airport user fees	750	-	132	-	(132)	750
Aircraft maintenance materials and supplies	563	-	71	178	(465)	347
Depreciation of property and equipment	316	-	16	4	2	338
Amortization of intangible assets	40	11	-	10	9	70
Commissions	188	-	-	-	-	188
Capacity purchase fees paid to Jazz	647	-	-	-	(647)	-
Special charge for labour restructuring	28	-	-	5	-	33
Other operating expenses	1,498	389	154	197	(490)	1,748
Total operating expenses	**7,603**	**458**	**918**	**641**	**(1,931)**	**7,689**
Operating income (loss)	**119**	**103**	**111**	**(14)**	**3**	**322**
Interest income	58	14	4	-	8	84
Interest expense	(225)	(11)	(7)	(12)	(18)	(273)
Gain on sale of US Airways shares	-	-	-	-	152	152
Gain (loss) on disposal	4	-	-	-	(4)	-
Dilution gain	-	-	-	-	220	220
Other non-operating income (expense)	24	(1)	-	1	2	26
Non-controlling interest	(9)	-	-	-	(44)	(53)
Foreign exchange gain (loss)	119	-	-	(1)	(1)	117
Recovery of (provision for) income taxes	(20)	-	-	-	(118)	(138)
Segment results / income (loss)	**$ 70**	**$ 105**	**$ 108**	**$ (26)**	**$ 200**	**$ 457**

	Nine months ended September 30, 2005 (restated)					
	Air Canada Services	Aeroplan	Jazz	ACTS	CIE	Consolidated Total
Passenger revenue	$ 6,248	$ -	$ 1	$ -	$ 51	$ 6,300
Cargo revenue	444	-	-	-	-	444
Other revenue	426	478	3	148	(331)	724
External revenue	7,118	478	4	148	(280)	7,468
Inter-segment revenue	120	8	715	414	(1,257)	-
Total revenues	**7,238**	**486**	**719**	**562**	**(1,537)**	**7,468**
Salaries, wages, and benefits	1,394	52	190	223	11	1,870
Aircraft fuel	1,620	-	115	-	(115)	1,620
Aircraft rent	251	-	52	-	(3)	300
Airport user fees	702	-	87	-	(87)	702
Aircraft maintenance materials and supplies	513	-	50	118	(418)	263
Depreciation of property and equipment	253	-	14	6	-	273
Amortization of intangible assets	44	5	-	10	16	75
Commissions	206	-	-	-	-	206
Capacity purchase fees paid to Jazz	499	-	-	-	(499)	-
Other operating expenses	1,474	357	116	150	(427)	1,670
Total operating expenses	**6,956**	**414**	**624**	**507**	**(1,522)**	**6,979**
Operating income (loss)	**282**	**72**	**95**	**55**	**(15)**	**489**
Interest income	34	2	1	-	10	47
Interest expense	(196)	(3)	(13)	(10)	(6)	(228)
Dilution gain	-	-	-	-	190	190
Gain (loss) on disposal	(1)	-	3	-	-	2
Other non-operating income (expense)	25	-	-	-	(33)	(8)
Non-controlling interest	(11)	-	-	-	(5)	(16)
Foreign exchange gain (loss)	58	-	-	-	(1)	57
Recovery of (provision for) income taxes	(76)	-	-	-	(94)	(170)
Segment results / income (loss)	**$ 115**	**$ 71**	**$ 86**	**$ 45**	**$ 46**	**$ 363**

Geographic Information

Passenger revenues	Three months ended September 30 2006	2005	Nine months ended September 30 2006	2005
Canada	**$ 1,045**	$ 1,000	**$ 2,801**	$ 2,593
US Transborder	**457**	398	**1,404**	1,176
Atlantic	**616**	635	**1,435**	1,365
Pacific	**310**	302	**735**	715
Other	**136**	126	**498**	451
Total passenger revenues	**$ 2,564**	**$ 2,461**	**$ 6,873**	**$ 6,300**

Cargo revenues	Three months ended September 30 2006	2005	Nine months ended September 30 2006	2005
Canada	**$ 32**	$ 32	**$ 88**	$ 94
US Transborder	**6**	7	**21**	24
Atlantic	**55**	54	**164**	161
Pacific	**55**	59	**157**	134
Other	**9**	10	**30**	31
Total cargo revenues	**$ 157**	**$ 162**	**$ 460**	**$ 444**

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 an origin or destination principally in Europe. Pacific refers to flights that cross the Pacific Ocean with an origin or destination principally in Asia.

Other revenues are principally provided to customers located in Canada.

Balance Sheet Information

	September 30, 2006					
	Air Canada Services	Aeroplan	Jazz	ACTS	CIE	Consolidated Total
Cash and cash equivalents	**$ 1,006**	**$ 282**	**$ 124**	**$ -**	**$ 335**	**$ 1,747**
Short-term investments	**416**	**281**	**-**	**-**	**442**	**1,139**
	1,422	**563**	**124**	**-**	**777**	**2,886**
Additions to capital assets	**658**	**15**	**18**	**1**	**-**	**692**
Total assets	**$ 10,324**	**$ 777**	**$ 479**	**$ 437**	**$ 576**	**$ 12,593**

	December 31, 2005					
	Air Canada Services	Aeroplan	Jazz	ACTS	CIE	Consolidated Total
Cash and cash equivalents	$ 1,000	$ 366	$ 34	$ -	$ 165	$ 1,565
Short-term investments	302	99	-	-	215	616
	1,302	465	34	-	380	2,181
Additions to capital assets	849	12	16	5	-	882
Total assets	$ 9,995	$ 674	$ 504	$ 381	$ 293	$ 11,847

The total assets of CIE is net of the intercompany eliminations between each of the four segments and ACE.

12. RECONCILIATION OF CANADIAN GAAP TO UNITED STATES GAAP

The consolidated financial statements of the Corporation have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"), which differ in certain respects from accounting principles generally accepted in the United States ("US GAAP"). The following table represents the significant reconciling items between US GAAP and Canadian GAAP. For a complete discussion of US and Canadian GAAP differences, refer to Note 23 to the 2005 annual consolidated financial statements of ACE and Sub-Note 3 below.

(Canadian dollars – millions except per share data)

	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
Income for the period in accordance with Canadian GAAP	**$ 103**	$ 271	**$ 457**	$ 363
Convertible securities (1)	**(49)**	56	**4**	14
Derivative instruments (2)	**(100)**	-	**(14)**	-
Jazz dilution gain reduction (3)	**-**	-	**(41)**	-
Interest expense (4)	-	-	**4**	-
Stock-based compensation (5)	**(3)**	(1)	**(6)**	(2)
Aircraft lease expense (6)	**(1)**	-	**(2)**	-
Aeroplan dilution gain reduction (7)	**-**	-	**-**	(82)
Labour related provisions (8)	**23**	-	**23**	-
Amortization of intangible assets	**(2)**	-	**(6)**	(1)
Income adjustments for the period before the following	**(132)**	55	**(38)**	(71)
Income tax adjustment	**27**	(2)	**7**	18
Respective period income adjustments	**(105)**	53	**(31)**	(53)
Income (loss) for the period in accordance with US GAAP	**$ (2)**	$ 324	**$ 426**	$ 310
Minimum pension liability adjustment (a)	**(14)**	238	**126**	(121)
Available-for-sale securities (a), (9)	**(44)**	36	**(96)**	36
Comprehensive income (loss) for the period in accordance with US GAAP	**$ (60)**	$ 598	**$ 456**	$ 225
Earnings (loss) per share - US GAAP (10)				
- Basic	**$ (0.06)**	$ 3.16	**$ 4.05**	$ 3.08
- Diluted	**$ (0.06)**	$ 2.75	**$ 3.68**	$ 2.83

(a) All items in Other Comprehensive Income are shown net of tax.

		September 30 , 2006		December 31, 2005
Deferred charges				
Balance under Canadian GAAP	$	122	$	145
Deferred finance charges (1,6)		(5)		(2)
Balance under US GAAP	$	117	$	143
Goodwill				
Balance under Canadian GAAP	$	-	$	-
Goodwill (3,4)		1,159		1,452
Balance under US GAAP	$	1,159	$	1,452
Intangible assets				
Balance under Canadian GAAP	$	2,193	$	2,462
Convertible preferred shares (4)		4	$	-
Goodwill		369		146
Balance under US GAAP	$	2,566	$	2,608
Other assets				
Balance under Canadian GAAP	$	329	$	392
Derivative instruments		(5)		(11)
Available-for-sale securities (9)		16		130
Balance under US GAAP	$	340	$	511
Accounts payable and other liabilities				
Balance under Canadian GAAP	$	1,532	$	1,355
Derivative insturments		20		-
Balance under US GAAP	$	1,552	$	1,355
Long-term debt and capital leases				
Balance under Canadian GAAP	$	3,643	$	3,543
Convertible securities		18		22
Balance under US GAAP	$	3,661	$	3,565
Convertible preferred shares				
Balance under Canadian GAAP	$	161	$	148
Reclassification of preferred shares		(161)		(148)
Balance under US GAAP	$	-	$	-
Pension and other benefit liabilities				
Balance under Canadian GAAP	$	2,006	$	2,154
Minimum pension liability adjustment		56		246
Balance under US GAAP	$	2,062	$	2,400
Future income taxes				
Balance under Canadian GAAP	$	180	$	221
Goodwill		44		22
Balance under US GAAP	$	224	$	243
Other long-term liabilities				
Balance under Canadian GAAP	$	401	$	446
Convertible preferred shares - embedded derivative		163		165
Convertible notes - embedded derivative		78		64
Balance under US GAAP	$	642	$	675
Temporary equity				
Balance under Canadian GAAP	$	-	$	-
Goodwill		195		182
Balance under US GAAP	$	195	$	182

	September 30, 2006	December 31, 2005
Shareholders' equity		
Share capital and other equity		
Balance under Canadian GAAP	**$ 714**	$ 747
Reclassification of convertible preferred shares and convertible notes	**(209)**	(209)
Future income tax (4)	**(6)**	-
Goodwill recorded at fresh-start	**1,596**	1,596
Labour related provisions (8)	**(23)**	-
Balance under US GAAP	**$ 2,072**	$ 2,134
Contributed Surplus		
Balance under Canadian GAAP	**$ 26**	$ 19
Stock-based compensation (5)	**(7)**	(13)
Balance under US GAAP	**$ 19**	$ 6
Retained Earnings		
Balance under Canadian GAAP	**$ 859**	$ 402
Convertible securities	**(33)**	(20)
Current year income adjustments	**(31)**	(51)
Cumulative prior year adjustments:		
Stock-based compensation (5)	**13**	16
Future income tax	**17**	(2)
Goodwill	**(94)**	-
Intangible asset amortization	**(3)**	-
Deriviative instruments	**(11)**	-
Convertible securities	**(58)**	(99)
Balance under US GAAP	**$ 659**	$ 246
Accumulated Other Comprehensive Income		
Balance under Canadian GAAP	**$ -**	$ -
Current year adjustments to comprehensive income:		
Minimum pension liability adjustment	**126**	(162)
Available-for-sale securities	**(96)**	108
Cumulative prior year adjustments to comprehensive income:		
Minimum pension liability adjustment	**(164)**	(2)
Available-for-sale securities	**108**	-
Balance under US GAAP	**$ (26)**	$ (56)
Balance under US GAAP	**$ 2,724**	$ 2,330

1. Convertible securities

Under Canadian GAAP, the convertible preferred shares issued in 2004 are presented as a compound instrument, with the value ascribed to the holder's conversion option presented in Equity less allocated fees and the remaining value ascribed to the financial liability presented as a long-term liability. Under US GAAP, the convertible preferred shares contain an embedded derivative which has been reported separately in Other long-term liabilities at its fair value and the remaining value ascribed to the convertible preferred shares less the direct costs of issuance is included in Temporary equity, as the conditions of redemption are not solely within the control of the Corporation. The adjustment to Deferred charges reflects applying the direct costs of issuance, recorded in Deferred charges under Canadian GAAP, against the amount recorded in Temporary equity under US GAAP. Under US GAAP, the changes in the fair value of the embedded derivative are included in Income and the accretion of the temporary equity to the redemption value over the period to redemption is reflected as a charge to Retained earnings. The change in the fair value of the embedded derivative includes the 5% accretion. The adjustment to Income reflects the change in fair value of the embedded derivative and the reversal of interest expense under Canadian GAAP and the adjustment to Retained earnings reflects the accretion of the temporary equity to the redemption value.

Under Canadian GAAP, the convertible notes issued in April 2005 are presented as a compound instrument with the value ascribed to the holders' conversion option less allocated fees presented in Equity and the remaining value ascribed to the financial liability presented in Long-term debt. Under US GAAP, the convertible notes contain an embedded derivative which has been reported separately in Other long-term liabilities at its fair value and the remaining value ascribed to the financial liability before costs of issuance is presented in Long-term debt. The direct costs of issuance are recorded in Deferred charges. Under US GAAP, the changes in the fair value of the embedded derivative are included in Income. The adjustment reflects the change in fair value of the embedded derivative and the difference in Interest expense.

2. Derivative financial instruments

Under US GAAP, all derivatives are recorded on the balance sheet at fair value. The Corporation and Predecessor Company have elected not to designate any derivatives as hedging instruments for US GAAP purposes and as such, changes in the fair value of all derivative instruments are recorded in income. The adjustment reflects recording of the fair value of outstanding derivative contracts that are recorded under hedge accounting under Canadian GAAP.

3. Jazz dilution gain adjustment

As described in Note 9, under Canadian GAAP, in Quarter 1 2006 ACE recorded a dilution gain of $220 as a result of the dilution of its interest in Jazz. Under US GAAP, the dilution gain is reduced by $41 due to the impact of the disposal of goodwill.

4. Special distribution of Aeroplan units

Under Canadian GAAP, as described in Note 10, during Quarter 1 2006 ACE's Board of Directors declared a special distribution of units of the Aeroplan Income Fund to ACE's shareholders. The special distribution to Class A and Class B shareholders is a non-monetary non-reciprocal transfer to owners, which is recorded at the carrying amount of the net assets transferred and does not give rise to a gain or loss. As Aeroplan LP is in a deficit position, in these consolidated financial statements, no amounts have been reflected for this element of the distribution, other than accounting entries relating to future income taxes described below.

Under Canadian GAAP, the special distribution to preferred shareholders of ACE is considered a non-reciprocal transfer to non-owners since the host instrument is classified as debt for accounting purposes. This results in net interest expense of $4 recorded in Quarter 1 2006 and a reduction to intangible assets of $4. Under US GAAP, the special distribution to preferred shareholders of ACE is considered a non-monetary non-reciprocal transfer to owners since the host instrument is classified as temporary equity for accounting purposes. Consistent with the accounting treatment of the special distribution for Class A and Class B shareholders, a non-monetary non-reciprocal transfer to owners is recorded at the carrying amount of the net assets transferred and does not give rise to a gain or loss. The adjustment under US GAAP is a reduction to net interest expense of $4 in Quarter 1 2006 and an increase to intangible assets of $4.

Under Canadian GAAP, a $65 reduction in future income tax assets was recorded in Quarter 1 2006, consisting of a $59 reduction in Share capital and Intangible assets for the portion related to the distribution to the Class A and Class B shareholders and $6 future income tax expense and reduction to Intangible assets for the portion related to the distribution to preferred shareholders. Under US GAAP, the $65 reduction in future income tax assets results in a $65 reduction of Share capital and Goodwill. The adjustment for US GAAP is a $65 increase in Intangible assets, a $65 decrease in Goodwill; a $6 decrease in future income tax expense and a $6 decrease in Share capital.

5. Stock-based compensation

Under Canadian GAAP, as described in Note 1, the Corporation has adopted EIC-162 in the period ended June 30, 2006 with restatement of prior periods. EIC-162 requires that the compensation cost for a stock option award attributable to an employee who is eligible to retire at the grant date be recognized on the grant date or for an employee who will become eligible to retire during the vesting period be recognized over the period from the grant date to the date the employee becomes eligible to retire (the "non-substantive vesting period approach").

Under US GAAP, the Corporation adopted Statement of Financial Accounting Standards ("FAS") No. 123 (revised 2004), "Share-Based Payment" ("FAS 123R") on January 1, 2006, which has the same requirements as EIC-162 under Canadian GAAP except FAS 123R is to be applied prospectively from January 1, 2006 to new option awards that have retirement eligibility provisions. The nominal vesting period approach is continued for any option awards granted prior to adopting FAS 123R and for the remaining portion of unvested outstanding options. Under US GAAP, the adjustment reflects the reversal of the charge to retained earnings of $16 as at January 1, 2005 ($13 as at January 1, 2006) an increase to Salaries, wages and benefits expense of $1 for the three months ended September 30, 2005 ($2 for the nine months ended September 30, 2005) and an increase to Salaries, wage and benefits expense of $3 for the three months ended September 30, 2006 ($6 for the nine months ended September 30, 2006), all with an offset to contributed surplus.

Under US GAAP, the impact of applying the non-substantive vesting period approach for awards granted after January 1, 2006 compared to the nominal vesting period approach is an increase to Salaries, wage and benefits expense of nil for the three month period ended September 30, 2006 ($3 for the nine month period ended September 30, 2006). The Salaries, wage and benefits expense for the nine month period ended September 30, 2006 would decrease by $4 had the non-substantive vesting period approach been applied retroactively.

6. Aircraft leases

Under Canadian GAAP, when a lease is extended and the payment terms are modified, the lessee should continue to account for the lease in accordance with the terms of the original lease contract until the original lease term expires. The difference between the modified payment and the payment under the terms of the original lease is deferred. Under US GAAP, any straight-line rent accruals and other deferred amounts should be amortized over the combined period of the remaining original lease term and the new lease term. Under US GAAP, additional aircraft lease expense of $1 has been recorded with the offset to deferred charges ($2 for the nine month period ended September 30, 2006).

7. Aeroplan dilution gain adjustment

During the course of preparing the annual 2005 consolidated financial statements, it was noted that the Aeroplan gain calculation, as reported in the three month period ended June 30, 2005, did not take into account the goodwill that is allocated to Aeroplan. As a result, the dilution gain for US GAAP purposes, previously reported at $190 less tax of $28, has been decreased by $60 to $108 less tax of $6.

As a result of this adjustment the interim periods in 2005 have been adjusted. As the income for the three month period ended June 30, 2005, previously reported at $142, has been restated to $82, the income for the nine month period ended September 30, 2005, previously reported at $370, has been restated to $310. This adjustment does not impact the amounts reported under Canadian GAAP.

8. Labour related provisions

Under Canadian GAAP, as described in Note 7, a review of outstanding labour provisions implemented prior to September 30, 2004 resulted in a $23 reversal of the provision applied against Share capital. Under US GAAP, the reversal of the $23 labour related provision implemented prior to September 30, 2004 is applied to income in the current period.

9. Available-for-sale securities

Under Canadian GAAP, portfolio investments are accounted for using the cost method. Under US GAAP, portfolio investments classified as available-for-sale securities are carried at market value with unrealized gains or losses reflected as a separate component of shareholders' equity and included in comprehensive income. Under US GAAP, an unrealized loss of $3 less tax of $1 ($30 unrealized gain less tax of $5 for the nine month period ended September 30, 2006) has been recorded as a separate component of shareholders' equity and included in other comprehensive income, to reflect the fair value of the remaining US Airways investment of $25 ($22 at December 31, 2005). This adjustment is in addition to a decrease in other comprehensive income of $50 less tax of $8 ($145 less tax of $24 for the nine month period ended September 30, 2006) to reverse the unrealized gains previously recorded in other comprehensive income, as the gain for the disposal of 1.25 million shares in Quarter 3 2006 and 3.25 million shares in Quarter 2 2006 is realized under Canadian GAAP.

10. Earnings per share

	Three months ended September 30		Nine months ended September 30	
	2006	2005	**2006**	2005
Numerator				
Numerator for basic earnings per share:				
Income (loss)	**$ (2)**	$ 324	**$ 426**	$ 310
Accretion of convertible preference shares	**(4)**	(4)	**(13)**	(12)
Adjusted numerator for income (loss) per share	**(6)**	320	**413**	298
Effect of potential dilutive securities:				
Convertible preferred shares	**4**	4	**13**	12
Convertible notes	**6**	5	**18**	9
Add back anti-dilutive impact	**(10)**	-	**-**	-
Adjusted income (loss) for diluted earnings per share	**(6)**	329	**444**	319
Denominator				
Denominator for basic earnings per share:				
Weighted-average shares	**102**	101	**102**	97
Effect of potential dilutive securities:				
Convertible preferred shares	**1**	1	**1**	2
Convertible notes	**11**	10	**11**	10
Stock options	**7**	7	**7**	4
Add back anti-dilutive impact	**(19)**	-	**-**	-
Denominator for diluted earnings per share:				
Adjusted weighted-average shares	**102**	119	**121**	113
Basic earnings (loss) per share	**$ (0.06)**	$ 3.16	**$ 4.05**	$ 3.08
Diluted earnings (loss) per share	**$ (0.06)**	$ 2.75	**$ 3.68**	$ 2.83

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.

11. Pension and other benefit plans

The components of US GAAP net periodic cost of defined benefit plans include the following:

	Three months ended September 30			
	Pension Benefits		Other Benefits	
	2006	2005	**2006**	2005
Service cost	**$ 65**	$ 51	**$ 20**	$ 24
Interest cost	**160**	162	**12**	12
Expected return on plan assets	**(185)**	(174)	**-**	-
Amortization of prior service cost	**-**	-	**-**	-
Amortization of net transition obligation	**-**	-	**-**	-
Amortization of experience (gains) losses	**5**	-	**(4)**	(1)
Total	**$ 45**	$ 39	**$ 28**	$ 35

	Nine months ended September 30			
	Pension Benefits		Other Benefits	
	2006	2005	**2006**	2005
Service cost	**$ 193**	$ 150	**$ 61**	$ 66
Interest cost	**481**	488	**36**	37
Expected return on plan assets	**(554)**	(521)	**(1)**	-
Amortization of prior service cost	**-**	-	**-**	-
Amortization of net transition obligation	**-**	-	**-**	-
Amortization of experience (gains) losses	**13**	-	**(13)**	(3)
Total	**$ 133**	$ 117	**$ 83**	$ 100

As of September 30, 2006 the Corporation had contributed $308 to its defined benefit pension plans. The Corporation expects to contribute an additional $116 during the remainder of 2006.

12. New accounting policies

Guidance on application of Variable Interest Entity standard

In April 2006, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FIN 46(R)-6, “Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)”, which provides additional clarification on how to determine the variability to be considered in applying FASB Interpretation No.46 (revised December 2003), “Consolidation of Variable Interest Entities.” FSP FIN46(R)-6 is effective prospectively to all entities with which the enterprise first becomes involved and to all entities previously considered when a reconsideration event has occurred beginning the first day of the first reporting period beginning after June 15, 2006. The Corporation adopted this standard as of Quarter 3 2006.

Accounting for certain hybrid financial instruments

In February 2006, the FASB issued FASB Statement 155, “Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statement No. 133 and 140” (“FAS155”), which permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, with changes in fair value recognized in earnings. The fair-value election will eliminate the need to separately recognize certain derivatives embedded in hybrid financial instruments under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. FAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity’s first fiscal year that begins after September 15, 2006. The Corporation will adopt this standard as of Quarter 1 2007 and is in the process of assessing the impact of adopting this standard on the consolidated financial position and results of operations.

Accounting for uncertainty in income taxes

In June 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109” (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes.” The interpretation prescribes a recognition threshold and measurement attribute for the financial statement accounting guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Corporation will adopt this standard as of Quarter 1 2007 and is in the process of assessing the impact of adopting this standard on the consolidated financial position and results of operations.

Accounting for defined benefit pension and other postretirement plans

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132 (R)” (“FAS 158”). FAS 158 requires an employer to (i) recognize the overfunded or underfunded status of a defined benefit plan (other than a multiemployer plan) as an asset or liability with changes in that funded status recognized through comprehensive income; and (ii) measure the funded status of a plan as of the year-end date. FAS 158 also specifies additional disclosure requirements. The US GAAP requirement to initially recognize the funded status of a defined benefit plan and to provide the required disclosures is effective as of the end of the fiscal year ending after December 15, 2006. The US GAAP requirement to measure plan assets and benefit obligations as of the date of the employer’s fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. FAS 158 requires prospective application with the transition asset or liability to be recognized in accumulated other comprehensive income in shareholders’ equity.

Under Canadian GAAP, the over or under funded status of defined benefit plans are not recognized in the statement of financial position, nor does Canadian GAAP currently require the recognition of other comprehensive income. Under Canadian GAAP, the overfunded or underfunded status of a plan is included in the notes to the financial statements in the form of a reconciliation of the overfunded or underfunded status to amounts recognized in an employer's statement of financial position. This will result in a US and Canadian GAAP difference for the year ending December 31, 2006.

The impact that the adoption of this new statement will have on ACE's US GAAP statement of financial position cannot be reasonably estimated, as the fair value of the pension plans' assets and obligations will not be readily available until the end of the year. However, it is anticipated that adoption of this new statement will result in the recognition of a liability for the unfunded pension obligation and an associated future tax asset, although it is not expected to impact reported US GAAP net income. Based on information as at December 31, 2005, the unfunded liability would have been $1,061.

13. FINANCIAL INSTRUMENTS

Fuel Price Risk Management

The Corporation enters into contracts with financial intermediaries to manage its exposure to jet fuel price volatility.

During Quarter 2 2006, the Corporation entered into two three-way collar option structures that have two call strike prices within each option, which puts a ceiling on the potential benefit to be realized by the Corporation if commodity prices increase above the threshold of the second call strike price. Due to the ceiling in these derivative instruments, this type of derivative does not qualify as a hedging instrument under GAAP. As at September 30, 2006, the fair value of these derivative instruments was $1 in favour of the counterparty and is recorded in Accounts payable and accrued liabilities on the consolidated statement of financial position. The Corporation has recognized a net loss of $2 in non-operating expense during Quarter 3 2006 (net loss of $1 since inception of these instruments in Quarter 2 2006).

Interest Rate Risk Management

Air Canada
Air Canada enters into interest rate swaps to manage the risks associated with interest rate movement on US and Canadian floating rate debt and deposits.

During Quarter 2 2006, Air Canada entered into 19 interest rate swaps with a nominal 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 November 2007. 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 did not apply hedge accounting to these derivative instruments.

Before September 30, 2006, four of these swaps were settled resulting in a net loss of $2. As at September 30, 2006, the fair value of the remaining 15 swaps was $14 in favour of the counterparty and is recorded in Other long-term liabilities on the consolidated statement of financial position. The Corporation has recognized a net loss of $12 in non-operating expense during Quarter 3 2006 (net loss of $14 since inception of these swaps in Quarter 2 2006).

Jazz
During Quarter 1 2006, Jazz entered into interest rate swaps to hedge its exposure to changes in interest rates (Note 5). Effective February 2, 2006, the Corporation is applying hedge accounting to these derivative instruments and no amount is recorded in these financial statements. As at September 30, 2006, the fair value of these swaps was $1 in favour of the counterparty.

14. CONTINGENCIES

U.S. DoJ Cargo Investigation

The European Commission, the United States Department of Justice (the "U.S. DoJ") and the Competition Bureau in Canada, among other competition authorities, are investigating alleged anti-competitive Cargo pricing activities, including certain fuel surcharges levied by a number of airlines and other Cargo operators. The U.S. DoJ has sought information from Air Canada as part of its investigation. Air Canada is cooperating fully with this investigation.

In addition, Air Canada is 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. It is not possible at this time to predict, with any degree of certainty, the outcome of these proceedings.

It is Air Canada's policy to conduct its business in full compliance with all applicable competition laws.

15. SUBSEQUENT EVENTS

Plan of arrangement and initial distribution of units of Aeroplan Income Fund

At a special meeting of shareholders on October 5, 2006, the shareholders of the Corporation approved a statutory arrangement pursuant to the Canada Business Corporations Act. On October 6, 2006, the Québec Superior Court has issued a final order approving the statutory arrangement, which became effective October 10, 2006. The arrangement grants authority to the board of directors of ACE to make from time to time one or more special distributions to ACE shareholders in an aggregate amount of up to $2 billion by way of reduction of the stated capital of the Class A variable voting shares, Class B voting shares and the preferred shares of ACE.

ACE intends, subject to the ACPA claim below, to proceed with an initial distribution of units of Aeroplan Income Fund under the plan of arrangement representing a portion of its interest in Aeroplan. The terms of the distribution, including the number of Aeroplan units to be distributed per Class A variable voting share, Class B share and preferred share (on an as-converted basis) of ACE, the record date to determine the ACE shareholders eligible to participate in such distribution and the anticipated payment date will be announced by subsequent news release after receipt of the tax ruling or opinion.

Due to restrictions applicable to Aeroplan Income Fund pursuant to United States securities legislation, U.S. shareholders will receive Aeroplan units only if they complete and submit a certification attesting that they are "qualified purchasers" for the purposes of the United States Investment Company Act of 1940 and institutional "accredited investors" for the purposes of Rules 501(a)(1), (2), (3) or (7) of Regulation D under the United States Securities Act of 1933. United States shareholders that do not satisfy such requirements or that do not submit a properly completed certification on or prior to a date to be specified by subsequent news release will receive the net cash proceeds of the sale on their behalf of the Aeroplan units which such shareholders would otherwise have been entitled to receive.

The Air Canada Pilots Association (“ACPA”) has commenced proceedings before the Ontario Superior Court of Justice against Air Canada, ACE and members of the Board of Directors of Air Canada alleging that certain past and future actions are oppressive to them. A variety of remedies have been sought against the parties seeking, among other things, limits on corporate distributions including those contemplated under the ACE plan of arrangement described above, which became effective on October 10, 2006, and restrictions on Air Canada’s ability to effect certain Corporate reorganization transactions to be made in connection with the offering of shares in the capital of Air Canada, including some of those described above. The claim was served on October 4, 2006. Management is of the view that the claim is without merit and will be defended. The interim injunction is scheduled to be heard in late December 2006.

Air Canada Initial Public Offering

On October 16, 2006 the Corporation and Air Canada filed a preliminary prospectus with all securities regulatory authorities throughout Canada for an initial public offering of shares in Air Canada (the “Offering”). The proposed Offering, of approximately $400, consists of $200 in variable voting shares and voting shares being issued and sold by Air Canada (the “Treasury Shares”) and $200 in a secondary offering of variable voting shares and voting shares being sold by ACE (the “Secondary Shares”), prior to any exercise of the 15% over-allotment option.

The securities offered have not been, and will not be, registered under the United States Securities Act of 1933, as amended, and may not be offered or sold in the United States absent registration or any applicable exemption from the registration requirement of such Act.

A corporate restructuring is planned to occur in connection with the initial public offering of common shares of Air Canada. Under the planned corporate restructuring, Air Canada Cargo and Air Canada Ground Handling are expected to become subsidiaries of Air Canada and ACE will transfer a 51 percent ownership in Air Canada Vacations to Air Canada. Jazz, Aeroplan and ACTS will remain subsidiaries of ACE. Preferred units in ACTS, which are held by Air Canada, will be purchased by ACE for proceeds of $672 million.

Upon completion of the offering of Air Canada shares and satisfaction of certain customary conditions, the revolving credit facility of Air Canada, as described in Note 5, will be amended and restated. The amended agreement will establish a $400 million senior secured revolving credit facility with a three-year term. In accordance with the provisions of the facility, the term may be consensually extended for additional one-year periods on each anniversary of the closing of the offering. The amended credit facility will contain customary representations and warranties and will be subject to customary terms and conditions (including negative covenants, financial covenants and events of default).