ACE AVIATION

Quarter 2 2007
Interim Unaudited
Consolidated Financial Statements
and Notes

August 9, 2007

Consolidated Statement of Operations

Unaudited (Canadian dollars in millions except per share figures)		Three Months Ended June 30 2007*	Three Months Ended June 30 2006	Six Months Ended June 30 2007*	Six Months Ended June 30 2006
Operating revenues					
Passenger		$ 2,336	$ 2,288	$ 4,488	$ 4,309
Cargo		135	152	275	303
Other		188	242	521	554
		2,659	2,682	5,284	5,166
Operating expenses					
Wages, salaries and benefits		626	636	1,324	1,278
Aircraft fuel		637	631	1,222	1,200
Aircraft rent		91	113	195	226
Airport and navigation fees		256	245	499	475
Aircraft maintenance, materials and supplies		121	118	263	247
Communications and information technology		69	69	145	147
Food, beverages and supplies		81	82	164	162
Depreciation, amortization and obsolescence		149	140	295	274
Commissions		51	59	110	127
Capacity purchase with Jazz		76	-	76	-
Special charge for labour restructuring	note 6	6	-	15	33
Other		400	408	909	878
		2,563	2,501	5,217	5,047
Operating income		**96**	**181**	**67**	**119**
Non-operating income (expense)					
Interest income		28	29	61	51
Interest expense		(96)	(91)	(219)	(179)
Interest capitalized		28	13	64	22
Aeroplan equity investment income	note 2	17	-	20	-
Jazz equity investment income	note 3	7	-	7	-
Dilution gain – Jazz		-	-	-	220
Gain on sale of US Airways shares		4	100	4	100
Gain on disposal of assets	note 11	14	1	21	4
Gain (loss) on financial instruments recorded at fair value	note 7	(6)	(1)	28	(3)
Other		(1)	1	(1)	6
		(5)	52	(15)	221
Income before the following items		91	233	52	340
Non-controlling interest		(56)	(19)	(79)	(34)
Foreign exchange gain		158	107	191	120
Provision for income taxes	note 8				
Current		-	-	(6)	-
Future		(75)	(85)	(112)	(72)
Income for the period		**$ 118**	**$ 236**	**$ 46**	**$ 354**
Earnings per share					
Basic		$ 1.14	$ 2.32	$ 0.45	$ 3.47
Diluted		$ 0.98	$ 2.05	$ 0.44	$ 3.16

The accompanying notes are an integral part of the interim consolidated financial statements.
**Effective March 14, 2007 the results and financial position of Aeroplan LP and effective May 24, 2007 the results and financial position of Jazz LP are not consolidated within ACE (Note 1).*

Consolidated Statement of Financial Position

Unaudited (Canadian dollars in millions)		June 30 2007*	December 31 2006
ASSETS			
Current			
Cash and cash equivalents		$ 1,041	$ 1,854
Short-term investments		1,061	1,324
		2,102	3,178
Restricted cash		33	109
Accounts receivable		794	729
Spare parts, materials and supplies		80	307
Prepaid expenses and other current assets		136	127
Future income taxes	note 8	342	584
ACTS assets held for sale	note 13	296	-
		3,783	5,034
Property and equipment		6,594	5,989
Deferred charges		56	116
Intangible assets		832	1,643
Deposits and other assets		334	323
Future income taxes	note 8	24	336
ACTS assets held for sale	note 13	215	-
		$ 11,838	**$ 13,441**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,260	$ 1,547
Advance ticket sales		1,370	832
Current portion of Aeroplan Miles obligation	note 2	59	58
Current portion of Aeroplan deferred revenues	note 2	-	799
Current portion of long-term debt and capital leases	note 4	440	367
Current taxes payable	note 8	-	345
ACTS current liabilities held for sale	note 13	105	-
		3,234	3,948
Long-term debt and capital leases	note 4	3,438	3,759
Convertible preferred shares		172	166
Future income taxes	note 8	94	136
Pension and other benefit liabilities		1,887	1,876
Aeroplan Miles obligation	note 2	57	105
Aeroplan deferred revenues	note 2	-	801
Other long-term liabilities	note 2	486	378
ACTS long-term liabilities held for sale	note 13	79	-
		9,447	11,169
Non-controlling interest		680	695
SHAREHOLDERS' EQUITY			
Share capital and other equity	note 9	336	742
Contributed surplus	note 2	516	25
Retained earnings		864	810
Accumulated other comprehensive income (loss)	note 1	(5)	-
		1,711	1,577
		$ 11,838	**$ 13,441**

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

**Effective March 14, 2007 the results and financial position of Aeroplan LP and effective May 24, 2007 the results and financial position of Jazz LP are not consolidated within ACE (Note 1).*

Consolidated Statement of Changes in Shareholders' Equity

Unaudited (Canadian dollars in millions)		Six Months Ended June 30 2007*	Year Ended December 31 2006	Six Months Ended June 30 2006
Share capital and other equity				
Common shares, beginning of period		$ 2,188	$ 2,231	$ 2,231
Distributions of Aeroplan and Jazz units	note 10	(426)	(59)	(59)
Issue of shares through stock options exercised		20	16	3
Common shares, end of period		1,782	2,188	2,175
Convertible preference shares		117	117	117
Convertible notes		92	92	92
Adjustment to shareholders' equity, beginning of period		(1,655)	(1,693)	(1,693)
Adjustment to fresh start provisions		-	38	-
Adjustment to shareholders' equity, end of period		(1,655)	(1,655)	(1,693)
Total share capital and other equity		336	742	691
Contributed surplus				
Balance, beginning of period		25	19	19
Fair value of stock options issued to Corporation employees recognized as compensation expense		8	13	4
Fair value of exercised stock options to share capital		-	(7)	-
Aeroplan negative investment	note 2	483	-	-
Total contributed surplus		516	25	23
Retained earnings				
Balance, beginning of period		810	402	402
Cumulative effect of adopting new accounting policies	note 1	8	-	-
		818	402	402
Net income for the period		46	408	354
		864	810	756
Accumulated other comprehensive income (loss)				
Balance, beginning of period		-	-	-
Cumulative effect of adopting new accounting policies	note 1	(7)	-	-
Other comprehensive income (loss)		2	-	-
		(5)	-	-
Total retained earnings and accumulated other comprehensive income (loss)		859	810	756
Total shareholders' equity		**$ 1,711**	**$ 1,577**	**$ 1,470**

Consolidated Statement of Comprehensive Income

Unaudited (Canadian dollars in millions)		Three Months Ended June 30 2007*	Three Months Ended June 30 2006	Six Months Ended June 30 2007*	Six Months Ended June 30 2006
Comprehensive income (loss)					
Net income for the period		$ 118	$ 236	$ 46	$ 354
Other Comprehensive income (loss), net of taxes:					
Net change in unrealized loss on US Airways securities	note 11	(4)	-	(8)	-
Reclassification of realized gains on US Airways securities to income	note 11	(7)	-	(7)	-
Net change in unrealized gains on fuel derivatives under hedge accounting	note 7	8	-	14	-
Reclassification of net realized losses on fuel derivatives to income	note 7	2	-	10	-
Equity adjustment from foreign currency translation	note 12	(7)	-	(7)	-
		(8)	**-**	2	**-**
Total comprehensive income		**$ 110**	**$ 236**	**$ 48**	**$ 354**

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

**Effective March 14, 2007 the results and financial position of Aeroplan LP and effective May 24, 2007 the results and financial position of Jazz LP are not consolidated within ACE (Note 1).*

Consolidated Statement of Cash Flows

Unaudited (Canadian dollars in millions)		Three Months Ended June 30 2007*	Three Months Ended June 30 2006	Six Months Ended June 30 2007*	Six Months Ended June 30 2006
Cash flows from (used for)					
Operating					
Income (loss) for the period		$ 118	$ 236	$ 46	$ 354
Adjustments to reconcile to net cash from operations					
Depreciation, amortization and obsolescence		149	140	295	274
Dilution gain – Jazz		-	-	-	(220)
Gain on sale of US Airways shares		(4)	(100)	(4)	(100)
Gain on disposal of assets	note 11	(14)	(1)	(21)	(4)
Foreign exchange gain		(154)	(134)	(187)	(130)
Future income taxes		75	86	112	71
Employee future benefit funding more than expense		(69)	(46)	(138)	(68)
Increase in accounts receivable		(75)	(127)	(93)	(143)
Decrease (increase) in spare parts, materials and supplies		(31)	(25)	3	35
Increase (decrease) in accounts payable and accrued liabilities		(144)	(43)	(39)	55
Increase (decrease) in advance ticket sales, net of restricted cash		195	183	429	401
Decrease in Aeroplan Miles obligation		(21)	(26)	(47)	(57)
Increase (decrease) in Aeroplan deferred revenues		-	28	(2)	45
Aircraft lease payments (in excess of) less than rent expense		(2)	(3)	(9)	(8)
Unrealized period change in fair value of derivatives	note 7	9	4	(32)	4
Capitalized interest		(28)	(13)	(64)	(22)
Non-controlling interest		52	16	70	21
Other		50	35	70	59
		106	**210**	**389**	**567**
Financing					
Issue of common shares		-	1	19	3
Issue of Jazz units		-	-	-	218
Aircraft related borrowings	note 4	532	98	644	222
Credit facility borrowings – Jazz		-	-	-	113
Reduction of long-term debt and capital lease obligations		(90)	(61)	(168)	(149)
Reduction of non-controlling interest	note 4	-	-	(36)	-
Distributions paid to non-controlling interests		(8)	(14)	(25)	(22)
Other		1	-		-
		435	**24**	**434**	**385**
Investing					
Short-term investments		16	8	(139)	(151)
Acquisition of Aeroman, net of cash	note 12	-	-	(53)	-
Proceeds from sale of Jazz units		-	-	-	14
Sale of US Airways shares		-	158	-	158
Additions to capital assets		(710)	(199)	(1,111)	(479)
Proceeds from sale of assets	note 11	-	-	45	-
Deconsolidation of Aeroplan cash	note 2	-	-	(231)	-
Deconsolidation of Jazz cash	note 3	(138)	-	(138)	-
Cash collateralization of letters of credit		-	-	12	(4)
Other		(21)	-	(21)	-
		(853)	**(33)**	**(1636)**	**(462)**
Increase (decrease) in cash and cash equivalents		**(312)**	**201**	**(813)**	**490**
Cash and cash equivalents, beginning of period		1,353	1,854	1,854	1,565
Cash and cash equivalents, end of period		**$ 1,041**	**$ 2,055**	**$ 1,041**	**$ 2,055**
Cash payments of interest		**$ 71**	**$ 74**	**$ 131**	**$ 137**
Cash payments of income taxes		**$ 3**	**$ -**	**$ 9**	**$ -**

Cash and cash equivalents exclude Short-term investments of $1,061 as at June 30, 2007 ($767 as at June 30, 2006).
The accompanying notes are an integral part of the interim consolidated financial statements.
**Effective March 14, 2007 the results and financial position of Aeroplan LP and effective May 24, 2007 the results and financial position of Jazz LP are not consolidated within ACE (Note 1).*

For the period ended June 30, 2007
(currencies in millions – Canadian dollars)

1. NATURE OF OPERATIONS AND ACCOUNTING POLICIES

ACE Aviation Holdings Inc. ("ACE"), which was incorporated on June 29, 2004, is an investment holding company of various aviation interests. Reference to the "Corporation" in the following notes to the consolidated financial statements refers to, as the context may require, ACE and its subsidiaries collectively, ACE and one or more of its subsidiaries, one or more of ACE's subsidiaries, or ACE itself.

ACE has four reportable segments: Air Canada, Aeroplan Limited Partnership ("Aeroplan") up to March 14, 2007, Jazz Air LP ("Jazz") up to May 24, 2007, and ACTS Limited Partnership ("ACTS").

As at June 30, 2007, ACE holds:

- a 75.0% direct ownership interest in Air Canada;
- a 31.1% indirect ownership interest in Aeroplan through its holding of Aeroplan Income Fund units;
- a 49.0% indirect ownership interest in Jazz LP through its holding of Jazz Income Fund units; and
- a 100% direct ownership interest in ACTS. Refer to Notes 12 and 13 for likely future changes to ACE's ownership interest.

The unaudited interim consolidated financial statements for the Corporation are based on the accounting policies consistent with those disclosed in Note 2 to the 2006 annual consolidated financial statements of the Corporation, with the exception of the changes in accounting policy described below in Changes in Accounting Policy.

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 2006 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 demand for services experienced within the segments of the Corporation varies over the calendar year. The Air Canada and Jazz segments have historically experienced greater demand in the second and third quarters as a result of the high number of leisure travelers with the preference to travel during the spring and summer months. Both segments have substantial fixed costs in their structures that do not fluctuate with passenger demand and load factors. The ACTS segment has experienced lower activity in Quarter 3 as the high demand for travel during the summer months results in airlines scheduling their service outside of that peak travel period.

ACCOUNTING FOR AEROPLAN

Effective March 14, 2007 as a result of the special distribution of Aeroplan Income Fund units, and the conversion of ACE's remaining Aeroplan LP units into units of Aeroplan Income Fund, the Corporation's results in these interim consolidated financial statements include the consolidation of Aeroplan operations only up to the date of distribution. From the date of distribution the investment that ACE has in Aeroplan is accounted for using the equity method (Note 2).

ACCOUNTING FOR JAZZ

Prior to the distribution of units on May 24, 2007 Air Canada consolidated Jazz as a variable interest entity ("VIE"). As a result of the Corporation's distribution of units of Jazz Air Income Fund ("JAIF") on May 24, 2007, ACE's ownership interest in JAIF was reduced from 58.8% to 49.0%. JAIF holds all of the outstanding units of Jazz LP. Effective May 24, 2007 JAIF was deemed to be the primary beneficiary of Jazz under AcG-15 *Consolidation of Variable Interest Entities,* and accordingly it consolidates Jazz from that date.

These interim consolidated financial statements include the consolidation of Jazz operations up to the date of the May 24, 2007 distribution and from that point the investment that ACE has in Jazz is accounted for using the equity method (Note 3).

CHANGES IN ACCOUNTING POLICY

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*, section 3251, *Equity*, and Emerging Issues Committee Abstract 164, *Convertible and Other Debt Instruments with Embedded derivatives* ("EIC-164").

Financial Instruments

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It requires that financial assets and financial liabilities, including derivatives, be 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. Under this standard, 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. An asset can be classified as available-for-sale when it has not been classified as trading or held-to-maturity. Transaction costs are expensed as incurred for financial instruments classified or designated as held-for-trading. For other financial instruments, transaction costs are capitalized on initial recognition.

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. 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. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

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 (loss) with the exception of derivatives designated in 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 remeasure 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.
- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method.
- 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.
- The equity investment in US Airways Group, Inc. that ACE holds is classified as available-for-sale and unrealized period changes in fair value are recorded in OCI.

Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. The purpose of the section is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows.

Hedges

Section 3865 specifies the criteria that must be satisfied in order for hedge accounting to be applied. 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.

Air Canada has designated 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. Upon maturity of the fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in Fuel expense.

When hedge accounting is discontinued, the amounts previously recognized in Accumulated OCI are reclassified to non-operating income (loss) during the periods when the variability in the cash flows of the hedged item affects net income. Gains and losses on derivative hedging items are reclassified to non-operating income (loss) immediately when the hedged item is sold or terminated early.

Comprehensive Income

Section 1530 introduces Comprehensive Income, which consists of Net Income and OCI. 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. These interim consolidated financial statements include the consolidated statement of comprehensive income for Quarter 2 2007; items affecting OCI are recorded prospectively commencing from January 1, 2007 including the transition adjustments noted below. 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.

Equity

Section 3251 establishes standards for the presentation of equity and the changes in equity during the period.

Impact Upon Adoption

In accordance with the transitional provisions of the standards, prior periods have not been restated for the adoption of these new accounting standards.

The transition adjustments attributable to the remeasurement 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 Retained earnings of the Corporation as at January 1, 2007. Adjustments arising from remeasuring financial assets classified as available-for-sale at fair value were recognized in opening AOCI as at that date.

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 Retained earnings 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)		
Deposits and other assets	$	23
Future income taxes ($6, net of valuation allowance $6)		-
Deferred charges		(29)
Accounts payable and accrued liabilities		19
Long-term debt and capital leases		(30)
Non-controlling interest		4
Retained earnings, net of nil tax		8
Accumulated other comprehensive income (loss), net of tax of $4		(7)

Convertible and Other Debt Instruments with Embedded Derivatives

EIC-164 provides guidance on whether an issuer of certain types of convertible debt instruments should classify the instruments as liabilities or equity, whether the instruments contain any embedded derivatives, and how the instruments should be accounted for and presented. The guidance also addresses earnings per share implications. The Corporation has adopted this guidance in Quarter 1 2007 to financial instruments accounted for in accordance with section 3855. There is no financial statement impact as a result of the adoption of this standard.

Accounting for Uncertainty in Income Taxes (FIN 48)

For US GAAP reporting, new standards from the Financial Accounting Standards Board (FASB) are effective on January 1, 2007 for the Corporation. FIN 48, *Accounting for Uncertainty in Income Taxes*, is an interpretation of FASB statement 109, *Accounting for Income Taxes*, that clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This implementation of this standard is in the Corporation's Quarter 2 2007 reconciliation of Canadian GAAP to US GAAP (Note 16).

FUTURE ACCOUNTING CHANGES

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 all of the consequences of the new standards, which may have a material impact on the Corporation's financial statements.

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.

2. ACCOUNTING FOR AEROPLAN

As a result of the distribution of units of Aeroplan Income Fund on March 14, 2007, ACE's ownership interest in Aeroplan was reduced to 40.1%, indirectly through the direct interest ACE has in Aeroplan Income Fund, which holds 100% of Aeroplan LP. As of the distribution date, ACE no longer consolidates the results and financial position of Aeroplan LP. On May 24, 2007, ACE's ownership interest in Aeroplan was further reduced to 31.1%.

The consolidated statement of operations includes $20 of equity income from the Aeroplan investment which represents the results of operations from the distribution date ($17 for Quarter 2 2007).

The consolidated statement of financial position as at June 30, 2007 does not include the financial position of Aeroplan. The comparative December 31, 2006 consolidated statement of financial position included the following items:

- cash and cash equivalents of $167, short-term investments of $453 and other current assets of $72;
- long-lived assets of $373;
- current liabilities of $670;
- long-term debt of $300; and
- Aeroplan long-term deferred revenues of $801.

Immediately prior to the distribution on March 14, 2007, ACE's net investment in Aeroplan LP was $(710), which was negative due to accumulated distributions to ACE in excess of income and capital invested, net of fair value adjustments recorded upon the application of fresh start reporting. Subsequent to the distribution on March 14, 2007, ACE's 40.1% proportionate interest in the accumulated deficit of Aeroplan LP was $284. ACE has retained this negative investment of $284 and reflected the amount in Other long term liabilities. As a result, the difference between the net investment prior to and after the distribution has been recorded as a credit to Contributed Surplus in the amount of $426. As described in Note 10, the May 24 distribution of Aeroplan units resulted in a further reduction to the negative investment in Aeroplan of $63 with a credit to contributed surplus of $57 and a reduction to interest expense of $6 for a total credit to contributed surplus of $483 for the six months ended June 30, 2007.

The Quarter 1 cash flow impact to ACE of deconsolidating Aeroplan of $231 reflects the Aeroplan cash being removed from the consolidated statement of financial position of ACE and is classified as a cash outflow from investing activities.

The Corporation has various related party transactions after removing Aeroplan from the consolidation of ACE and these transactions are recorded at the exchange amount. Related party trade balances arise from the provision of services, as outlined in the table below, and the allocation of employee related costs.

The related party balances with Aeroplan resulting from the application of the commercial and contractual agreements between Air Canada and Aeroplan were as follows:

	June 30 2007
Accounts receivable	$ 25
	$ 25

The related party revenues and expenses to Air Canada with Aeroplan for the three months ended June 30, 2007 and the period from March 14, 2007 to June 30, 2007 are summarized as follows:

	Three months ended June 30 2007	Period ended June 30 2007
Revenues		
Revenues from Aeroplan related to Aeroplan rewards	$ 91	$ 129
Cost of Aeroplan Miles purchased from Aeroplan	(62)	(84)
Property rental revenues from related parties	4	5
	$ 33	**$ 50**
Expenses		
Call centre management and marketing fees for services from Aeroplan	$ 1	$ 2
Recovery of wages, salary and benefit expense for employees assigned to Aeroplan	(13)	(17)
	$ (12)	**$ (15)**

AEROPLAN MILES OBLIGATION

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 has a liability related to Aeroplan Miles which were issued prior to January 1, 2002. As a result, there is a continuing obligation relating to these Miles. Aeroplan assumed responsibility for all Miles issued beginning January 1, 2002.

As of June 30, 2007, a liability for approximately 10 billion Miles, or $116, remains in Air Canada, of which $59 is included in current liabilities (total liability of 15 billion Miles, or $163, as at December 31, 2006).

The 2006 consolidated financial statements of ACE presented this obligation within Aeroplan deferred revenues on the consolidated statement of financial position. As a result of Aeroplan no longer being consolidated in ACE effective March 14, 2007, the comparative December 31, 2006 obligation of $163 has been presented separately in the Quarter 2 2007 interim consolidated statement of financial position.

3. ACCOUNTING FOR JAZZ

As a result of the distribution of units of Jazz Air Income Fund on May 24, 2007, ACE's ownership interest in Jazz was reduced from 58.8% to 49.0%, which is held indirectly through the direct interest ACE has in Jazz Air Income Fund, which holds 100% of Jazz. As of the distribution date, ACE no longer consolidates the results and financial position of Jazz.

The consolidated statement of operations includes $7 of equity income from the Jazz investment which represents the results of operations from the May 24, 2007 distribution.

The consolidated statement of financial position as at June 30, 2007 does not include the financial position of Jazz. The comparative December 31, 2006 consolidated statement of financial position included the following items:

- 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; and
- other long term liabilities of $71.

As at May 24, 2007, ACE's net investment in Jazz was $42.

The Quarter 2 cash flow impact to ACE of deconsolidating Jazz of $138 reflects the Jazz cash being removed from the consolidated statement of financial position of ACE and is classified as a cash outflow from investing activities.

The Corporation has various related party transactions after removing Jazz from the consolidation of ACE. These transactions are recorded at the exchange amount. Related party trade balances arise from the provision of services, as outlined in the table below, and the allocation of employee related costs.

The related party balances with Jazz resulting from the application of the commercial and contractual agreements were as follows:

		June 30 2007
Accounts receivable	$	107
Accounts payable		77
	$	30

The related party revenues and expenses with Jazz for the period from May 24, 2007 to June 30, 2007 are summarized as follows:

		Period Ended June 30 2007
Revenues		
Revenue from Corporate services and other (Air Canada)	$	6
Maintenance revenue from Jazz (ACTS)		3
Property rental revenues with Jazz (Air Canada)		1
	$	**10**
Expenses (Air Canada)		
Expense from Capacity Purchase Agreement with Jazz	$	76
Pass-through fuel expense from Jazz		29
Pass-through airport user fees from Jazz		17
Pass-through other expense from Jazz		2
Other expenses from Jazz		1
	$	**125**

4. LONG-TERM DEBT AND CAPITAL LEASES

ACE CONVERTIBLE SENIOR NOTES

In connection with the distributions of units of Aeroplan Income Fund and Jazz Air Income Fund to the shareholders of ACE (Note 10), the conversion rate of the 4.25% Convertible Senior Notes due 2035 ("Convertible Notes") to 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 has been adjusted.

As a result of the January 10, 2007 distribution the conversion rate was adjusted from 22.2838 to 27.6987, effective January 27, 2007. As a result of the March 14, 2007 distribution the conversion rate was adjusted from 27.6987 to 32.5210, effective March 31, 2007. As a result of the May 24, 2007 distribution the conversion rate was adjusted from 32.5210 to 37.6879, effective June 12, 2007.

All the adjustments described above during 2007 were determined in accordance with the terms of indenture governing the Convertible Notes.

AIR CANADA AIRCRAFT FINANCING

On April 19, 2007, Air Canada received a commitment for loan guarantee support,subject to the fulfillment of certain terms and conditions, from the Export-Import Bank of the United States ("EXIM") covering seven Boeing 777 aircraft to be delivered in 2007. During the six months ended June 30, 2007 Air Canada took delivery of 5 Boeing 777 aircraft, one of which was delivered during Quarter 1, 2007. One of the aircraft delivered was acquired on operating lease from ILFC. The remaining four were financed under the loan guarantee support provided by EXIM.

The following table summarizes the loans, which are secured by the delivered aircraft, related to the acquisition of Boeing aircraft financed under the loan guarantee support provided by EXIM:

	Number of Aircraft	Interest Rate	Maturity	Original US$ Loan Amount	Original CDN$ Loan Amount
Quarter 2 2007					
Boeing 777	4	5.435%	2019	415	441

The interest rate above represents the weighted average fixed interest rate on the loans.

The following table summarizes the principal repayment requirements (in CDN$) of the Boeing aircraft financing obtained during Quarter 2 2007:

	Remainder of 2007	2008	2009	2010	2011	2012
Boeing aircraft financing	$ 18	$ 37	$ 37	$ 37	$ 37	$ 37

The following table summarizes the loans, secured by the delivered aircraft, which Air Canada drew during the six month period ended June 30, 2007 to finance the acquisition of Embraer aircraft:

	Number of Aircraft	Interest Rate	Maturity	Original US$ Loan Amount	Original CDN$ Loan Amount
Quarter 2 2007					
Embraer 190	4	7.161%	2019	$ 90	$ 96
Quarter 1 2007					
Embraer 190	4	6.813%	2019	$ 90	$ 105
Total	**8**			**$ 180**	**$ 201**

The interest rates above represent the weighted average fixed interest rate on the loans.

The following table summarizes the principal repayment requirements (in CDN$) of the Embraer aircraft financing obtained during the six month period ended June 30, 2007:

	Remainder of 2007	2008	2009	2010	2011	2012
Embraer aircraft financing	$ 4	$ 9	$ 9	$ 10	$ 10	$ 15

REDUCTION IN NON-CONTROLLING INTEREST

During Quarter 1 2007 the Corporation refinanced five CRJ aircraft and the refinancing included a payment of the non-controlling interest portion of the leasing arrangement to third parties of $36.

5. POST-EMPLOYMENT EXPENSES

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

	Three Months Ended		Six Months Ended	
	June 30 2007	June 30 2006	June 30 2007	June 30 2006
Pension benefit expense	$ 37	$ 46	$ 75	$ 91
Other employee future benefit expense	23	27	53	55
	$ 60	**$ 73**	**$ 128**	**$ 146**
Amount charged to Aeroplan	(2)	-	(2)	-
Net pension and other employee benefits expense	**$ 58**	**$ 73**	**$ 126**	**$ 146**

6. LABOUR RELATED PROVISIONS

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 (current portion included in Accounts payable and accrued liabilities):

	Three Months Ended		Six Months Ended	
	June 30 2007	June 30 2006	June 30 2007	June 30 2006
Beginning of period	$ 67	$ 133	$ 77	$ 144
Interest accretion	2	3	3	5
Amounts disbursed	(12)	(14)	(23)	(27)
Deconsolidation of Jazz (Note 1)	(4)	-	(4)	-
End of period	53	122	53	122
Current portion	(27)	(37)	(27)	(37)
	$ 26	**$ 85**	**$ 26**	**$ 85**

During 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 and was adjusted during Quarter 3 2006. The amount reversed has been applied as an adjustment to shareholders' equity.

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):

	Three Months Ended		Six Months Ended	
	June 30 2007	June 30 2006	June 30 2007	June 30 2006
Beginning of period	$ 39	$ 44	$ 32	$ 13
Special charge for labour restructuring:				
2007 ACTS workforce reduction	6	-	15	-
2006 non-unionized reduction	-	-	-	33
Charges recorded in wages, salaries and benefits	9	3	11	3
Amounts disbursed	(10)	(4)	(14)	(6)
End of period	44	43	44	43
Current portion	(27)	(35)	(27)	(35)
	$ 17	**$ 8**	**$ 17**	**$ 8**

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

During Quarter 2 2007, under special charges for labour restructuring, a charge of $6 ($15 for the six month period ending June 30, 2007) was recorded in the ACTS segment for the workforce reduction announced as a result of the termination of a heavy maintenance contract at ACTS. This workforce reduction will be completed during 2007.

During Quarter 1 2006 a workforce reduction plan was announced to reduce non-unionized employee levels by 20 percent. A special charge of $28 was recorded in the Air Canada segment and $5 in ACTS in Quarter 1 2006 relating to this program. During Quarter 4 2006, the estimated cost of this plan to the Air Canada segment was revised due to the favourable impact of attrition and other factors which reduced the cost of achieving the target. As a result, the Air Canada segment recorded a reduction of $8 in Quarter 4 2006 to the special charge for labour restructuring.

7. DERIVATIVE AND FINANCIAL INSTRUMENTS

FUEL PRICE RISK MANAGEMENT

The financial results of Air Canada are impacted by changes in jet fuel prices as a result of Air Canada's inherent dependence on energy for its operations. To manage its exposure to jet fuel prices, Air Canada enters into derivative contracts with financial intermediaries for the purpose of managing volatility in operating cash flows. Air Canada 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. Air Canada does not purchase or hold any derivative financial instruments for trading purposes.

Air Canada designates its fuel derivatives as 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 period change in fair value is recorded in non-operating income (expense).

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. Air Canada'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 Air Canada'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 Air Canada 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 Air Canada, 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. For those fuel derivatives that do not qualify for hedge accounting, the period changes in fair value of the fuel derivatives are recorded in non-operating income.

The following table provides the changes in fair value of designated hedging items before the impact of tax during the six month period ended June 30, 2007:

Increase (decrease)	Fair value of outstanding fuel derivatives	OCI / AOCI	Fuel expense	Non-operating income (loss)	Retained earnings / non-controlling interest	Cash on settlement
January 1, 2007	$ (18)	$ (26)	$ -	$ -	$ 8	$ -
Unrealized period change in fair value	39	9	-	30	-	-
Realized loss on maturing contracts	14	8	8	-	-	(14)
March 31, 2007	$ 35	$ (9)	$ 8	$ 30	$ 8	$ (14)
Unrealized period change in fair value	6	13	-	(7)	-	
Realized gain on maturing contracts	(5)	3	(3)	(7)	-	4
June 30, 2007	$ 36	$ 7	$ 5	$ 16	$ 8	$ (10)

OCI amounts for the three months ended June 30, 2007 are presented net of tax expense of $6 in the Consolidated Statement of Comprehensive Income ($9 for the six months ended June 30, 2007).

FOREIGN EXCHANGE RISK MANAGEMENT

Air Canada enters into certain foreign exchange forward contracts or currency swaps to manage the risks associated with foreign currency exchange rates. As at June 30, 2007, Air Canada had entered into foreign currency forward contracts and option agreements on US$1,574 of future purchases in 2007 and 2008. The fair value of these foreign currency contracts as at June 30, 2007 is $73 in favour of the counterparty (December

31, 2006 - $25 in favour of Air Canada on $503 of future purchases in 2007). These derivative instruments have not been designated as hedges for accounting purposes. The unrealized loss has been recorded in foreign exchange.

During Quarter 1 2007, Air Canada's currency swaps for five CRJ leases with third parties were settled at their fair value of $10 (which was equal to carrying value) upon the expiry of the lease term.

8. INCOME TAXES

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

Asset		June 30 2007		March 31 2007		December 31 2006
Future income taxes asset recorded in current assets (a)	$	342	$	51	$	584
Future income taxes asset (a)	$	24	$	214	$	336
	$	366	$	265	$	920

Liability		June 30 2007		March 31 2007		December 31 2006
Current taxes payable (b)	$	-	$	(6)	$	(345)
Future income taxes liability (b)	$	(94)	$	(136)	$	(136)
	$	(94)	$	(142)	$	(481)

a) FUTURE INCOME TAXES ASSETS

During Quarter 2 2007, the Corporation has determined that it is more likely than not that certain future income tax assets of $220, which were offset by a valuation allowance, will be realized through a combination of future reversals of temporary differences and taxable income.

During Quarter 2 2007, the Corporation realized $111 of non-current future income tax assets, through the distribution of Aeroplan units and Jazz units (Note 10).

Miscellaneous adjustments reduced future income tax assets in Quarter 2 2007 by $8.

During Quarter 1 2007, future income tax assets of Air Canada of $345 were utilized to recover a current tax payable of the same amount.

During Quarter 1 2007 the Corporation realized $328 of future income tax assets through the distribution of Aeroplan units (Note 10). In addition, the Corporation realized $40 of future income tax assets through the distribution of Jazz units (Note 10) which had been offset by a valuation allowance.

Miscellaneous adjustments increased future income tax assets in Quarter 1 2007 by $18.

b) CURRENT TAXES PAYABLE AND FUTURE INCOME TAXES LIABILITY

During Quarter 2 2007, future income tax liabilities declined by $42 due to a reduction in the carrying value of certain intangibles and other assets with indefinite lives. The reduction in the carrying values resulted from recognition of future income tax assets that existed at fresh start and for which valuation allowance was recorded.

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 during Quarter 1 2007. During Quarter 1 2007 the Air Canada segment recorded interest expense of $6 due on the tax balance prior to its recovery. This amount was recorded in Current income taxes on the consolidated statement of operations in Quarter 1.

c) PROVISION FOR INCOME TAXES

Components of the provision for income taxes are as follows:

	Three Months Ended June 30 2007	Three Months Ended June 30 2006	Six Months Ended June 30 2007	Six Months Ended June 30 2006
Recovery of (provision for) income taxes before under noted items	$ (68)	$ (102)	$ (65)	$ (73)
Special distribution of Aeroplan units	(9)	-	(38)	(6)
Special distribution of Jazz units	(2)	-	(6)	-
Effect of changes in tax elections previously estimated	-	-	(17)	-
Issue of Jazz units	-	-	-	(10)
Effect of tax rate changes on temporary differences	2	17	12	17
Valuation allowance reversal	2	-	2	-
Interest expense	-	-	(6)	-
Recovery of (provision for) income taxes	**$ (75)**	**$ (85)**	**$ (118)**	**$ (72)**

Future income tax expense of $17 was recorded during Quarter 1 2007 as a result of a change to previously estimated amounts on certain tax elections.

9. SHARE INFORMATION

The issued and outstanding common shares of ACE as at June 30, 2007, along with potential common shares, are as follows:

Outstanding shares (000)	June 30 2007	December 31 2006
Issued and outstanding		
Class A variable voting shares	79,277	79,499
Class B voting shares	24,098	22,772
Total issued and outstanding	103,375	102,271
Potential common shares		
Convertible preference shares	11,014	10,747
Convertible notes	12,437	7,354
Stock options	4,439	3,598
Total potential common shares	27,890	21,699

The information presented in the table above reflects the changes in connection with the distributions of units of Aeroplan Income Fund and units of Jazz Air Income Fund as described in Note 2, Note 3 and Note 10.

10. DISTRIBUTIONS OF AEROPLAN AND JAZZ UNITS

On March 3, 2006, ACE effected a distribution of 0.18 units of Aeroplan Income Fund per Class A Variable Voting Share, Class B Voting Share and Preferred Share (on an as converted basis) of ACE to its shareholders of record as at such date by way of reduction of capital. For the purposes of the distribution, ACE converted 20,204,165 units of Aeroplan LP into 20,204,165 units of Aeroplan Income Fund which were distributed to ACE's shareholders on the record date.

On October 5, 2006, the shareholders of ACE approved a statutory plan of arrangement pursuant to the Canada Business Corporations Act. On October 6, 2006, the Quebec Superior Court issued a final order approving the statutory plan of arrangement, which became effective October 10, 2006. The arrangement granted authority to the board of directors of ACE to make from time to time one or more distributions to ACE shareholders in an aggregate amount of up to $2 billion by way of reduction of the stated capital of the Variable Voting Shares, Voting Shares and Preferred Shares (hereafter referred to as the "Plan").

On December 28, 2006, ACE announced the terms of a distribution under the Plan, pursuant to which ACE shareholders of record on January 10, 2007, would receive a distribution of 50 million units of Aeroplan Income Fund, or approximately 0.442 units of Aeroplan Income Fund per Variable Voting Share, Voting Share and Preferred Share (on an as converted basis) of ACE. Based on a closing price of $17.97 per unit of Aeroplan Income Fund on the TSX on January 10, 2007, the value of the distribution was approximately $899 million. In anticipation of the distribution, on December 28, 2006, ACE exchanged 50 million units of Aeroplan LP into 50 million units of Aeroplan Income Fund and caused such units of Aeroplan Income Fund to be distributed to ACE's eligible shareholders of record on January 10, 2007. ACE also exchanged on January 10, 2007, 60 million units of Aeroplan LP into 60 million units of Aeroplan Income Fund for internal reorganization purposes.

On March 2, 2007, ACE announced a second distribution under the Plan pursuant to which ACE's shareholders of record on March 14, 2007 were entitled to receive 20,272,917 units of Aeroplan Income Fund, or approximately 0.177 units of Aeroplan Income Fund, and 25 million units of Jazz Air Income Fund units, or approximately 0.219 units of Jazz Air Income Fund per Variable Voting Share, Voting Share and Preferred Share (on an as converted basis) of ACE. Based on a closing price of $19.40 per unit of Aeroplan Income Fund and $8.60 per unit of Jazz Air Income Fund on the TSX on March 14, 2007, the value of the distribution was approximately $608 million. For the purpose of the distribution, on March 14, 2007, ACE exchanged 25 million units of Jazz LP into 25 million units of Jazz Air Income Fund. For internal reorganization purposes, on March 14, 2007, ACE also exchanged its remaining 40,545,835 units of Aeroplan LP into 40,545,835 units of Aeroplan Income Fund.

On March 30, 2007, ACE exchanged its remaining 47,226,920 units of Jazz LP at that time into 47,226,920 units of Jazz Air Income Fund for internal reorganization purposes.

On May 11, 2007, ACE announced a third and final distribution under the Plan pursuant to which ACE's shareholders of record on May 24, 2007 were entitled to receive 18 million units of Aeroplan Income Fund, or approximately 0.157 units of Aeroplan Income Fund, and 12 million units of Jazz Air Income Fund units, or approximately 0.105 units of Jazz Air Income Fund per Variable Voting Share, Voting Share and Preferred Share (on an as converted basis) of ACE. Based on a closing price of $21.50 per unit of Aeroplan Income Fund and $8.26 per unit of Jazz Air Income Fund on the TSX on May 24, 2007, the value of the distribution was approximately $486 million.

The following table summarizes the units distributed to shareholders during Quarter 2 2007:

Distributions	**May 24, 2007 Aeroplan units distributed**	**May 24, 2007 Jazz units distributed**
Distributed to common shareholders	16,274,237	10,849,492
Distributed to preferred shareholders	1,725,763	1,150,508
	18,000,000	12,000,000

The following table summarizes the units distributed to shareholders during Quarter 1 2007:

Distributions	January 10 2007 Aeroplan units distributed	March 14 2007 Aeroplan units distributed	March 14 2007 Jazz units distributed
Distributed to common shareholders	45,240,473	18,345,927	22,623,690
Distributed to preferred shareholders	4,759,527	1,926,990	2,376,310
	50,000,000	20,272,917	25,000,000

Since the approval of the statutory plan of arrangement in October 2006, approximately $2 billion has been distributed under the $2 billion plan.

Distributions to Common Shareholders

The distributions to holders of Variable Voting Shares and Voting Shares totaling 79,860,637 units of Aeroplan Income Fund ("Aeroplan units") and 33,473,182 units of Jazz Air Income Fund ("Jazz units") were non-monetary non-reciprocal transfers 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. For the Quarter 2, 2007 Aeroplan units distributed, as Aeroplan was an equity investment at the time of distribution, $57 was recorded as a reduction of the negative equity investment in Aeroplan offset by an increase to contributed surplus. The 2007 distributions involved the use of future income tax assets, of which $354 related to the distributions to the common shareholders which was recorded as a reduction in share capital.

Distribution to common shareholders	Aeroplan units distributed	Reduction to share capital due to FIT
January 10, 2007	45,240,473	$ (192)
March 14, 2007	18,345,927	(82)
May 24, 2007	16,274,237	(80)
	79,860,637	$ (354)

For the Jazz units distributed, $23 was recorded as a reduction to share capital ($8 during Quarter 2 2007 and $15 during Quarter 1 2007) and an increase to non-controlling interest on the consolidated statement of financial position, representing the proportionate carrying amount of ACE's investment in Jazz related to the distribution to the Class A and Class B shareholders. The 2007 distributions involved the use of future income tax assets, of which $49 related to the distributions to the common shareholders which was recorded as a reduction in share capital. The following table summarizes the financial statement impact of the Jazz units distributed to Class A and Class B shareholders:

Distribution to common shareholders	Jazz units distributed	Reduction to share capital recorded	Reduction to share capital due to FIT
March 14, 2007	22,623,690	$ (15)	$ (36)
May 24, 2007	10,849,492	(8)	(13)
	33,473,182	$ (23)	$ (49)

Distributions to Preferred Shareholders

The distributions to preferred shareholders of ACE totaled 8,412,280 Aeroplan units and 3,526,818 Jazz units. These transactions were considered a non-reciprocal transfer to non-owners since the holders of the Preferred Shares are not considered owners of the Corporation for accounting purposes. The transfers are measured at fair value at the date of distribution and results in net interest expense being recorded, which is the fair value of each distribution less the gain recorded. The gain recorded is the fair value of the distribution in excess of the Corporation's proportionate carrying value of its investment. The fair value of the distribution is based on the closing price of the Aeroplan Income Fund units and Jazz Air Income Fund units on the TSX on the day of the distribution.

The Aeroplan units distributed to preferred shareholders resulted in net interest expense recorded during the six month period ended June 30, 2007 and a proportionate reduction to intangible assets related to fair value adjustments to Aeroplan intangibles that are recorded on consolidation as a result of the dilution of interests. The following table summarizes the financial statement impact of the Aeroplan units distributed to preferred shareholders:

Distribution to preferred shareholders	Aeroplan units distributed	Fair value of distribution	Gain on distribution	Net interest expense recorded	Reduction to intangible asset recorded
Quarter 1 2007					
January 10, 2007	4,759,527	$ 86	$ 78	$ 8	$ (8)
March 14, 2007	1,926,990	37	33	4	(4)
Quarter 2 2007					
May 24, 2007	1,725,763	37	43	(6)	-
	8,412,280	$ 160	$ 154	$ 6	$ (12)

The Jazz units distributed to preferred shareholders resulted in net interest expense recorded during the six month period ended June 30, 2007 and an increase to non-controlling interest as a result of the dilution of interests. The following table summarizes the financial statement impact of the Jazz units distributed to preferred shareholders:

Distribution to preferred shareholders	Jazz units distributed	Fair value of distribution	Gain on distribution	Net interest expense recorded	Increase in non-controlling interest recorded
Quarter 1 2007					
March 14, 2007	2,376,310	$ 21	$ 19	$ 2	$ (2)
Quarter 2 2007					
May 24, 2007	1,150,508	10	9	1	(1)
	3,526,818	$ 31	$ 28	$ 3	$ (3)

The distributions described above had no cash tax consequences.

In accordance with the terms of the ACE Convertible Senior Notes, the distributions during the six month period ended June 30, 2007 and return of capital triggered a conversion rate adjustment (Note 4). This change in the conversion rate did not have any accounting consequences.

In accordance with the terms of the ACE stock option plan, each distribution during the six month period ended June 30, 2007 triggered an adjustment to the 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, whether vested or not, in a consistent manner with the adjustment to the conversion rate for the convertible senior notes, as outlined in the following table:

	Before Adjustment		After Adjustment	
Distribution	Exercise Price	Options Outstanding	Exercise Price	Options Outstanding
January 10, 2007	$ 26.04	3,570,390	$ 20.95	4,436,644
March 14, 2007	22.02	3,397,496	18.76	3,989,011
May 24, 2007	18.53	3,854,370	15.98	4,466,744

11. SEGMENT INFORMATION

COMPOSITION OF BUSINESS SEGMENTS

The Corporation has four reportable segments: Air Canada (previously Air Canada Services), Aeroplan (up to March 14, 2007), Jazz (up to May 24, 2007), and ACTS.

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. As described in Note 2, on March 14, 2007 the Corporation ceased to consolidate Aeroplan and therefore the equity investment income from ACE's investment in Aeroplan during Quarter 1 2007 and Quarter 2 2007 is recorded within CIE. As described in Note 3, on May 24, 2007 the Corporation ceased to consolidate Jazz and the equity investment income from ACE's investment during Quarter 2 2007 is recorded within CIE. 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 for the period when Aeroplan was consolidated related mainly to the revenue recognition timing difference from when Aeroplan records revenues, which is at the time a Mile is redeemed, to the consolidated accounting policy of revenue recognition at the time reward transportation is provided. In addition, within the Aeroplan segment of the ACE consolidated financial statements, Aeroplan revenue from the redemption of Miles is recorded 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.

The Jazz segment, included up to May 24, 2007, is operating under the capacity purchase agreement ("Jazz CPA") with Air Canada.

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 business segment and geographic region to the applicable amounts in the consolidated financial statements follows:

	Three Months Ended June 30, 2007*						Three Months Ended June 30, 2006					
	Air Canada	**Aeroplan***	**Jazz***	**ACTS**	**CIE**	**Total ACE**	**Air Canada**	**Aeroplan**	**Jazz**	**ACTS**	**CIE**	**Total ACE**
Passenger revenue	$ 2,336	$ -	$ -	$ -	$	$ 2,336	$ 2,262	$ -	$ -	$ -	$ 26	$ 2,288
Cargo revenue	135	-	-	-	-	135	152	-	-	-	-	152
Other revenue	118	-	1	56	13	188	121	181	2	55	(117)	242
External revenue	2,589	-	1	56	13	2,659	2,535	181	2	55	(91)	2,682
Inter-segment revenue	46	-	248	202	(496)	-	41	2	338	171	(552)	-
Total revenues	**2,635**	**-**	**249**	**258**	**(483)**	**2,659**	**2,576**	**183**	**340**	**226**	**(643)**	**2,682**
Wages, salaries and benefits	475	-	56	90	5	626	449	20	77	83	7	636
Aircraft fuel	636	-	54	-	(53)	637	631	-	71	-	(71)	631
Aircraft rent	71	-	22	-	(2)	91	83	-	33	-	(3)	113
Airport and navigation fees	257	-	33	-	(34)	256	245	-	43	-	(43)	245
Aircraft maintenance, materials and supplies	205	-	20	79	(183)	121	189	-	22	67	(160)	118
Depreciation of property and equipment	126	-	4	3	(2)	131	105	-	7	1	1	114
Amortization of intangible assets	10	-	-	5	-	15	13	4	-	3	3	23
Obsolescence provisions	-	-	-	3	-	3	-	-	-	3	-	3
Commissions	51	-	-	-	-	51	59	-	-	-	-	59
Capacity purchase fees paid to Jazz	232	-	-	-	(156)	76	215	-	-	-	(215)	-
Special charge for labour restructuring	-	-	-	6	-	6	-	-	-	-	-	-
Other operating expenses	484	-	34	63	(31)	550	474	128	51	68	(162)	559
Total operating expenses	**2,547**	**-**	**223**	**249**	**(456)**	**2,563**	**2,463**	**152**	**304**	**225**	**(643)**	**2,501**
Operating income (loss)	**88**	**-**	**26**	**9**	**(27)**	**96**	**113**	**31**	**36**	**1**	**-**	**181**
Interest income	23	-	1	-	4	28	20	4	1	-	4	29
Interest expense	(86)	-	(1)	(5)	(4)	(96)	(76)	(4)	(2)	(4)	(5)	(91)
Interest capitalized	28	-	-	-	-	28	13	-	-	-	-	13
Aeroplan equity investment income	-	-	-	-	17	17	-	-	-	-	-	-
Jazz equity investment income	-	-	-	-	7	7	-	-	-	-	-	-
Gain on sale of US Airways shares	-	-	-	-	4	4	-	-	-	-	100	100
Gain on disposal of assets	14	-	-	-	-	14	1	-	-	-	-	1
Gain (loss) on financial instruments recorded at fair value	(6)	-	-	-	-	(6)	(1)	-	-	-	-	(1)
Other non-operating income (expense)	(6)	-	1	-	4	(1)	(3)	1	-	(1)	4	1
Non-controlling interest	(4)	-	-	-	(52)	(56)	(3)	-	-	-	(16)	(19)
Foreign exchange gain (loss)	160	-	-	(1)	(1)	158	108	-	-	-	(1)	107
Recovery of (provision for) income taxes	(56)	-	-	-	(19)	(75)	(20)	-	-	-	(65)	(85)
Segment income (loss)	**$ 155**	**$ -**	**$ 27**	**$ 3**	**$ (67)**	**$ 118**	**$ 152**	**$ 32**	**$ 35**	**$ (4)**	**$ 21**	**$ 236**

**Effective March 14, 2007 the results and financial position of Aeroplan LP and effective May 24, 2007 the results and financial position of Jazz LP are not consolidated within ACE (Note 1). Aeroplan and Jazz equity investment income is recorded within CIE prospectively from March 14, 2007 and May 24, 2007 respectively.*

	Six Months Ended June 30, 2007*						Six Months Ended June 30, 2006					
	Air Canada	Aeroplan*	Jazz*	ACTS	CIE	Total ACE	Air Canada	Aeroplan	Jazz	ACTS	CIE	Total ACE
Passenger revenue	$ 4,473	$ -	$ -	$ -	$ 15	$ 4,488	$ 4,264	$ -	$ -	$ -	$ 45	$ 4,309
Cargo revenue	275	-	-	-	-	275	303	-	-	-	-	303
Other revenue	327	198	3	113	(120)	521	316	378	4	101	(245)	554
External revenue	5,075	198	3	113	(105)	5,284	4,883	378	4	101	(200)	5,166
Inter-segment revenue	94	3	610	398	(1,105)	-	87	5	656	325	(1,073)	-
Total revenues	**5,169**	**201**	**613**	**511**	**(1,210)**	**5,284**	**4,970**	**383**	**660**	**426**	**(1,273)**	**5,166**
Wages, salaries and benefits	974	17	139	176	18	1,324	912	38	151	164	13	1,278
Aircraft fuel	1,221	-	125	-	(124)	1,222	1,200	-	130	-	(130)	1,200
Aircraft rent	144	-	57	-	(6)	195	166	-	65	-	(5)	226
Airport and navigation fees	500	-	80	-	(81)	499	475	-	83	-	(83)	475
Aircraft maintenance, materials and supplies	429	-	50	158	(374)	263	396	-	45	131	(325)	247
Depreciation of property and equipment	244	-	9	4	(1)	256	206	-	11	3	1	221
Amortization of intangible assets	19	3	-	10	-	32	26	8	-	6	6	46
Obsolescence provisions	1	-	-	6	-	7	1	-	-	6	-	7
Commissions	110	-	-	-	-	110	127	-	-	-	-	127
Capacity purchase fees paid to Jazz	462	-	-	-	(386)	76	421	-	-	-	(421)	-
Special charge for labour restructuring	-	-	-	15	-	15	28	-	-	5	-	33
Other operating expenses	1,055	141	91	130	(199)	1,218	1,023	267	103	129	(335)	1,187
Total operating expenses	**5,159**	**161**	**551**	**499**	**(1,153)**	**5,217**	**4,981**	**313**	**588**	**444**	**(1,279)**	**5,047**
Operating income (loss)	**10**	**40**	**62**	**12**	**(57)**	**67**	**(11)**	**70**	**72**	**(18)**	**6**	**119**
Interest income	49	3	2	-	7	61	37	8	2	-	4	51
Interest expense	(177)	(3)	(3)	(10)	(26)	(219)	(147)	(7)	(4)	(8)	(13)	(179)
Interest capitalized	64	-	-	-	-	64	23	-	(1)	-	-	22
Aeroplan equity investment income	-	-	-	-	20	20	-	-	-	-	-	-
Jazz equity investment income	-	-	-	-	7	7	-	-	-	-	-	-
Dilution gain - Jazz	-	-	-	-	-	-	-	-	-	-	220	220
Gain on sale of US Airways shares	-	-	-	-	4	4					100	100
Gain on disposal of assets	21	-	-	-	-	21	3	-	-	-	1	4
Gain on financial instruments recorded at fair value	28	-	-	-	-	28	(3)	-	-	-	-	(3)
Other non-operating income (expense)	(10)	(1)	1	-	9	(1)	1	-	-	(1)	6	6
Non-controlling interest	(6)	-	-	-	(73)	(79)	(7)	-	-	-	(27)	(34)
Foreign exchange gain	193	-	-	(1)	(1)	191	121	-	-	-	(1)	120
Recovery of (provision for) income taxes	(51)	-	-	-	(67)	(118)	9	-	-	-	(81)	(72)
Segment income (loss)	**$ 121**	**$ 39**	**$ 62**	**$ 1**	**$ (177)**	**$ 46**	**$ 26**	**$ 71**	**$ 69**	**$ (27)**	**$ 215**	**$ 354**

**Effective March 14, 2007 the results and financial position of Aeroplan LP and effective May 24, 2007 the results and financial position of Jazz LP are not consolidated within ACE (Note 1). Aeroplan and Jazz equity investment income is recorded within CIE prospectively from March 14, 2007 and May 24, 2007 respectively.*

GEOGRAPHIC INFORMATION

Passenger revenues	Three Months Ended June 30 2007	Three Months Ended June 30 2006	Six Months Ended June 30 2007	Six Months Ended June 30 2006
Canada	$ 1,011	$ 969	$ 1,865	$ 1,755
US Transborder	469	474	961	948
Atlantic	476	479	837	818
Pacific	237	228	450	426
Other	143	138	375	362
	$ 2,336	**$ 2,288**	**$ 4,488**	**$ 4,309**

Cargo revenues	Three Months Ended June 30 2007	Three Months Ended June 30 2006	Six Months Ended June 30 2007	Six Months Ended June 30 2006
Canada	$ 26	$ 29	$ 51	$ 57
US Transborder	6	6	13	14
Atlantic	50	51	107	106
Pacific	43	56	83	105
Other	10	10	21	21
	$ 135	**$ 152**	**$ 275**	**$ 303**

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

Other revenues are principally provided to customers located in Canada.

SEGMENT ASSET INFORMATION

June 30 2007*	Air Canada	ACTS	CIE	Total
Cash and cash equivalents	$ 871	$ 4	$ 166	$ 1,041
Short-term investments	880	-	181	1,061
	$ 1,751	$ 4	$ 347	$ 2,102
Total assets	**$ 11,246**	**$ 843**	**$ (251)**	**$ 11,838**

**Effective March 14, 2007 the results and financial position of Aeroplan LP and effective May 24, 2007 the results and financial position of Jazz LP are not consolidated within ACE (Note 1).*

December 31 2006	Air Canada	Aeroplan	Jazz	ACTS	CIE	Total
Cash and cash equivalents	$ 1,312	$ 167	$ 135	$ -	$ 240	$ 1,854
Short-term investments	798	453	-	-	73	1,324
	$ 2,110	$ 620	$ 135	$ -	$ 313	$ 3,178
Total assets	**$ 11,388**	**$ 824**	**$ 483**	**$ 989**	**$ (243)**	**$ 13,441**

Substantially all of the Corporation's property and equipment are related to operations in Canada.

The total assets of CIE is net of the inter-company eliminations between each of the segments and ACE.

US AIRWAYS INVESTMENT

During Quarter 2, 2007 the Corporation disposed of 0.249 million shares of its holding in US Airways Group, Inc. ("US Airways"). The net proceeds from the sale transactions amounted to $8 (US$8). The corporation recorded a pre-tax gain of $4 ($3 after tax) and a reduction to AOCI of $7, net of tax as a result of this transaction.

As at June 30, 2007, the Corporation continued to hold 0.251 million shares in US Airways with a market value of $8 (US$8). The period change in fair value has been treated as a charge through OCI amounting to $4, net of tax of $1 during Quarter 2 2007 (six month period ended charge of $8, net of tax of $2). As at June 30, 2007, an amount of $3, net of tax, relating to the unrealized gain on the investment is included in AOCI.

Subsequent to June 30, 2007 the Corporation disposed of the remaining 0.251 million shares of its holding in US Airways. The net proceeds from the sale transactions amounted to $8 (US$8). During Quarter 3 2007 the Corporation will record a pre-tax gain of $4 ($3 after tax) and a reduction of AOCI of $3, net of tax, as a result of this transaction.

DISPOSAL OF PROPERTY

During Quarter 2 2007, a CRJ-100 aircraft owned by Air Canada and leased to Jazz was damaged beyond repair. Given estimated insurance proceeds, Air Canada has recorded a gain on disposal of $14 in Quarter 2, 2007.

During Quarter 1 2007 Air Canada sold one of its commercial real estate properties with a carrying value of $37 for proceeds of $42. The gain on sale of $5 ($4 net of tax) has been recorded in Quarter 1 2007 in the Air Canada segment.

12. ACQUISITION OF AEROMAN

On February 13, 2007, ACTS LP, through a wholly-owned subsidiary, acquired 80% of Aeromantenimiento, S.A. ("Aeroman"), the aircraft maintenance division of Grupo TACA Holdings Limited ("Grupo TACA") of El Salvador. Total consideration for this acquisition included cash as well as a right to acquire an equity stake in ACTS LP.

The cash component of US$45 consisted of cash of $50 (US$43) on closing and milestone payments of up to $2 (US$2) in the aggregate, funded by ACTS LP through ACE's available cash resources.

A Class A non-voting redeemable share in a wholly-owned subsidiary of ACTS LP ("exchangeable share") was issued to Grupo TACA. The rights attached to the exchangeable share provide for, upon the closing of a monetization transaction pertaining to ACTS LP, the exchangeable share held by Grupo TACA to be exchanged for a variable number of shares or equity interest in ACTS LP. Subsequent to the issue of the exchangeable share, ACE agreed to a transfer of Grupo TACA's rights to a Grupo TACA related party**.** The estimated fair value of this redemption obligation is presented as a liability. The size of the equity stake to be acquired by Grupo TACA in ACTS LP will be confirmed at the time of the monetization of ACTS LP (Note 13) and is currently expected to represent up to approximately 5% of the total equity of ACTS LP. Prior to ACTS LP's monetization, Grupo TACA can put its right to acquire equity in ACTS LP back to ACE at a discounted value from US$40.4 and accreting up to a cap of US$50.5 over 12 months or the date of monetization, if earlier. Following ACTS LP's monetization, if Grupo TACA has exchanged its exchangeable share, Grupo TACA can put its equity in ACTS LP (or the successor from the monetization process) to ACE at US$50.5 over 12 months commencing from the date of monetization.

In connection with this acquisition, ACTS LP and its wholly-owned subsidiary also entered into a shareholders agreement with Grupo TACA. The agreement provides Grupo TACA a put option to sell the remaining 20% non-controlling interest in Aeroman to ACTS LP, exercisable at any time after February 13, 2009 for up to 50% of its interest and after February 13, 2012 for all or part of its then remaining interest. These dates are subject to a one year extension under certain circumstances. The exercise price for each option is based on a formula that is designed to be the greater of i) fair market value of the non-controlling interest at the time the option is exercised, as determined by a third party valuator; ii) US$19 up to February 13, 2013; and iii) a formula based amount linked to the fair value of ACTS LP.

As a result of the put option on 20% of the shares held by Grupo TACA, ACTS LP is considered to have acquired 100% of Aeroman and has recognized a liability for the remaining 20% non-controlling interest. Subsequent to the acquisition, consolidated earnings includes 100% of the earnings of Aeroman. In addition, the liability related to the put option is variable as its value is based on the estimated fair value of the underlying equity interest and therefore changes to fair value will be included in earnings.

This acquisition has been accounted for under the purchase method and the operations of the acquired entity are consolidated from the date of acquisition. The net assets acquired and the aggregate fair values of the consideration given are as follows:

Assets		
Cash and non-cash working capital	$	6
Property and equipment		16
Intangible assets		63
Goodwill		57
		142
Liabilities assumed		-
Net assets	**$**	**142**
Consideration given:		
Cash on closing	$	50
Financial liabilities:		
Class A non-voting redeemable share of a wholly-owned subsidiary (US$50.5)		58
Additional cash consideration		2
Transaction costs		4
		114
20% non-controlling interest subject to a put option		28
	$	**142**

Aeroman has been determined to be a self-sustaining foreign operation and therefore any changes to foreign exchange affecting the net investment in Aeroman are recorded through OCI, net of nil tax. During Quarter 2 2007, a foreign exchange loss of $7, net of nil tax ($7, net of nil tax, for the six month period ending June 30, 2007) was recorded.

13. DISPOSAL OF INTEREST IN ACTS

On June 22, 2007 ACE announced that it has agreed to sell a 70% interest in ACTS. ACE will retain a 30% equity interest in ACTS and Air Canada will remain its largest customer. The transaction is expected to close during the third quarter of 2007, subject to customary closing conditions and regulatory approvals. Net cash proceeds to be received by ACE from this transaction will be confirmed on closing after confirmation of certain final adjustments.

As disclosed in Note 12 ACE has an obligation to redeem an exchangeable share in a wholly owned subsidiary of ACTS that was issued to Grupo TACA. Under the terms of the exchangeable share, Grupo TACA has a right to acquire up to approximately 5% of the equity of ACTS LP from ACE, or to receive from ACE a cash payment of up to US$50.5.

The assets and liabilities of ACTS, as reported within the consolidated accounts and net of inter-company balances, have been classified as held for sale and are shown separately on the consolidated statement of financial position. The Corporation will maintain significant involvement in ACTS following the sale transaction. As a result, ACTS does not meet the criteria for discontinued operations and the operating results are not reported as a separate element of the Corporation's earnings.

14. COMMITMENTS

During Quarter 2 2007, Air Canada amended agreements with Boeing to cancel orders for two Boeing 777 aircraft scheduled for delivery in 2009. In addition, Air Canada increased its order for Boeing 787 aircraft by 23, bringing its total firm orders to 37 Boeing 787 aircraft. Following the amendment, Air Canada has options to acquire an additional 23 Boeing 787 aircraft. The deliveries of the 37 Boeing 787 aircraft committed to by Air Canada are scheduled to be completed by 2014.

In conjunction with the amended agreements, Air Canada 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 in Note 15 – Commitments in the 2006 annual consolidated financial statements. Should Air Canada 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.

Based on June 30, 2007 exchange rates, the impact of the amended agreements on the previously disclosed committed capital expenditures as described in Note 15 – commitments in the 2006 annual consolidated financial statements of ACE are as follows:

Change in capital commitments **Increase (decrease)**		**CDN**
Year ending December 31, 2007	$	28
Year ending December 31, 2008		(9)
Year ending December 31, 2009		(293)
Year ending December 31, 2010		72
Year ending December 31, 2011		263
Thereafter		2,815
	$	**2,876**

Final aircraft delivery prices include estimated escalation and deferred price delivery payment interest calculated based on the 90-day USD LIBOR rate at June 30, 2007.

15. CONTINGENCIES

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 Air Canada. Competition authorities have sought or requested information from Air Canada as part of their investigations. Air Canada is cooperating with these investigations which may lead to proceedings against Air Canada and a number of airlines and other cargo operators. Air Canada 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. 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 liability to Air Canada, which may be material. It is Air Canada's policy to conduct its business in full compliance with all applicable competition laws.

16. 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 2006 annual consolidated financial statements of ACE.

(Canadian dollars – millions except per share data)	Three Months Ended June 30 2007	Three Months Ended June 30 2006	Six Months Ended June 30 2007	Six Months Ended June 30 2006
Income for the period in accordance with Canadian GAAP	$ 118	$ 236	$ 46	$ 354
Convertible securities (2)	30	15	109	53
Derivative financial instruments (3)	16	44	41	86
Jazz dilution gain	-	-	-	(41)
Distributions (7)	(5)	-	9	4
Stock-based compensation	(1)	(3)	(2)	(3)
Aircraft leases	(1)	(1)	(2)	(1)
Amortization of intangible assets	(1)	(2)	(3)	(4)
Post-employment benefits	17	-	14	-
Non-controlling interest	(5)	-	(8)	-
Income adjustments for the period before the following	50	53	158	94
Income tax adjustment	2	(12)	27	(20)
Respective period income adjustments in accordance with US GAAP	52	41	185	74
Income for the period in accordance with US GAAP	$ 170	$ 277	$ 231	$ 428
Total comprehensive income for the period in accordance with Canadian GAAP	110	236	48	354
Respective period income adjustments in accordance with US GAAP	52	41	185	74
Pension adjustment (a) (10)	704	35	706	140
Derivative financial instruments (a) (3)	(10)	-	(24)	-
Available-for-sale securities (a) (4)	-	(66)	-	(52)
Total comprehensive income for the period in accordance with US GAAP	**$ 856**	**$ 246**	**$ 915**	**$ 516**
Earnings per share – US GAAP (12)				
- Basic	$ 1.60	$ 2.68	$ 2.14	$ 4.11
- Diluted	$ 1.38	$ 2.35	$ 1.99	$ 3.65

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

	June 30 2007	December 31 2006
Deferred charges		
Balance under Canadian GAAP	$ 56	$ 116
Deferred finance charges (2)	3	(6)
Balance under US GAAP	**$ 59**	**$ 110**
Goodwill		
Balance under Canadian GAAP	$ -	$ -
Goodwill (11)	-	675
Balance under US GAAP	**$ -**	**$ 675**
Intangible assets		
Balance under Canadian GAAP	$ 832	$ 1,643
Distributions (5,7)	-	4
Goodwill (11)	844	915
Balance under US GAAP	**$ 1,676**	**$ 2,562**
Deposits and other assets		
Balance under Canadian GAAP	$ 334	$ 323
Derivative financial instruments (3)	-	(1)
Available-for-sale securities (4)	-	23
Pension asset adjustment (10)	927	91
Deconsolidation of Jazz (6)	(46)	-
Balance under US GAAP	**$ 1,215**	**$ 436**

	June 30 2007	December 31 2006
ACTS assets held for sale		
Balance under Canadian GAAP	$ 215	$ -
Disposal of interest in ACTS (8)	40	-
Balance under US GAAP	**$ 255**	**$ -**
Accounts payable and accrued liabilities		
Balance under Canadian GAAP	$ 1,260	$ 1,547
Derivative financial instruments (3)	-	29
Balance under US GAAP	**$ 1,260**	**$ 1,576**
Long-term debt and capital leases		
Balance under Canadian GAAP	$ 3,438	$ 3,759
Convertible securities (2)	21	17
Balance under US GAAP	**$ 3,459**	**$ 3,776**
Convertible preferred shares		
Balance under Canadian GAAP	$ 172	$ 166
Reclassification of convertible preferred shares (2)	(172)	(166)
Balance under US GAAP	**$ -**	**$ -**
Future income taxes		
Balance under Canadian GAAP	$ 94	$ 136
Goodwill (11)	127	88
Balance under US GAAP	**$ 221**	**$ 224**
Pension and other benefit liabilities		
Balance under Canadian GAAP	$ 1,887	$ 1,876
Additional minimum pension liability adjustment (10)	-	108
Pension liability adjustment (6,10)	137	227
Post-employment benefits	(83)	(69)
Balance under US GAAP	**$ 1,941**	**$ 2,142**
Other long-term liabilities		
Balance under Canadian GAAP	$ 486	$ 378
Convertible preferred shares – embedded derivative (2)	83	178
Convertible notes – embedded derivative (2)	58	60
Distributions (7)	39	-
Deconsolidation of Aeroplan (5)	(175)	-
Balance under US GAAP	**$ 491**	**$ 616**
ACTS long-term liabilities held for sale		
Balance under Canadian GAAP	$ 79	$ -
Acquisition of Aeroman (9)	(54)	-
Balance under US GAAP	**$ 25**	**$ -**
Non-controlling interest		
Balance under Canadian GAAP	$ 680	$ 695
Earnings allocation to non-controlling interest	8	-
Acquisition of Aeroman (9)	58	-
Additional non-controlling interest – Jazz	-	41
Additional non-controlling interest – Air Canada	202	202
Balance under US GAAP	**$ 948**	**$ 938**
Temporary equity		
Balance under Canadian GAAP	$ -	$ -
Reclassification of convertible preferred shares (2)	209	200
Balance under US GAAP	**$ 209**	**$ 200**

		June 30 2007		December 31 2006
Shareholders' equity				
Share capital and other equity				
Balance under Canadian GAAP	$	336	$	742
Reclassification of convertible preferred shares and convertible notes (2)		(209)		(209)
Future income tax (7)		(49)		(6)
Goodwill recorded at fresh-start (11)		1,596		1,596
Distributions (7)		(3)		-
Labour related provisions		(23)		(23)
Balance under US GAAP	**$**	**1,648**	**$**	**2,100**
Contributed surplus				
Balance under Canadian GAAP	$	516	$	25
Deconsolidation of Aeroplan (5)		(262)		-
Distributions (7)		(33)		-
Stock-based compensation		(4)		(6)
Balance under US GAAP	**$**	**217**	**$**	**19**
Retained earnings				
Balance under Canadian GAAP	$	864	$	810
Convertible securities (2)		(47)		(38)
Current year income adjustments		185		(185)
Cumulative prior year adjustments:				
Stock-based compensation		6		13
Future income tax (11)		24		17
Goodwill (11)		(94)		(94)
Intangible asset amortization		(11)		(3)
Derivative financial instruments (3)		(33)		(11)
Post-employment benefits		48		-
Aircraft leases		(3)		-
Distributions		4		-
Labour related provisions		23		-
Jazz dilution gain		(41)		-
Air Canada dilution gain		(202)		-
Convertible securities (2)		(45)		(58)
Balance under US GAAP	**$**	**678**	**$**	**451**
Accumulated other comprehensive income (loss)				
Balance under Canadian GAAP	$	(5)	$	-
Current year adjustments to comprehensive income:				
Minimum pension liability adjustment (10)		-		74
Pension adjustment (10)		706		-
Derivative financial instruments (3)		(24)		-
Available-for-sale securities (4)		-		(89)
Cumulative prior year adjustments to comprehensive income:				
Minimum pension liability adjustment (10)		(90)		(164)
Pension adjustment (10)		(136)		(136)
Derivative financial instruments (3)		26		-
Available-for-sale securities (4)		-		108
Balance under US GAAP	**$**	**477**	**$**	**(207)**
Balance under US GAAP	**$**	**3,020**	**$**	**2,363**

1. Accounting for uncertainty in income taxes

Under US GAAP, the Corporation adopted FASB Interpretation No.48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes* on January 1, 2007, which 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*. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 defines the recognition threshold as more likely than not, meaning greater than 50 percent, to be sustained upon audit by the taxing authorities based solely on the technical merits of the position. If the recognition threshold is met, the tax benefit is measured and recognized as the largest amount of benefit that is in management's judgment more likely than not to be realized. If the recognition threshold is not met, no benefit can be recognized in the financial statements. The provisions of FIN 48 also provide guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. In accordance with the transitional provisions of the standard, prior periods are not restated for the adoption of this new accounting standard.

The Corporation's balance of uncertain tax positions was not materially impacted as a result of the adoption of FIN 48. There was no cumulative effect adjustment to the Corporation's opening retained earnings. However, during the period, management determined that a net increase of $29 for income tax reserves was required for tax positions related to prior years. This increase in income tax reserves did not result in any current taxes payable. There was no impact to the consolidated statement of operations for this net increase as the future income tax assets were offset by valuation allowance. The amount of unrecognized tax benefits were $44 at January 1, 2007 and $73 at June 30, 2007.

The unrecognized tax benefits of $44 at January 1, 2007 are for tax positions that are permanent in nature and, if recognized, would reduce the effective tax rate if not for the valuation allowance.

The Corporation recognizes interest expense and penalties related to unrecognized tax benefits within the provision for income tax expense on the statement of operations. No interest expense or penalties related to unrecognized tax benefits were recorded during 2007. As at January 1 and June 30, 2007, the total amount of interest and penalties in relation to uncertain tax positions in the consolidated statement of financial position is nil.

The Corporation files Canadian federal income tax returns and income tax returns in various provincial jurisdictions. In general, the tax years 2002 through 2006 remain subject to examination by Canadian tax authorities.

Based on the outcome of these examinations or as a result of the expiration of statutes of limitation for specific taxing jurisdictions, it is reasonably possible that unrecognized tax positions could change within the next twelve months. However, the Corporation can not currently estimate the range of any possible change.

2. Convertible securities

As described in Note 1 of the of the Quarter 2 2007 interim unaudited consolidated financial statements of ACE, 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*, section 3251, *Equity*, and Emerging Issues Committee Abstract 164, *Convertible and Other Debt Instruments with Embedded derivatives* ("EIC-164").

Under Canadian GAAP, 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. Under US GAAP, transaction costs are recorded in deferred charges and are amortized as a component of interest expense.

<u>Preferred Shares</u>

Under Canadian GAAP, the convertible preferred shares issued in 2004 are presented as a compound instrument, with the value ascribed to the holders' conversion option presented in share capital and other 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 in 2006 and convertible preferred shares in 2007 reflects applying the direct costs of issuance, recorded in Deferred charges under Canadian GAAP prior to January 1, 2007 and against the convertible preferred shares since January 1, 2007, 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.

Convertible Notes

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 share capital and other equity and the remaining value ascribed to the financial liability presented in Long-term debt. The direct costs of issuance are recorded in deferred charges prior to January 1, 2007 and against the long-term debt since January 1, 2007. 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.

3. Derivative financial instruments

Derivative instruments are recorded on the consolidated statement of financial position at fair value. Changes in the fair values of derivative instruments are recognized in non-operating income (loss) with the exception of derivatives designated in effective cash flow hedges.

Under Canadian GAAP, Air Canada has designated 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. Upon maturity of the fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in Fuel expense.

When hedge accounting is discontinued, the amounts previously recognized in AOCI are reclassified to non-operating income (loss) during the periods when the variability in the cash flows of the hedged item affects net income. Gains and losses on derivative hedging items are reclassified to non-operating income (loss) immediately when the hedged item is sold or terminated early.

The adoption of the new Canadian standards (refer to Note 1 of the Quarter 2 2007 interim unaudited consolidated financial statements of ACE) have harmonized the accounting treatment of derivative financial instruments under Canadian and US GAAP.

The Corporation has elected not to designate any derivatives as hedging instruments for US GAAP purposes and as such, the effective portion of the change in the fair value of the hedging derivative under Canadian GAAP is reclassified from OCI to earnings. The transitional adjustment to the new Canadian GAAP standards adopted January 1, 2007 (refer to Note 1 of the Quarter 2 2007 interim unaudited consolidated financial statements of ACE) is reversed under US GAAP.

Prior to January 1, 2007, under Canadian GAAP, derivatives designated in effective cash flow hedges were not recorded on the consolidated statement of financial position. The adjustment reflects recording of the fair value of outstanding derivative contracts that were recorded under hedge accounting under Canadian GAAP to income.

4. Available-for-sale securities

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").

The adoption of the new Canadian standards (refer to Note 1 of the Quarter 2 2007 interim unaudited consolidated financial statements of ACE) have harmonized the accounting treatment of available-for-sale securities under Canadian and US GAAP prospectively from January 1, 2007. The transitional adjustment to the new Canadian GAAP standards adopted January 1, 2007 (refer to Note 1 of the Quarter 2 2007 interim unaudited consolidated financial statements of ACE) is reversed under US GAAP.

Prior to January 1, 2007, under Canadian GAAP, portfolio investments were accounted for using the cost method. Under US GAAP, an unrealized gain of $16 less tax of $3 for the three months ended June 30, 2006 ($33 less tax of $6 for the six month period ended June 30, 2006) was recorded as a separate component of shareholders' equity and included in other comprehensive income, to reflect the fair value of the US Airways investments held during the year. The fair value of the remaining US Airways investment as at June 30, 2006 was $99. This adjustment is in addition to a decrease in other comprehensive income of $95 less tax of $16 for the three months ended June 30, 2006 to reverse the unrealized gains previously recorded in other comprehensive income, as the gain for the disposal of 3.25 million shares in Quarter 2 2006 is realized under Canadian GAAP.

5. Accounting for Aeroplan

Refer to Note 2 of the Quarter 2 2007 interim unaudited consolidated financial statements for a detailed description of the accounting for Aeroplan.

The adjustment under US GAAP is a reduction to goodwill of $226, a reduction to intangible assets of $211, a reduction to contributed surplus of $262 and a reduction to other long-term liabilities of $175.

6. Accounting for Jazz

Refer to Note 3 of the Quarter 2 2007 interim unaudited consolidated financial statements for a detailed description of the accounting for Jazz.

The adjustment under US GAAP is a reduction to non-controlling interest of $41, a reduction to pension and other benefit liabilities of $9, a reduction to intangible assets of $4 and a reduction to deposits and other assets of $46.

7. Distributions of Aeroplan and Jazz units

Refer to Note 10 of the Quarter 2 2007 interim unaudited consolidated financial statements for a detailed description of the distributions of Aeroplan and Jazz units.

<u>Distributions to Preferred Shareholders</u>

Canadian GAAP

Under Canadian GAAP, the distributions to preferred shareholders of ACE were considered a non-reciprocal transfer to non-owners since the holders of the Preferred Shares are not considered owners of the Corporation for accounting purposes.

<u>Aeroplan</u>

The Aeroplan units distributed to preferred shareholders resulted in net interest expense of $12 recorded during Quarter 1 2007 and a proportionate reduction to intangible assets of $12 related to fair value adjustments to Aeroplan intangibles that are recorded on consolidation as a result of the dilution of interests.

The Aeroplan units distributed to preferred shareholders resulted in net interest income of $6 recorded during Quarter 2 2007 and a proportionate reduction of the negative equity investment in Aeroplan of $6.

<u>Jazz</u>

The Jazz units distributed to preferred shareholders resulted in net interest expense of $3 recorded ($1 during Quarter 2 2007 and $2 during Quarter 1 2007) and an increase to non-controlling interest of $3 as a result of the dilution of interests.

US GAAP

Under US GAAP, the distributions to preferred shareholders of ACE are considered non-monetary non-reciprocal transfers to owners since the host instrument is classified as temporary equity for accounting purposes. Consistent with the accounting treatment of the distributions for Class A and Class B shareholders, 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 at June 30, 2007, the adjustment under US GAAP is a reduction to contributed surplus of $39 and an increase to other long-term liabilities of $39.

For the three months ended June 30, 2007, the adjustment under US GAAP is an increase to net interest expense of $5 (comprised of an increase to net interest expense of $6 due to Aeroplan and a reduction to net interest expense of $1 due to Jazz), an increase to contributed surplus of $6 and a reduction to share capital and other equity of $1.

For the six months ended June 30, 2007, the adjustment under US GAAP is a reduction to net interest expense of $9 (comprised of a reduction to net interest expense of $6 due to Aeroplan and a reduction to net interest expense of $3 due to Jazz), an increase to contributed surplus of $6, an increase to intangibles assets of $12 (subsequently reclassified to other long-term liabilities refer to item 5 on the Accounting for Aeroplan), and a reduction to share capital and other equity of $3.

Refer to Note 8 of the Quarter 2 2007 interim unaudited consolidated financial statements for the accounting entries relating to future income taxes on the Aeroplan and Jazz units distributed.

For the three months ended June 30, 2007, the adjustment under US GAAP is a reduction of $10 to future income tax expense and share capital and other equity.

For the six months ended June 30, 2007, the adjustment under US GAAP is a reduction of $43 to future income tax expense and share capital and other equity.

8. Disposal of interest in ACTS

Refer to Note 13 of the Quarter 2 2007 interim unaudited consolidated financial statements for a detailed description of the disposal of interests in ACTS.

The adjustment under US GAAP is a reduction to intangible assets of $23, a reduction to goodwill of $17, an increase to ACTS assets held for sale of $40.

9. Acquisition of Aeroman

Refer to Note 12 of the Quarter 2 2007 interim unaudited consolidated financial statements for a detailed description of the acquisition of Aeroman.

On February 13, 2007, ACTS LP, through a wholly-owned subsidiary, acquired 80% of Aeromantenimiento, S.A. ("Aeroman"), the aircraft maintenance division of Grupo TACA Holdings Limited ("Grupo TACA") of El Salvador. Total consideration for this acquisition included cash as well as a right to acquire an equity stake in ACTS LP.

Under Canadian GAAP, ACTS LP is considered to have acquired 100% of Aeroman and has recognized a liability for the remaining 20% non-controlling interest. This acquisition has been accounted for under the purchase method and the operations of the acquired entity are consolidated from the date of acquisition.

Under US GAAP, ACTS LP is considered to have acquired an 80% interest in Aeroman and a 20% non-controlling interest.

The adjustment under US GAAP in Quarter 2 2007 is to reduce to the fair value allocated to the Aeroman identifiable assets by $13 (subsequently reclassified to ACTS assets held for sale - refer to item 8 on the Disposal of interest in ACTS), recognize a 20% non-controlling interest of $4 and recognize additional goodwill of $17 (subsequently reclassified to ACTS assets held for sale - refer to item 8 on the Disposal of interest in ACTS).

In connection with the acquisition, a Class A non-voting redeemable share in a wholly-owned subsidiary of ACTS LP (“exchangeable share”) was issued to Grupo TACA. The rights attached to the exchangeable share provide for, upon the closing of a monetization transaction pertaining to ACTS LP, the exchangeable share held by Grupo TACA to be exchanged for a variable number of shares or equity interest in ACTS LP. Under Canadian GAAP, the estimated fair value of this redemption obligation is presented as a liability. Under US GAAP, as the conditions of redemption are not solely within the control of the Corporation, the liability included in ACTS long-term liabilities held for sale of $54 has been reclassified to non-controlling interest.

10. Pension and other benefit plans

Prior to December 31, 2006, US GAAP required the unfunded accumulated benefit obligation to be recorded as additional minimum liability. The excess of the unfunded accumulated benefit obligation over the unrecognized prior service costs was recorded in other comprehensive income. The adjustment resulted in a $138 increase less tax of $64 to other comprehensive income for the change in the additional minimum pension liability from $246 at December 31, 2005 to $108 at December 31, 2006.

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. Upon adoption of the new statement, ACE adopted a policy of measuring the funded status of the defined benefit pension plan on a semi-annual basis. 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 was effective as of the end of the fiscal year ending after December 15, 2006.

Under Canadian GAAP, the over or under funded status of defined benefit plans is not recognized in the statement of financial position.

The impact of the adoption of this new statement as at December 31, 2006 resulted in the recognition of an additional liability for the unfunded obligation of $200 for pension plans and $27 for other postretirement plans and a pension asset for the overfunded obligations of $86 for pension plans and $5 for other postretirement plans. The offset of these adjustments resulted in a decrease to accumulated other comprehensive income of $136. The impact of adopting this new statement does not affect reported US GAAP net income.

For the three months ended June 30, 2007, the adjustment under US GAAP is an increase to other comprehensive of $704 (net of tax of $317) (comprised of a net gain arising during the period of $703 and amortization of net actuarial loss included in net periodic pension cost of $1) for pension plans and nil for other postretirement plans, an increase to other assets of $836 and a reduction to pension and other benefit liabilities of $185.

For the six months ended June 30, 2007, the adjustment under US GAAP is an increase to other comprehensive of $706 (net of tax of $318) (comprised of a net gain arising during the period of $703 and amortization of net actuarial loss included in net periodic pension cost of $3) for pension plans and nil for other postretirement plans, an increase to other assets of $836 and a reduction to pension and other benefit liabilities of $188.

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

	Three months ended June 30			
	Pension Benefits		Other Benefits	
	2007	**2006**	**2007**	**2006**
Service cost	$ 64	$ 64	$ 16	$ 19
Interest cost	164	160	12	12
Expected return on plan assets	(193)	(184)	-	-
Amortization of prior service cost	-	-	-	-
Amortization of net transition obligation	-	-	-	-
Amortization of experience (gains) losses	2	4	(22)	(4)
Total	**$ 37**	**$ 44**	**$ 6**	**$ 27**

	Six months ended June 30			
	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
Service cost	$ 127	$ 128	$ 37	$ 40
Interest cost	327	320	25	24
Expected return on plan assets	(386)	(369)	-	-
Amortization of prior service cost	-	-	-	-
Amortization of net transition obligation	-	-	-	-
Amortization of experience (gains) losses	4	9	(22)	(9)
Total	**$ 72**	**$ 88**	**$ 40**	**$ 55**

As of June 30, 2007 the Corporation had contributed $232 to its defined benefit pension plans. The Corporation expects to contribute an additional $156 during the remainder of 2007.

11. Fresh start reporting and goodwill

Under Canadian GAAP, upon emergence from creditor protection, the identifiable assets and liabilities of an enterprise are revalued based on the fair values of such assets and liabilities in a manner similar to that used for a business combination. The difference between the fair value of the Corporations' equity over the fair value of the identifiable assets and liabilities is not permitted to be recorded as an asset (goodwill) under Canadian GAAP. US GAAP does not prohibit the recognition of goodwill to the extent that the reorganization value exceeds the fair value of the specific tangible and identifiable intangibles of the Corporation. The resulting goodwill under US GAAP is not amortized and is subject to an impairment test on an annual basis or earlier if an event occurs or circumstances change that would more likely than not reduce the fair value of the respective reporting unit below the carrying amount.

Under Canadian GAAP, the benefit of future income tax assets that exist at fresh start, and for which a valuation allowance is recorded against, 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. Under US GAAP the benefit of future income tax assets that exist at fresh start will be recognized first to reduce to nil any goodwill, then intangibles with any remaining amount taken to income.

12. Earnings per share

	Three Months Ended		Six Months Ended	
(in millions, except per share amounts)	June 30 2007	June 30 2006	June 30 2007	June 30 2006
Numerator:				
Numerator for basic earnings per share:				
Income for the year	$ 170	$ 277	$ 231	$ 428
Accretion of convertible preferred shares (a)	(5)	(4)	(10)	(9)
Adjusted numerator for earnings per share	165	273	221	419
Effect of potential dilutive securities:				
Convertible preferred shares (b)	5	4	10	9
Convertible notes (b)	6	6	12	12
Add back anti-dilutive impact			(12)	
Adjusted earnings for diluted earnings per share	$ 176	$ 283	$ 231	$ 440
Denominator:				
Denominator for basic earnings per share:				
Weighted-average shares	103	102	103	102
Effect of potential dilutive securities:				
Convertible preferred shares	11	10	11	10
Convertible notes	11	7	10	7
Stock options	2	1	2	1
Add back anti-dilutive impact:			(10)	
Adjusted weighted-average shares for diluted earnings per share	127	120	116	120
Basic earnings per share	**$ 1.60**	**$ 2.68**	**$ 2.14**	**$ 4.11**
Diluted earnings per share	**$ 1.38**	**$ 2.35**	**$ 1.99**	**$ 3.65**

(a) Income is reduced by the accretion of the convertible preferred shares under US GAAP to obtain income available to common shareholders.

(b) The adjustment to the numerator under US GAAP is different than the adjustment to the numerator under Canadian GAAP due to the difference in the value recorded at inception as described in item 2 and the difference in accretion rates.

13. New accounting policies

Accounting for certain hybrid financial instruments

In February 2006, the Financial Accounting Standards Board (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 adoption of this standard in Quarter 1 2007 did not impact the consolidated financial position and results of operations.

14. Future accounting policies

Fair value option

In February 2007, the FASB issued FASB Statement 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("FAS 159"), which permits an entity to measure certain financial assets and financial liabilities at fair value. Under FAS 159, entities that elect the fair value option will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option may be elected on an instrument-by-instrument basis, with few exceptions, as long as it is applied to the instrument in its entirety. The Corporation will adopt this standard as of Quarter 1 2008 and is in the process of assessing the impact of adopting this standard on the consolidated financial position and results of operations.