ACE AVIATION

Quarter 2 2008
Interim Unaudited
Consolidated Financial Statements
and Notes

August 8, 2008

Consolidated Statement of Operations

Unaudited (Canadian dollars in millions except per share figures)		Three Months Ended June 30 2008	Three Months Ended June 30 2007*	Six Months Ended June 30 2008	Six Months Ended June 30 2007*
Operating revenues					
Passenger		$ 2,454	$ 2,336	$ 4,765	$ 4,488
Cargo		139	135	263	275
Other		190	188	481	521
		2,783	2,659	5,509	5,284
Operating expenses					
Wages, salaries and benefits		487	626	983	1,324
Aircraft fuel		848	637	1,563	1,222
Aircraft rent		69	91	132	195
Airport and navigation fees		255	256	496	499
Aircraft maintenance, materials and supplies		172	121	375	263
Communications and information technology		72	69	145	145
Food, beverages and supplies		81	81	158	164
Depreciation, amortization and obsolesence		171	149	340	295
Commissions		47	51	100	110
Capacity purchase with Jazz	Note 13	233	76	468	76
Special charge for labour restructuring		-	6	-	15
Other		350	400	778	909
		2,785	2,563	5,538	5,217
Operating income (loss) before under-noted item		**(2)**	**96**	**(29)**	**67**
Provision for cargo investigations	Note 11	-	-	(125)	-
Operating income (loss)		**(2)**	**96**	**(154)**	**67**
Non-operating income (expense)					
Interest income		23	28	48	61
Interest expense		(87)	(96)	(183)	(219)
Interest capitalized		8	28	25	64
Gain on disposal of assets	Note 1	915	18	961	25
Gain (loss) on financial instruments recorded at fair value	Note 5	176	(6)	153	28
Equity and other investment income	Note 1	5	24	17	27
Other		-	(1)	(1)	(1)
		1,040	(5)	1,020	(15)
Income before the following items		**1,038**	**91**	**866**	**52**
Non-controlling interest		(32)	(56)	32	(79)
Foreign exchange gain (loss)		48	158	(41)	191
Provision for income taxes	Note 6				
Current		(1)	-	(1)	(6)
Future		(223)	(75)	(208)	(112)
Income for the period		**$ 830**	**$ 118**	**$ 648**	**$ 46**
Income per share					
Basic		$ 15.46	$ 1.14	$ 11.24	$ 0.45
Diluted		$ 10.76	$ 0.98	$ 8.18	$ 0.44

The accompanying notes are an integral part of the interim consolidated financial statements.
**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS, respectively, are not consolidated with ACE (Note 1).*

Consolidated Statement of Financial Position

Unaudited (Canadian dollars in millions)		June 30 2008	December 31 2007
ASSETS			
Current			
Cash and cash equivalents		$ 1,481	$ 2,300
Short-term investments		844	839
		2,325	3,139
Restricted cash		42	124
Accounts receivable	Note 9	943	793
Aircraft fuel inventory		117	98
Fuel derivatives	Note 5	382	68
Prepaid expenses and other current assets		131	182
Future income taxes	Note 6	-	200
		3,940	4,604
Property and equipment	Note 2	7,502	7,925
Deferred charges		49	51
Intangible assets		660	647
Deposits and other assets	Note 5	650	527
		$ 12,801	**$ 13,754**
LIABILITIES			
Current			
Accounts payable and accrued liabilities	Note 9	$ 1,183	$ 1,249
Advance ticket sales		1,722	1,245
Current portion of Aeroplan Miles obligation		55	55
Current portion of long-term debt and capital leases		396	686
		3,356	3,235
Long-term debt and capital leases	Note 2	4,141	4,006
Convertible preferred shares		194	182
Future income taxes	Note 6	50	50
Pension and other benefit liabilities		1,738	1,824
Other long-term liabilities		511	483
		9,990	9,780
Non-controlling interest		724	757
SHAREHOLDERS' EQUITY	Note 7		
Share capital and other equity		307	450
Contributed surplus		170	504
Retained earnings		1,368	2,209
Accumulated other comprehensive income		242	54
		2,087	3,217
		$ 12,801	**$ 13,754**

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**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS, respectively, are not consolidated with ACE (Note 1).*

Consolidated Statement of Changes in Shareholders' Equity

Unaudited (Canadian dollars in millions)		Six Months Ended June 30 2008	Year Ended December 31 2007*	Six Months Ended June 30 2007*
Share capital				
Common shares, beginning of period		$ 243	$ 533	$ 533
Repurchase and cancellation of common shares	Note 7	(180)	-	-
Distributions of Aeroplan units	Note 1	-	(306)	(354)
Distributions of Jazz units	Note 1	-	(70)	(72)
Issue of shares through stock options exercised		37	86	20
Total share capital		100	243	127
Other equity				
Convertible preferred shares		117	117	117
Convertible senior notes	Note 2	90	90	92
Total share capital and other equity		307	450	336
Contributed surplus				
Balance, beginning of period		504	25	25
Repurchase and cancellation of common shares	Note 7	(329)	-	-
Fair value of stock options issued to Corporation employees recognized as compensation expense		2	25	8
Fair value of exercised stock options to share capital		(7)	(29)	-
Aeroplan negative investment	Note 1	-	483	483
Total contributed surplus		170	504	516
Retained earnings				
Balance, beginning of period		2,209	810	810
Repurchase and cancellation of common shares	Note 7	(1,489)	-	-
Cumulative effect of adopting new accounting policies		-	5	8
Repair schemes and Non-compete agreement		-	(4)	-
		720	811	818
Net income for the period		648	1,398	46
Total retained earnings		1,368	2,209	864
Accumulated other comprehensive income				
Balance, beginning of period		54	-	-
Cumulative effect of adopting new accounting policies		-	(7)	(7)
Other comprehensive income		188	61	2
Total accumulated other comprehensive income		242	54	(5)
Total retained earnings and accumulated other comprehensive income		1,610	2,263	859
Total shareholders' equity		**$ 2,087**	**$ 3,217**	**$ 1,711**

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**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS, respectively, are not consolidated with ACE (Note 1).*

Consolidated Statement of Comprehensive Income

Unaudited (Canadian dollars in millions)		Three Months Ended June 30 2008	Three Months Ended June 30 2007*	Six Months Ended June 30 2008	Six Months Ended June 30 2007*
Comprehensive income					
Net income for the period		$ 830	$ 118	$ 648	$ 46
Other comprehensive income (loss), net of taxes:	Note 5				
Net change in unrealized loss on US Airways securities		-	(4)	-	(8)
Reclassification of realized gains on US Airways securities to income		-	(7)	-	(7)
Net change in unrealized gain on Jazz Air Income Fund		(6)	-	65	-
Reclassification of net realized gains on Jazz Air Income Fund to income		(65)	-	(65)	-
Net change in unrealized gain on Aeroplan Income Fund		331	-	331	-
Reclassification of net realized gains on Aeroplan Income Fund to income		(331)	-	(331)	-
Net gains on fuel derivatives under hedge accounting		173	8	273	14
Reclassification of net realized (gains) losses on fuel derivatives to income		(62)	2	(85)	10
Unrealized loss on translation of self-sustaining operation (net of nil tax)		-	(7)	-	(7)
		40	(8)	188	2
Total comprehensive income		**$ 870**	**$ 110**	**$ 836**	**$ 48**

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**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS, respectively, are not consolidated with ACE (Note 1).*

Consolidated Statement of Cash Flows

Unaudited (Canadian dollars in millions)		Three Months Ended June 30 2008	Three Months Ended June 30 2007*	Six Months Ended June 30 2008	Six Months Ended June 30 2007*
Cash flows from (used for)					
Operating					
Net income for the period		$ 830	$ 118	$ 648	$ 46
Adjustments to reconcile to net cash from operations					
Depreciation, amortization and obsolescence		171	149	340	295
Gain on disposal of assets	Note 1	(915)	(18)	(961)	(25)
Foreign exchange gain		(64)	(154)	1	(187)
Future income taxes		223	75	208	112
Excess of employee future benefit funding over expense		(31)	(69)	(82)	(138)
Decrease in Aeroplan miles obligation		(13)	(21)	(29)	(49)
Provision for cargo investigation		-	-	125	-
Non-controlling interest		36	52	(32)	70
Financial instruments and other		(168)	36	(181)	9
Changes in non-cash working capital balances		148	(37)	409	314
		217	**131**	**446**	**447**
Financing					
Issue of common shares		29	-	30	19
Repurchase and cancellation of common shares	Note 7	(500)	-	(1,998)	-
Aircraft related borrowings	Note 2	126	532	313	644
Distributions paid to non-controlling interest		-	(8)	-	(61)
Reduction of long-term debt and capital lease obligations		(319)	(90)	(642)	(168)
Other		-	1	-	-
		(664)	**435**	**(2,297)**	**434**
Investing					
Short-term investments		(165)	16	(4)	(139)
Proceeds from sale of Aeroplan units	Note 5	692	-	692	-
Proceeds from sale of Jazz units	Note 5	85	-	182	-
Exercise of ACTS Aero put option	Note 1	(19)	-	(19)	-
Proceeds from escrow related to sale of ACTS	Note 1	-	-	40	-
Proceeds from sale of other assets	Note 2	-	-	27	45
Proceeds from sale-leaseback transactions	Note 2	297	-	708	-
Additions to capital assets		(225)	(738)	(628)	(1,175)
Deconsolidation of Aeroplan cash	Note 1	-	-	-	(231)
Deconsolidation of Jazz cash	Note 1	-	(138)	-	(138)
Acquisition of Aeroman, net of cash		-	-	-	(53)
Other		9	(18)	34	(3)
		674	**(878)**	**1,032**	**(1,694)**
Increase (decrease) in cash and cash equivalents		**227**	**(312)**	**(819)**	**(813)**
Cash and cash equivalents, beginning of period		1,254	1,353	2,300	1,854
Cash and cash equivalents, end of period		**$ 1,481**	**$ 1,041**	**$ 1,481**	**$ 1,041**
Cash payments of interest		$ 81	$ 71	$ 149	$ 131
Cash payments of income taxes		$ 1	$ 3	$ 3	$ 9

Cash and cash equivalents exclude Short-term investments of $844 as at June 30, 2008 ($1,061 as at June 30, 2007).
The accompanying notes are an integral part of the interim consolidated financial statements.
**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS, respectively, are not consolidated with ACE (Note 1).*

(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 a holding company of 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 aviation interests collectively, ACE and one or more of its aviation interests, one or more of ACE's aviation interests, or ACE itself.

ACE has two reportable segments: Air Canada and Corporate Items and Eliminations ("CIE"). During 2007 ACE had the following reportable segments: Air Canada, Aeroplan Limited Partnership ("Aeroplan") up to March 14, 2007, Jazz Air LP ("Jazz") up to May 24, 2007, ACTS LP ("ACTS") up to October 16, 2007, and CIE.

As at June 30, 2008, ACE holds:

- a 75.0% direct ownership interest in Air Canada; and
- a 27.8% direct ownership interest in Aero Technical Support & Services Holdings ("ACTS Aero").

The unaudited interim consolidated financial statements for the Corporation are based on the accounting policies consistent with those disclosed in Note 2 to the 2007 annual consolidated financial statements of the Corporation, with the exception of the changes in accounting policies 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 2007 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 Air Canada segment has historically experienced greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months. Air Canada has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short-term.

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

The notes to the financial statements describe various transactions completed during the quarters ended June 30, and six months ending June 30, 2008 and 2007 where gains on disposal of assets have been realized. A summary of the transactions follows:

		Three Months Ended June 30		Six Months Ended June 30	
		2008	**2007**	**2008**	**2007**
Sale of Aeroplan Income Fund units	Note 5	$ 830	$ -	$ 830	$ -
Sale of Jazz Air Income Fund units	Note 5	78	-	167	-
Boeing 767 impairment provision	Note 2	-	-	(38)	-
Disposal of CRJ-100 Aircraft	Note 2	-	14	-	14
Sale of US Airways shares	Note 5	-	4	-	4
Sale of commercial real estate	Note 2	-	-	-	5
Other		7	-	2	2
Gain on disposal of assets		**$ 915**	**$ 18**	**$ 961**	**$ 25**

ACCOUNTING FOR AEROPLAN

Effective March 14, 2007 as a result of the special distribution of Aeroplan Income Fund ("AIF") units, and the conversion of ACE's remaining Aeroplan LP units into units of AIF, the Corporation's results in these interim consolidated financial statements include the consolidation of Aeroplan operations only up to the date of distribution. From that day on, ACE's investment in Aeroplan is accounted for using the equity method. Subsequent to the sale of units on June 2, 2008 (Note 5), ACE has no ownership interest in Aeroplan.

Immediately prior to the distribution on March 14, 2007, ACE's net investment in Aeroplan was negative $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 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 was recorded as a credit to Contributed surplus in the amount of $426. The May 24, 2007 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 cash flow impact to ACE of deconsolidating Aeroplan of $231 reflects the Aeroplan cash removed from the consolidated statement of financial position of ACE is classified as a cash outflow from investing activities.

Distributions to common and preferred shareholders during the six months ended June 30, 2007, resulted in:

- a $354 reduction to share capital due to the use of future income tax assets;
- interest expense of $6; and
- a proportionate reduction to intangible assets of $12 related to the fair value adjustments to Aeroplan intangibles recorded on consolidation as a result of the dilution of interests.

Refer to Note 4 in the notes of the 2007 annual consolidated financial statements of the Corporation for complete disclosure of 2007 Aeroplan transactions.

With the reduction of the ownership interest below 20% and the termination of the Securityholders' Agreement on May 9, 2008, ACE no longer had significant influence over Aeroplan.

ACCOUNTING FOR JAZZ

Prior to the distribution of units on May 24, 2007 Air Canada consolidated Jazz under ACG-15 Consolidation of Variable Interest Entities ("AcG 15"). 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%. This ownership interest was further reduced to 20.1% on October 22, 2007 and to 9.5% on January 24, 2008. JAIF holds all of the outstanding units of Jazz. 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. Prior to May 24, 2007 inter-company transactions were eliminated in these consolidated financial statements.

These consolidated financial statements include the consolidation of Jazz operations up to the date of the May 24, 2007 distribution and from that date ACE's investment in Jazz was accounted for using the equity method. Subsequent to the sale on January 24, 2008 and termination of the Securityholders' Agreement on February 7, 2008, ACE no longer equity accounted for Jazz and ACE's investment in Jazz was classified as an available-for-sale investment. Subsequent to the completion of the sale of JAIF units on June 2, 2008 (Note 5) ACE has no ownership interest in Jazz.

Refer to Note 13 for a summary of the transactions between Air Canada and Jazz under the Jazz Capacity Purchase Agreement (the "Jazz CPA") for the three and six month periods ended June 30, 2008 and 2007.

Distributions to common and preferred shareholders during the six months ended June 30, 2007, resulted in:

- a $72 reduction to share capital;
- interest expense of $3; and

- a proportionate reduction to intangible assets of $3 related to the fair value adjustments to Jazz intangibles recorded on consolidation as a result of the dilution of interests.

Refer to Note 5 in the notes of the 2007 annual consolidated financial statements of the Corporation for complete disclosure of 2007 Jazz transactions.

ACCOUNTING FOR ACTS

On October 16, 2007 ACE sold substantially all of the assets and liabilities of ACTS to ACTS Aero for cash and equity. Subsequently, ACE held a 22.8% equity interest in ACTS Aero which purchased the assets and conducts the business previously operated by ACTS. On January 14, 2008, the full balance of $40 of funds held in escrow on the closing of the monetization of ACTS were received by ACE.

As part of the monetization process an entity related to Grupo TACA exchanged its exchangeable share and received $31 cash, a 5% equity stake in ACTS and a put option that allowed it to put its 5% equity interest back to ACE for US$18 within 12 months. Refer to Note 6 in the notes of the 2007 annual consolidated financial statements of the Corporation for complete disclosure of the monetization. During Quarter 2, 2008, the entity related to Grupo TACA exercised its put option and sold its 5% equity interest to ACE for $19 (US$18) increasing ACE's ownership interest in ACTS Aero from 22.8% to 27.8%. The liability related to this redemption obligation, initially recorded, was settled as part of the transaction.

These consolidated financial statements include the consolidation of ACTS operations up to October 16, 2007. From that date ACE's investment in ACTS Aero is accounted for using the equity method. As at June 30, 2008 ACE's investment in ACTS Aero has a carrying amount of $82 ($72 at December 31, 2007) and is included in Deposits and other assets.

CHANGES IN ACCOUNTING POLICIES

Capital Disclosures and Financial Instruments – Presentation and Disclosure

Effective January 1, 2008, the Corporation adopted three new CICA accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments – Disclosures*, and section 3863, *Financial Instruments – Presentation*.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose is to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital. Refer to Note 12 for the Corporation's Section 1535 disclosures.

Sections 3862 and 3863 replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements in certain areas, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Refer to Note 5 for the Corporation's financial instruments disclosures. Where the disclosure requirements of the new standards did not change from the previous standard and where there have been no significant updates from the disclosures in Note 20 of the 2007 annual consolidated financial statements of the Corporation, no additional disclosure has been provided.

Inventories

Effective January 1, 2008, the Corporation adopted CICA section 3031, *Inventories*, which replaced section 3030, *Inventories*. Section 3031 provides more extensive guidance on measurement, and expands disclosure requirements to increase transparency. The Corporation's accounting policy for aircraft fuel inventory is consistent with measurement requirements in the new standard and as a result, no adjustment was recorded on transition; however, additional disclosures are required. The additional disclosure requirements will be applied as described below.

The main features of the new standard, which impact the Corporation, include:

- Measurement of inventories at the lower of cost and net realizable value, with guidance on the determination of costs.

- Consistent use of either a first-in first-out or weighted average formula to measure the cost of other inventories. The Corporation uses a weighted average formula to measure cost.

- Reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories.

- Disclosure of the accounting polices used, carrying amounts, amounts recognized as an expense, write-downs, and the amount of any reversal of any write-downs recognized as a reduction in expenses.

Future Accounting Standard Changes

In February 2008, the CICA issued section 3064, *Goodwill and Intangible Assets* which provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The standard is effective for fiscal years beginning on or after October 1, 2008, and requires retroactive application to prior period financial statements. The Corporation is in the process of evaluating the impact of this new standard for adoption on January 1, 2009.

In February 2008, the Canadian Accounting Standards Board confirmed January 1, 2011 as the changeover date for Canadian publicly accountable enterprises to start using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures. The Corporation is currently evaluating the impact of the adoption of IFRS on its consolidated financial statements.

2. FINANCING AND INVESTING ACTIVITIES

ACE CONVERTIBLE SENIOR NOTES

In connection with the share purchase and cancellation by ACE on June 18, 2008, described in Note 7, the conversion rate of ACE's 4.25% Convertible Senior Notes Due 2035 was adjusted from 39.0341 to 40.6917 (after it had been adjusted from 37.6879 to 39.0341 effective January 11, 2008) Class A variable voting shares or Class B voting shares per $1,000 principal amount of Convertible Senior Notes. The adjustment is effective June 19, 2008 and has been determined in accordance with the terms of the indenture governing the Convertible Senior Notes.

During Quarter 1, 2008, Convertible Senior Notes with a face value of $1 were converted at the option of the holder and ACE settled for cash of $1, reducing the liability and equity portions of the notes. The gain realized on conversion was negligible.

AIR CANADA AIRCRAFT FINANCING AND INVESTING

Revolving Credit Facility

Air Canada has a secured revolving credit facility of $400, as further described in Note 11 to the 2007 annual consolidated financial statements of the Corporation, which is not available to Air Canada until and unless Air Canada and the lenders conclude amendments satisfactory to each of them relating to a financial covenant and other business terms. Subsequent to June 30, 2008, Air Canada and the lenders have entered into an amending agreement pursuant to which the parties undertake to negotiate such further amendments to the facility and Air Canada agrees not to request any funding under the facility until such further amendments are agreed. The outcome of the negotiations remain uncertain such that there can be no assurance that amendments satisfactory to the parties will be concluded, that amounts under the facility will ever be available to Air Canada, that Air Canada will not decide to terminate the facility, or that a replacement facility will be concluded.

Sale-Leaseback

During Quarter 2, 2008, Air Canada received delivery of three Boeing 777 aircraft. One aircraft was financed with guarantee support from the Export-Import Bank of the United States (“EXIM”), as outlined below. Two of the aircraft were financed under sale and leaseback transactions with proceeds of $297. The resulting gain on sale of $30 has been deferred and will be recognized as a reduction to Aircraft rent expense over the term of the leases. The leases are accounted for as operating leases with 12 year terms, paid monthly.

During Quarter 1, 2008, Air Canada received delivery of four Boeing 777 aircraft. One aircraft was financed with guarantee support from EXIM, as outlined below. Three of the aircraft were financed under sale and leaseback transactions with proceeds of $411. The resulting gain on sale of $47 has been deferred and will be recognized as a reduction to Aircraft rent expense over the term of the leases. The leases are accounted for as operating leases with 12 year terms, paid monthly.

Borrowings

Boeing

The following table summarizes the Japanese Yen (JPY) denominated loans, secured by the delivered aircraft, that Air Canada drew during the six month period ended June 30, 2008 to finance the acquisition of two Boeing aircraft:

	Number of Aircraft	Interest Rate	Maturity	Original JPY Loan Amount	Original CDN$ Loan Amount
Quarter 2 2008					
Boeing 777 - 300	1	1.05%	2020	11,199	$ 106
Quarter 1 2008					
Boeing 777 - 200	1	1.03%	2020	10,387	$ 98

During Quarter 2, 2008, financing fees of $3 were recorded for these borrowings ($4 recorded during the first quarter of 2008). These fees are capitalized for periods preceding the dates that the assets are available for service.

The following table summarizes the principal repayment requirements (in CDN$) of the Boeing aircraft financing obtained during the six month period ended June 30, 2008, based upon the foreign exchange rate as at June 30, 2008:

	Remainder of 2008	2009	2010	2011	2012	Thereafter	Total
Boeing aircraft financing	$ 9	$ 17	$ 17	$ 17	$ 17	$ 127	$ 204

Embraer

During Quarter 1, 2008, Air Canada received delivery of three Embraer 190 aircraft. The following table summarizes the loans, secured by the delivered aircraft, that Air Canada drew during the six month period ended June 30, 2008 to finance the acquisition of Embraer aircraft:

	Number of Aircraft	Interest Rate	Maturity	Original US$ Loan Amount	Original CDN$ Loan Amount
Quarter 1 2008					
Embraer 190	3	4.97 - 6.39%	2020	$ 68	$ 67

During Quarter 1, 2008, financing fees of $1 were recorded for these borrowings. These fees are capitalized for periods preceding the dates that the assets are available for service.

The following table summarizes the principal repayment requirements (in CDN$) of the Embraer aircraft financing obtained during the six month period ended June 30, 2008, based upon the foreign exchange rate as at June 30, 2008:

	Remainder of 2008	2009	2010	2011	2012	Thereafter	Total
Embraer aircraft financing	$ 2	$ 3	$ 3	$ 3	$ 4	$ 53	$ 68

Disposals of and Provisions for Assets

During Quarter 2, 2008:

- There were no significant disposals or provisions during the quarter.

During Quarter 1, 2008:

- Air Canada recorded an impairment charge of $38 ($26 net of tax) on its fleet of B767-200 aircraft due to the revised retirement date of the aircraft.

- Air Canada sold an A319 aircraft for proceeds of $23 with a book value of $21, resulting in a gain on sale of $2 ($1 net of tax).

During Quarter 2, 2007:

- A CRJ-100 aircraft owned by Air Canada and leased to Jazz was damaged beyond repair. Given the estimated insurance proceeds, Air Canada recorded a gain on disposal of $14.

During Quarter 1, 2007:

- Air Canada sold one of its commercial real estate properties for net proceeds of $42 with a carrying value of $37. Air Canada recorded a gain on sale of $5 ($4 net of tax).

- Air Canada sold 18 parked aircraft for proceeds of $2 with a nil book value. Air Canada recorded a gain on sale of $2 ($1 net of tax).

Predelivery Financing

During Quarter 2, 2008:

- Air Canada drew an additional amount of $13 and made repayments of $197 on the predelivery financing as described in Note 11 to the 2007 annual consolidated financial statements of the Corporation.

During Quarter 1, 2008:

- Air Canada drew an additional amount of $26 and made repayments of $238 on the predelivery financing, which is described in Note 11 to the 2007 annual consolidated financial statements of the Corporation.

Commitments

Refer to Note 10 for a discussion of Air Canada's aircraft commitments.

3. PENSION AND OTHER EMPLOYEE FUTURE BENEFITS EXPENSE

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

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

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007*	2008	2007*
Pension benefit expense	$ 28	$ 37	$ 45	$ 75
Other employee future benefits expense	26	23	52	53
	54	**60**	**97**	**128**
Amount charged to Aeroplan and ACTS Aero	(11)	(2)	(20)	(2)
Net pension benefit and other employee future benefits expense	**$ 43**	**$ 58**	**$ 77**	**$ 126**

**Effective March 14, 2007, the results and financial position of Aeroplan, effective May 24, 2007, the results and financial position of Jazz and effective October 16, 2007, the results and financial position of ACTS are not consolidated with ACE (Note 1).*

4. LABOUR RELATED PROVISIONS

The following table outlines the changes to labour related provisions which are included in long-term employee liabilities (current portion included in Accounts payable and accrued liabilities):

		Three Months Ended June 30		Six Months Ended June 30	
		2008	2007*	2008	2007*
Beginning of period		$ 58	$ 106	$ 66	$ 109
Interest accretion		1	2	2	3
Charges recorded in wages, salaries and benefits		13	15	13	26
Amounts disbursed		(10)	(22)	(19)	(37)
Deconsolidation of Jazz	Note 1	-	(4)	-	(4)
End of period		62	97	62	97
Current portion		(25)	(54)	(25)	(54)
		$ 37	**$ 43**	**$ 37**	**$ 43**

**Effective May 24, 2007, the results and financial position of Jazz are not consolidated with ACE (Note 1). Effective October 16, 2007, the results and financial position of ACTS are not consolidated with ACE (Note 1).*

The Corporation offers severance programs to certain employees from time to time. The cost of these programs is recorded within operating expenses. During the second quarter of 2008, the Corporation recorded an expense of $5 against these ongoing programs.

In response to record high fuel prices, on June 17, 2008, Air Canada announced a reduction in capacity which will impact fleet and staffing levels effective with the implementation of its fall and winter schedule. The expected reduction in flying will require fewer employees to operate the airline resulting in a decrease in staff levels of up to 2,000 positions across all levels of the organization. Air Canada recorded an expense of $8 in Wages, salaries and benefits expense related to the reduction of non-unionized employees under this plan in the second quarter of 2008. Costs related to the planned unionized staff reductions are not yet determinable.

During Quarter 2, 2007, a charge of $6 ($15 for the six months ended 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.

5. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

As described in Note 1, the Corporation adopted CICA Section 3862 and 3863 effective January 1, 2008. These new standards enhance disclosure with respect to financial instruments.

Summary of Financial Instruments

	Carrying Amounts					
	June 30, 2008					December 31 2007
	Financial instruments classification					
	Held for trading	Held to maturity	Loans and receivables	Liabilities at amortized cost	Total	
Financial Assets						
Cash and cash equivalents	$ 1,481	$ -	$ -	$ -	$ 1,481	$ 2,300
Short-term investments	844	-	-	-	844	839
Restricted cash	42	-	-	-	42	124
Accounts receivable	-	-	943	-	943	793
Deposits and other assets						
Restricted cash	91	-	-	-	91	84
Asset backed commercial paper	29	-	-	-	29	29
Aircraft related and other deposits	-	321	-	-	321	307
Derivative instruments						
Fuel derivatives (1)	37	-	-	-	37	10
Foreign exchange derivatives	1	-	-	-	1	-
Interest rate swaps	7	-	-	-	7	7
	$ 2,532	**$ 321**	**$ 943**	**$ -**	**$ 3,796**	**$ 4,493**
Financial Liabilities						
Accounts payable	$ -	$ -	$ -	$ 1,183	$ 1,183	$ 1,266
Current portion of long-term debt and capital leases	-	-	-	396	396	686
Long-term debt and capital leases	-	-	-	4,141	4,141	4,006
Convertible preferred shares	-	-	-	194	194	182
Derivative instruments						
Foreign exchange derivatives	-	-	-	-	-	124
Cross-currency interest rate swaps	13	-	-	-	13	-
Interest rate swaps	-	-	-	-	-	2
	$ 13	**$ -**	**$ -**	**$ 5,914**	**$ 5,927**	**$ 6,266**

(1) The fuel derivatives above relate to the current and long-term portion of fuel derivatives not designated under fuel hedge accounting. Fuel derivatives under hedge accounting have a fair value of $463 ($67 as at December 31, 2007) and are described further below.

There have been no changes in classification of financial instruments since December 31, 2007.

For cash flow purposes, the Corporation may settle, from time to time, certain short-term investments prior to their original maturity. For this reason, these financial instruments do not meet the criteria of held to maturity and are therefore designated as held for trading. They are recorded at fair value with changes in fair value recorded in interest income.

Collateral held in leasing arrangements

Air Canada holds security deposits with a carrying value of $14, which approximates fair value, as security for certain aircraft leased and sub-leased to third parties. Of these deposits, $9 has been assigned as collateral to secure Air Canada's obligations to the lessors of the aircraft. Any collateral held by Air Canada is returned to the lessee or sub-lessee, as the case may be at the end of the lease or sub-lease term provided there have been no events of default under the leases or sub-leases.

Summary of Gains (Losses) on Financial Instruments Recorded at Fair Value

	Three Months Ended June 30		Six Months Ended June 30	
	2008	**2007**	**2008**	**2007**
Ineffective portion of fuel hedges	$ 115	$ (14)	$ 82	$ 16
Fuel derivatives not under hedge accounting	79	2	85	4
Cross currency interest rate swaps	(19)	-	(13)	-
Other	1	6	(1)	8
Gain (loss) on financial instruments recorded at fair value	**$ 176**	**$ (6)**	**$ 153**	**$ 28**

Risk Management

The Corporation is exposed to the following risks as a result of holding financial instruments: interest rate risk, foreign exchange risk, liquidity risk, market risk, and fuel price risk. The following is a description of these risks and how they are managed.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Corporation enters into both fixed and floating rate debt and also leases certain assets where the rental amount fluctuates based on changes in short term interest rates. The Corporation manages interest rate risk on a portfolio basis and seeks financing terms in individual arrangements that are most advantageous taking into account all relevant factors, including credit margin, term and basis. The risk management objective is to minimize the potential for changes in interest rates to cause adverse changes in cash flows to the Corporation. The temporary investment portfolio which earns a floating rate of return is an economic hedge for a portion of the floating rate debt.

The ratio of fixed to floating rate debt outstanding is designed to maintain flexibility in the Air Canada's capital structure and is based upon a long term objective of 60% fixed and 40% floating. Air Canada's current ratio is 60% fixed and 40% floating, including the effects of interest rate swap positions.

The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during the first six months of 2008:

- Air Canada entered into three cross-currency interest rate swap agreements with terms of March 2019, May 2019 and June 2019 respectively, relating to Boeing 777 financing with an aggregate notional value of $294 (US$289) as at June 30, 2008. These swaps convert US denominated debt principal and interest payments into Canadian denominated debt at a foreign exchange rate of par (US$1/CAD$1) and convert from a fixed rate of 5.208% to a floating rate. These derivative instruments have not been designated as hedges for accounting purposes and are fair valued on a quarterly basis. As at June 30, 2008, the fair value of these contracts was $13 in favour of the counterparty. Air Canada recorded a loss of $19 during the three months ended June 30, 2008 ($13 loss for the six months ended June 30, 2008).

- During Quarter 1, 2008, Air Canada's one remaining Embraer 190 aircraft interest rate swap contract matured, with a fair value of $2 in favour of the counterparty. No gain or loss was recorded during the period.

Foreign Exchange Risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The majority of the Corporation's outstanding debt is denominated in US dollars. The US dollar debt acts as an economic hedge against the related aircraft, which is routinely purchased and sold by Air Canada in US dollars.

The Corporation is also exposed to foreign exchange risk on foreign currency denominated trade receivables and foreign currency denominated net cash flows.

The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows. To help manage this risk, the Corporation enters into certain foreign exchange forward contracts or currency swaps. As at June 30, 2008, the Corporation had entered into foreign currency forward contracts and option agreements converting US dollars and Euros into Canadian dollars on $1,993 (US$1,958) and $30 (EUR 19) which mature in 2008, 2009, and 2010. The fair value of these foreign currency contracts as at June 30, 2008 is $1 in favour of Air Canada (December 31, 2007 - $124 in favour of third parties on $2,132 (US $2,158) and $26 (EUR 18) which mature in 2008 and 2009). During the three months ended June 30, 2008, a gain of $4 was recorded in foreign exchange gain (loss) related to these derivatives ($83 for the six months ended June 30, 2008). These derivative instruments have not been designated as hedges for accounting purposes.

The cross-currency swap as described above under interest rate risk management acts as an economic hedge of the foreign exchange risk on the financing related to two Boeing 777 aircraft with a principal amount of $294 (US$289) as at June 30, 2008.

Air Canada had also entered into currency swap agreements for 11 CRJ aircraft. These agreements matured in January 2008 with a nominal fair value. No gain or loss was recorded during the period.

Liquidity risk

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities. The long-term debt issued by the Corporation generally has fixed principal and interest repayment requirements over the term of the instrument.

The Corporation monitors and manages liquidity risk by preparing rolling cash flow forecasts, monitoring the condition and value of assets available to be used as security in financing arrangements, and maintaining flexibility in financing arrangements. Refer to the Maturity Analysis below for additional information.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: foreign exchange risk, interest rate risk and other price risk, which includes commodity price risk. Refer to the Asset-Backed Commercial Paper section below for information regarding these instruments held by the Corporation and the associated market risks.

The Corporation is exposed to market risks through the derivative instruments entered into. The Corporation uses derivative instruments only for risk management purposes and not for generating trading profit. As such, any change in cash flows associated with derivative instruments due to their exposure to market risks is designed to be offset by changes in cash flows related to the risk being hedged.

Sensitivity Analysis

The following table is a sensitivity analysis for each type of market risk relevant to the significant financial instruments recorded by the Corporation. The sensitivity analysis is based on a reasonably possible movement within the forecast period, being one year. These assumptions may not be representative of actual movements in these risks and should not be relied upon.

	Interest rate risk(1)	Foreign exchange rate risk (2)		Other price risk (3)		Other price risk (3)	
	Income	Income		Income	OCI, net	Income	OCI, net
	1% change	5% increase	5% decrease	10% decrease		10% increase	
Cash and cash equivalents	$ 13	$ -	$ -	$ -	$ -	$ -	$ -
Short-term investments	$ 9	$ -	$ -	$ -	$ -	$ -	$ -
Aircraft related deposits	$ -	$ (8)	$ 8	$ -	$ -	$ -	$ -
Long-term debt and capital leases	$ 14	$ 210	$ (210)	$ -	$ -	$ -	$ -
Foreign exchange derivatives	$ -	$ (135)	$ 139	$ -	$ -	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ (117)	$ (44)	$ 123	$ 41
Cross-currency interest rate swaps	$ 15	$ (17)	$ 17	$ -	$ -	$ -	$ -

(1) Changes in interest rates will impact income favourably or unfavourably by approximately the same amount, based on current price levels and assumptions.
(2) Increase in foreign exchange relates to a strengthening of the Canadian dollar.
(3) Other price risk relates to the Air Canada's fuel derivatives. The sensitivity analysis is based upon a 10% decrease or increase in the price of the underlying commodity. It also assumes that hedge accounting is 100% effective for the period and that changes in the fair value for derivatives that mature within one year are recorded in income whereas derivatives maturing beyond one year are recorded in OCI.

Fuel Price Risk

In order to manage its exposure to jet fuel prices and minimize volatility in operating cash flows, Air Canada enters into derivative contracts with financial intermediaries. 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 long 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.

Fuel derivatives include both derivatives designated and not designated under fuel hedge accounting. The current portion of the derivative asset of $382 is included in Fuel derivatives and the long term portion of the derivative asset of $118 is included in Deposits and other assets on the Consolidated statement of financial position.

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

- The fair value of outstanding fuel derivatives under hedge accounting at June 30, 2008 was $463 in favour of the Corporation.
- The change in fair value of derivatives during Quarter 2, 2008, was $370 ($483 for the six months ended June 30, 2008):
  - o The unrealized effective change in the fair value of derivatives recorded in Other comprehensive income ("OCI") during the second quarter of 2008 was $213 before tax

expense of $68 ($347 before tax expense of $110 for the six months ended June 30, 2008). The realized effective change in the fair value of derivatives recorded in OCI during the second quarter of 2008 was $42 before tax expense of $14 ($54 before tax expense of $18 for the six months ended June 30, 2008). OCI amounts for the three and six months ended June 30, 2008 of $173 and $273, respectively, are presented net of tax expense on the Consolidated statement of comprehensive income.

  - The ineffective change in the fair value of derivatives recorded in non-operating income (expense) for the second quarter of 2008 was a gain of $115 ($82 for the six months ended June 30, 2008). The ineffective portion is calculated as the difference between the intrinsic value and change in fair market value of the derivatives as well as the difference between the Air Canada proxy derivative value and the counterparty derivative value. The gain in non-operating income (expense) is due to the change in fair market value of the derivatives being higher than the change in intrinsic value.

- During Quarter 1, 2008, hedge accounting was discontinued for certain fuel hedge contracts, with a fair value of $8, where the hedging relationship ceased to satisfy the conditions for hedge accounting. Certain of these contracts were redesignated under hedge accounting during the second quarter of 2008. Air Canada still continues to hold these derivatives as it believes they continue to be good economic hedges in managing its exposure to jet fuel prices. The value of the Accumulated other comprehensive income ("AOCI") balance recognized in connection with these derivatives will be taken into fuel expense upon the maturity of the contracts. No further dedesignations were required during the second quarter of 2008.

- During Quarter 2, 2008, fuel derivative contracts matured with fair values in favour of Air Canada for $93.

- During Quarter 2, 2008, the benefit to fuel expense was $92 before tax expenses of $30 ($126 for the six months ended June 30, 2008 before tax expenses of $41). This benefit was recognized through the removal of the amount from AOCI. The after tax amount of $62 is shown in Reclassification of net realized (gains) losses on fuel derivatives to income on the Consolidated statement of comprehensive income ($85 for the six months ended June 30, 2008).

- During Quarter 2, 2008, the net impact to AOCI was an increase of $163 before tax expense of $52 ($275 before tax expense of $87 for the six months ended June 30, 2008). As at June 30, 2008, the balance in AOCI was $359 before tax. The estimated net amount of existing gain and losses reported in AOCI that is expected to be reclassified to net income (loss) during the following 12 months is $308 before tax.

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

- During Quarter 2, 2008, fuel derivative contracts matured in favour of Air Canada for $12 ($19 for the six months ended June 30, 2008).

- The fair value of outstanding fuel derivatives not under hedge accounting at June 30, 2008 was $37 in favour of Air Canada.

- The change in fair value of the derivative contracts for the period was a gain of $79 ($85 for the six months ended June 30, 2008) and was recorded in non-operating income (expense).

Asset-Backed Commercial Paper ("ABCP")

Air Canada holds $37 ($29 net of a fair value adjustment) in non-bank sponsored ABCP which has been recorded in Deposits and other assets. These investments were scheduled to mature during the third quarter 2007. An agreement in principle to restructure the ABCP investments was approved by the Pan-Canadian Committee for Third Party Structured ABCP ("Committee") on December 23, 2007 and approved by vote, which occurred on April 25, 2008. Under the terms of the restructuring, all of the ABCP would be exchanged for longer-term notes that will match the maturity of the underlying assets in the proposed structure. Air Canada is not accruing interest on these investments at this time.

The carrying value as at June 30, 2008 is based on a number of assumptions as to the fair value of the investments including factors such as estimated cash flow scenarios and risk adjusted discount rates. The assumptions used in estimating the fair value of the investments are subject to change, which may result in further adjustments to non-operating results in the future. No adjustments to the carrying value were recorded during the first six months of 2008.

Maturity Analysis

The following is a maturity analysis, based on contractual undiscounted cash flows, for selected financial liabilities. The analysis includes both the principal and interest component of the payment obligations on long-term debt and is based on interest rates and the applicable foreign exchange rate effective as at June 30, 2008.

	Remainder of 2008	2009	2010	2011	2012	Thereafter	Total
Convertible senior notes	$ 7	$ 14	$ 330	$ -	$ -	$ -	$ 351
Long-term debt obligations	153	299	278	283	287	2,009	3,309
Debt consolidated under AcG-15	101	106	153	338	93	304	1,095
Capital lease obligations	119	161	157	151	192	604	1,384
	$ 380	**$ 580**	**$ 918**	**$ 772**	**$ 572**	**$ 2,917**	**$ 6,139**

Maturities also include Accounts payable and accrued liabilities of $1,183 which are expected to be settled within one year.

Aeroplan

On April 21, 2008 ACE sold a total of 20.4 million trust units of AIF at a price of $17.50 per unit representing total net proceeds to ACE of $343 and realized a gain on sale of $413 ($340 after tax). Following the sale, ACE held 9.9% of the issued and outstanding units of AIF.

On June 2, 2008, ACE sold the remaining trust units of AIF for total net proceeds to ACE of $349, and realized a gain on sale of $417 ($344 after tax). ACE no longer has an ownership interest in Aeroplan.

With the reduction of the ownership interest below 20% and the termination of the Securityholders' Agreement on May 9, 2008, ACE no longer had significant influence over Aeroplan. The equity investment ACE had in Aeroplan was classified as available-for-sale and the investment was adjusted to fair value. The adjustment to fair value recorded to OCI was $331, net of tax of $72, which was subsequently realized into income on June 2, 2008 as part of the final sale.

Jazz

On June 2, 2008, ACE sold its remaining trust units of JAIF for total net proceeds to ACE of $85, and realized a gain on sale of $78 ($62 net of taxes). Net realized gains of $65, net of tax of $14, were taken into income from OCI. ACE no longer has an ownership interest in Jazz.

On January 24, 2008 ACE sold a total of 13 million trust units of JAIF at a price of $7.45 per unit representing total net proceeds to ACE of $97 and realized a gain on sale of $89 ($71 net of taxes). Following the sale, ACE held 9.5% of the issued and outstanding units of JAIF.

With the reduction of the ownership interest below 20% and the termination of the Securityholders' Agreement on February 7, 2008, ACE no longer had significant influence over Jazz. The equity investment ACE had in Jazz was classified as available-for-sale and unrealized period changes in fair value were recorded in OCI. The adjustment to fair value recorded in OCI amounted to $71, net of tax of ($15) during Quarter 1, 2008. During Quarter 2, 2008, the period change in fair value of ($6), net of tax of $1, was recorded in OCI.

US Airways (2007)

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 held 0.251 million shares in US Airways with a market value of $8 (US$8). The period change in fair value had 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.

6. INCOME TAXES

Asset	June 30 2008	December 31 2007
Future income tax asset recorded in current assets (a)	$ -	$ 200

Liability	June 30 2008	December 31 2007
Accrued income tax provision (b)	$ (96)	$ -
Long-term tax payable (b)	(10)	(10)
Future income tax liability (b)	(50)	(50)
	$ (156)	**$ (60)**

a) Future Income Tax Assets

During 2008, future income tax assets declined by $200 as a result of the following:

- a $146 reduction through the realization of future income tax assets on the disposal of AIF units (Note 5);
- a $34 reduction through the realization of future income tax assets on the disposal of JAIF units (Note 5); and
- a $20 reduction for valuation allowance recorded on certain future income tax assets of ACE.

b) Taxes Payable and Future Income Tax Liability

An accrued income tax provision of $96 recorded by Air Canada is included in Accounts payable and accrued liabilities. This is a non-cash item that is expected to reverse.

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

It has been assumed that certain intangibles and other assets with nominal tax cost and a carrying value of approximately $381 have indefinite lives and accordingly, the associated future income tax liability is not expected to reverse until the assets are disposed of or become amortizable, resulting in the reporting of a future income tax liability of $50.

c) Provision For Income Taxes

Components of the provision for income taxes are as follows:

		Three Months Ended June 30		Six Months Ended June 30	
		2008	2007	2008	2007
Provision for income taxes before under noted items		$ (57)	$ (66)	$ (9)	$ (70)
Disposal of Aeroplan units		(146)	-	(146)	-
Disposal of Jazz units		(16)	-	(34)	-
Valuation allowance		(5)	2	(20)	2
Provision for cargo investigation	Note 11	-	-	-	-
Special distribution of Aeroplan and Jazz units		-	(11)	-	(44)
Interest expense		-	-	-	(6)
Provision for income taxes		**$ (224)**	**$ (75)**	**$ (209)**	**$ (118)**

Refer to Note 5 for future income taxes recorded in other comprehensive income related to fuel derivatives designated under hedge accounting.

7. SHARE INFORMATION

The issued and outstanding common shares of ACE as at June 30, 2008, along with potential common shares, are as follows:

Outstanding shares (000)	June 30 2008	December 31 2007
Issued and outstanding		
Class A variable voting shares	25,807	82,229
Class B voting shares	9,100	23,709
Total issued and outstanding	**34,907**	**105,938**
Potential common shares		
Convertible preferred shares	11,572	11,291
Convertible senior notes	13,133	12,210
Stock options	70	1,682
Total potential common shares	**24,775**	**25,183**

Substantial Issuer Bid – January 2008

On January 10, 2008, ACE accepted for purchase and cancellation a total of 40,023,427 Class A Variable Voting Shares and 9,894,166 Class B Voting Shares at $30.00 per share for an aggregate purchase price of $1,498 in accordance with the terms of a substantial issuer bid. No Convertible Preferred Shares of ACE were deposited on an as converted basis under the offer.

Upon purchase and cancellation by ACE of the Class A Variable Voting Shares and Class B Voting Shares, Share capital decreased by $115, Contributed surplus decreased by $228, and Retained earnings decreased by $1,155.

In connection with the share purchase and cancellation by ACE, the conversion rate of ACE's 4.25% Convertible Senior Notes Due 2035 was adjusted from 37.6879 to 39.0341 Class A variable voting shares or Class B voting shares per $1,000 principal amount of Convertible Senior Notes. The adjustment is effective January 11, 2008 and was determined in accordance with the terms of the indenture governing the Convertible Senior Notes.

Substantial Issuer Bid – June 2008

On June 18, 2008, ACE accepted for purchase and cancellation a total of 12,537,084 Class A Variable Voting Shares and 10,190,187 Class B Voting Shares at $22.00 per share for an aggregate purchase price of $500 in accordance with the terms of a substantial issuer bid. No Convertible Preferred Shares of ACE were deposited on an as converted basis under the offer.

Upon purchase and cancellation by ACE of the Class A Variable Voting Shares and Class B Voting Shares, Share capital decreased by $65, Contributed surplus decreased by $101, and Retained earnings decreased by $334.

In connection with the share purchase and cancellation by ACE, the conversion rate of ACE's 4.25% Convertible Senior Notes Due 2035 was adjusted from 39.0341 to 40.6917 Class A variable voting shares or Class B voting shares per $1,000 principal amount of Convertible Senior Notes. The adjustment is effective June 19, 2008 and was determined in accordance with the terms of the indenture governing the Convertible Senior Notes.

8. SEGMENT INFORMATION

Composition of Business Segments

ACE has two reportable segments: Air Canada and Corporate Items and Eliminations ("CIE"). During 2007 ACE had the following reportable segments: Air Canada, Aeroplan Limited Partnership ("Aeroplan") up to March 14, 2007, Jazz Air LP ("Jazz") up to May 24, 2007, ACTS LP ("ACTS") up to October 16, 2007, and CIE.

CIE includes the corporate, financing and investing activities of ACE. ACE's investments in Aeroplan, Jazz and ACTS Aero were changed in 2007 from the consolidation to equity method of accounting reported under the CIE segment. As of May 9, 2008 and February 7, 2008, ACE no longer equity accounts for Aeroplan (Note 5) and Jazz (Note 5), respectively, but distributions from Aeroplan and Jazz are recorded in the CIE segment. 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 (up to March 14, 2007) and the timing of revenue recognition related to maintenance services provided by ACTS (completed contract basis of accounting for engine and component maintenance services, up to October 16, 2007) versus the expense recognition in Air Canada and Jazz, which is as the work is completed. In addition, consolidation adjustments were made related to the timing of revenue and expense recognition pertaining to power-by-the-hour contracts. Subsequent to the change in accounting for ACE's investments in Aeroplan and ACTS, these consolidation adjustments are no longer recorded in 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 for travel, 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.

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 to the applicable amounts in the consolidated financial statements follows:

	Three Months Ended June 30								
	Air Canada	CIE	2008 Total ACE	Air Canada	Aeroplan	Jazz	ACTS	CIE	2007* Total ACE
Passenger revenue	$ 2,454	$ -	$ 2,454	$ 2,336	$ -	$ -	$ -	$ -	$ 2,336
Cargo revenue	139	-	139	135	-	-	-	-	135
Other revenue	189	1	190	128	-	1	56	3	188
External revenue	2,782	1	2,783	2,599	-	1	56	3	2,659
Inter-segment revenue	-	-	-	40	-	248	202	(490)	-
Total revenues	**2,782**	**1**	**2,783**	**2,639**	**-**	**249**	**258**	**(487)**	**2,659**
Wages, salaries and benefits	480	7	487	475	-	56	90	5	626
Aircraft fuel	848	-	848	636	-	54	-	(53)	637
Aircraft rent	69	-	69	75	-	22	-	(6)	91
Airport and navigation fees	255	-	255	257	-	33	-	(34)	256
Aircraft maintenance, materials and supplies	172	-	172	205	-	20	79	(183)	121
Communications and information technology	72	-	72	67	-	1	4	(3)	69
Food, beverages and supplies	81	-	81	78	-	2	-	1	81
Depreciation, amortization and obsolesence	173	(2)	171	136	-	4	11	(2)	149
Commissions	47	-	47	51	-	-	-	-	51
Capacity purchase with Jazz	233	-	233	232	-	-	-	(156)	76
Special charge for labour restructuring	-	-	-	-	-	-	6	-	6
Other	345	5	350	339	-	31	59	(29)	400
Total operating expenses	**2,775**	**10**	**2,785**	**2,551**	**-**	**223**	**249**	**(460)**	**2,563**
Operating income (loss) before under noted item	**7**	**(9)**	**(2)**	**88**	**-**	**26**	**9**	**(27)**	**96**
Provision for cargo investigation	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Operating income (loss)	**7**	**(9)**	**(2)**	**88**	**-**	**26**	**9**	**(27)**	**96**
Interest income	15	8	23	23	-	1	-	4	28
Interest expense	(78)	(9)	(87)	(86)	-	(1)	(5)	(4)	(96)
Interest capitalized	8	-	8	28	-	-	-	-	28
Gain on disposal of assets	7	908	915	14	-	-	-	4	18
Gain (loss) on financial instruments recorded at fair value	176	-	176	(6)	-	-	-	-	(6)
Equity and other investment income	-	5	5	-	-	-	-	24	24
Other non-operating income (expense)	-	-	-	(6)	-	1	-	4	(1)
Non-controlling interest	(3)	(29)	(32)	(4)	-	-	-	(52)	(56)
Foreign exchange gain (loss)	48	-	48	160	-	-	(1)	(1)	158
Provision for income taxes	(58)	(166)	(224)	(56)	-	-	-	(19)	(75)
Segment income (loss)	**$ 122**	**$ 708**	**$ 830**	**$ 155**	**$ -**	**$ 27**	**$ 3**	**$ (67)**	**$ 118**

**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS, respectively, are not consolidated with ACE (Note 1). ACTS Aero equity investment income is recorded within CIE prospectively from October 16, 2007. Aeroplan and Jazz equity investment income is recorded up to May 9, 2008 and February 7, 2008 respectively. Subsequent to these effective dates, distribution income from Aeroplan and Jazz is recorded within CIE. For the three months ending June 30, 2008, equity income of $2 relating to ACE's equity investments is included in Equity and other investment income.*

	Six Months Ended June 30								
	Air Canada	CIE	2008 Total ACE	Air Canada	Aeroplan	Jazz	ACTS	CIE	2007* Total ACE
Passenger revenue	$ 4,765	$ -	$ 4,765	$ 4,473	$ -	$ -	$ -	$ 15	$ 4,488
Cargo revenue	263	-	263	275	-	-	-	-	275
Other revenue	480	1	481	337	198	3	113	(130)	521
External revenue	5,508	1	5,509	5,085	198	3	113	(115)	5,284
Inter-segment revenue	1	(1)	-	94	3	610	398	(1,105)	-
Total revenues	**5,509**	**-**	**5,509**	**5,179**	**201**	**613**	**511**	**(1,220)**	**5,284**
Wages, salaries and benefits	961	22	983	974	17	139	176	18	1,324
Aircraft fuel	1,563	-	1,563	1,221	-	125	-	(124)	1,222
Aircraft rent	132	-	132	154	-	57	-	(16)	195
Airport and navigation fees	496	-	496	500	-	80	-	(81)	499
Aircraft maintenance, materials and supplies	375	-	375	429	-	50	158	(374)	263
Communications and information technology	145	-	145	138	7	2	8	(10)	145
Food, beverages and supplies	158	-	158	158	-	6	-	-	164
Depreciation, amortization and obsolesence	344	(4)	340	264	3	9	20	(1)	295
Commissions	100	-	100	110	-	-	-	-	110
Capacity purchase with Jazz	468	-	468	462	-	-	-	(386)	76
Special charge for labour restructuring	-	-	-	-	-	-	15	-	15
Other	772	6	778	759	134	83	122	(189)	909
Total operating expenses	**5,514**	**24**	**5,538**	**5,169**	**161**	**551**	**499**	**(1,163)**	**5,217**
Operating income (loss) before under noted item	**(5)**	**(24)**	**(29)**	**10**	**40**	**62**	**12**	**(57)**	**67**
Provision for cargo investigation	(125)	-	(125)	**-**	**-**	**-**	**-**	**-**	**-**
Operating income (loss)	**(130)**	**(24)**	**(154)**	**10**	**40**	**62**	**12**	**(57)**	**67**
Interest income	33	15	48	49	3	2	-	7	61
Interest expense	(159)	(24)	(183)	(177)	(3)	(3)	(10)	(26)	(219)
Interest capitalized	25	-	25	64	-	-	-	-	64
Gain (loss) on disposal of assets	(29)	990	961	21	-	-	-	4	25
Gain on financial instruments recorded at fair value	153	-	153	28	-	-	-	-	28
Equity and other investment income	-	17	17	-	-	-	-	27	27
Other non-operating income (expense)	(2)	1	(1)	(10)	(1)	1	-	9	(1)
Non-controlling interest	(6)	38	32	(6)	-	-	-	(73)	(79)
Foreign exchange gain (loss)	(41)	-	(41)	193	-	-	(1)	(1)	191
Provision for income taxes	(10)	(199)	(209)	(51)	-	-	-	(67)	(118)
Segment income (loss)	**$ (166)**	**$ 814**	**$ 648**	**$ 121**	**$ 39**	**$ 62**	**$ 1**	**$ (177)**	**$ 46**

**Effective March 14, 2007, May 24, 2007, and October 16, 2007, the results and financial position of Aeroplan, Jazz and ACTS, respectively, are not consolidated with ACE (Note 1). ACTS Aero equity investment income is recorded within CIE prospectively from October 16, 2007. Aeroplan and Jazz equity investment income is recorded up to May 9, 2008 and February 7, 2008 respectively. Subsequent to these effective dates, distribution income from Aeroplan and Jazz is recorded within CIE. For the six months ending June 30, 2008, equity income of $12 relating to ACE's equity investments is included in Equity and other investment income.*

Included within Depreciation, amortization and obsolescence is depreciation of property and equipment for Quarter 2, 2008, within the Air Canada segment of $161 (six months ending June 30, 2008 - $320). This is broken down by segment for 2007 as follows; Air Canada $126 (six months ending June 30, 2007 - $244), Aeroplan nil (six months ending June 30, 2007 - nil), Jazz $4 (six months ending June 30, 2007 - $9), ACTS $3 (six months ending June 30, 2007 - $4), and CIE ($2) (six months ending June 30, 2007 – ($1)).

Geographic Information

	Three Months Ended June 30		Six Months Ended June 30	
Passenger revenues	**2008**	**2007***	**2008**	**2007***
Canada	$ 1,076	$ 1,011	$ 1,998	$ 1,865
US Transborder	458	469	988	961
Atlantic	488	476	858	837
Pacific	242	237	447	450
Other	190	143	474	375
	$ **2,454**	**$ 2,336**	$ **4,765**	**$ 4,488**

	Three Months Ended June 30		Six Months Ended June 30	
Cargo revenues	**2008**	**2007***	**2008**	**2007***
Canada	$ 27	$ 26	$ 50	$ 51
US Transborder	4	6	9	13
Atlantic	60	50	118	107
Pacific	36	43	64	83
Other	12	10	22	21
	$ **139**	**$ 135**	$ **263**	**$ 275**

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

Passenger and cargo revenues are based on the actual flown revenue for flights with an origin and destination in a specific country or region. Atlantic refers to flights that cross the Atlantic Ocean with origins and destinations principally in Europe. Pacific refers to flights that cross the Pacific Ocean with origins and destinations principally in Asia. Other passenger and cargo revenues refer to flights with origins and destinations principally in South America, South Pacific, and the Caribbean. Other operating revenues are principally derived from customers located in Canada. Passenger revenues includes revenues from Aeroplan related to Aeroplan rewards net of purchase of Aeroplan miles of $30 for Quarter 2, 2008 ($70 for the six months ending June 30, 2008) and $29 for Quarter 2, 2007 ($62 for the six months ending June 30, 2007).

Segment Asset Information

	June 30, 2008		
	Air Canada	CIE	Total
Cash and cash equivalents	$ 719	$ 762	$ 1,481
Short-term investments	778	66	844
	$ 1,497	**$ 828**	**$ 2,325**
Equity investment (ACTS Aero)	$ -	$ 82	$ 82
Additions to capital assets – six months	$ 628	$ -	$ 628
Total assets	**$ 12,187**	**$ 614**	**$ 12,801**

	December 31, 2007		
	Air Canada	CIE	Total
Cash and cash equivalents	$ 527	$ 1,773	$ 2,300
Short-term investments	712	127	839
	$ 1,239	**$ 1,900**	**$ 3,139**
Equity investments (Aeroplan, Jazz, ACTS Aero)	$ -	$ (56)	$ (56)
Additions to capital assets (a) - 2007	$ 2,596	$ -	$ 2,622
Total assets	**$ 11,820**	**$ 1,934**	**$ 13,754**

(a) The consolidated total includes additions to capital assets of $10 for Jazz and $16 for ACTS, that were segments up to May 24, 2007 and October 16, 2007 respectively.

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

9. RELATED PARTY TRANSACTIONS

At June 30, 2008 ACE holds a 75% ownership interest in Air Canada. Air Canada has various related party transactions with ACTS Aero, an ACE related entity. Subsequent to the sale of Jazz units on January 24, 2008 and the termination of the Securityholders' Agreement on February 7, 2008, ACE no longer exercised significant influence over Jazz. Refer to Note 13 – Capacity Purchase Agreement for a summary of transactions under the Jazz CPA. Subsequent to the sale on April 24, 2008 and the termination of the Securityholders' Agreement on May 9, 2008, ACE no longer exercised significant influence over Aeroplan.

Related party trade balances, as outlined below, mainly arise from the provision of services, including the allocation of employee related costs. Trade balances between the related parties have trade terms which generally require payment 30 days after receipt of invoice.

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

	June 30 2008	December 31 2007
Accounts receivable		
ACTS Aero (Air Canada)	$ 99	$ 99
	$ 99	**$ 99**
Accounts payable and accrued liabilities		
ACTS Aero (Air Canada)	$ 37	$ 88
	$ 37	**$ 88**

Refer to Note 13 – Jazz Capacity Purchase Agreement for transactions with Jazz. Up until October 15, 2007 the results and financial position of ACTS are consolidated within ACE (Note 8). The related party revenues and expenses with ACTS Aero are summarized as follows:

	Three Months Ended June 30 2008	Six Months Ended June 30 2008
Revenues		
Property rental revenues (ACTS Aero)	$ 9	$ 17
Revenues from information technology services (ACTS Aero)	4	7
Revenues from corporate services and other (ACTS Aero)	5	18
	$ 18	**$ 42**
Expenses		
Maintenance expense for services from ACTS Aero	$ 134	$ 275
Recovery of wages, salary and benefit expense for employees assigned to ACTS Aero	(68)	(135)
	$ 66	**$ 140**

10. COMMITMENTS

The table below provides Air Canada's current contractual obligations as at June 30, 2008 related to operating lease obligations and committed capital expenditures.

	Remainder of 2008	2009	2010	2011	2012	Thereafter	Total
Operating lease commitments	$ 148	$ 300	$ 289	$ 226	$ 208	$ 718	$ 1,889
Committed capital expenditures	195	75	84	83	453	3,745	4,635
	$ 343	**$ 375**	**$ 373**	**$ 309**	**$ 661**	**$ 4,463**	**$ 6,524**

Boeing 787

Boeing has notified Air Canada that its first Boeing 787 aircraft originally scheduled for delivery in February 2010 is scheduled for delivery in January 2012, with additional deliveries, originally scheduled for completion between 2010 and 2014, being delayed by approximately two to two and a half years. Air Canada's capital expenditure projections, including the predelivery payments, have been amended to reflect this delay.

11. CONTINGENCIES

Investigations by Competition Authorities Relating to Cargo

The European Commission, the United States Department of Justice and the Competition Bureau in Canada, among other competition authorities, are investigating alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada, a number of whom, including Air Canada, have received a statement of objections from the European Commission that sets out the European Commission's preliminary assessment in relation to such matter. Air Canada has provided its reply to the statement of objections. Competition authorities have sought or requested information from Air Canada as part of their investigations. Air Canada is cooperating with these investigations, which are likely to lead to proceedings against Air Canada and a number of airlines and other cargo operators in certain jurisdictions. 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.

During Quarter 1, 2008, Air Canada recorded a provision of $125 as a preliminary estimate. This estimate is based upon the current status of the investigations and proceedings and Air Canada's assessment as to the potential outcome for certain of them. This provision does not address the proceedings in all jurisdictions, but only where there is sufficient information to do so. Management has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings. Additional material provisions may be required.

12. CAPITAL MANAGEMENT

ACE is an investment holding company of aviation interests which include, as at June 30, 2008, a controlling interest in Air Canada, and a non-controlling interest in ACTS Aero. ACE manages its capital at the parent company level separately from the capital of its subsidiary, Air Canada. Each of the ACE and Air Canada Boards of Directors approves, the ACE or Air Canada objectives and policies for managing capital as the case may be. For purposes of disclosure of capital management, the Corporation has provided separate information about ACE and Air Canada. The ACE information is provided at the parent company level as if its investments were not consolidated and for Air Canada information is provided based on its consolidated financial statements.

ACE

ACE views capital as the sum of parent company debt consisting of convertible notes, convertible preferred shares, non-controlling interest and shareholders' equity. This definition of capital is used by management and may not be comparable to measures presented by other public companies. Capital managed by ACE, summarized from the consolidated statement of financial position, follows:

	June 30 2008	December 31 2007
Convertible senior notes*	$ 278	$ 273
Convertible preferred shares*	194	182
Non-controlling interest	724	757
Shareholders' equity*	2,087	3,217
Capital	**$ 3,283**	**$ 4,429**

** For accounting purposes, the convertible senior notes and convertible preferred shares are presented as compound instruments. The carrying values ascribed to the holders' conversion options within the senior notes and preferred shares, included in shareholders' equity as at June 30, 2008, amount to $90 ($90 as at December 31, 2007) and $117 ($117 as at December 31, 2007), respectively.*

ACE's business strategy, to surface shareholder value and to return capital to its shareholders, has influenced its capital management objectives.

Consistent with ACE's strategy to surface shareholder value, in the six months ended June 30, 2008, ACE sold the remaining 40.3 million trust units of Aeroplan Income Fund for net proceeds of $692, and realized a gain on disposal of $830 ($684 after tax). ACE also sold the remaining 24.7 million trust units of Jazz Air Income Fund for net proceeds of $182 and realized a gain on disposal of $167 ($133 after tax). As at June 30, 2008, ACE has retained ownership interests in Air Canada (75.0%) and ACTS (27.8%). ACE no longer has any ownership interest in Aeroplan or Jazz.

During Quarter 2, 2008, ACE returned capital to its shareholders by way of a substantial issuer bid, wherein ACE completed the purchase and cancellation of 22.7 million common shares for an aggregate purchase price of $500.

During Quarter 1, 2008, ACE returned capital to its shareholders by way of a substantial issuer bid, wherein ACE completed the purchase and cancellation of 49.9 million common shares for an aggregate purchase price of $1,498.

As at June 30, 2008, ACE's capital amounted to $3,283, a decline of $1,146 during the six months ended June 30, 2008 ($4,429 as at December 31, 2007) mainly due to the issuer bids. ACE unconsolidated cash, cash equivalents and short-term investments amounted to $828 ($1,900 as at December 31, 2007).

AIR CANADA

Air Canada views capital as the sum of long-term debt, non-controlling interest, capitalized operating leases and shareholders' equity. Air Canada currently has predelivery financing arranged, which is related to future deliveries, and as the aircraft have not yet been delivered, this debt is excluded from the capital base. Air Canada includes capitalized operating leases, which is a measure commonly used in the industry ascribing a value to obligations under operating leases. The value is based on annualized aircraft rent expense multiplied by 7.5, which is a factor commonly used in the airline industry. The measure used may not necessarily reflect the fair value or net present value related to the future minimum lease payments as the measure is not based on the remaining contractual payments and the factor may not recognize discount rates implicit in the actual leases or current rates for similar obligations with similar terms and risks. This definition of capital is used by management and may not be comparable to measures presented by other public companies.

Air Canada also monitors its ratio of adjusted net debt to net debt plus shareholders' equity. Adjusted net debt is calculated as the sum of long-term debt, non-controlling interest and capitalized operating leases less cash, cash equivalents and short-term investments.

Air Canada's main objectives when managing capital are:

- to structure repayment obligations in line with the expected life of Air Canada's principal revenue generating assets;
- to ensure Air Canada has access to capital to fund Air Canada's fleet renewal and refurbishment program and to ensure adequate cash levels to withstand deteriorating economic conditions that may arise;
- to maintain an appropriate balance between debt supplied capital versus investor supplied capital as measured by the adjusted net debt to net debt plus equity ratio; and
- to maintain Air Canada's credit ratings to facilitate access to capital markets at competitive interest rates.

In order to maintain or adjust the capital structure, Air Canada may adjust the type of capital utilized, including purchase versus lease decisions, defer or cancel aircraft expenditures by not exercising available options or selling current aircraft options and issuing debt or equity securities, all subject to market conditions and the terms of the underlying third party agreements.

AIR CANADA

Air Canada's total capital as at June 30, 2008 and December 31, 2007 is calculated as follows:

	June 30 2008	December 31 2007
Long-term debt and capital lease obligations	$ 3,863	$ 4,006
Current portion of long-term debt and capital lease obligations	396	413
	4,259	4,419
Non-controlling interest	190	184
Capitalized operating leases	1,950	2,115
Less predelivery financing included in long-term debt	(135)	(521)
Adjusted debt and non-controlling interest	6,264	6,197
Shareholders' equity	2,467	2,443
Total Capital	**$ 8,731**	**$ 8,640**
Adjusted debt and non-controlling interest	$ 6,264	$ 6,197
Less cash, cash equivalents and short-term investments	(1,497)	(1,239)
Adjusted net debt and non-controlling interest	**$ 4,767**	**$ 4,958**
Adjusted net debt to adjusted net debt plus shareholders' equity ratio	**65.9%**	**67.0%**

The improvement from December 31, 2007 in the ratio is attributable, in part, to the increase in cash, cash equivalents and short-term investments recorded during the six months ended June 30, 2008.

13. JAZZ CAPACITY PURCHASE AGREEMENT

Air Canada and Jazz are parties to the Jazz CPA pursuant to which Air Canada purchases substantially all of Jazz's fleet capacity based on predetermined rates, in addition to reimbursing Jazz, without mark-up, for certain pass-through costs as defined in the Jazz CPA which include fuel, airport and user fees and other. The fees include both a variable component that is dependent on Jazz aircraft utilization and a fixed component and are recorded in the applicable category within the operating expenses in the results of Air Canada. Refer to Note 22 – Related Party Transactions in the 2007 annual consolidated financial statements of the Corporation for further details regarding the Jazz CPA. Up until May 24, 2007, the results of Jazz are consolidated within ACE (Note 1).

The following table outlines CPA and pass-through costs for the period:

	Three Months Ended June 30		Six Months Ended June 30	
	2008	**2007**	**2008**	**2007**
Expenses from CPA with Jazz	$ 233	$ 232	$ 468	$ 462
Pass through fuel expense from Jazz	115	81	208	152
Pass through airport expense from Jazz	50	52	100	99
Pass through other expense from Jazz	6	7	21	20
	$ 404	**$ 372**	**$ 797**	**$ 733**

14. 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 2007 annual consolidated financial statements of ACE.

	Three Months Ended June 30		Six Months Ended June 30	
(Canadian dollars in millions except per share data)	**2008**	**2007**	**2008**	**2007**
Income for the period in accordance with Canadian GAAP	$ 830	$ 118	$ 648	$ 46
Convertible securities (2)	5	30	72	109
Derivative financial instruments (3)	163	16	275	41
Distributions	-	(5)	-	9
Stock-based compensation	-	(1)	-	(2)
Aircraft leases	(1)	(1)	(2)	(2)
Amortization of intangible assets (4)	(7)	(1)	(13)	(3)
Post-employment benefits (6)	(4)	17	(4)	14
Pension and post-retirement benefits (5)	1	-	1	-
Sale of Jazz Air Income Fund units (8)	6	-	12	-
Sale of Aeroplan Income Fund units (7)	(87)	-	(87)	-
Non-controlling interest (10)	(26)	(5)	(44)	(8)
Income adjustments for the period before the following	50	50	210	158
Income tax adjustment	(33)	2	(66)	27
Respective period income adjustments in accordance with US GAAP	17	52	144	185
Income for the period in accordance with US GAAP	**$ 847**	**$ 170**	**$ 792**	**$ 231**
Total comprehensive income for the period in accordance with Canadian GAAP	$ 870	$ 110	$ 836	$ 48
Respective period income adjustments in accordance with US GAAP	17	52	144	185
Defined benefit pension plans: (a) (5)				
Net actuarial (loss) gain arising during the period	(173)	703	(173)	703
Amortization of net actuarial loss included in net periodic pension cost	1	1	1	3
Jazz Air Income Fund defined benefit pension plans (8)	-	-	2	-
Net change in unrealized gain on Jazz Air Income Fund (8)	(6)	-	-	-
Derivative financial instruments (a) (3)	(111)	(10)	(188)	(24)
Total comprehensive income for the period in accordance with US GAAP	**$ 598**	**$ 856**	**$ 622**	**$ 915**
Earnings per share – US GAAP (11)				
- Basic	$ 15.69	$ 1.60	$ 13.57	$ 2.14
- Diluted	$ 10.96	$ 1.38	$ 9.77	$ 1.99

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

	June 30 2008	December 31 2007
Deferred charges		
Balance under Canadian GAAP	$ 49	$ 51
Aircraft leases	(9)	(6)
Convertible securities (2)	5	6
Deferred finance charges	45	42
Balance under US GAAP	**$ 90**	**$ 93**
Intangible assets		
Balance under Canadian GAAP	$ 660	$ 647
Goodwill (4)	890	889
Balance under US GAAP	**$ 1,550**	**$ 1,536**
Deposits and other assets		
Balance under Canadian GAAP	$ 650	$ 527
Pension asset adjustment (5)	308	293
Investment in Jazz Air Income Fund (8)	-	(14)
Investment in ACTS	10	10
Balance under US GAAP	**$ 968**	**$ 816**
Accounts payable and accrued liabilities		
Balance under Canadian GAAP	$ 1,183	$ 1,249
Tax adjustment – Pension (5)	(64)	-
Tax adjustment – Other	(7)	-
Pension liability adjustment (5)	(90)	(90)
Convertible notes – embedded derivative (2)	-	47
Balance under US GAAP	**$ 1,022**	**$ 1,206**
Current portion of long-term debt and capital leases		
Balance under Canadian GAAP	$ 396	$ 686
Convertible securities (2)	-	17
Balance under US GAAP	**$ 396**	**$ 703**
Long-term debt and capital leases		
Balance under Canadian GAAP	$ 4,141	$ 4,006
Convertible securities (2)	14	-
Deferred finance charges	45	42
Balance under US GAAP	**$ 4,200**	**$ 4,048**
Convertible preferred shares		
Balance under Canadian GAAP	$ 194	$ 182
Reclassification of convertible preferred shares (2)	(194)	(182)
Balance under US GAAP	**$ -**	**$ -**
Future income taxes		
Balance under Canadian GAAP	$ 50	$ 50
Goodwill (4)	112	112
Balance under US GAAP	**$ 162**	**$ 162**

Certain items as at December 31, 2007 have been reclassified to conform to the current quarter's presentation.

	June 30 2008	December 31 2007
Pension and other benefit liabilities		
Balance under Canadian GAAP	$ 1,738	$ 1,824
Pension and post-retirement liability adjustment (5)	97	(154)
Pension and post-retirement liability adjustment - early measurement date (5)	13	-
Pension adjustment due to valuation allowance (5)	(2)	(1)
Post-employment benefits (6)	(82)	(86)
Post-employment benefits - early measurement date (6)	4	-
Balance under US GAAP	**$ 1,768**	**$ 1,583**
Other long-term liabilities		
Balance under Canadian GAAP	$ 511	$ 483
Convertible preferred shares – embedded derivative (2)	60	81
Convertible notes – embedded derivative (2)	9	-
Investment in Aeroplan Income Fund (7)	-	(87)
Balance under US GAAP	**$ 580**	**$ 477**
Non-controlling interest		
Balance under Canadian GAAP	$ 724	$ 757
Earnings allocation to non-controlling interest (10)	57	17
Additional non-controlling interest – Air Canada	202	202
Balance under US GAAP	**$ 983**	**$ 976**
Temporary equity		
Balance under Canadian GAAP	$ -	$ -
Reclassification of convertible preferred shares (2)	229	219
Balance under US GAAP	**$ 229**	**$ 219**

Certain items as at December 31, 2007 have been reclassified to conform to the current quarter's presentation.

	June 30 2008	December 31 2007
Shareholders' equity		
Share capital and other equity		
Balance under Canadian GAAP	$ 307	$ 450
Reclassification of convertible preferred shares and convertible notes (2)	(207)	(207)
Future income tax	(19)	(19)
Goodwill recorded at fresh-start (4)	1,596	1,596
Distributions	(7)	(7)
Labour related provisions	(23)	(23)
Substantial issuer bids (9)	(1,052)	-
Balance of Share capital and other equity under US GAAP	**$ 595**	**$ 1,790**
Contributed surplus		
Balance under Canadian GAAP	$ 170	$ 504
Deconsolidation of Aeroplan	(260)	(260)
Distributions	(33)	(33)
Redemption of convertible notes	(1)	(1)
Substantial issuer bids (9)	199	-
Balance of Contributed surplus under US GAAP	**$ 75**	**$ 210**
Retained earnings		
Balance under Canadian GAAP	$ 1,368	$ 2,209
Convertible securities (2)	(67)	(57)
Substantial issuer bids (9)	853	-
Change in pension and post-retirement measurement date (5)	(13)	-
Change in pension and post-retirement measurement date – Non-controlling interest	3	-
Change in post-employment measurement date (6)	(4)	-
Change in post-employment measurement date - Non-controlling interest	1	-
Current year income adjustments	144	203
Cumulative prior year adjustments:		
Stock-based compensation	-	6
Future income tax	54	24
Goodwill	(94)	(94)
Intangible asset amortization	(39)	(11)
Derivative financial instruments	88	(30)
Pension and post-retirement benefits	1	-
Post-employment benefits	65	48
Aircraft leases	(7)	(3)
Distributions	13	4
Labour related provisions	23	23
Jazz dilution gain	(41)	(41)
Air Canada dilution gain	(202)	(202)
Convertible securities	90	(45)
Secondary offering of Aeroplan units	(48)	-
Secondary offering of Jazz units	30	-
Monetization of ACTS	(31)	-
Non-controlling interest	(20)	-
Balance of Retained earnings under US GAAP	**$ 2,167**	**$ 2,034**

Certain items as at December 31, 2007 have been reclassified to conform to the current quarter's presentation.

	June 30 2008	December 31 2007
Accumulated other comprehensive income		
Balance under Canadian GAAP	$ 242	$ 54
Current year adjustments to comprehensive income (a):		
Defined benefit pension plans: (5)		
Net actuarial (loss) gain arising during the period	(173)	484
Amortization of net actuarial loss included in net periodic pension cost	1	3
Jazz Air Income Fund defined benefit pension plans (8)	2	7
Derivative financial instruments (3)	(188)	(82)
Cumulative prior year adjustments to comprehensive income (a):		
Minimum pension liability adjustment		(90)
Pension and post-retirement adjustment	270	(127)
Jazz Air Income Fund defined benefit pension plans	(2)	(9)
Derivative financial instruments (3)	(56)	26
Balance of Accumulated other comprehensive income under US GAAP	**$ 96**	**$ 266**
Balance of Shareholders' equity under US GAAP	**$ 2,933**	**$ 4,300**

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

Certain items as at December 31, 2007 have been reclassified to conform to the current quarter's presentation.

1. Fair Value Measurements

In September 2006, the FASB issued FASB Statement 157 *Fair Value Measurements* ("FAS 157"), which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. The statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Beginning in fiscal year 2008, the Corporation has elected to partially adopt FAS 157 in accordance with FASB Staff Position No. FAS 157-2, which delays the effective date of FAS 157 to fiscal years beginning after November 15, 2008. This applies to all non-recurring fair value measurements of non-financial assets and non-financial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. This includes those measured at fair value in goodwill impairment testing, asset retirement obligations initially measured at fair value, exit and disposal costs initially measured at fair value, and those initially measured at fair value in a business combination.

The implementation of FAS 157 for financial assets and financial liabilities, effective January 1, 2008, did not have a material impact on the Corporation's consolidated financial position and results of operations. The Corporation is currently assessing the impact of FAS 157 for non-financial assets and non-financial liabilities on its consolidated financial position and results of operations.

		Fair value measurements at reporting date using		
	June 30 2008	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Assets				
Held-for-trading securities				
Cash and cash equivalents	$ 1,481	$ -	$ 1,481	$ -
Short-term investments	844	-	844	-
Restricted cash	42	-	42	-
Deposits and other assets				
Restricted cash	91	-	91	-
Asset backed commercial paper	29	-	-	29
Derivative instruments				
Fuel derivatives [(1)]	37	-	37	-
Foreign exchange derivatives	1	-	1	-
Interest rate swaps	7	-	7	-
Total	**$ 2,532**	**$ -**	**$ 2,503**	**$ 29**

[(1)] *The fuel derivatives above exclude fuel derivatives designated as hedges under Canadian GAAP which have a fair value of $463 derived using significant other observable inputs (level 2).*

	June 30 2008	Fair value measurements at reporting date using: Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Liabilities				
Derivative instruments				
Cross-currency interest rate swaps	$ 13	$ -	$ 13	$ -
Convertible preferred shares - embedded derivative	60	-	-	60
Convertible notes - embedded derivative	9	-	-	9
Total	**$ 82**	**$ -**	**$ 13**	**$ 69**

2. Convertible securities

Preferred Shares

Under Canadian GAAP, the convertible preferred shares issued in 2004 are presented as a compound instrument. At the date of issuance, the value ascribed to the holder's conversion option, which is presented in Share capital and other equity was $123 less allocated fees of $6; the value ascribed to the financial liability was $127. Under US GAAP, the convertible preferred shares contain an embedded derivative which has been reported separately as an Other long-term liability at its fair value of $60 as at June 30, 2008 ($81 as at December 31, 2007). The convertible preferred shares were initially recorded at $162 which is the proceeds received less direct costs of issuance and the fair value of the embedded derivative, as of the date of issuance, and is included in Temporary equity as the conditions of redemption are not solely within the control of the Corporation. The adjustment to Convertible preferred shares reflects applying the direct costs of issuance, recorded against the Convertible preferred shares under Canadian GAAP since January 1, 2007, against the amount recorded in Temporary equity.

For the convertible preferred shares, 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 per annum on the convertible preferred shares.

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 2005 are presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which is presented in Share capital and other equity, was $94 less allocated fees of $2; the value ascribed to the financial liability was $236.

Under US GAAP the convertible notes were initially recorded at $260 which is the proceeds received before costs of issuance and the fair value of the embedded derivative, as of the date of issuance of $70. The direct costs of issuance of $11 are recorded in deferred charges. The adjustment also reflects a decrease to the liability related to the fair value of the embedded derivative and reduction to interest expense. The embedded derivative is reported as Other long-term liabilities at its fair value of $9 as at June 30, 2008 (reported as Accounts payable and accrued liabilities, $47 as at December 31, 2007).

The summary impact of the convertible securities to the reconciliation of Canadian GAAP to US GAAP is as follows:

	Three months ended June 30			
	Preferred shares		Convertible notes	
	2008	2007	2008	2007
Gain (loss) on change in fair value of the embedded derivative	$ (17)	$ 27	$ 20	$ (3)
Credit / (Debit) to interest expense	6	5	(4)	1
Total	**$ (11)**	**$ 32**	**$ 16**	**$ (2)**

	Six months ended June 30			
	Preferred shares		Convertible notes	
	2008	2007	2008	2007
Gain (loss) on change in fair value of the embedded derivative	$ 21	$ 95	$ 38	$ 2
Credit to interest expense	11	10	2	2
Total	**$ 32**	**$ 105**	**$ 40**	**$ 4**

3. Financial instruments & hedge accounting

Under Canadian GAAP, the Corporation has designated its fuel derivatives as cash flow hedges while under US GAAP, the Corporation has elected not to designate its fuel derivatives as cash flow hedges.

The adjustment reflects the reclassification of the "Net gains on fuel derivatives under hedge accounting" under Canadian GAAP of $173 (net of tax of $82) for the three months and $273 (net of tax of $128) for the six months ended June 30, 2008; and the "Reclassification of net realized (gains) losses on fuel derivatives to income" under Canadian GAAP of $62 (net of tax of $30) for the three months and $85 (net of tax of $41) for the six months ended June 30, 2008 from OCI to earnings. The transitional adjustment to the new Canadian GAAP standards adopted January 1, 2007 is reversed under US GAAP. On January 1, 2007, the adjustment under US GAAP is an increase to the fair value of outstanding fuel derivatives of $18, an increase to accumulated other comprehensive income of $26, a decrease to retained earnings of $5 and a decrease to non-controlling interest of $3.

4. 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.

5. Pension and post-retirement benefits

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements*

No. 87, 88, 106, and 132 (R) ("FAS 158"). FAS 158 requires an employer to (i) recognize the overfunded or underfunded status of a defined benefit plan (other than a multiemployer plan) as an asset or liability with changes in that funded status recognized through comprehensive income; and (ii) measure the funded status of a plan as of the year-end date. FAS 158 also specifies additional disclosure requirements.

Funded status

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.

The US GAAP adjustment is to recognize the funded status of benefit plans in the balance sheet by aggregating overfunded plans separately from underfunded plans and recording the resulting amounts as an asset and a liability, respectively. The current portion of the liability represents the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next twelve months exceeds the fair value of plan assets. The actuarial gains or losses and past service costs or credits that arise during the period are recognized as a component of other comprehensive income, net of tax. Under Canadian GAAP, these amounts are not recorded on the balance sheet until the period in which they affect earnings. Furthermore, under Canadian GAAP, the current portion of the liability represents the past service contributions for the Domestic Registered Plans scheduled to be paid in the next twelve months.

For the three months and six months ended June 30, 2008, the adjustment under US GAAP is a decrease to other comprehensive income of $172 (net of tax of $64), an increase to deposits and other assets of $15 and an increase to pension and other benefit liabilities of $251.

Change in measurement date

The US GAAP requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008 and has been adopted in the first quarter of 2008 through opening retained earnings. The implementation of the change in measurement date to December 31 resulted in an increase to pension and other benefit liabilities offset by a decrease to opening retained earnings of $13 (due to Pension benefit plans of $7 and Post-retirement benefit plans of $6).

Limit on carrying value of accrued benefit asset

In addition to the above adjustment relating to the recognition of the funded status of a defined benefit plan, under Canadian GAAP, when a defined benefit plan gives rise to an accrued benefit asset, an entity should recognize a valuation allowance for any excess of the adjusted benefit asset over the expected future benefit. The accrued benefit asset should be presented on the entity's balance sheet net of the valuation allowance. A change in the valuation allowance should be recognized in income for the period in which the change occurs. Under US GAAP, the recognition of a valuation allowance is not permitted. Included in the adjustment is the reversal of the valuation allowance recognized under Canadian GAAP.

<u>Components of US GAAP net periodic cost of defined benefit plans</u>

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

	Three months ended June 30			
	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
Service cost	$ 53	$ 64	$ 17	$ 16
Interest cost	178	164	13	12
Expected return on plan assets	(206)	(193)	-	-
Amortization or recognition of experience (gains) losses	2	2	-	(22)
Total	**$ 27**	**$ 37**	**$ 30**	**$ 6**

	Six months ended June 30			
	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
Service cost	$ 103	$ 127	$ 34	$ 37
Interest cost	351	327	26	25
Expected return on plan assets	(412)	(386)	-	-
Amortization or recognition of experience (gains) losses	2	4	(4)	(22)
Total	**$ 44**	**$ 72**	**$ 56**	**$ 40**

As of June 30, 2008 the Corporation had contributed $154 to its defined benefit pension plans. The Corporation expects to contribute an additional $302 during the remainder of 2008.

6. Post-employment benefits

Under Canadian GAAP, the actuarial gains and losses related to post-employment benefits, which are non-accumulating, are amortized over the average expected period that the benefits will be paid. Under US GAAP, the actuarial gains and losses related to post-employment benefits, which are non-accumulating, are included in income in the period that they arise.

The implementation of the change in measurement date to December 31 resulted in an increase to pension and other benefit liabilities offset by a decrease to opening retained earnings of $4 due to post-employment benefit plans.

7. Sale of Aeroplan Income Fund units

As described in Note 5 of the of the Quarter 2 2008 interim unaudited consolidated financial statements of ACE, on April 21, 2008 ACE sold a total of 20.4 million trust units of AIF at a price of $17.50 per unit representing total net proceeds to ACE of $343 and realized a gain on sale of $413 ($340 after tax) under Canadian GAAP.

On June 2, 2008, ACE sold the remaining trust units of AIF for total net proceeds to ACE of $349, and realized a gain on sale of $417 ($344 after tax) under Canadian GAAP.

The accounting is the same under US and Canadian GAAP. The difference that arises is due to a difference in the US GAAP carrying value of the Aeroplan investment.

The April 21, 2008 US GAAP adjustment is a decrease to the gain on sale of $44 offset by an increase to the negative investment of $44 which results in a realized gain on sale of $369 under US GAAP.

The June 2, 2008 US GAAP adjustment is a decrease to the gain on sale of $43 offset by an increase to the negative investment of $43 which results in a realized gain on sale of $374 under US GAAP.

8. Sale of Jazz Air Income Fund units

As described in Note 5 of the of the Quarter 2 2008 interim unaudited consolidated financial statements of ACE, on January 24, 2008 ACE sold a total of 13 million trust units of JAIF at a price of $7.45 per unit representing total net proceeds to ACE of $97 and realized a gain on sale of $89 ($71 net of taxes) under Canadian GAAP.

On June 2, 2008, ACE sold its remaining trust units of JAIF for total net proceeds to ACE of $85, and realized a gain on sale of $78 ($62 net of taxes). Net realized gains of $65, net of tax of $14, were taken into income from OCI under Canadian GAAP.

The accounting is the same under US and Canadian GAAP. The difference that arises is due to a difference in the US GAAP carrying value of the Jazz investment.

The January 24, 2008 US GAAP adjustment is an increase to the gain on sale of $6, an increase to the Jazz investment of $7 and an increase in OCI of $1. The adjustments result in a realized gain on sale of $95 under US GAAP.

With the reduction of the ownership interest below 20% and the termination of the Securityholders' Agreement on February 7, 2008, ACE no longer had significant influence over Jazz. The US GAAP adjustment is an increase to the Jazz investment of $1 offset by an increase in OCI of $1.

The equity investment ACE had in Jazz was classified as available-for-sale and unrealized period changes in fair value were recorded in OCI. The adjustment to fair value recorded in OCI amounted to $71, net of tax of ($15) under Canadian GAAP during Quarter 1, 2008. The Quarter 1 2008 US GAAP adjustment is an increase to the Jazz investment of $6 offset by an increase in OCI of $6.

The June 2, 2008, US GAAP adjustment is an increase to the gain on sale of $6 offset by a decrease in OCI of $6.

9. Substantial Issuer Bids

Substantial Issuer Bid – January 2008

As described in Note 7 of the of the Quarter 2 2008 interim unaudited consolidated financial statements of ACE, on January 10, 2008, ACE accepted for purchase and cancellation a total of 40,023,427 Class A Variable Voting Shares and 9,894,166 Class B Voting Shares at $30.00 per share for an aggregate purchase price of $1,498 in accordance with the terms of a substantial issuer bid.

Upon purchase and cancellation by ACE of the Class A Variable Voting Shares and Class B Voting Shares, Share capital decreased by $115, Contributed surplus decreased by $228, and Retained earnings decreased by $1,155 under Canadian GAAP.

The accounting is the same under US and Canadian GAAP. The difference that arises is due to a difference in carrying value of the US GAAP shareholder's equity.

The US GAAP adjustment is a decrease to share capital of $729, an increase to contributed surplus of $138 and an increase to retained earnings of $591.

Substantial Issuer Bid – June 2008

On June 18, 2008, ACE accepted for purchase and cancellation a total of 12,537,084 Class A Variable Voting Shares and 10,190,187 Class B Voting Shares at $22.00 per share for an aggregate purchase price of $500 in accordance with the terms of a substantial issuer bid.

Upon purchase and cancellation by ACE of the Class A Variable Voting Shares and Class B Voting Shares, Share capital decreased by $65, Contributed surplus decreased by $101, and Retained earnings decreased by $334.

As described above, the accounting is the same under US and Canadian GAAP. The difference that arises is due to a difference in carrying value of the US GAAP shareholder's equity.

The US GAAP adjustment is a decrease to share capital of $323, an increase to contributed surplus of $61 and an increase to retained earnings of $262.

10. Non-controlling interest

The non-controlling interest adjustment reflects the deduction made in the amount of the 25% non-controlling interest's proportion of Air Canada's income or loss adjustments as ACE holds a 75% direct ownership interest in Air Canada.

11. Earnings per share

(Canadian dollars in millions except per share data)	Three Months Ended June 30 2008	Three Months Ended June 30 2007	Six Months Ended June 30 2008	Six Months Ended June 30 2007
Numerator:				
Numerator for basic earnings per share:				
Income for the year	$ 847	$ 170	$ 792	$ 231
Accretion of convertible preferred shares (a)	(5)	(5)	(10)	(10)
Adjusted numerator for earnings per share	842	165	782	221
Effect of potential dilutive securities:				
Convertible preferred shares (b)	5	5	10	10
Convertible notes (b)	6	6	7	12
Add back anti-dilutive impact	-		-	(12)
Adjusted earnings for diluted earnings per share	$ 853	$ 176	$ 799	$ 231
Denominator:				
Denominator for basic earnings per share:				
Weighted-average shares	54	103	58	103
Effect of potential dilutive securities:				
Convertible preferred shares	11	11	11	11
Convertible notes	13	11	13	10
Stock options	-	2	-	2
Add back anti-dilutive impact	-		-	(10)
Adjusted weighted-average shares for diluted earnings per share	78	127	82	116
Basic earnings per share	**$ 15.69**	**$ 1.60**	**$ 13.57**	**$ 2.14**
Diluted earnings per share	**$ 10.96**	**$ 1.38**	**$ 9.77**	**$ 1.99**

(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.

12. Recently issued accounting standards effective in the period

Fair Value Measurements

In September 2006, the FASB issued FASB Statement 157 *Fair Value Measurements* ("FAS 157"), which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. The statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Beginning in fiscal year 2008, the Corporation has elected to partially adopt FAS 157 in accordance with FASB Staff Position No. FAS 157-2, which delays the effective date of FAS 157 to fiscal years beginning after November 15, 2008. This applies to all non-recurring fair value measurements of non-financial assets and non-financial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. This includes those measured at fair value in goodwill impairment testing, asset retirement obligations initially measured at fair value, exit and disposal costs initially measured at fair value, and those initially measured at fair value in a business combination.

The implementation of FAS 157 for financial assets and financial liabilities, effective January 1, 2008, did not have a material impact on the Corporation's consolidated financial position and results of operations. The Corporation is currently assessing the impact of FAS 157 for non-financial assets and non-financial liabilities on its consolidated financial position and results of operations.

Fair Value Option for Financial Assets and Financial Liabilities

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. FAS 159 became effective in Q1 2008 however the Corporation has decided not to adopt the fair value option for any of its existing financial instruments.

13. Recently issued accounting standards

Derivative Instruments and Hedging Activities

In March 2008, the FASB issued FASB Statement 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* ("FAS 161"), which amends the disclosure requirements for derivative instruments and hedging activities. FAS 161 requires additional disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of this standard in Q1 2009 will not have a material impact on our financial position or results of operations. The Corporation is in the process of evaluating the disclosure impacts of this standard.

Determination of the Useful Life of Intangible Assets

In April 2008, the FASB issued FSP FAS 142-3 *Determination of the Useful Life of Intangible Assets* ("FSP FAS 142-3") which amends the list of factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under Statement 142. The new guidance applies to (1) intangible assets that are acquired individually or with a group of other assets and (2) intangible assets acquired in both business combinations and asset acquisitions.

FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. While the guidance on determining the useful life of a recognized intangible asset must be applied prospectively only to intangible assets acquired after the FSP's effective date, the disclosure requirements of the FSP must be applied prospectively to all intangible assets recognized as of, and after, the FSP FAS 142-3's effective date. Early adoption is prohibited.

The Corporation is currently evaluating the effects, if any, that FSP FAS 142-3 may have on its financial statements.

Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)

In May 2008, the FASB issued FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* ("FSP APB 14-1") which addresses the accounting for convertible debt securities that, upon conversion, may be settled by the issuer fully or partially in cash (i.e. if the investor elects to convert, the issuer has the right to pay some or all of the conversion value in cash rather than to settle the conversion value fully in shares).

FSP APB 14-1 clarifies the accounting for convertible debt instruments that may be settled in cash upon conversion and specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods.

FSP APB 14-1 does not change the accounting for more traditional types of convertible debt securities that do not have a cash settlement feature. Also, FSP APB 14-1 does not apply if, under existing GAAP for derivatives, the embedded conversion feature must be accounted for separately from the rest of the instrument.

FSP APB 14-1 is effective for fiscal years and interim periods beginning after December 15, 2008. FSP APB 14-1 should be applied retrospectively to all past periods presented — even if the instrument has matured, has been converted, or has otherwise been extinguished as of FSP APB 14-1's effective date.

The Corporation is currently evaluating the effects, if any, that FSP APB 14-1 may have on its financial statements.

Determining Whether an Instrument (or an Embedded Feature) Is Indexed to an Entity's Own Stock

In June 2008, the Emerging Issues Task Force issued EITF Issue No. 07-5 *Determining Whether an Instrument (or an Embedded Feature) Is Indexed to an Entity's Own Stock* ("EITF 07-5").

The instruments affected by this Issue may contain contract terms that call into question whether the instrument or embedded feature is indexed to the entity's own stock. A derivative instrument or embedded derivative feature that is deemed indexed to an entity's own stock may be exempt from the requirements of Statement 133 for derivatives. In addition, a freestanding instrument that is indexed to a company's own stock remains eligible for equity classification under Issue 00-19.

The consensus addresses the following issues:

- How an entity should evaluate whether an instrument (or embedded feature) is indexed to its own stock.
- How the currency in which the strike price of an equity-linked financial instrument (or embedded equity-linked feature) is denominated affects the determination of whether the instrument is indexed to an entity's own stock.
- How an issuer should account for market-based employee stock option valuation instruments.

The consensus is effective for fiscal years and interim periods beginning after December 15, 2008. The consensus must be applied to outstanding instruments as of the beginning of the fiscal year in which the Issue is adopted as a cumulative-effect adjustment to the opening balance of retained earnings for that fiscal year. Early application is not permitted.

The Corporation is currently evaluating the effects, if any, that EITF 07-5 may have on its financial statements.