2013

Consolidated Financial Statements and Notes

February 12, 2014

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements have been prepared by management. Management is responsible for the fair presentation of the consolidated financial statements in conformity with generally accepted accounting principles in Canada which incorporates International Financial Reporting Standards. Management is responsible for the selection of accounting policies and making significant accounting judgements and estimates. Management is also responsible for all other financial information included in management's discussion and analysis and for ensuring that this information is consistent, where appropriate, with the information contained in the consolidated financial statements.

Management is responsible for establishing and maintaining adequate internal control over financial reporting which includes those policies and procedures that provide reasonable assurance over the safeguarding of assets and over the completeness, fairness and accuracy of the consolidated financial statements and other financial information.

The Audit, Finance and Risk Committee, which is comprised entirely of independent directors, reviews the quality and integrity of the Corporation's financial reporting and recommends approval to the Board of Directors; oversees management's responsibilities as to the adequacy of the supporting systems of internal controls; provides oversight of the independence, qualifications and appointment of the external auditor; and, pre-approves audit and audit-related fees and expenses. The Board of Directors approves the Corporation's consolidated financial statements, management's discussion and analysis and annual report disclosures prior to their release. The Audit, Finance and Risk Committee meets with management, the internal auditors and external auditors at least four times each year to review and discuss financial reporting issues and disclosures, auditing and other matters.

The external auditors, PricewaterhouseCoopers LLP, conduct an independent audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and express their opinion thereon. Those standards require that the audit is planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The external auditors have unlimited access to the Audit, Finance and Risk Committee and meet with the Committee on a regular basis.

(signed) Calin Rovinescu
Calin Rovinescu
President and Chief Executive Officer

(signed) Michael Rousseau
Michael Rousseau
Executive Vice President and Chief Financial Officer

February 11, 2014

Independent Auditor's Report

To the Shareholders of Air Canada

We have audited the accompanying consolidated financial statements of Air Canada and its subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2013, December 31, 2012 and January 1, 2012 and the consolidated statement of operations, statement of comprehensive income, statement of changes in equity and statement of cash flow for the years ended December 31, 2013 and December 31, 2012, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Air Canada and its subsidiaries as at December 31, 2013, December 31, 2012 and January 1, 2012 and their financial performance and their cash flows for the years ended December 31, 2013 and December 31, 2012 in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP[1]

Montreal, Quebec
February 11, 2014

[1] CPA auditor, CA, public accountancy permit No. 18144

"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(Canadian dollars in millions)		December 31, 2013	December 31, 2012	January 1, 2012
ASSETS				
Current				
Cash and cash equivalents	Note 2P	$ 750	$ 754	$ 777
Short-term investments	Note 2Q	1,458	1,219	1,251
Total cash, cash equivalents and short-term investments		2,208	1,973	2,028
Restricted cash	Note 2R	92	96	76
Accounts receivable		589	550	712
Aircraft fuel inventory		71	84	92
Spare parts and supplies inventory	Note 2S	65	66	93
Prepaid expenses and other current assets		263	232	255
Total current assets		3,288	3,001	3,256
Property and equipment	Note 4	5,073	4,711	4,938
Intangible assets	Note 5	304	314	312
Goodwill	Note 6	311	311	311
Deposits and other assets	Note 7	494	510	595
Total assets		**$ 9,470**	**$ 8,847**	**$ 9,412**
LIABILITIES				
Current				
Accounts payable and accrued liabilities		$ 1,129	$ 1,161	$ 1,175
Advance ticket sales		1,687	1,599	1,554
Current portion of long-term debt and finance leases	Note 8	374	499	419
Total current liabilities		3,190	3,259	3,148
Long-term debt and finance leases	Note 8	3,959	3,259	3,707
Pension and other benefit liabilities	Note 9	2,687	4,686	5,563
Maintenance provisions	Note 10	656	571	548
Other long-term liabilities	Note 11	375	419	463
Total liabilities		**$ 10,867**	**$ 12,194**	**$ 13,429**
EQUITY				
Shareholders' equity				
Share capital	Note 13	827	813	840
Contributed surplus		80	62	58
Deficit		(2,367)	(4,281)	(4,989)
Total shareholders' equity		(1,460)	(3,406)	(4,091)
Non-controlling interests		63	59	74
Total equity		(1,397)	(3,347)	(4,017)
Total liabilities and equity		**$ 9,470**	**$ 8,847**	**$ 9,412**

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

On behalf of the Board of Directors:

(signed) David I. Richardson

David I. Richardson
Chairman

(signed) Christie J.B. Clark

Christie J.B. Clark
Chair of the Audit, Finance and Risk Committee

CONSOLIDATED STATEMENT OF OPERATIONS

For the year ended December 31 (Canadian dollars in millions except per share figures)		2013	2012
Operating revenues			
Passenger	Note 20	$ 11,021	$ 10,737
Cargo	Note 20	474	488
Other		887	889
Total revenues		**12,382**	**12,114**
Operating expenses			
Aircraft fuel		3,534	3,561
Wages, salaries and benefits		2,247	2,110
Benefit plan amendments	Note 9	(82)	(127)
Capacity purchase agreements		1,123	1,072
Airport and navigation fees		983	992
Aircraft maintenance		632	672
Sales and distribution costs		613	603
Depreciation, amortization and impairment		578	669
Aircraft rent		318	336
Food, beverages and supplies		289	291
Communications and information technology		190	188
Other		1,338	1,305
Total operating expenses		**11,763**	**11,672**
Operating income		**619**	**442**
Non-operating income (expense)			
Foreign exchange gain (loss)		(120)	106
Interest income		32	37
Interest expense		(397)	(304)
Interest capitalized		46	18
Net financing expense relating to employee benefits	Note 9	(208)	(288)
Gain (loss) on financial instruments recorded at fair value	Note 17	37	(20)
Loss on investments in Aveos	Note 19	-	(65)
Other		(7)	(6)
Total non-operating expense		(617)	(522)
Income (loss) before income taxes and discontinued operations		**2**	**(80)**
Income taxes	Note 12	8	(1)
Net income (loss) from continuing operations		**$ 10**	**$ (81)**
Net loss from discontinued operations - Aveos	Note 19	**-**	**(55)**
Net income (loss)		**$ 10**	**$ (136)**
Net income (loss) attributable to:			
Shareholders of Air Canada		6	(140)
Non-controlling interests		4	4
Net income (loss)		**$ 10**	**$ (136)**
Net income (loss) per share attributable to shareholders of Air Canada	Note 15		
Basic earnings (loss) per share from continuing operations		$ 0.02	$ (0.31)
Diluted earnings (loss) per share from continuing operations		$ 0.02	$ (0.31)
Basic and diluted loss per share from discontinued operations		$ -	$ (0.20)
Basic and diluted earnings (loss) per share		$ 0.02	$ (0.51)

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (Canadian dollars in millions)		2013	2012
Comprehensive income			
Net income (loss)		$ 10	$ (136)
Other comprehensive income, net of taxes of nil:			
Remeasurements on employee benefit liabilities	Note 9	1,908	826
Total comprehensive income		**$ 1,918**	**$ 690**
Comprehensive income attributable to:			
Shareholders of Air Canada		$ 1,914	$ 686
Non-controlling interests		4	4
Total comprehensive income		**$ 1,918**	**$ 690**
Comprehensive income (loss) attributable to shareholders of Air Canada from:			
Continuing operations		$ 1,914	$ 741
Discontinued operations		-	(55)
		$ 1,914	$ 686

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Canadian dollars in millions)	Share capital	Contributed surplus	Deficit	Total shareholders' equity	Non-controlling interests	Total equity
January 1, 2012	$ 840	$ 58	$ (4,989)	$ (4,091)	$ 74	$ (4,017)
Net income (loss)	-	-	(140)	(140)	4	(136)
Remeasurements on employee benefit liabilities	-	-	826	826	-	826
Total comprehensive income	-	-	686	686	4	690
Share-based compensation	-	4	-	4	-	4
Expiration of warrants	(18)	-	18	-	-	-
Shares purchased and cancelled under issuer bid	(9)	-	4	(5)	-	(5)
Distributions	-	-	-	-	(19)	(19)
December 31, 2012	$ 813	$ 62	$ (4,281)	$ (3,406)	$ 59	$ (3,347)
Net income	-	-	6	6	4	10
Remeasurements on employee benefit liabilities	-	-	1,908	1,908	-	1,908
Total comprehensive income	-	-	1,914	1,914	4	1,918
Share-based compensation	-	12	-	12	-	12
Performance share units reclassed to equity settled (Note 2i)	-	7	-	7	-	7
Repurchase of warrants (Note 13)	(2)	-	-	(2)	-	(2)
Shares issued (Note 13)	16	(1)	-	15	-	15
December 31, 2013	$ 827	$ 80	$ (2,367)	$ (1,460)	$ 63	$ (1,397)

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

CONSOLIDATED STATEMENT OF CASH FLOW

For the year ended December 31 (Canadian dollars in millions)		2013	2012
Cash flows from (used for)			
Operating			
Net income (loss)		$ 10	$ (136)
Adjustments to reconcile to net cash from operations			
Depreciation, amortization and impairment		578	669
Foreign exchange (gain) loss	Note 17	200	(96)
Employee benefit funding (greater than) less than expense		(3)	76
Benefit plan amendments	Note 9	(82)	(127)
Fuel and other derivatives	Note 17	(33)	(36)
Loss on investments in Aveos	Note 19	-	65
Discontinued operations – Aveos	Note 19	(29)	29
Change in maintenance provisions		29	(2)
Changes in non-cash working capital balances		33	220
Provision for cargo investigations	Note 18	-	(8)
Other		28	(11)
Net cash flows from operating activities		**731**	**643**
Financing			
Proceeds from borrowings	Note 8	1,973	132
Reduction of long-term debt and finance lease obligations	Note 8	(1,646)	(442)
Issue of common shares, net		14	-
Shares purchased for cancellation		-	(5)
Distributions related to aircraft special purpose leasing entities		-	(16)
Other		(15)	-
Net cash flows from (used in) financing activities		**326**	**(331)**
Investing			
Short-term investments		(210)	27
Additions to property, equipment and intangible assets		(962)	(444)
Proceeds from sale of assets		70	50
Other		41	32
Net cash flows used in investing activities		**(1,061)**	**(335)**
Decrease in cash and cash equivalents		**(4)**	**(23)**
Cash and cash equivalents, beginning of year		754	777
Cash and cash equivalents, end of year		**$ 750**	**$ 754**

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

FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012
(CANADIAN DOLLARS IN MILLIONS – EXCEPT PER SHARE AMOUNTS)

1. GENERAL INFORMATION

The accompanying audited consolidated financial statements (the "financial statements") are of Air Canada (the "Corporation"). The term "Corporation" also refers to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly-owned operating subsidiaries, Touram Limited Partnership ("Air Canada Vacations") and Air Canada *rouge* LP doing business under the brand name Air Canada *rouge*™ ("Air Canada *rouge*"). These financial statements also include certain aircraft leasing entities, which are consolidated under IFRS 10 Consolidated Financial Statements, with nominal equity owned by other parties.

Air Canada is incorporated and domiciled in Canada. The address of its registered office is 7373 Côte-Vertu Boulevard West, Saint-Laurent, Quebec.

Air Canada is Canada's largest domestic, US transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-US transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-US transborder routes are operated under the brand name "Air Canada Express" and operated by third parties such as Jazz Aviation LP ("Jazz") and Sky Regional Airlines Inc. ("Sky Regional") through capacity purchase agreements (each a "CPA"). Air Canada also offers scheduled passenger services on domestic and Canada-US transborder routes through capacity purchase agreements on other regional carriers, including those operating aircraft of 18 seats or less, some of which are referred to as Tier III carriers. Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance network.

Air Canada Cargo, an operating division of Air Canada, is Canada's largest provider of air cargo services. Air Canada offers air cargo services on domestic and U.S. transborder routes as well as on international routes between Canada and major markets in Europe, Asia, South America and Australia.

In 2012, the Air Canada Leisure Group was created to co-ordinate the Corporation's activities in the leisure travel markets. The Air Canada Leisure Group consists of Air Canada Vacations and Air Canada *rouge*. Air Canada Vacations is a leading Canadian tour operator. Based in Montreal and Toronto, Air Canada Vacations operates its business in the outbound leisure travel market (Caribbean, Mexico, U.S., Europe, Central and South America, South Pacific, Australia and Asia) by developing, marketing and distributing vacation travel packages. Air Canada Vacations also offers cruise packages in North America, Europe and the Caribbean.

Air Canada *rouge* launched its operations on July 1, 2013 with a start-up fleet of four aircraft transferred from the mainline fleet – two Boeing 767-300ER and two Airbus A319 aircraft. By the end of 2013, the fleet was comprised of eight Airbus A319 and two Boeing 767 aircraft. Air Canada *rouge* provides scheduled passenger service within certain of Air Canada's leisure travel markets.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation prepares its financial statements in accordance with generally accepted accounting principles in Canada ("GAAP") as set out in the CPA Canada Handbook – Accounting ("CPA Handbook") which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These financial statements were approved for issue by the Board of Directors of the Corporation on February 11, 2014.

These financial statements are based on the accounting policies as described below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

A) BASIS OF MEASUREMENT

These financial statements have been prepared under the historical cost convention, except for the revaluation of cash, cash equivalents and short-term investments, restricted cash and derivative instruments which are measured at fair value.

B) PRINCIPLES OF CONSOLIDATION

These financial statements include the accounts of Air Canada and its subsidiaries. Subsidiaries are all entities (including structured entities) which Air Canada controls. For accounting purposes, control is established by an investor when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. All inter-company balances and transactions are eliminated.

Non-controlling interests represent equity interests in subsidiaries owned by outside parties. The share of net assets of subsidiaries attributable to non-controlling interests is presented as a component of equity.

Structured Entities

The Corporation has aircraft leasing and other agreements with a number of structured entities. Under IFRS 10 Consolidated Financial Statements, the Corporation controls and consolidates leasing entities covering aircraft (23 as at December 31, 2013), including the structured entity created for the benefit of the Enhanced Equipment Trust Certificates ("EETC") financing structure undertaken by Air Canada in 2013 in relation to the acquisition of five Boeing 777 aircraft, four of which were delivered in 2013. The Corporation has concluded that it controls these entities because the lease or other agreements with these structured entities give Air Canada the power to control the principal economic decision on lease expiry of whether to purchase the aircraft and thereby collapse the structured entity.

The Corporation also leases certain aircraft from structured entities where it does not guarantee any portion of the residual value of the aircraft on lease expiry. In the absence of residual value guarantees, the Corporation's maximum exposure to loss from its involvement with these structured entities is limited principally to its lease payments. These entities are not controlled and are not consolidated by the Corporation.

Impact upon adoption of IFRS 10 – Consolidated Financial Statements

The Corporation adopted IFRS 10 effective January 1, 2013, in accordance with the applicable transitional provisions. IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under previous IFRS, consolidation was required when an entity had the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation—Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements.

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

Under the guidance of SIC Interpretation 12 – Consolidation of Special Purpose Entities which was applicable to periods prior to January 1, 2013, the Corporation consolidated three of the Fuel Facility Corporations located in Canada. The Corporation assessed its consolidation conclusions at January 1, 2013 under IFRS 10 and determined that it does not have control over and should not, consolidate the three Fuel Facility Corporations that were previously consolidated following the guidance in SIC-12.

The Corporation has accounted for this change in accounting policy using the relevant transitional provisions and derecognized the carrying amount of the assets, liabilities and non-controlling interests of the three Fuel Facility Corporations as at January 1, 2012. The adjustments for each financial statement line item affected are presented in the tables below.

Adjustments to consolidated statement of financial position

	December 31, 2012	January 1, 2012
Cash and cash equivalents	$ (4)	$ (71)
Short-term investments	(49)	-
Property and equipment	(160)	(150)
Current portion of long-term debt	(7)	(5)
Long-term debt	(190)	(199)
Other long-term liabilities	(8)	(6)
Decrease in net assets	**$ 8**	**$ 11**
Deficit	(3)	(6)
Non-controlling interests	(5)	(5)
Equity	**$ (8)**	**$ (11)**

Adjustments to consolidated statement of operations and statement of comprehensive income

	Year ended December 31, 2012
Other revenues	$ (6)
Depreciation, amortization and impairment	(9)
Increase in net income and comprehensive income	$ 3
Increase in net income and comprehensive income attributable to:	
Shareholders of Air Canada	3
Non-controlling interests	-
Equity	$ 3

These adjustments had an impact of $0.01 on basic and diluted earnings per share for the year ended December 31, 2012.

C) PASSENGER AND CARGO REVENUES

Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. The Corporation has formed alliances with other airlines encompassing loyalty program participation, interline agreements and code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided. Passenger revenue also includes certain fees and surcharges and revenues from passenger-related services such as ticket changes, seat selection, and excess baggage which are recognized as the services are provided.

Airline passenger and cargo advance sales are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aimia Canada Inc. ("Aeroplan"), a corporation that provides loyalty program

services to Air Canada and purchases seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada (the "CPSA").

D) CAPACITY PURCHASE AGREEMENTS

Air Canada has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers, including those operating aircraft of 18 seats or less, some of which are referred to as Tier III carriers. Under these agreements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue. Operating expenses under capacity purchase agreements include the capacity purchase fees, which, under the capacity purchase agreement between the Corporation and Jazz (the "Jazz CPA"), are based on variable and fixed rates ("CPA Rates") plus mark-up and pass-through costs. The CPA Rates are periodically set by the parties for rate periods of three years. The parties set the rates through negotiations based on, amongst other things, Jazz's forecasted costs for the applicable rate period and an operating plan for the applicable rate period provided by Air Canada, and the results of benchmarking exercises, which compare Jazz costs to other regional carriers. Pass-through costs are non-marked-up costs charged to the Corporation and include fuel, airport and user fees and other costs. These expenses are recorded in the applicable category within Operating expenses.

E) AEROPLAN LOYALTY PROGRAM

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

Under the CPSA, Aeroplan purchases passenger tickets from Air Canada to meet its obligation for the redemption of Aeroplan Miles® for air travel. The proceeds from the sale of passenger tickets to Aeroplan are included in Advance ticket sales. Revenue related to these passenger tickets is recorded in passenger revenues when transportation is provided.

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

F) OTHER REVENUES

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

Other revenue also includes revenue related to the lease or sublease of aircraft to third parties. Lease or sublease revenues are recognized on a straight line basis over the term of the lease or sublease. Rental revenue from operating leases and subleases amounted to $53 in 2013 (2012 – $90).

In certain subleases of aircraft to Jazz, for accounting purposes, the Corporation acts as an agent and accordingly reports the sublease revenues net against aircraft rent expense as the terms of the sublease match the terms of the Corporation's lease. The Corporation acts as lessee and sublessor in these matters.

G) EMPLOYEE BENEFITS

The cost of pensions, other post-retirement and post-employment benefits earned by employees is actuarially determined annually as at December 31. The cost is determined using the projected unit credit method and assumptions including market interest rates, salary escalation, retirement ages of employees, mortality rates, and health care costs.

Past service costs are recognized immediately in income. Gains and losses on curtailments or settlements are recognized in the period in which the curtailment or settlement occurs.

Net actuarial gains and losses are recognized immediately in other comprehensive income and deficit without subsequent reclassification to income. The current service cost and recognized element of any past service cost of employee benefits expense is recorded in Wages, salaries and benefits. The interest arising on the net benefit obligations are presented in Net financing expense relating to employee benefits.

Certain of the Corporation's pension plans are subject to minimum funding requirements. The liability in respect of minimum funding requirements is determined using the projected minimum funding requirements, based on management's best estimates of the actuarially determined funded status of the plan, market discount rates and salary escalation estimates. The liability in respect of the minimum funding requirement and any subsequent remeasurement of that liability are recognized immediately in other comprehensive income and deficit without subsequent reclassification to income.

Impact upon adoption of Amendments to IAS 19 – Employee Benefits

The Corporation adopted the revised IAS 19 standard effective January 1, 2013, in accordance with the applicable transitional provisions. The amendments to IAS 19 make significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and expanded the disclosures for employee benefits. Actuarial gains and losses are renamed 'remeasurements' and are recognized immediately in Other comprehensive income ("OCI"). Remeasurements recognized in OCI are not recycled through profit or loss in subsequent periods. The amendments also accelerate the recognition of past service costs whereby they are recognized in the period of a plan amendment, irrespective of whether the benefits have vested. The annual expense for a funded benefit plan is computed based on the application of the discount rate to the net defined benefit asset or liability, including interest on any liability in respect of minimum funding requirements. The Corporation continues to immediately recognize in the deficit all pension and benefit adjustments recognized in OCI. The Corporation also continues to recognize interest expense on net post-employment benefit liabilities in Net financing expense related to employee benefits in the consolidated statement of operations.

The Corporation adopted these amendments retrospectively and adjusted its equity as at January 1, 2012 to recognize previously unrecognized past service costs. The financing expense and employee benefit expense for the comparable period have been adjusted to reflect the accounting changes for defined benefit plans. The adjustments for each financial statement line item affected are presented in the tables below.

Adjustments to consolidated statement of financial position

	December 31, 2013	December 31, 2012	January 1, 2012
Decrease in Pension and other benefit liabilities	$ (3)	$ (3)	$ -
Increase in Equity	$ 3	$ 3	$ -

Adjustments to consolidated statement of operations

	Year ended December 31	
	2013	2012
Increase in:		
Wages, salaries, and benefits	$ -	$ 1
Benefit plan amendments	-	(3)
Net financing expense relating to employee benefits	312	272
Decrease in net income	**$ 312**	**$ 270**
Decrease in net income after accounting change attributable to:		
Shareholders of Air Canada	312	270
Non-controlling interests	-	-
	$ 312	**$ 270**

These adjustments reduced basic and diluted earnings per share by $1.12 for the year ended December 31, 2013 (2012 - $0.97 for the year ended December 31, 2012).

Adjustments to consolidated statement of comprehensive income

	Year ended December 31	
	2013	2012
Increase in other comprehensive income:		
Remeasurements of post-employment benefit liabilities	$ 312	$ 273
Decrease in net income	(312)	(270)
Change in total comprehensive income	**$ -**	**$ 3**

With retrospective application of the amended standard as at January 1, 2013, restated net income for 2012 is lower than originally reported under the previous accounting standard. The decrease arises from net financing expense relating to the pension benefit liability which is calculated using the discount rate used to value the benefit obligation. As the discount rate is lower than the expected rate of return on plan assets, financing expense increases as the interest attributable to plan assets declines. The difference between the actual rate of return on plan assets and the discount rate is included in OCI as a remeasurement. Also, under the amended standard, the interest cost on the additional minimum funding liability is recorded in the consolidated statement of operations, whereas it was reported in other comprehensive income under the previous standard. The impact of this change is that restated net income for 2012 decreases and other comprehensive income increases by the same amount, with no net impact on total comprehensive income. The amended standard also accelerates the recognition of past service costs whereby they are recognized in the period of a plan amendment, irrespective of whether the benefits have vested. The impact of this change is that restated net income and total comprehensive income for the twelve months ended December 31, 2012 increased $3 for Benefit plan amendments.

The amended standard did not have any net impact on the consolidated statement of cash flows.

H) EMPLOYEE PROFIT SHARING PLANS

The Corporation has employee profit sharing plans. Payments are calculated based on full calendar year results and an expense recorded throughout the year as a charge to Wages, salaries and benefits based on the estimated annual payment under the plan.

I) SHARE-BASED COMPENSATION PLANS

Certain employees of the Corporation participate in Air Canada's Long-Term Incentive Plan, which provides for the grant of stock options and performance share units ("PSUs"), as further described in Note 14. PSUs are notional share units which are exchangeable, on a one-to-one basis, as determined by the Board of Directors based on factors such as the remaining number of shares authorized for issuance under the Long-Term Incentive Plan as described in Note 14, for Air Canada shares, or the cash equivalent. The options and PSUs granted contain both time and performance based vesting features as those further described in Note 14.

The fair value of stock options with a graded vesting schedule is determined based on different expected lives for the options that vest each year, as it would be if the award were viewed as several separate awards, each with a different vesting date, and it is accounted for over the respective vesting period taking into consideration forfeiture estimates. For a stock option award attributable to an employee who is eligible to retire at the grant date, the fair value of the stock option award is expensed on the grant date. For a stock option award attributable to an employee who will become eligible to retire during the vesting period, the fair value of the stock option award is recognized over the period from the grant date to the date the employee becomes eligible to retire. The Corporation recognizes compensation expense and a corresponding adjustment to Contributed surplus equal to the fair value of the equity instruments granted using the Black-Scholes option pricing model taking into consideration forfeiture estimates. Compensation expense is adjusted for subsequent changes in management's estimate of the number of options that are expected to vest.

A prospective change in accounting for PSUs was made in 2013 from cash-settled instruments to equity-settled instruments based on settlement experience. Grants of PSUs are accounted for as equity settled instruments. Accordingly, the Corporation recognizes compensation expense offset by Contributed surplus equal to the market value of an Air Canada common share at the date of grant on a straight line basis over the applicable vesting period, taking into consideration forfeiture estimates. Compensation expense is adjusted for subsequent changes in management's

current estimate of the number of PSUs that are expected to vest. Refer to Note 17 for a description of derivative instruments used by the Corporation to hedge the cash flow exposure to PSUs.

Air Canada also maintains an employee share purchase plan. Under this plan, contributions by the Corporation's employees are matched to a specific percentage by the Corporation. Employees must remain with the Corporation until March 31 of the subsequent year for vesting of the Corporation's contributions. These contributions are expensed in Wages, salaries, and benefits expense over the vesting period.

J) MAINTENANCE AND REPAIRS

Maintenance and repair costs for both leased and owned aircraft are charged to Aircraft maintenance as incurred, with the exception of maintenance and repair costs related to return conditions on aircraft under operating lease, which are accrued over the term of the lease, and major maintenance expenditures on owned and finance leased aircraft, which are capitalized as described below in Note 2T.

Maintenance and repair costs related to return conditions on aircraft leases are recorded over the term of the lease for the end of lease maintenance return condition obligations within the Corporation's operating leases, offset by a prepaid maintenance asset to the extent of any related power-by-the-hour maintenance service agreements or any recoveries under aircraft subleasing arrangements. The provision is recorded within Maintenance provisions using a discount rate taking into account the specific risks of the liability over the remaining term of the lease. Interest accretion on the provision is recorded in Other non-operating expense. For aircraft under operating leases which are subleased to third parties, the expense relating to the provision is presented net on the income statement of the amount recognized for any reimbursement of maintenance cost which is the contractual obligation of the sublessee. The reimbursement is recognized when it is virtually certain that reimbursement will be received when the Corporation settles the obligation. Any changes in the maintenance cost estimate, discount rates, timing of settlement or difference in the actual maintenance cost incurred and the amount of the provision is recorded in Aircraft maintenance in the period.

K) OTHER OPERATING EXPENSES

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

L) FINANCIAL INSTRUMENTS

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

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated statement of financial position when the Corporation becomes a party to the contractual provisions of the financial instrument or derivative contract. All financial instruments are required to be measured at fair value on initial recognition. The Corporation's own credit risk and the credit risk of the counterparty are taken into consideration in determining the fair value of financial assets and financial liabilities, including derivative instruments. Measurement in subsequent periods is dependent upon the classification of the financial instrument. The Corporation classifies its financial assets as either fair value through profit or loss ("FVTPL"), loans and receivables or, held to maturity. The classification depends on the purpose for which the financial assets were acquired.

Management determines the classification of its financial assets at initial recognition. Financial assets at FVTPL are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorized as held for trading unless they are designated as hedges. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Held-to-maturity financial assets are non-derivatives that have fixed and determinable payments and the entity has the ability and intent to hold the asset until maturity. For financial instruments classified as other than held-for-trading, transaction costs are added to the initial fair value of the related financial instrument. Financial assets and financial liabilities classified as held-for-trading are measured at FVTPL. Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are measured at amortized cost using the effective interest rate method.

The Corporation assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For loans and receivables, the amount of the loss is measured as the difference

between the asset's carrying value and the present value of estimated future cash flows. The carrying amount of the asset is reduced by the amount of the loss and the latter is recognized in the consolidated statement of operations.

The Corporation enters into interest rate, foreign currency, fuel derivatives and share forward contracts to manage the associated risks. Derivative instruments are recorded on the consolidated statement of financial position at fair value, including those derivatives that are embedded in financial or non-financial contracts that are required to be accounted for separately. Changes in the fair value of derivative instruments are recognized in Non-operating income (expense). These derivative contracts are included in the consolidated statement of financial position at fair value in Prepaid expenses and other current assets, Deposits and other assets, Accounts payable and accrued liabilities, or Other long-term liabilities based on the terms of the contractual agreements. All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the consolidated statement of cash flow.

The Corporation has implemented the following classifications:

- Cash and cash equivalents and Short-term investments are classified as held-for-trading and any period change in fair value is recorded through Interest income in the consolidated statement of operations.

- Restricted cash is classified as held-for-trading and any period change in fair value is recorded through Interest income in the consolidated statement of operations.

- Aircraft related and other deposits are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in the consolidated statement of operations, as applicable.

- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in the consolidated statement of operations, as applicable.

- Accounts payable, credit facilities, and bank loans are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest expense is recorded in the consolidated statement of operations, as applicable.

Impact upon adoption of IFRS 13 – Fair Value Measurement

The Corporation adopted IFRS 13 on January 1, 2013 on a prospective basis. Under previous IFRS, guidance on measuring and disclosing fair value was dispersed among the specific standards requiring fair value measurements. IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. This new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Corporation to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

M) FOREIGN CURRENCY TRANSLATION

The functional currency of Air Canada and its subsidiaries is the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the consolidated statement of financial position. Non-monetary assets and liabilities, revenues and expenses arising from transactions denominated in foreign currencies, are translated at the historical exchange rate or the average exchange rate during the period, as applicable. Adjustments to the Canadian dollar equivalent of foreign denominated monetary assets and liabilities due to the impact of exchange rate changes are recognized in Foreign exchange gain (loss).

N) INCOME TAXES

The tax expense for the period comprises current and deferred income tax. Tax expense is recognized in the consolidated statement of operations, except to the extent that it relates to items recognized in OCI or directly in equity, in which case the tax is netted with such items.

The current income tax expense is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the jurisdictions where the Corporation and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax

regulations are subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognized if they arise from the initial recognition of goodwill; and deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

O) EARNINGS PER SHARE

Basic earnings per share ("EPS") is calculated by dividing the net income (loss) for the period attributable to the shareholders of Air Canada by the weighted average number of ordinary shares outstanding during the period. Shares held in trust for employee share-based compensation awards are treated as treasury shares and excluded from basic shares outstanding in the calculation of basic EPS.

Diluted EPS is calculated by adjusting the weighted average number of ordinary shares outstanding for dilutive potential ordinary shares. The Corporation's potentially dilutive ordinary shares comprise stock options, warrants, and any shares held in trust for employee share-based compensation awards. The number of shares included with respect to time vesting options and warrants is computed using the treasury stock method unless they are anti-dilutive. Under this method, the proceeds from the exercise of such instruments are assumed to be used to purchase Class B Voting Shares at the average market price for the period and the difference between the number of shares issued upon exercise and the number of shares assumed to be purchased are included in the calculation. The number of shares included with respect to performance-based employee share options is treated as contingently issuable shares because their issue is contingent upon satisfying specified conditions in addition to the passage of time. If the specified conditions are met, then the number of shares included is also computed using the treasury stock method unless they are anti-dilutive.

P) CASH AND CASH EQUIVALENTS

Cash and cash equivalents include $186 pertaining to investments with original maturities of three months or less at December 31, 2013 ($218 as at December 31, 2012). Investments include bankers' acceptances and bankers' discount notes, which may be liquidated promptly and have original maturities of three months or less.

Q) SHORT-TERM INVESTMENTS

Short-term investments, comprised of bankers' acceptances and bankers' discount notes, have original maturities over three months, but not more than one year.

R) RESTRICTED CASH

The Corporation has recorded Restricted cash under Current assets representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance ticket sales, as well as funds held in escrow accounts relating to Air Canada Vacations credit card booking transactions, recorded under Current liabilities, for certain travel related activities.

Restricted cash with maturities greater than one year from the balance sheet date is recorded in Deposits and other assets. This restricted cash relates to funds on deposit with various financial institutions as collateral for letters of credit and other items.

S) AIRCRAFT FUEL INVENTORY AND SPARE PARTS AND SUPPLIES INVENTORY

Inventories of aircraft fuel and spare parts, other than rotables, and supplies are measured at the lower of cost and net realizable value, with cost being determined using a weighted average formula.

The Corporation did not recognize any write-downs on inventories or reversals of any previous write-downs during the periods presented. Included in Aircraft maintenance is $48 related to spare parts and supplies consumed during the year (2012 – $43).

T) PROPERTY AND EQUIPMENT

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

The Corporation allocates the amount initially recognized in respect of an item of property and equipment to its significant components and depreciates separately each component. Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Aircraft and flight equipment are componentized into airframe, engine, and cabin interior equipment and modifications. Airframe and engines are depreciated over 20 to 25 years, with 10% to 20% estimated residual values. Cabin interior equipment and modifications are depreciated over the lesser of 5 years or the remaining useful life of the aircraft. Spare engines and related parts ("rotables") are depreciated over the average remaining useful life of the fleet to which they relate with 10% to 20% estimated residual values. Cabin interior equipment and modifications to aircraft on operating leases are amortized over the term of the lease. Major maintenance of airframes and engines, including replacement spares and parts, labour costs and/or third party maintenance service costs, are capitalized and amortized over the average expected life between major maintenance events. Major maintenance events typically consist of more complex inspections and servicing of the aircraft. All maintenance of fleet assets provided under power-by-the-hour contracts are charged to operating expenses in the income statement as incurred. Buildings are depreciated on a straight-line basis over their useful lives not exceeding 50 years or the term of any related lease, whichever is less. Leasehold improvements are amortized over the lesser of the lease term or 5 years. Ground and other equipment is depreciated over 3 to 25 years.

Residual values and useful lives are reviewed at least annually and depreciation rates are adjusted accordingly on a prospective basis. Gains and losses on disposals of property and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of non-operating gains and losses in the consolidated statement of operations.

U) INTEREST CAPITALIZED

Borrowing costs are expensed as incurred. For borrowing costs attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use, the costs are capitalized as part of the cost of that asset. Capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and the activities to prepare the asset for its intended use are in progress. Borrowing costs are capitalized up to the date when the project is completed and the related asset is available for its intended use.

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined at the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Corporation that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

V) LEASES

Leases are classified as finance leases when the lease arrangement transfers substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Gains and losses on sale and operating leaseback transactions are recognized immediately in the consolidated statement of operations when it is clear that the transactions are established at fair value. If the sale price is below fair value, any loss is recognized immediately except that, if the loss is compensated for by future lease payments at below market price, it is deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the gain is deferred and amortized over the period for which the asset is expected to be used. In the context of sale and finance leaseback transactions, any gain on the sale is deferred and amortized over the lease term.

W) INTANGIBLE ASSETS

Intangible assets are initially recorded at cost. Indefinite life intangible assets are not amortized while assets with finite lives are amortized on a straight line basis over their estimated useful lives.

	Estimated Useful Life	Remaining amortization period as at December 31, 2013
International route rights and slots	Indefinite	not applicable
Marketing based trade names	Indefinite	not applicable
Contract and customer based	10 years	1 year
Technology based (internally developed)	5 years	1 to 5 years

Development costs that are directly attributable to the design, development and testing of identifiable software products are recognized as technology based intangible assets if certain criteria are met, including technical feasibility and intent and ability to develop and use the technology to generate probable future economic benefits; otherwise they are expensed as incurred. Directly attributable costs that are capitalized as part of the technology based intangible assets include software-related, employee and third party development costs and an appropriate portion of relevant overhead. Air Canada has international route and slot rights which enable the Corporation to provide services internationally. The value of the recorded intangible assets relates to the cost of route and slot rights at Tokyo's Narita International Airport, Washington's Reagan National Airport and London's Heathrow Airport. Air Canada expects to provide service to these international locations for an indefinite period.

Air Canada and certain of its subsidiaries have trade names, trademarks, and domain names (collectively, "Trade Names"). These items are marketing based intangible assets as they are primarily used in the selling and promotion of Air Canada's products and services. The Trade Names create brand recognition with customers and potential customers and are capable of contributing to cash flows for an indefinite period of time. Air Canada intends to continuously re-invest and market the Trade Names to support classification as indefinite life intangibles. If there were plans to cease using any of the Trade Names, the specific names would be classified as finite and amortized over the expected remaining useful life.

X) GOODWILL

Goodwill represents the excess of the cost of an acquisition over the fair value of the Corporation's share of the net identifiable assets of the acquired business at the date of acquisition. Goodwill is tested at least annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. For the purpose of impairment testing, goodwill is tested for impairment at the lowest level within the entity at which the goodwill is monitored for internal management purposes, being the operating segment level (Note DD). No impairment losses have been recorded against the value of goodwill since its acquisition.

Y) IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets include property and equipment, finite lived intangible assets, indefinite lived intangible assets and goodwill. Assets that have an indefinite useful life, including goodwill are tested at least annually for impairment or when events or circumstances indicate that the carrying value may not be recoverable. Assets that are subject to depreciation or amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment test is performed by comparing the carrying amount of the asset or group of assets to their recoverable amount. Recoverable amount is calculated as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units or CGUs). Management has determined that the appropriate level for assessing impairments is at the North American (for narrowbody aircraft) and international (for widebody aircraft) fleet levels for aircraft and related assets supporting the operating fleet. Parked aircraft not used in operations and aircraft leased or subleased to third parties are assessed for impairment at the individual asset level. Value in use is calculated based upon a discounted cash flow analysis. An impairment loss is recognized for the amount by which the asset's or cash generating unit's carrying amount exceeds its recoverable amount.

Long-lived assets, other than goodwill, that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date. Management assesses whether there is any indication that an impairment loss recognized in a prior period no longer exists or has decreased. In assessing whether there is a possible reversal of an impairment loss, management considers the indicators that gave rise to the impairment loss. If any such indicators exist that an impairment loss has reversed, management estimates the recoverable amount of the long-lived asset. An impairment loss recognized in prior periods for an asset other than goodwill shall be reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. The carrying amount of any individual asset in the CGU is not increased above the carrying value that would have been determined had the original impairment not occurred. A reversal of an impairment loss is recognized immediately in the consolidated statement of operations.

Z) NON-CURRENT ASSETS (OR DISPOSAL GROUPS) HELD FOR SALE

Non-current assets (or disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell. There are currently no assets held for sale.

AA) PROVISIONS

Provisions are recognized when there is a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the obligation. If the effect is significant, the expected cash flows are discounted using a rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as Interest expense within Other non-operating expense.

The Corporation records an asset and related provision for the costs associated with the retirement of long-lived tangible assets when a legal or constructive obligation to retire such assets exists. The provision recorded in Other long-term liabilities is measured as the best estimate of the expenditure required to settle the present obligation at each reporting period. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and then amortized in accordance with the accounting policy in Note 2T. In subsequent periods, the asset retirement provision is adjusted for the passage of time through charges to Interest expense. Any change in the amount of the underlying cash flows, due to changes in the discount rate or changes in the estimate of the expenditure required to settle the present obligation, adjusts both the asset retirement provision and the related asset.

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

Total aircraft operating lease rentals over the lease term are amortized to operating expense (aircraft rent) on a straight-line basis. Included in Deposits and other assets and Other long-term liabilities are the differences between the straight line aircraft rent expense and the payments as stipulated under the lease agreement.

CC) EXCEPTIONAL ITEMS

Exceptional items are those items that in management's view are required to be separately disclosed by virtue of their size or incidence to enable a full understanding of the Corporation's financial performance.

DD) SEGMENT REPORTING

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of operations, has been identified as the Chief Executive Officer. Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions.

EE) ACCOUNTING STANDARDS ADOPTED ON JANUARY 1, 2013

In addition to the adoption of the accounting standard changes for IAS 19 – Employee Benefits and IFRS 13 – Fair Value Measurement described above in Note 2G and 2L, the Corporation adopted the following accounting standard changes effective January 1, 2013.

IFRS 11 – Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will

recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under previous IFRS, entities had the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities-Non-monetary Contributions by Venturers. There was no impact to the Corporation's financial statements upon adoption of this standard.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities which have been included by the Corporation within the 2013 notes to the consolidated financial statements.

Amendments to IAS 1 – Financial Statement Presentation

The amendments to IAS 1 require entities to separate items presented in OCI into two groups, based on whether or not they may be recycled to profit or loss in the future. Items that will not be recycled such as remeasurements related to IAS 19 will be presented separately from items that may be recycled in the future, such as deferred gains and losses on cash flow hedges. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately.

The Corporation has adopted the amendments to IAS 1 effective January 1, 2013. These changes did not result in any adjustments as the components of OCI for 2013 and the comparative period only includes items relating to remeasurements on post-employment benefit plans which are not reclassified to net income.

Amendments to Other Standards

In addition, there have been amendments to other standards, including IFRS 7 Financial Instruments: Disclosure, IAS 27, Separate Financial Statements, and IAS 28, Investments in Associates and Joint Ventures. IFRS 7 amendments require disclosure about the effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position. IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13. The Corporation has adopted these amendments effective January 1, 2013 and added disclosures to address the requirements within the 2013 notes to the consolidated financial statements.

FF) ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

The following is an overview of accounting standard changes that the Corporation will be required to adopt in future years. The Corporation does not expect to adopt any of these standards before their effective dates. The Corporation continues to evaluate the impact of these standards on its consolidated financial statements.

IFRS 9 – Financial Instruments

IFRS 9 introduces new requirements for the classification and measurement of financial assets. IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement to be measured at amortized cost or fair value in subsequent accounting periods following initial recognition. Specifically, financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods.

Requirements for classification and measurement of financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, Financial Instruments – Recognition and Measurement, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

IFRS 9 was amended in November 2013, to (i) include guidance on hedge accounting, (ii) allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk, from financial liabilities designated under the fair value option, in OCI, without having to adopt the remainder of IFRS 9, and to (iii) remove the previous mandatory effective date for adoption of January 1, 2015, although the standard is available for early adoption.

Amendments to IAS 32 – Financial Instruments: Presentation

IAS 32 addresses inconsistencies when applying the offsetting requirements, and is effective for annual periods beginning on or after January 1, 2014.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. These estimates and associated assumptions are based on historical experience, future operating plans and various other factors believed to be reasonable under the circumstances, and the results of such estimates form the basis of judgments about carrying values of assets and liabilities. These underlying assumptions are reviewed on an ongoing basis. Actual results could differ materially from those estimates.

Significant estimates made in the preparation of these financial statements include, but are not limited to, the following areas, with further information contained in the applicable accounting policy or note:

- Employee future benefits
  - The cost and related liabilities of the Corporation's pensions, other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions including discount rates, future salary increases, mortality rates and future benefit increases. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty. Refer to Note 9 for additional information.
- Depreciation and amortization period for long-lived assets
  - The Corporation makes estimates about the expected useful lives of long-lived assets and the expected residual values of the assets based on the estimated current fair value of the assets, the Corporation's fleet plans and the cash flows they generate. Changes to these estimates, which can be significant, could be caused by a variety of factors, including changes to maintenance programs, changes in jet fuel prices and other operating costs, changes in utilization of the aircraft, and changing market prices for new and used aircraft of the same or similar types. Estimates and assumptions are evaluated at least annually. Generally, these adjustments are accounted for on a prospective basis, through depreciation and amortization expense. For the purposes of sensitivity analysis on these estimates, a 50% reduction to residual values on aircraft with remaining useful lives greater than five years results in an increase of $22 to annual depreciation expense. For aircraft with shorter remaining useful lives, the residual values are not expected to change significantly.
- Impairment considerations on long-lived assets
  - An impairment test is performed by comparing the carrying amount of the asset or cash-generating unit to their recoverable amount, which is calculated as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. Value in use is calculated based upon a discounted cash flow analysis, which requires management to make a number of significant assumptions including assumptions relating to future operating plans, discount rates and future growth rates. Refer to Notes 5 and 6 for additional information.
- Maintenance provisions
  - The recording of maintenance provisions related to return conditions on aircraft leases requires management to make estimates of the future costs associated with the maintenance events required under the lease return condition and estimates of the expected future maintenance condition of the aircraft at the time of lease expiry. These estimates take into account current costs of these maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Any difference in the actual maintenance cost incurred and the amount of the provision is recorded in maintenance expense in the period. The effect of any changes in estimates, including changes in discount rates, inflation assumptions, cost estimates or lease expiries, is also recognized in maintenance expense in the period. Refer to Note 10(a) for additional information.

4. PROPERTY AND EQUIPMENT

	Aircraft and flight equipment	Buildings and leasehold improvements	Ground and other equipment	Purchase deposits and assets under development	Total
Year ended December 31, 2012					
At January 1, 2012	$ 4,346	$ 356	$ 140	$ 96	$ 4,938
Additions	86	38	18	282	424
Reclassifications	30	24	-	(54)	-
Disposals	(22)	-	(1)	-	(23)
Depreciation	(571)	(33)	(24)	-	(628)
At December 31, 2012	$ 3,869	$ 385	$ 133	$ 324	$ 4,711
At December 31, 2012					
Cost	$ 5,991	$ 662	$ 311	$ 324	$ 7,288
Accumulated depreciation	(2,122)	(277)	(178)	–	(2,577)
	$ 3,869	**$ 385**	**$ 133**	**$ 324**	**$ 4,711**
Year ended December 31, 2013					
At January 1, 2013	$ 3,869	$ 385	$ 133	$ 324	$ 4,711
Additions	736	(4)	27	198	957
Reclassifications	143	3	20	(166)	-
Disposals	(65)	-	-	-	(65)
Depreciation	(445)	(32)	(23)	-	(500)
Impairment	(30)	-	-	-	(30)
At December 31, 2013	$ 4,208	$ 352	$ 157	$ 356	$ 5,073
At December 31, 2013					
Cost	$ 6,119	$ 660	$ 359	$ 356	$ 7,494
Accumulated depreciation	(1,911)	(308)	(202)	-	(2,421)
	$ 4,208	**$ 352**	**$ 157**	**$ 356**	**$ 5,073**

The Corporation took delivery of four Boeing 777 aircraft in 2013. These aircraft were financed through the proceeds from the private offering of enhanced equipment trust certificates as described in Note 8. In 2013, an impairment charge of $30 was recorded in Depreciation, amortization and impairment expense related mainly to four A340-300 aircraft (none of which were operated by Air Canada). The impairment charge was based upon the net proceeds expected upon the return or other disposition of these aircraft. In 2013, these four A340-300 aircraft were sold with proceeds approximating book value.

As at December 31, 2013, property and equipment included finance leased assets including 18 aircraft (2012 – 19) with a net book value of $150 (2012 – $177) and facilities with a net book value of $45 (2012 – $47).

Included in aircraft and flight equipment are 32 aircraft and 6 spare engines (2012 – 28 aircraft and 8 spare engines) which are leased to Sky Regional, Jazz (Note 16) and third parties with a cost of $481 (2012 – $371) less accumulated depreciation of $124 (2012 – $112) including accumulated impairment losses of $26 related to the fleet of A340-300 aircraft (2012 - $46) for a net book value of $357 (2012 – $259). Depreciation expense for 2013 for this aircraft and flight equipment amounted to $38 (2012 – $50).

Interest capitalized during 2013 amounted to $46 at an interest rate of 8.36% (2012 $18 at an interest rate of 10.85%) and is included in Purchase deposits and assets under development in the table above.

Certain property and equipment are pledged as collateral as further described under the applicable debt instrument in Note 8.

5. INTANGIBLE ASSETS

	International route rights and slots	Marketing based trade names	Contract and customer based	Technology based (internally developed)	Total
Year ended December 31, 2012					
At January 1, 2012	$ 97	$ 87	$ 12	$ 116	$ 312
Additions	–	1	–	35	36
Amortization	–	–	(5)	(29)	(34)
At December 31, 2012	$ 97	$ 88	$ 7	$ 122	$ 314
At December 31, 2012					
Cost	$ 97	$ 88	$ 20	$ 333	$ 538
Accumulated amortization	–	–	(13)	(211)	(224)
	$ 97	**$ 88**	**$ 7**	**$ 122**	**$ 314**
Year ended December 31, 2013					
At January 1, 2013	$ 97	$ 88	$ 7	$ 122	$ 314
Additions	-	-	-	30	30
Amortization	-	-	(4)	(36)	(40)
At December 31, 2013	$ 97	$ 88	$ 3	$ 116	$ 304
At December 31, 2013					
Cost	$ 97	$ 88	$ 20	$ 363	$ 568
Accumulated amortization	-	-	(17)	(247)	(264)
	$ 97	**$ 88**	**$ 3**	**$ 116**	**$ 304**

Certain international route rights and slots are pledged as security for senior secured notes as described in Note 8(b).

An annual impairment review is conducted on all intangible assets that have an indefinite life. International route rights and slots and marketing based trade names are considered to have an indefinite life. The impairment review is carried out at the level of a cash-generating unit. On this basis, an impairment review was performed at the North American and international fleet levels for aircraft and related assets supporting the operating fleet. A summary of the allocation of the indefinite lived intangible assets to the cash-generating units is presented below.

	2013	2012
North American	41	41
International	144	144
	$ 185	**$ 185**

The recoverable amount of the cash-generating units has been measured based on their value in use, using a discounted cash flow model. Cash flow projections are based on the annual business plan approved by the Board of Directors of Air Canada. In addition, management-developed projections are made covering a three-year period. These cash flows are management's best estimate of future events taking into account past experience and future economic assumptions, such as the forward curves for crude-oil and the exchange rates. Cash flows beyond the three-year period are projected to increase consistent with the long-term growth assumption of the airline considering various factors such as industry growth assumptions. The pre-tax discount rate applied to the cash flow projections is derived from the Corporation's weighted average cost of capital adjusted for taxes and specific risks associated with the CGU being tested.

For the annual 2013 impairment review, the most recent calculations from the 2011 period were carried forward as the calculation of the recoverable amount exceeded the carrying amount by a substantial margin, the assets and liabilities making up the CGU had not changed significantly and no events had occurred or circumstances had changed which would indicate that the likelihood of the recoverable asset not exceeding the carrying value was remote.

Key assumptions used for the value in use calculations in fiscal 2011 were as follows:

	2011
Pre-tax discount rate	15.6%
Long-term growth rate	2.5%
Jet fuel price range per barrel	\$125 – \$135

The recoverable amount of both cash-generating units based on value in use exceeded their respective carrying values by approximately \$1,400. If the discount rate were increased by 380 basis points, the excess of recoverable amount over carrying value would be reduced to nil.

6. GOODWILL

Goodwill is tested at least annually for impairment. For the purpose of impairment testing, goodwill is tested for impairment using the fair value less cost to sell model at the operating segment level. Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions.

In assessing the goodwill for impairment, the Corporation compares the aggregate recoverable amount consisting of the sum of its quoted equity market capitalization and the fair value of its debt to the carrying value of its net assets excluding long term debt. An impairment charge is recognized to the extent that the carrying value exceeds the recoverable amount.

No impairment charges have arisen as a result of the reviews performed as at December 31, 2013 and 2012. Reasonably possible changes in key assumptions would not cause the recoverable amount of goodwill to fall below the carrying value.

7. DEPOSITS AND OTHER ASSETS

		2013		2012	
Restricted cash	Note 2R	$	190	$	188
Aircraft related deposits (a)			84		105
Aircraft lease payments in excess of rent expense	Note 2BB		65		50
Prepayments under maintenance agreements	Note 2J		64		72
Share forward contracts	Note 17		36		10
Deposit related to pension and benefits agreements	Note 9 &19		9		29
Other deposits			29		25
Other			17		31
		$	494	$	510

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

8. LONG-TERM DEBT AND FINANCE LEASES

	Final Maturity	Weighted Average Interest Rate (%)	2013	2012
Aircraft financing (a)				
Fixed rate US dollar financing	2014 - 2025	6.52	$ 1,706	$ 1,278
Floating rate US dollar financing	2015 - 2021	2.39	609	650
Floating rate Japanese yen financing	2020	0.28	116	152
Senior secured notes – US dollar (b)	2019 - 2020	7.61	745	-
Senior secured notes – CDN dollar (b)	2019	7.63	300	-
Senior secured notes – US dollar (b)	2013	-	-	796
Senior secured notes – CDN dollar (b)	2013	-	-	300
Other secured financing – US dollar (b) and (c)	2014 - 2019	6.01	467	245
Other secured financing – CDN dollar (d)	2015	9.15	126	26
Long-term debt		**6.03**	**4,069**	**3,447**
Finance lease obligations (e)	2014 - 2033	10.12	328	363
Total debt and finance leases		**6.33**	**4,397**	**3,810**
Unamortized discount			-	(9)
Unamortized debt issuance costs			(64)	(43)
Current portion			(374)	(499)
Long-term debt and finance leases			**3,959**	**3,259**

The total weighted average interest rate presented above excludes the impact of interest rate swaps applicable to certain aircraft financing arrangements.

(a) Aircraft financing (US$2,177, and JPY11,476) is secured primarily by specific aircraft with a carrying value of $3,222 (2012 – $3,193). For the majority of the financing, principal and interest is repayable quarterly until maturity and can be repaid at any time with the payment of applicable fees. US$264 and JPY11,476 of the financing is supported by a loan guarantee by the Export-Import Bank of the United States ("EXIM").

On May 9, 2013, in connection with the financing of five new Boeing 777-300ER aircraft, four of which were delivered in 2013, with the remaining aircraft scheduled for delivery in February 2014, Air Canada completed a private offering of three tranches of enhanced equipment trust certificates ("EETC") with a combined aggregate face amount of US$715.

The private offering is comprised of Class A, Class B and Class C certificates.

- The Class A certificates, with a US$425 face amount, have an interest rate of 4.125% per annum and a final expected distribution date of May 15, 2025.
- The Class B certificates, with a US$182 face amount, have an interest rate of 5.375% per annum and a final expected distribution date of May 15, 2021.
- The Class C certificates, with US$108 face amount, will have an interest rate of 6.625% per annum and a final expected distribution date of May 15, 2018.

The trust certificates have a weighted average interest rate of approximately 4.7% per annum.

The trust certificates represent an interest in three separate pass through trusts. The trusts consist of a separate trust for each of the Class A, B and C certificates. The trusts use the proceeds from the offering to acquire equipment notes that are issued to finance the acquisition of each of the five new Boeing 777-300ER aircraft. The proceeds from the offering of the trust certificates are held in escrow until the delivery of the respective aircraft. Funds held in escrow by the depositary are not assets of Air Canada and are not reported as assets or debt on Air Canada's consolidated statement of

financial position. In connection with the acquisition of the first four aircraft, an amount of US$571 was drawn from the proceeds held in escrow in connection with the delivery and is included in Aircraft financing in the table above.

The equipment notes issued are secured by each of the five Boeing 777-300ER aircraft being acquired, and the security interest in each of the aircraft benefits from the protections of the Cape Town Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment, as enacted in Canada.

In respect of the Class A certificates and the Class B certificates, the trustee distributes all payments of principal, premium (if any) and interest received on the related equipment notes to the holders of the Class A certificates and Class B certificates, subject to the subordination provisions applicable to the certificates. Scheduled payments of principal and interest received by the trust on the related equipment notes are distributed to the holders of the Class A certificates and Class B certificates on the regular distribution dates of May 15 and November 15, which commenced on November 15, 2013.

In respect of the Class C certificates, the trustee distributes all payments of principal, premium (if any) and interest received on the related equipment notes to the holders of the Class C certificates, subject to the subordination provisions applicable to the certificates. Scheduled payments of interest made on the equipment notes are distributed to the holders of the Class C certificates on the regular distribution dates of May 15 and November 15, which commenced on November 15, 2013. The entire principal amount is scheduled to be paid on May 15, 2018.

Cash deposits with the trustee of $6 at December 31, 2013 are reported in Investing on the consolidated statement of cash flow. Financing fees paid in conjunction with the offering were $15 and are reported in Financing on the consolidated statement of cash flow.

(b) On September 26, 2013, the Corporation completed private offerings of senior secured notes, consisting of (i) US$400 principal amount of 6.750% senior secured first lien notes due 2019 and $300 principal amount of 7.625% senior secured first lien notes due 2019 (the "New Senior First Lien Notes") and (ii) US$300 principal amount of 8.750% senior secured second lien notes due 2020 (the "New Senior Second Lien Notes" and together with the New Senior First Lien Notes, the "New Senior Notes"). The Corporation also completed the closing of its US$400 new senior secured (first lien) credit facility, comprised of a US$300 term loan maturing in 2019 and a US$100 revolving credit facility (collectively, the "New Credit Facility"). The term loan is included in Other secured financing in the table above. As at December 31, 2013, the Corporation had not drawn on the revolving credit facility.

The Corporation received, in total, net proceeds of approximately $1,300 from the sale of the New Senior Notes and from term loan borrowings under the New Credit Facility (in each case, after deduction of the applicable transaction costs, fees and expenses). The Corporation applied a portion of such net proceeds and borrowings to purchase all of its outstanding 9.250% Senior Secured Notes due 2015, 10.125% Senior Secured Notes due 2015 and 12.000% Senior Second Lien Notes due 2016 (collectively, the "Existing Notes") that were validly tendered on or before the early tender deadline (which was September 18, 2013), in connection with the cash tender offers commenced by the Corporation on September 5, 2013. In October 2013, the Corporation used a portion of the remaining net proceeds and borrowings to redeem the remaining Existing Notes of $70 not tendered prior to the early tender deadline. The Corporation is using the remaining net proceeds for working capital and general corporate purposes.

In conjunction with the purchase of the Existing Notes, the premium costs paid, in the amount of $61, as well as the write off of existing transaction costs and discounts related to the Existing Notes, in the amount of $34, were recorded as an interest charge in 2013.

The New Senior Notes and the Corporation's obligations under the New Credit Facility are senior secured obligations of Air Canada, guaranteed on a senior secured basis by one or more of Air Canada's subsidiaries, and secured (on a first lien basis with respect to the New Senior First Lien Notes and Air Canada's obligations in the New Credit Facility, and on a second lien basis with respect to the New Senior Second Lien Notes), subject to certain permitted liens and exclusions, by certain accounts receivable, certain real estate interests, certain spare engines, ground service equipment, certain airport slots and gate leaseholds, and certain Pacific routes and the airport slots and gate leaseholds utilized in connection with those Pacific routes. The applicable margin with respect to loans under the revolving credit facility in the New Credit Facility is 4.50% with respect to LIBOR loans and banker's acceptances and 3.50% with respect to the Index Rate loans or Canadian Prime Rate loans. The applicable margin with respect to the term loans under the New Credit Facility is 4.50% with respect to LIBOR loans and 3.50% with respect to the Index Rate loans. All such applicable margins are subject to the adjustments and other terms provided for in the New Credit Facility.

(c) Other US dollar secured financings are fixed and floating rate financings that are secured by certain assets including assets described in b) above relating to the New Credit Facility. It also includes a revolving credit facility for the financing of jet fuel. Financial covenants under the revolving credit facility require the Corporation to maintain certain minimum operating results and cash balance tests. In 2012, this debt amount included spare engines financings of which an amount of US$44 was repaid in 2013.

(d) Other CDN dollar secured financing is a revolving credit facility for the financing of jet fuel. Financial covenants under the agreement require the Corporation to maintain certain minimum operating results and cash balance tests.

(e) Finance leases, related to facilities and aircraft, total $328 ($76 and US$237) (2012 - $363 ($78 and US$286)). During 2013, the Corporation recorded interest expense on finance lease obligations of $46 (2012 – $40). The carrying value of aircraft and facilities under finance leases amounted to $150 and $45 respectively (2012 – $177 and $47).

Air Canada has aircraft leasing transactions with a number of structured entities. Air Canada controls and consolidates leasing entities covering 23 aircraft as at December 31, 2013. This debt amount includes any guarantee by Air Canada in the residual value of the aircraft upon expiry of the lease. The related aircraft are charged as collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to Air Canada, as lessee, in the event of default or early termination of the lease.

Certain aircraft and other secured finance agreements contain collateral fair value tests. Under the tests, Air Canada may be required to provide additional collateral or prepay part of the financings. The maximum amount payable in 2014, assuming the collateral is worth nil, is $271 (US$257). The maximum amount payable declines over time in relation to the outstanding principal. Total collateral as at December 31, 2013 is $5 (US$5) (2012 - $20(US$20)) in the form of cash deposits, included in Deposits and other assets, has been provided under the fair value test for certain of these aircraft leases.

Cash interest paid on Long-term debt and finance leases in 2013 by the Corporation was $345 (2012 – $287).

Refer to Note 16 for the Corporation's principal and interest repayment requirements as at December 31, 2013.

9. PENSIONS AND OTHER BENEFIT LIABILITIES

The Corporation maintains several defined benefit and defined contribution plans providing pension, other post-retirement and post-employment benefits to its employees, and to former employees for whom the related pension assets and liabilities have not yet been settled.

The Corporation is the administrator and sponsoring employer of ten Domestic Registered Plans ("Domestic Registered Plans") with defined benefit commitments registered under the Pension Benefits Standard Act, 1985 (Canada). The US plan, UK plan and Japan plan are international plans covering members in those countries. In addition, the Corporation maintains a number of supplementary pension plans which are not registered. The defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and final average earnings for a specified period. Under the terms of the domestic registered and supplementary plans, there is no indexation provided after January 1, 2007. Benefit payments are from trustee-administered funds, however there are also a number of unfunded plans where the Corporation meets the benefit payment obligation as it falls due. Plan assets held in trusts are governed by regulations. The governance of the plans, overseeing all aspects of the plans including investment decisions and contributions, lies primarily with the Corporation. The Pension Committee, a committee of the Board of Directors, assists in the monitoring and oversight of the plans to ensure pension liabilities are appropriately funded, pension assets are prudently invested, risk is managed at an acceptable level and retirement benefits are administered in a proper and effective manner.

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

Amendments to the Defined Benefit Pension Plans

In December 2013, amendments to the defined benefit pension plans, determined in accordance with new collective agreements during 2011 and 2012 and changes applicable to non-unionized employees as communicated to them in 2013, were approved by OSFI and became effective January 1, 2014. As a result of this approval, the Corporation has recorded a credit of $82 in Benefit plan amendments in 2013 related to the impact of those amendments on pension liabilities. By virtue of its size and incidence, this item is separately disclosed within the consolidated statement of operations.

In 2012, as a result of changes to retirement age in the collective agreement between Air Canada and the Air Canada Pilots Association, which were not subject to regulatory approval, the Corporation recorded a credit of $127 in Benefit plan amendments.

Pension Plan Cash Funding Obligations

As at January 1, 2013, the aggregate solvency deficit in the domestic registered pension plans was $3,700. The next required valuations to be made as at January 1, 2014, will be completed in the first half of 2014, but as described below, they will not increase the 2014 pension past service cost funding obligations. Based on preliminary estimates, in aggregate, the domestic registered pension plans are estimated to be in a small surplus position on a solvency basis as at January 1, 2014.

Pension funding obligations are generally dependent on a number of factors, including the assumptions used in the most recently filed actuarial valuation reports for current service (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, existing pension legislation and changes in economic conditions (mainly the return on fund assets and changes in interest rates). Actual contributions that are determined on the basis of future valuation reports filed annually may vary significantly from projections. In addition to changes in plan demographics and experience, actuarial assumptions and methods may be changed from one valuation to the next, including due to changes in plan experience, financial markets, future expectations, changes in legislation and other factors.

In July 2009, the Government of Canada adopted the *Air Canada 2009 Pension Regulations*. The Air Canada 2009 Pension Regulations relieved Air Canada from making any past service contributions (i.e. special payments to amortize the plan deficits) to its domestic defined benefit registered pension plans in respect of the period beginning April 1, 2009 and ending December 31, 2010. Thereafter, in respect of the period from January 1, 2011 to December 31, 2013, the aggregate annual past service contribution was the lesser of (i) $150, $175, and $225 in respect of 2011, 2012, and 2013,

respectively, on an accrued basis, and (ii) the maximum past service contribution permitted under the Canadian Income Tax Act. Current service contributions continued to be made in the normal course while the *Air Canada 2009 Pension Regulations* were in effect.

In December 2013, further to an agreement reached with Air Canada in March 2013, the Government of Canada formally approved the *Air Canada Pension Plan Funding Regulations, 2014* ("the "2014 Regulations") under the *Pension Benefits Standards Act, 1985* in respect of special payments under Air Canada's defined benefit plans applicable to the period between 2014 to 2020 inclusive, expiring December 31, 2020. According to the terms of the 2014 Regulations, Air Canada will be required to make payments of at least $150 annually with an average of $200 per year, to contribute an aggregate minimum of $1,400 over seven years in solvency deficit payments, in addition to its pension current service payments. Air Canada may elect to opt out of the regulations and have special payments in respect of all Air Canada pension plans, collectively, determined in accordance with normal funding rules.

Under the agreement with the Government of Canada, in respect of the plan years during which Air Canada funds its plan pursuant to the 2014 Regulations, Air Canada is subject to a series of covenants and undertakings, including a prohibition on dividends and share repurchases, as well as certain limitations on executive compensation arrangements. As requested by the Government of Canada, Air Canada has also agreed to use reasonable efforts, during the negotiations of the next collective agreements with Air Canada's Canadian-based unions, to seek to include in those collective agreements provisions which would have employees contribute fifty per cent of their pension plan normal costs, and has agreed not to implement pension plan benefit improvements without regulatory approval.

Giving effect to the Air Canada 2009 Pension Regulations as outlined above, total employer pension funding contributions during 2013 amounted to $475. After taking into account the effect of the 2014 Regulations, total employer contributions to defined benefit pension plans for 2014 are expected to be $439.

Pension and Benefits Agreement with Aveos

Air Canada and Aveos were parties to a Pension and Benefits Agreement covering the transfer of certain pension and benefit assets and obligations to Aveos. On July 14, 2011 (the "Certification Date"), certain unionized employees of Air Canada elected to become employees of Aveos.

Following Aveos filing for court protection pursuant to the Companies' Creditors Arrangements Act ("CCAA") in March 2012, OSFI ordered the termination of Aveos' defined benefit pension plans and, as a result, the assets and liabilities accruing prior to the Certification Date in respect of transferred employees were not transferred to Aveos' plans and remain under Air Canada's pension plans. Settlement of obligations under the other post-retirement and post-employment benefits plans pertaining to the transferred unionized employees were concluded in October 2013 with payment in trust to Aveos by Air Canada in the amount of $6, for distribution to Aveos eligible recipients. The letter of credit of $20 previously issued in favour of Aveos was returned to Air Canada.

Benefit Obligation and Plan Assets

These consolidated financial statements include all of the assets and liabilities of all Corporation-sponsored plans. The net benefit obligation is recorded in the statement of financial position as follows:

	2013	2012
Accrued benefit liabilities for		
Pension benefits obligation	$ 1,578	$ 3,528
Other employee future benefits	1,183	1,230
Net benefit obligation	**2,761**	**4,758**
Current portion	(74)	(72)
Pension and other benefit liabilities	**$ 2,687**	**$ 4,686**

The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2014. The current portion is included in Accounts payable and accrued liabilities. The following table presents financial information related to the changes in the pension and other post-employment benefits plans:

	Pension Benefits		Other Employee Future Benefits	
	2013	2012	2013	2012
Change in benefit obligation				
Benefit obligation at beginning of year	$ 16,446	$ 14,461	$ 1,230	$ 1,116
Current service cost	264	215	60	62
Interest cost	704	737	53	55
Employees' contributions	71	71	-	-
Benefits paid	(850)	(775)	(50)	(51)
Remeasurements:				
Experience loss (gain)	30	(42)	(28)	(61)
Loss (gain) from change in demographic assumptions	764	79	32	2
Loss (gain) from change in financial assumptions	(1,245)	1,829	(101)	116
Plan amendments	(82)	(123)	-	(4)
Plan settlements	-	(9)	(26)	-
Foreign exchange (gain) loss	45	3	13	(5)
	16,147	16,446	1,183	1,230
Change in plan assets				
Fair value of plan assets at beginning of year	13,253	11,907	-	-
Return on plan assets, excluding amounts included in Net financing expense	1,199	1,021	-	-
Interest income	563	607	-	-
Employer contributions	475	433	50	51
Employees' contributions	71	71	-	-
Benefits paid	(850)	(775)	(50)	(51)
Plan settlements	-	(9)	-	-
Administrative expenses paid from plan assets	(7)	(7)	-	-
Foreign exchange gain (loss)	41	5	-	-
	14,745	13,253	-	-
Deficit at end of year	**1,402**	**3,193**	**1,183**	**1,230**
Additional minimum funding liability	176	335	-	-
Net benefit obligation	**$ 1,578**	**$ 3,528**	**$ 1,183**	**$ 1,230**

The actual return on plan assets was $1,762 (2012 – $1,628).

The net benefit obligation for pension benefits was $1,578 (2012 – $3,528). The decrease is mainly the result of the increase in plan assets and the reduction in accrued benefit obligation resulting from the increase in discount rates, partially offset by the impact of the change in mortality assumptions as further described below.

The weighted average duration of the defined benefit obligation is 13.3 years (2012 – 13.8 years).

Pension and Other Employee Future Benefit Expense

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

	Pension Benefits		Other Employee Future Benefits	
	2013	2012	2013	2012
Consolidated Statement of Operations				
Components of cost				
Current service cost	$ 264	$ 215	$ 60	$ 62
Past service cost from plan amendments	(82)	(123)	-	(4)
Administrative and other expenses	7	6	-	-
Actuarial (gains) losses	-	-	(16)	(12)
Total cost recognized in Wages, salaries and benefits	**$ 189**	**$ 98**	**$ 44**	**$ 46**
Net financing expense relating to employee benefits	**$ 155**	**$ 233**	**$ 53**	**$ 55**
Total cost recognized in statement of operations	**$ 344**	**$ 331**	**$ 97**	**$ 101**
Consolidated Other Comprehensive (Income) Loss				
Remeasurements:				
Experience loss (gain), including foreign exchange	35	(44)	(23)	(53)
Loss (gain) from change in demographic assumptions	764	79	32	2
Loss (gain) from change in financial assumptions	(1,245)	1,829	(98)	114
Return on plan assets	(1,199)	(1,021)	-	-
Minimum funding liability	(174)	(1,732)	-	-
Total cost recognized in OCI	**$ (1,819)**	**$ (889)**	**$ (89)**	**$ 63**

Composition of Pension Plan Assets

Domestic Registered Plans

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

	2013	2012	Target Allocation(1)
Non-matched assets (mainly equities)	52.8%	54.9%	53.0%
Matched assets (mainly Canadian bonds)	47.2%	45.1%	47.0%
	100.0%	**100.0%**	**100.0%**

(1) Weighted average of the Master Trust Fund target allocation (99% of Domestic Registered Plan assets) and the Bond Fund target allocation. The Bond Fund serves the purpose of altering the asset mix of some of the participating plans. These plans exhibit characteristics that differ from the majority of the participating plans, which are solely invested in the Master Trust.

All invested assets within the Master Trust are comprised of the following asset categories:

	2013	2012
Bonds	47%	51%
Equities	21%	22%
Privately held entities	21%	19%
Cash and cash equivalents	11%	8%
	100%	**100%**

For the Master Trust Fund, approximately 79% of assets as of December 31, 2013 have a quoted market price in an active market (81% as of December 31, 2012). Assets that do not have a quoted market price in an active market are mainly investments in privately held entities.

Included in plan assets, for determining the net benefit obligation for accounting purposes, are 17,647,059 Class B Voting Shares of Air Canada with a fair value of $131 (2012 – $31) which were issued in 2009 in connection with pension funding agreements reached with all of the Corporation's Canadian-based unions. All future net proceeds of sale of such shares, when realised, are to be contributed to the pension plans.

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Funds, as amended during 2013. The investment return objective is to achieve a total annualized rate of return that exceeds by a minimum of 1.0% before investment fees on average over the long term (i.e. 10 years) the total annualized return that could have been earned by passively managing the Liability Benchmark. The Liability Benchmark, which is referenced to widely used Canadian fixed income performance benchmarks (DEX), is composed of a mix of the DEX Universe Provincial Bond Index, DEX Long Term Provincial Bond Index and DEX Real Return Bond Index that closely matches the characteristics of the pension liabilities.

Recognizing the importance of surplus risk management, Air Canada manages the Domestic Registered Plans in an effort to optimally minimize surplus risk (defined as the difference between asset value and pension liability value), which is considered to be the key risk to be minimized and monitored. In addition, the objective of the investment strategy is to invest the assets of the Master Trust in a prudent and diversified manner to minimize the risk of price fluctuation of asset classes and individual investments within those asset classes and to combine those asset classes and individual investments in an effort to reduce overall risk.

In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes invested within the Master Trust Fund:

- Non-matched assets are mainly equities, and are required to be diversified among industries and economic sectors. Foreign equities can comprise 25% to 39% of the total market value of the invested assets of the Master Trust Fund. Limitations are placed on the overall allocation to any individual security. Foreign equities at December 31, 2013 were 19% of assets of the Master Trust Fund. Investments in alternative investments are allowed up to 20% of the total market value of the invested assets of the Master Trust Fund. Alternative investments are investments in non-publicly traded securities and in non-traditional asset classes. They may comprise, but are not limited to investments in real estate, agriculture, timber, private equity, venture capital, infrastructure, emerging markets debt, high yield bonds and commodity futures.

- Matched assets are mainly Canadian bonds, oriented toward long term investment grade securities rated "BBB" or higher. With the exception of Government of Canada securities or a province thereof, in which the plan may invest the entire fixed income allocation, these investments are required to be diversified among individual securities and sectors.

Derivatives are permitted provided that they are used for managing a particular risk (including interest rate risk related to pension liabilities) or to create exposures to given markets and currencies and that counterparties have a minimum credit rating of A. As of December 31, 2013, a 21% derivatives exposure to matched assets is in place to hedge interest rate risk related to pension liabilities.

The trusts for the supplemental plans are invested 50% in indexed equity investments, in accordance with their investment policies, with the remaining 50% held by the Canada Revenue Agency as a refundable tax, in accordance with tax legislation.

Risks

Through its defined benefit pension plans, the Corporation is exposed to a number of risks, the most significant of which are detailed below:

Asset risk

Non-matched assets are subject to market and equity price risks. Investments in equity and other investments are subject to changes in price which may not be offset by changes in the value of plan liabilities. The plan liabilities are calculated using a discount rate set with reference to corporate bond yields. If plan assets underperform this yield, this will create a deficit. Certain plan assets are invested in foreign equities, which are also subject to foreign exchange risk.

Interest rate risk

A decrease in corporate and/or government bond yields will increase plan liabilities, which will be partially offset by an increase in the value of the plans' bond holdings.

Funding risk

Adverse changes in the value of plan assets or in interest rates could have a significant impact on pension plan solvency valuations and cash funding requirements. Refer to discussion above with respect to past service funding obligations while the 2014 Regulations are in effect.

Life expectancy

The majority of the plans' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities.

Assumptions

Management is required to make significant estimates about actuarial and financial assumptions to determine the cost and related liabilities of the Corporation's employee future benefits.

Financial assumptions

Discount Rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximate the timing and amount of expected benefit payments.

Future increases in compensation are based upon the current compensation policies, labour agreements and economic forecasts.

The significant weighted average assumptions used to determine the Corporation's accrued benefit obligations and cost are as follows:

	Pension Benefits		Other Employee Future Benefits	
	2013	2012	2013	2012
Discount rate used to determine:				
Accrued benefit cost for the year ended December 31	4.30%	5.20%	4.17%	4.90%
Accrued benefit liability as at December 31	4.90%	4.30%	4.80%	4.17%
Rate of future increases in compensation used to determine:				
Accrued benefit cost for the year ended December 31	2.50%	2.50%	not applicable	not applicable
Accrued benefit obligation as at December 31	2.50%	2.50%	not applicable	not applicable

Actuarial assumptions

Mortality rates

The cost and related liabilities of the Corporation's pension plans, and other post-retirement and post-employment benefit programs are determined using actuarial valuations. The actuarial valuations include several economic and demographic assumptions including mortality rates. For the December 31, 2013 accounting valuations, the mortality assumption has been updated to reflect the results of a mortality study specific to Air Canada pension plan membership which was completed in the fourth quarter of 2013. The change in mortality rate assumptions resulted in an actuarial remeasurement of the accounting liabilities with the impact being recorded in other comprehensive income. The improvements in assumed mortality rates are consistent with those presented by the Canadian Institute of Actuaries ("CIA") which issued a draft report during the third quarter of 2013 proposing new mortality tables for use in the valuation of Canadian pension and benefit plans. The CIA is expected to issue further guidance for mortality rate assumptions by early 2014, and Air Canada's experience will be remeasured against the revised CIA tables.

Sensitivity Analysis

Sensitivity analysis is based on changing one assumption while holding all other assumptions constant. In practice, this may be unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to variations in significant actuarial assumptions, the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as for calculating the liability recognized in the statement of financial position.

Sensitivity analysis on 2013 pension expense and net financing expense relating to pension benefit liabilities, based on different actuarial assumptions with respect to discount rate is set out below. The effects on each pension plan of a change in an assumption are weighted proportionately to the total plan obligation to determine the total impact for each assumption presented.

	0.25 Percentage Point	
	Decrease	Increase
Discount rate on obligation assumption		
Pension expense	$ 15	$ (14)
Net financing expense relating to pension benefit liabilities	4	8
	$ 19	**$ (6)**
Increase (decrease) in pension obligation	**$ 530**	**$ (537)**

An increase of one year in the mortality rate assumption would increase the pension benefit obligation by $394.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 6% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2013 (2012 – 6.75%). The rate is assumed to decrease gradually to 5% by 2015. A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by $4 and the obligation by $55. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by $4 and the obligation by $53.

A 0.25 percentage point decrease in discount rate would have increased the total of current and interest costs by less than $1 and the obligation by $42. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by less than $1 and the obligation by $36.

Defined Contribution Pension Plans

The Corporation's management, administrative and certain unionized employees may participate in defined contribution pension plans or multi-employer plans which are accounted for as defined contribution plans. Contributions range from 3% to 6% of annual pay for those employees in Canada and 3% to 7% of annual pay for those participants in the United Kingdom. The Corporation contributes an amount expressed as a percentage of employees' contributions with such percentage varying by group and based on the number of years of service.

The Corporation's expense for defined contribution pension plans amounted to $5 for the year ended December 31, 2013 (2012 – $3). Expected total employer contributions to defined contribution pension plans for 2014 are $6.

10. PROVISIONS FOR OTHER LIABILITIES

The following table provides a continuity schedule of all recorded provisions. Refer to Note 18 for additional information on Litigation provisions. Current provisions are recorded in Accounts payable and accrued liabilities.

	Maintenance (a)	Asset retirement (b)	Litigation	Other (c)	Total provisions
At December 31, 2012					
Current	$ 14	$ –	$ 29	$ 18	$ 61
Non-current	571	19	–	–	590
	$ 585	**$ 19**	**$ 29**	**$ 18**	**$ 651**
Provisions arising during the year	$ 72	$ -	$ 2	$ -	$ 74
Amounts disbursed	(9)	-	(2)	(17)	(28)
Changes in estimated costs	(40)	(2)	-	(1)	(43)
Accretion expense	6	-	-	-	6
Foreign exchange loss	42	-	-	-	42
At December 31, 2013	**$ 656**	**$ 17**	**$ 29**	**$ -**	**$ 702**
Current	$ -	$ -	$ 29	$ -	$ 29
Non-current	656	17	-	-	673
	$ 656	**$ 17**	**$ 29**	**$ -**	**$ 702**

(a) Maintenance provisions relate to the provision for the costs to meet the contractual return conditions on aircraft under operating leases. The provision relates to leases with expiry dates ranging from 2014 to 2024 with the average remaining lease term of approximately four years. The maintenance provisions take into account current costs of maintenance events, estimates of inflation surrounding these costs as well as assumptions surrounding utilization of the related aircraft. Assuming the aggregate cost for return conditions increases by 5%, holding all other factors constant, there would be a cumulative balance sheet adjustment to increase the provision by $32 at December 31, 2013 and an increase to maintenance expense in 2014 of approximately $4. If the discount rates were to increase by 1%, holding all other factors constant, there would be a cumulative balance sheet adjustment to decrease the provision by $15 at December 31, 2013. Due to low market rates of interest, a 1% decrease in discount rates was not considered a reasonable scenario.

(b) Under the terms of certain land and facilities leases, the Corporation has an obligation to restore the land to vacant condition at the end of the lease and to rectify any environmental damage for which it is responsible. The related leases expire over terms ranging from 2014 to 2041. These provisions are based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches. The non-current provision is recorded in Other long-term liabilities.

(c) A liability of $18 was recorded in Wages, salaries and benefits related to employee profit sharing payments. The liability was an estimate based upon a number of assumptions and the Corporation's assessment as to the expected outcome related to this matter. During 2013, the provision was settled resulting in a cash payment in the amount of $17.

11. OTHER LONG-TERM LIABILITIES

		2013	2012
Proceeds from contractual commitments (a)		$ 107	$ 107
Deferred income tax	Note 12	49	49
Collateral held in leasing arrangements and other deposits		29	46
Aircraft rent in excess of lease payments	Note 2BB	27	33
Long-term employee liabilities		25	28
Other	Note 10(b)	138	156
		$ 375	$ 419

(a) Proceeds from contractual commitments represent non-refundable proceeds received, net of related costs and deposits, in consideration of various contractual commitments and will be recognized as reductions in the cost of those contractual commitments when incurred.

12. INCOME TAXES

Income Tax Expense

	2013	2012
Current income tax recovery in respect of prior years	$ (8)	$ -
Deferred income tax expense	-	1
Income tax expense (recovery)	**$ (8)**	**$ 1**

The income tax expense (recovery) differs from the amount that would have resulted from applying the statutory income tax rate to income before income tax expense as follows:

	2013	2012
Income (loss) before income taxes	$ 2	$ (135)
Statutory income tax rate based on combined federal and provincial rates	26.57%	26.49%
Income tax expense (recovery) based on statutory tax rates	1	(36)
Effects of:		
Non-taxable portion of capital gains	(3)	(4)
Non-deductible expenses	11	12
Tax rate changes on deferred income taxes	(6)	(17)
Recognition of previously unrecognized deferred income tax assets	(9)	-
Unrecognized deferred income tax assets	-	39
Adjustment in respect of current income tax of prior years	(8)	-
Other	6	7
Income tax expense (recovery)	**$ (8)**	**$ 1**

The applicable statutory tax rate is 26.57% (2012 - 26.49%). The Corporation's applicable tax rate is the Canadian combined rates applicable in the jurisdictions in which the Corporation operates.

The income tax expense relating to components of Other comprehensive income is as follows:

	2013	2012
Net gain on remeasurements on employee benefit liabilities	$ 521	$ 213
Recognition of previously unrecognized deferred income tax assets	(525)	(213)
Tax rate changes on deferred income taxes	4	-
Income tax expense in Other comprehensive income	**$ -**	**$ -**

Deferred Income Tax

Certain intangible assets with nominal tax cost and a carrying value of $185 have indefinite lives and accordingly, the associated deferred income tax liability of $49 (2012 - $49) is not expected to reverse until the assets are disposed of, become impaired or amortizable. In addition, the Corporation has other deferred income tax liabilities in the amount of $41, against which a deferred income tax asset of similar amount has been recognized. The recognized net deferred income tax liability of $49 is included in Other long-term liabilities.

Deferred income tax assets are recognized to the extent that the realization of the related tax benefit is probable. The Corporation has unrecognized tax loss carryforwards of $1,404 and temporary differences of $5,290 for which no deferred income tax assets could be recognized. However, the future tax deductions underlying these deferred income tax assets remain available for use in the future to reduce taxable income. The following are the Federal non-capital tax loss expiry dates:

	Tax Losses
2026	$ 2
2027	9
2028	962
2029	409
2030	11
2031	6
2032	1
2033	2
	$ 1,402

There are net capital losses as at December 31, 2013 of $2 (2012 – $2).

Cash income taxes recovered in 2013 by the Corporation were $5 (2012 – $1 paid).

13. SHARE CAPITAL

	Number of shares	Value
At January 1, 2012	277,371,493	$ 840
Shares purchased and cancelled under issuer bid	(3,019,600)	(9)
Expiration of warrants	–	(18)
Shares in trust for employee recognition award	91,910	–
At December 31, 2012	**274,443,803**	**813**
Shares issued on the exercise of stock options	2,064,264	4
Shares issued on the exercise of warrants	7,916,667	12
Repurchase of warrants	-	(2)
Shares in trust for employee recognition award	107,705	-
At December 31, 2013	**284,532,439**	**$ 827**

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

		2013	2012
Issued and outstanding			
Class A variable voting shares		26,577,512	33,006,104
Class B voting shares		257,954,927	241,437,699
Total issued and outstanding		**284,532,439**	**274,443,803**
Potential ordinary shares			
Warrants		-	10,000,000
Shares held in trust	Note 14	1,337,377	1,445,082
Stock options	Note 14	10,079,694	8,410,403
Total potential ordinary shares		**11,417,071**	**19,855,485**

Ordinary Shares

As at December 31, 2013, the ordinary shares issuable by Air Canada consist of an unlimited number of Class A Variable Voting Shares ("Variable Voting Shares") and an unlimited number of Class B Voting Shares ("Voting Shares"). The two classes of ordinary shares have equivalent rights as common shareholders except for voting rights. Holders of Variable Voting Shares are entitled to one vote per share unless (i) the number of Variable Voting Shares outstanding, as a percentage of the total number of voting shares of Air Canada exceeds 25% or (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Variable Voting Share will decrease proportionately such that (i) the Variable Voting Shares as a class do not carry more than 25% of the aggregate votes attached to all issued and outstanding voting shares of Air Canada and (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting do not exceed 25% of the votes that may be cast at such meeting.

Variable Voting Shares may only be held, beneficially owned or controlled, directly or indirectly, by persons who are not Canadians (within the meaning of the *Canada Transportation Act*). An issued and outstanding Variable Voting Share shall be converted into one Voting Share automatically and without any further act of Air Canada or the holder, if such Variable Voting Share becomes held, beneficially owned and controlled, directly or indirectly, otherwise than by way of security only, by a Canadian, as defined in the *Canada Transportation Act*.

Voting Shares may only be held, beneficially owned and controlled, directly or indirectly, by Canadians. An issued and outstanding Voting Share shall be converted into one Variable Voting Share automatically and without any further act of Air Canada or the holder, if such Voting Share becomes held, beneficially owned or controlled, directly or indirectly, otherwise than by way of security only, by a person who is not a Canadian.

Warrants

In 2013, the Corporation purchased for cancellation 2,083,333 warrants expiring July 30, 2013 for an aggregate purchase price of $2, representing the average trading price, at the time of purchase, of Air Canada shares on the Toronto Stock Exchange less the exercise price of $1.51 of each warrant. In addition, the outstanding number of ordinary shares increased by 7,916,667 upon exercise of warrants with proceeds to Air Canada of $12.

In 2012, 79,430,300 warrants with an exercise price of $2.20 expired. Upon expiry, the value ascribed to the Share capital related to the warrants of $18 was reclassified to the Deficit. No warrants were exercised during 2012.

The Corporation has no warrants left outstanding.

Normal Course Issuer Bid

In 2011, Air Canada received approval from the Toronto Stock Exchange ("TSX") to implement a normal course issuer bid to purchase, for cancellation, up to 24,737,753 Class A Variable Voting Shares and/or Class B Voting Shares (the "Shares"), representing, at that time, 10% of the total public float of the Shares. The repurchase program, which commenced on December 12, 2011 and ended December 11, 2012, was conducted through the facilities of the TSX.

During 2012, the Corporation purchased and cancelled 3,019,600 shares for cash at an average cost of $1.67 per share.

Shareholder Rights Plan

In 2012, the shareholders of Air Canada approved amendments to the shareholder rights plan agreement (the "Rights Plan") which provide that, subject to certain exceptions identified in the Rights Plan, the Rights Plan, as last amended, would be triggered in the event of an offer to acquire 20% or more of the outstanding Class A variable voting shares and Class B voting shares of Air Canada calculated on a combined basis, instead of 20% or more of either the outstanding Class A variable voting shares or the Class B voting shares calculated on a per class basis as was the case under the Rights Plan prior to the amendments that came into effect in 2012.

The amendments to the Rights Plan were proposed and implemented in order to render effective a decision issued by Canadian securities regulatory authorities (pursuant to an application of Air Canada) that effectively treats Air Canada's Class A variable voting shares and Class B voting shares as a single class for the purposes of applicable take-over bid requirements and early warning reporting requirements contained under Canadian securities laws.

Under the terms of the Rights Plan, one right (a "Right") has been issued with respect to each Class B Voting Share and each Class A Variable Voting Share (each a "Share") of Air Canada issued and outstanding as of the close of business on March 30, 2011 or subsequently issued. These Rights would become exercisable only when a person, including any party related to it, acquires or announces its intention to acquire 20% or more of the outstanding Class A Variable Voting Shares and Class B Voting Shares of Air Canada calculated on a combined basis, without complying with the "Permitted Bid" provisions of the Rights Plan or, in certain cases, without the approval of the Board. Until such time, the Rights are not separable from the shares, are not exercisable and no separate rights certificates are issued. To qualify as a "Permitted Bid" under the Rights Plan, a bid must, among other things: (i) be made to all holders of Shares, (ii) remain open for a period of not less than 60 days, (iii) provide that no Shares shall be taken up unless more than 50% of the then outstanding Class A Variable Voting Shares and Class B Voting Shares, on a combined basis, other than the Shares held by the person pursuing the acquisition and parties related to it, have been tendered and not withdrawn, and (iv) provide that if such 50% condition is satisfied, the bid will be extended for at least 10 business days to allow other shareholders to tender.

Following the occurrence of an event which triggers the right to exercise the Rights and subject to the terms and conditions of the Rights Plan, each Right would entitle the holders thereof, other than the acquiring person or any related persons, to exercise their Rights and purchase from Air Canada two hundred dollars worth of Class A Variable Voting Shares or Class B Voting Shares for one hundred dollars (i.e. at a 50% discount to the market price at that time). Upon such exercise, holders of rights beneficially owned and controlled by Qualified Canadians would receive Class B Voting Shares and holders of rights beneficially owned or controlled by persons who are not Qualified Canadians would receive Class A Variable Voting Shares.

The Rights Plan is scheduled to expire at the close of business on the date immediately following the date of Air Canada's annual meeting of shareholders to be held in 2014, unless terminated earlier in accordance with the terms of the Rights Plan. The Rights Plan may be renewed or extended with shareholders' approval.

14. SHARE-BASED COMPENSATION

Air Canada Long-Term Incentive Plan

Certain of the Corporation's employees participate in the Air Canada Long-term Incentive Plan (the "Long-term Incentive Plan"). The Long-term Incentive Plan provides for the grant of options and performance share units to senior management and officers of Air Canada. 19,470,294 shares are authorized for issuance under the Long-term Incentive Plan in respect of either of stock options or performance share units.

Stock Options

The options to purchase shares granted under the Long-term Incentive Plan have a maximum term of seven years and an exercise price based on the fair market value of the shares at the time of the grant of the options. Fifty percent of options are time-based and vest over four years. The remaining options will vest based upon performance conditions. The performance vesting conditions are based on operating margin (operating income over operating revenues) targets established by the Air Canada Board over the same time period. Each option entitles the employee to purchase one ordinary share at the stated exercise price. The terms of the Long-term Incentive Plan specify that following retirement an employee may exercise options granted with the rights to exercise continuing for the three years after the retirement date.

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

	2013	2012
Compensation expense ($ millions)	$ 3	$ 2
Number of stock options granted to Air Canada employees	4,052,085	2,922,043
Weighted average fair value per option granted ($)	$ 1.29	$ 0.44
Aggregated fair value of options granted ($ millions)	$ 5	$ 1
Weighted average assumptions:		
Share price	$ 2.95	$ 0.96
Risk-free interest rate	1.20%-2.21%	1.22%-1.89%
Expected volatility	48.8%-74.2%	50.9%-77.7%
Dividend yield	0%	0%
Expected option life (years)	5.25	5.25

Expected volatility was determined at the time of grant using the Air Canada share price on a historical basis. It reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome.

A summary of the Long-term Incentive Plan option activity is as follows:

	2013		2012	
	Options	Weighted Average Exercise Price/Share	Options	Weighted Average Exercise Price/Share
Beginning of year	8,410,403	$ 2.68	6,581,242	$ 4.07
Granted	4,052,085	2.95	2,922,043	0.98
Exercised	(2,064,264)	1.44	–	–
Expired	(311,655)	21.00	(100,315)	2.54
Forfeited	(6,875)	12.18	(992,567)	6.91
Outstanding options, end of year	**10,079,694**	**$ 2.47**	**8,410,403**	**$ 2.68**
Options exercisable, end of year	**1,609,601**	**$ 3.61**	**2,657,585**	**$ 5.01**

The weighted average share price on the date of exercise for options exercised in 2013 was $6.56. There were no options exercised in 2012.

		2013 Outstanding Options			2013 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$11.08 – 18.60	2014	237,661	1	$ 14.71	237,661	$ 14.71
$8.51	2015	5,500	2	8.51	5,500	8.51
$0.97 – $1.59	2016	442,500	3	1.30	442,500	1.30
$1.78 – $1.91	2017	31,250	4	1.85	–	–
$2.34	2018	2,612,356	5	2.34	577,828	2.34
$0.96 - $1.28	2019	2,698,342	6	0.98	346,112	1.00
$2.49 – $5.69	2020	4,052,085	7	2.95	–	–
		10,079,694		**$ 2.47**	**1,609,601**	**$ 3.61**

		2012 Outstanding Options			2012 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$21.00	2013	315,405	1	$ 21.00	315,405	$ 21.00
$11.08 – $18.60	2014	237,661	2	14.71	237,661	14.71
$8.51	2015	5,500	3	8.51	5,500	8.51
$0.97 – $1.59	2016	2,110,625	4	1.30	1,722,344	1.32
$1.78 – $1.91	2017	50,000	5	1.85	12,500	1.85
$2.34	2018	2,913,400	6	2.34	364,175	2.34
$0.96 – $1.28	2019	2,777,812	7	0.98	–	–
		8,410,403		**$ 2.68**	**2,657,585**	**$ 5.01**

Performance Share Units

The Long-term Incentive Plan also includes performance share units ("PSUs"), which are accounted for as equity settled instruments. The vesting term of PSUs is three years and generally includes time based vesting features as well as performance based vesting features, which are based upon achievement of earnings targets established over the vesting period. The terms of the plan specify that upon the retirement of an employee, the number of PSUs that vest are prorated based on the total number of completed months of active service during the PSU vesting term. The PSUs granted may only be redeemed for Air Canada shares purchased on the secondary market and/or equivalent cash at the discretion of the Board of Directors.

The compensation expense related to PSUs in 2013 was $12 (2012 –$6).

A summary of the Long-term Incentive Plan performance share unit activity is as follows:

	2013	2012
Beginning of year	7,255,711	6,115,840
Granted	4,047,136	2,712,230
Settled	(1,661,624)	(1,095,422)
Forfeited	(203,253)	(476,937)
Outstanding PSUs, end of year[(1)]	**9,437,970**	**7,255,711**

(1) 1,299,533 PSUs were eligible for vesting as at December 31, 2013, of which all were vested in accordance with the terms of the program. These PSUs which vested in 2013 are planned to be settled in 2014.

Refer to Note 17 for a description of derivative instruments used by the Corporation to mitigate the cash flow exposure to the PSUs granted.

Employee Recognition Award

In 2011, Air Canada's Board of Directors approved a special one-time Employee Recognition Award in the form of Air Canada shares granted to all eligible unionized and certain non-unionized employees worldwide, where permitted. Under the award, eligible employees were granted an aggregate of approximately 3.3 million shares with a grant date fair value of $11. Half of these shares vested immediately upon issuance and the other half vest at the end of three years. Pursuant to the award, the Corporation purchased approximately 3.3 million shares for $11, of which half were distributed to the eligible employees and the other half are held in trust over the vesting period. The shares held in trust were recorded at cost of $6 and are reported net against Share capital. Compensation expense for these shares will be recognized over the vesting period. The compensation expense recorded in 2013 was $2 (2012 - $2). Refer to Note 13 for the number of remaining shares held in trust as at period end which will vest in the first quarter of 2014.

Employee Share Purchase Plan

Eligible employees can participate in the employee share purchase plan under which employees can invest up to 6% of their base salary for the purchase of shares on the secondary market. Air Canada will match 33.3% of the investments made by the employee during the first year of participation in the program, with a 50% match after 12 months of continuous participation in the program. During 2013, the Corporation recorded compensation expense of $1 (2012 – less than $1).

15. EARNINGS PER SHARE

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

(in millions, except per share amounts)	2013	2012
Numerator:		
Numerator for basic and diluted earnings per share:		
Net income (loss) attributable to shareholders of Air Canada from continuing operations	$ 6	$ (85)
Net loss attributable to shareholders of Air Canada from discontinued operations	-	(55)
Net income (loss) attributable to shareholders of Air Canada	$ 6	$ (140)
Denominator:		
Weighted-average shares	277	276
Effect of potential dilutive securities:		
Warrants	2	-
Stock options	4	1
Shares held in Trust for employee share-based compensation award	1	1
	7	2
Add back anti-dilutive impact	-	(2)
Adjusted denominator for diluted earnings per share	**284**	**276**
Basic earnings (loss) per share from continuing operations	**$ 0.02**	**$ (0.31)**
Diluted earnings (loss) per share from continuing operations	**$ 0.02**	**$ (0.31)**
Basic and diluted earnings (loss) per share from discontinued operations	**$ -**	**$ (0.20)**
Diluted earnings (loss) per share	**$ 0.02**	**$ (0.51)**

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

Basic EPS is calculated based on the weighted average number of ordinary shares outstanding after deducting shares held in trust for the purposes of the Employee Recognition Award.

Excluded from the 2013 calculation of diluted earnings per share were 7,027,000 (2012 – 7,865,000) outstanding options where the options' exercise prices were greater than the average market price of the ordinary shares for the year. In 2012, 9,638,190 warrants were excluded from the calculation of diluted earnings per share as the warrants' exercise prices were greater than the average market price of the ordinary shares for the year. All warrants were exercised or settled in 2013.

16. COMMITMENTS

Boeing

As at December 31, 2013, the Corporation has outstanding purchase commitments with The Boeing Company ("Boeing") for the acquisition of 37 Boeing 787 aircraft. The first six deliveries are scheduled for 2014 and the remaining 31 between 2015 and 2019. The Corporation also has purchase options for 13 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on previously determined pricing and delivery positions), and purchase rights for 10 Boeing 787 aircraft (entitling Air Canada to purchase aircraft based on Boeing's then current pricing).

The Corporation has financing commitments covering 31 of the 37 Boeing 787 firm aircraft orders. The financing terms for 28 out of the 31 covered aircraft is for 80% of the aircraft delivery price and the term to maturity is 12 years with straight-line principal repayments. For the remaining 3 out of the 31 covered aircraft, the financing under the commitment covers up to 90% of the capital expenditure and the term to maturity is 15 years with principal payments made on a mortgage style basis resulting in equal installment payments of principal and interest over the term to maturity.

In addition, the Corporation has an outstanding purchase commitment for the acquisition of one Boeing 777 aircraft, scheduled for delivery in February 2014. This aircraft, together with four Boeing 777 aircraft which were delivered in 2013, is financed through the proceeds from the private offering of enhanced equipment trust certificates as described in Note 8. The Corporation also has purchase rights for 13 Boeing 777 (entitling Air Canada to purchase aircraft based on previously determined pricing).

In December 2013, as part of the narrowbody fleet renewal plan, the Corporation announced an agreement with Boeing, which is subject to conclusion of final documentation and other conditions, which includes firm orders for 33 737 MAX 8 and 28 737 MAX 9 aircraft with substitution rights between them as well as for the 737 MAX 7 aircraft. It also provides for options for 18 aircraft and certain rights to purchase an additional 30. Deliveries are scheduled to begin in 2017 with 2 aircraft, and with the remaining deliveries between 2018 to 2021, subject to deferral and acceleration rights. These Boeing 737 aircraft orders are not included in the capital commitments disclosure until such time as final documentation and other conditions are met.

Operating Lease and Capital Commitments

The estimated aggregate cost of the future firm Boeing 787 aircraft deliveries and other capital purchase commitments as at December 31, 2013 approximates $4,986 (of which $3,392 is subject to committed financing, subject to the fulfillment of certain terms and conditions). US dollar amounts are converted using the December 31, 2013 closing rate of CDN$1.0636. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day US LIBOR rate at December 31, 2013.

	2014	2015	2016	2017	2018	Thereafter	Total
Capital commitments	$ 916	$ 727	$ 1,067	$ 1,378	$ 643	$ 255	**$ 4,986**

As at December 31, 2013 the future minimum lease payments under existing operating leases of aircraft and other property amount to $1,744 using year end exchange rates.

	2014	2015	2016	2017	2018	Thereafter	Total
Aircraft	$ 313	$ 263	$ 223	$ 195	$ 169	$ 266	**$ 1,429**
Other property	46	43	27	24	22	153	**315**
Total	**$ 359**	**$ 306**	**$ 250**	**$ 219**	**$ 191**	**$ 419**	**$ 1,744**

Non-cancellable Sublease Receipts

The Corporation leases or subleases to third parties 12 aircraft and 6 spare engines which have final maturities ranging from 2014 to 2016 and the future minimum rentals receivable under such leases and subleases amount to $24 using year end exchange rates.

	2014	2015	2016	2017	2018	Thereafter	Total
Subleases	$ 16	$ 6	$ 2	$ -	$ -	$ -	**$ 24**

For accounting purposes, the Corporation acts as an agent and subleases certain aircraft to Jazz on a flow-through basis, which are reported net on the consolidated statement of operations. These subleases relate to 25 Bombardier CRJ-200 aircraft and 15 Bombardier CRJ-705 aircraft which have final maturities ranging from 2015 to 2024. The sublease revenue and lease expense related to these aircraft each amounted to $78 in 2013 (2012 – $76). The operating lease commitments under these aircraft, which are recovered from Jazz, are not included in the aircraft operating lease commitments or non-cancellable lease and sublease receipt tables above but are summarized as follows:

	2014	2015	2016	2017	2018	Thereafter	Total
Jazz flow – through leases	$ 81	$ 79	$ 73	$ 67	$ 64	$ 277	**$ 641**

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

The Corporation leases and subleases certain aircraft to Sky Regional, which are charged back to Air Canada through the CPA with Sky Regional. These are reported net on the consolidated statement of operations. The leases and subleases relate to 5 Bombardier Q400 aircraft and 15 Embraer 175 aircraft. The leases and sublease revenue and expense related to these aircraft each amount to $27 in 2013 and are not included in the non-cancellable lease and sublease receipts above.

The future minimum non-cancellable commitment for the next 12 months under the Jazz CPA is approximately $801 and under the capacity purchase agreements with other regional carriers is $109. The rates and mark-up under the Jazz CPA are subject to change based upon, amongst other things, changes in Jazz's costs and the level of flying contracted by Air Canada.

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2013 on Long-term debt and finance lease obligations are as follows:

Principal	2014	2015	2016	2017	2018	Thereafter	Total
Long-term debt obligations	$ 312	$ 613	$ 317	$ 426	$ 309	$ 2,092	**$ 4,069**
Finance lease obligations	62	61	26	27	30	122	**328**
	$ 374	**$ 674**	**$ 343**	**$ 453**	**$ 339**	**$ 2,214**	**$ 4,397**

Interest	2014	2015	2016	2017	2018	Thereafter	Total
Long-term debt obligations	$ 229	$ 192	$ 172	$ 180	$ 137	$ 176	**$ 1,086**
Finance lease obligations	30	23	19	16	13	37	**138**
	$ 259	**$ 215**	**$ 191**	**$ 196**	**$ 150**	**$ 213**	**$ 1,224**

Principal repayments in the table above exclude transaction costs of $64 which are offset against Long-term debt and finance leases in the consolidated statement of financial position.

The following is a maturity analysis, based on contractual undiscounted cash flows, for 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 December 31, 2013.

	2014	2015	2016	2017	2018	Thereafter	Total
Long-term debt obligations	$ 541	$ 805	$ 489	$ 606	$ 446	$ 2,268	**$ 5,155**
Finance lease obligations	92	84	45	43	43	159	**466**
Accounts payable and accrued liabilities	1,129	-	-	-	-	-	**1,129**
	$ 1,762	**$ 889**	**$ 534**	**$ 649**	**$ 489**	**$ 2,427**	**$ 6,750**

Minimum Committed Purchase of Aeroplan Miles

The CPSA between the Corporation and Aeroplan outlines a requirement for the Corporation to purchase a minimum number of Aeroplan Miles® from Aeroplan. The estimated minimum requirement for 2014 is $218. The annual commitment is based on 85% of the average total Aeroplan Miles® actually issued in respect of Air Canada flights or Air Canada airline affiliate products and services in the three preceding calendar years. During 2013, the Corporation purchased $242 of Aeroplan Miles® from Aeroplan.

17. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

	Carrying Amounts				
	December 31, 2013				December 31, 2012
	Financial instruments classification				
	Held for trading	Loans and receivables	Liabilities at amortized cost	Total	
Financial Assets					
Cash and cash equivalents	$ 750	$ -	$ -	$ 750	$ 754
Short–term investments	1,458	-	-	1,458	1,219
Restricted cash	92	-	-	92	96
Accounts receivable	-	589	-	589	550
Deposits and other assets					
Restricted cash	190	-	-	190	188
Aircraft related and other deposits	-	122	-	122	159
Prepayment option on senior secured notes	2	-	-	2	15
Derivative instruments					
Fuel derivatives	20	-	-	20	16
Share forward contracts	56	-	-	56	10
Foreign exchange derivatives	13	-	-	13	–
Interest rate swaps	10	-	-	10	13
	$ 2,591	$ 711	$ -	$ 3,302	$ 3,020
Financial Liabilities					
Accounts payable	$ -	$ -	$ 1,026	$ 1,026	$ 1,028
Current portion of long–term debt and finance leases	-	-	374	374	499
Long–term debt and finance leases	-	-	3,959	3,959	3,259
	$ -	$ -	$ 5,359	$ 5,359	$ 4,786

There have been no changes in classification of financial instruments since December 31, 2012.

For cash flow purposes, the Corporation may settle, from time to time, certain cash equivalents and 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.

Summary of Gain (loss) on Financial Instruments Recorded at Fair Value

	2013	2012
Fuel derivatives	$ (6)	$ (43)
Share forward contracts	42	5
Prepayment option on senior secured notes	2	15
Interest rate swaps	(1)	(1)
Other	-	4
Gain (loss) on financial instruments recorded at fair value	$ 37	$ (20)

Risk Management

Under its risk management policy, the Corporation manages its interest rate risk, foreign exchange risk, share-based compensation risk and market risk (e.g. fuel price risk) through the use of various interest rate, foreign exchange, fuel and other derivative financial instruments. The Corporation uses derivative financial instruments only for risk management purposes, not for generating trading profit. As such, any change in cash flows associated with derivative instruments is designed to be offset by changes in cash flows related to the risk being hedged.

As noted below, the Corporation uses derivative instruments to provide economic hedges to mitigate various risks. The derivative fair values represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Fair value of these derivatives is determined using prices in active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. The valuation technique incorporates all factors that would be considered in setting a price, including the Corporation's own credit risk and the credit risk of the counterparty.

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 short-term 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 obligations outstanding is designed to maintain flexibility in the Corporation's capital structure and is based upon a long term objective of 60% fixed and 40% floating but allows flexibility in the short-term to adjust to prevailing market conditions. The ratio at December 31, 2013 is 74% fixed and 26% floating, including the effects of interest rate swap positions (71% and 29%, respectively as at December 31, 2012). The following are the current derivatives employed in interest rate risk management activities and the adjustments recorded during 2013:

- As at December 31, 2013, the Corporation had two interest rate swap agreements in place with terms to July 2022 and January 2024 relating to two Boeing 767 aircraft financing agreements with an aggregate notional value of $62 (US$58) (2012 – $65 (US$66)). These swaps convert the lease payments on the two aircraft leases from fixed to floating rates. The fair value of these contracts as at December 31, 2013 was $10 in favour of the Corporation (2012 – $13 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2013, a loss of $1 was recorded in Gain on financial instruments recorded at fair value related to these derivatives (2012 – $2 gain).

Interest income includes $29 (2012 – $33) related to Cash and cash equivalents and Short-term investments, which are classified as held for trading. Interest expense reflected on the consolidated statement of operations relates to financial liabilities recorded at amortized cost.

Foreign Exchange Risk

The Corporation's financial results are reported in Canadian dollars, while a large portion of its revenues, expenses, debt obligations and capital commitments are in foreign currencies, primarily in US dollars. Foreign exchange risk is the risk that fluctuations in foreign exchange rates will adversely impact operating results and cash flows.

The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

The Corporation's cash inflows are primarily in Canadian dollars, while a large portion of its outflows are in US dollars. This unbalanced mix results in an annual US dollar shortfall from operations. In order to mitigate this imbalance, the Corporation has adopted a number of risk management strategies, which include:

- The practice of converting excess revenues from offshore currencies into US dollars. In 2013, this conversion generated coverage for approximately 25% of the imbalance.
- Holding US cash reserves as an economic hedge against changes in the value of the US dollar. US dollar cash and short-term investment balances as at December 31, 2013 amount to $791(US$743) ($581 (US$584) as at December 31, 2012).
- Locking in the foreign exchange rate through the use of a variety of foreign exchange derivatives which have maturity dates corresponding to the forecasted dates of US dollar shortfalls.

The target coverage of the above strategies is to cover 50% of the net US dollar exposure on a rolling 12 month basis. The level of foreign exchange derivatives entered into and their related maturity dates are dependent upon a number of factors, which include the amount of foreign revenue conversion available, US dollar net cash flows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2013, as further described below, and the value of US cash reserves, approximately 50% of net US cash outflows are hedged in 2014.

As at December 31, 2013, the Corporation had outstanding foreign currency options and swap agreements to purchase US dollars and Euros against Canadian dollars on $1,645 (US$1,547) and $72 (EUR $34, GBP $16) which mature in 2014 and 2015 at a weighted average rate of $1.0341 per $1.00 US dollar (2012 – $1,289 (US$1,296) which matured in 2013). The fair value of these foreign currency contracts as at December 31, 2013 was $13 in favour of the Corporation (2012 – less than $1 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2013, a gain of $68 was recorded in Foreign exchange gain (loss) related to these derivatives (2012 – $20 gain).

Share-based Compensation Risk

The Corporation issues share-based compensation to its employees in the form of stock options and PSUs as described in Note 14. Each PSU entitles the employees to receive a payment in the form of one Air Canada ordinary share, cash in the amount equal to market value of one ordinary share, or a combination thereof, at the discretion of the Board of Directors.

Share-based compensation risk refers to the risk that future cash flows to settle the PSUs will fluctuate because of changes in the Corporation's share price. To hedge the exposure to outstanding PSUs, the Corporation entered into share forward contracts to hedge PSUs that may vest between 2014 and 2016, subject to the terms of vesting including realization of performance vesting criteria. The contracts were prepaid by the Corporation. The forward dates for the share forward contracts coincide with the vesting terms and planned settlement dates of 7,523,112 PSUs from 2014 to 2016. These contracts were not designated as hedging instruments for accounting purposes. Accordingly, changes in the fair value of these contracts are recorded in Gain (loss) on financial instruments recorded at fair value in the period in which they arise. During 2013, a gain of $42 was recorded (2012 – gain of $5). As at December 31, 2013, the fair value of the share forward contracts is $56 in favour of the Corporation (2012 – $10 in favour of the Corporation), with those contracts maturing in 2014 of $20 recorded in Prepaid expenses and other current assets and the remainder of $36 is recorded in Deposits and other assets.

Liquidity risk

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities and other contractual obligations, including pension funding obligations as described in Note 9 and covenants in credit card agreements as described below. 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 well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. The Corporation's principal objective in managing liquidity risk is to maintain a minimum unrestricted liquidity level of $1,700. This minimum target level was determined in conjunction with Air Canada's liquidity risk management strategy and replaces the previous target of maintaining at least 15% of 12 month trailing revenues. At December 31, 2013, unrestricted liquidity was $2,364 comprised of Cash and cash equivalents and Short-term investments of $2,208 and undrawn lines of credit of $156.

A maturity analysis of the Corporation's financial liabilities, other fixed operating commitments and capital commitments is set out in Note 16.

Market Risks

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 for jet fuel.

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 as at December 31, 2013. The sensitivity analysis is based on a reasonably possible movement in the relevant risk factor. These assumptions may not be representative of actual movements in these risks and should not be relied upon. Given potential volatility in the financial and commodity markets, the actual percentage changes may differ significantly from the percentage changes outlined below. Changes in income generally cannot be extrapolated because the relationship of the change in assumption to the change in income may not be linear. Each risk is contemplated independent of other risks. In reality, changes in one factor may result in changes in another, which may magnify or counteract the sensitivities.

The sensitivity analysis related to derivative contracts is based on the estimated fair value change applicable to the derivative as at December 31, 2013 considering a number of variables including the remaining term to maturity and does not consider the fair value change that would be applicable to the derivative assuming the market risk change was applicable to the maturity date of the derivative contract.

	Interest rate risk(1)	Foreign exchange rate risk(2)		Other price risk(3)	
	Income	Income		Income	
	1% increase	5% increase	5% decrease	10% increase	10% decrease
Cash and cash equivalents	$ 7	$ (4)	$ 4	$ -	$ -
Short–term investments	$ 15	$ (29)	$ 29	$ -	$ -
Aircraft related deposits	$ -	$ (3)	$ 3	$ -	$ -
Long–term debt and finance leases	$ (10)	$ 195	$ (195)	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ 32	$ (17)
Share forward contracts	-	-	-	6	(6)
Foreign exchange derivatives	$ -	$ (22)	$ 24	$ -	$ -
Interest rate swaps	$ (3)	$ -	$ -	$ -	$ -

(1) *Due to currently low market rates of interest, a 1% decrease in interest rates was not considered a reasonable scenario within the forecast period, being one year.*

(2) *Increase (decrease) in foreign exchange relates to a strengthening (weakening) of the Canadian dollar versus the U.S. dollar. The impact on long-term debt and finance leases includes $6 related to the Canadian dollar versus the Japanese yen. The impact of changes in other currencies is not significant to the Corporation's financial instruments.*

(3) *The sensitivity analysis for fuel derivatives is based upon a 10% increase or decrease in the price of the underlying commodity. The sensitivity analysis for share forward contracts is based upon a 10% increase or decrease in the Air Canada share price.*

Covenants in Credit Card Agreements

The Corporation has various agreements with companies that process customer credit card transactions. Approximately 85% of the Corporation's sales are processed using credit cards, with remaining sales processed through cash or online banking based transactions. The Corporation receives payment for a credit card sale generally in advance of when the passenger transportation is provided.

The terms of the Corporation's principal credit card processing agreements for credit card processing services in North America are in effect for another four years each, and the agreements contain triggering events upon which the Corporation is required to provide the credit card processor with cash deposits. The obligation to provide cash deposits and the required amount of deposits are each based upon a matrix measuring, on a quarterly basis, both a fixed charge coverage ratio for the Corporation and the unrestricted cash and short-term investments of the Corporation. In 2013, the Corporation made no cash deposits under these agreements (nil in 2012).

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2013, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments and Accounts receivable. Cash and cash equivalents and Short-term investments are in place with major financial institutions, the Canadian government, and major corporations. Accounts receivable are generally the result of sales of tickets to individuals, often through the use of major credit cards, through geographically dispersed travel

agents, corporate outlets, or other airlines. Credit rating guidelines are used in determining counterparties for fuel hedging. In order to manage its exposure to credit risk and assess credit quality, the Corporation reviews counterparty credit ratings on a regular basis and sets credit limits when deemed necessary.

Fuel Price Risk

Fuel price risk is the risk that future cash flows will fluctuate because of changes in jet fuel prices. In order to manage its exposure to jet fuel prices and to help mitigate volatility in operating cash flows, the Corporation enters into derivative contracts with financial intermediaries. The Corporation uses derivative contracts based on jet fuel, heating oil and crude-oil based contracts. The Corporation's policy permits hedging of up to 75% of the projected jet fuel purchases for the next 12 months, 50% for the next 13 to 24 months and 25% for the next 25 to 36 months. These are maximum (but not mandated) limits. There is no minimum monthly hedging requirement. There are regular reviews to adjust the strategy in light of market conditions.

During 2013:

- The Corporation recorded a loss of $6 in Loss on financial instruments recorded at fair value related to fuel derivatives ($43 loss in 2012).
- The Corporation purchased crude-oil and refined products-based call options and call spreads covering a portion of 2013 and 2014 fuel exposure. The cash premium related to these contracts was $39 ($51 in 2012 for 2012 and 2013 exposures).
- Fuel derivative contracts cash settled with a fair value of $29 in favour of the Corporation ($3 in favour of the Corporation in 2012).

As of December 31, 2013, approximately 20% of the Corporation's anticipated purchases of jet fuel for 2014 are hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US$100 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2014 period are comprised of call options with notional volumes of 5,136,000 barrels. The fair value of the fuel derivatives portfolio at December 31, 2013 is $20 in favour of the Corporation ($16 in favour of the Corporation in 2012) and is recorded within Prepaid expenses and other current assets.

Financial Instrument Fair Values in the Consolidated Statement of Financial Position

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

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

Management estimated the fair value of its long-term debt based on valuation techniques taking into account market rates of interest, the condition of any related collateral, the current conditions in credit markets and the current estimated credit margins applicable to the Corporation based on recent transactions. Based on significant observable inputs (Level 2 in the fair value hierarchy), the estimated fair value of debt approximates its carrying value of $4,333.

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Following is a classification of fair value measurements recognized in the consolidated statement of financial position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

		Fair value measurements at reporting date using:		
Recurring measurements	December 31, 2013	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 equivalents	$ 186	$ -	$ 186	$ -
Short–term investments	1,458	-	1,458	-
Deposits and other assets				
Prepayment option on senior secured notes	2	-	-	2
Derivative instruments				
Fuel derivatives	20	-	20	-
Share forward contracts	56	-	56	-
Foreign exchange derivatives	13	-	13	-
Interest rate swaps	10	-	10	-
Total	**$ 1,745**	**$ -**	**$ 1,743**	**$ 2**

Financial assets held by financial institutions in the form of cash and restricted cash have been excluded from the fair value measurement classification table above as they are not valued using a valuation technique.

The Corporation's policy is to recognize transfers into and transfers out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. There were no transfers within the fair value hierarchy during 2013.

In measuring the fair value of the prepayment option on the New Senior Notes issued in September 2013, which is categorized as Level 3 in the fair value hierarchy, the Corporation takes into account various factors including the prepayment terms in the notes, market rates of interest, the current conditions in credit markets and the current estimated credit margin applicable to the Corporation.

The change in Level 3 assets in 2013 related to a loss of $15 recorded in Interest expense for the fair value of the prepayment option within the senior secured notes which were extinguished in September 2013, upon refinancing with the issuance of New Senior Notes. The fair value of the prepayment option on the New Senior Notes that were issued is $2. The Corporation's credit margin is considered a Level 3 input and an increase of 1% to the credit margin would result in a decrease of $1 to the prepayment option asset, and a decrease of 1% to the credit margin would result in a $2 increase to the prepayment option asset

Offsetting of Financial Instruments in the Consolidated Statement of Financial Position

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position where the Corporation has a legally enforceable right to set-off the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously. In the normal course of business, the Corporation enters into various master netting arrangements or other similar arrangements that do not meet the criteria for offsetting in the consolidated statement of financial position but still allow for the related amounts to be set off in certain circumstances, such as the termination of the contracts or in the event of bankruptcy or default of either party to the agreement.

Air Canada participates in industry clearing house arrangements whereby certain accounts receivable balances related to passenger, cargo and other billings are settled on a net basis with the counterparty through the clearing house. These billings are mainly the result of interline agreements with other airlines, which are commercial agreements that enable the sale and settlement of travel and related services between the carriers. Billed and work in process interline

receivables are presented on a gross basis and amount to $61 as at December 31, 2013. These balances will be settled at a net value at a later date; however such net settlement amount is unknown until the settlement date.

The following table presents the recognized financial instruments that are offset, or subject to enforceable master netting arrangements or other similar arrangements but not offset, as at December 31, 2013 and 2012, and shows in the Net column what the net impact would be on the consolidated statement of financial position if all set-off rights were exercised.

	Amounts offset			Amounts not offset	Net
Financial assets	Gross assets	Gross liabilities offset	Net amounts presented	Financial instruments	
December 31, 2013					
Derivative assets	$ 99	$ -	$ 99	$ -	$ 99
Accounts receivable	96	(48)	48	(36)	12
	$ 195	**$ (48)**	**$ 147**	**$ (36)**	**$ 111**
December 31, 2012					
Derivative assets	$ 39	$ -	$ 39	$ -	$ 39
Accounts receivable	154	(91)	63	(39)	24
	$ 193	**$ (91)**	**$ 102**	**$ (39)**	**$ 63**

	Amounts offset			Amounts not offset	Net
Financial liabilities	Gross liabilities	Gross assets offset	Net amounts presented	Financial instruments	
December 31, 2013					
Accounts payable	$ 118	$ (48)	$ 70	$ (36)	$ 34
December 31, 2012					
Accounts payable	$ 161	$ (91)	$ 70	$ (39)	$ 31

18. CONTINGENCIES, GUARANTEES AND INDEMNITIES

Contingencies and Litigation Provisions

Investigations by Competition Authorities Relating to Cargo

The European Commission and the United States Department of Justice investigated, and the Competition Bureau in Canada is investigating, alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators, including Air Canada. Competition authorities in several jurisdictions sought or requested information from Air Canada as part of their investigations. Air Canada has been cooperating with these investigations, which are likely to lead, or have led, 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, and may otherwise become implicated, in a number of class action lawsuits and other proceedings in Canada, Europe and the United States in connection with these allegations. In the United States, the investigation by the US Department of Justice concluded with no proceedings having been instituted against Air Canada and in 2012, the Corporation entered into a settlement agreement relating to class action proceedings in the United States in connection with these allegations under which Air Canada made a payment of $8 without any admission of liability.

In 2010, the European Commissions rendered a decision finding that 12 air cargo carriers (including groups of related carriers) had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006. Air Canada was among the carriers subject to the decision and a fine of 21 Euros (approximately C$29) was imposed on Air Canada. Air Canada is appealing this decision and filed an application for appeal before the European General Court. In 2011, Air Canada paid the fine, as required, pending the outcome of its appeal.

As at December 31, 2013, Air Canada has a provision of $27 relating to outstanding claims in this matter, which is recorded in Accounts payable and accrued liabilities. This provision is an estimate based upon the status of investigations and proceedings at this time and Air Canada's assessment as to the potential outcome for certain of them. The provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Air Canada has determined it is not possible at this time to predict with any degree of certainty the outcome of all proceedings and investigations. As stated above, Air Canada is appealing the decision issued by the European Commission and, if and as appropriate, based on the outcome of any updates regarding this appeal as well as developments regarding proceedings and investigations in other jurisdictions, may adjust the provision in its results for subsequent periods as required.

Mandatory Retirement

Air Canada is engaged in a number of proceedings involving challenges to the mandatory retirement provisions of certain of its collective agreements, including the previous Air Canada-Air Canada Pilots Association collective agreement, which incorporated provisions of the pension plan terms and conditions applicable to pilots requiring them to retire at age 60. Air Canada has fully or partially resolved some of these complaints and is defending others. At this time, it is not possible to determine with any degree of certainty the extent of any financial liability that may arise from Air Canada being unsuccessful in its defence of these proceedings, though any such financial liability, if imposed, would not be expected to be material.

Other Contingencies

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

With respect to 12 aircraft leases, the difference between the reduced rents as a result of the implementation of the Plan of Reorganization, Compromise and Arrangement under the *Companies' Creditors Arrangement Act* ("CCAA") on September 30, 2004 and amounts which would have been due under the original lease contracts will be forgiven at the expiry date of the leases if no material default has occurred by such date. In the event of a material default which does not include any cross defaults to other unrelated agreements (including unrelated agreements with the counterparties to these aircraft leases), this difference plus interest will become due and payable and all future rent will be based on the original contracted rates. Rent expense is being recorded on the renegotiated lease agreements and any additional liability would be recorded only at the time management believes the amount is likely to be incurred.

Refer to Note 10 for a continuity schedule of litigation provisions.

Guarantees

Guarantees in Fuel Facilities Arrangements

The Corporation participates in fuel facility arrangements operated through eight Fuel Facility Corporations, along with other airlines that contract for fuel services at various major airports in Canada. The Fuel Facility Corporations operate on a cost recovery basis. The purpose of the Fuel Facility Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the land rights under the land leases. The aggregate debt of the eight Fuel Facility Corporations in Canada that have not been consolidated by the Corporation under IFRS 10 Consolidated Financial Statements is approximately $394 as at December 31, 2013 (December 31, 2012 - $390), which is the Corporation's maximum exposure to loss before taking into consideration the value of the assets that secure the obligations and any cost sharing that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote. Each contracting airline participating in a Fuel Facility Corporation shares pro rata, based on system usage, in the guarantee of this debt. The maturities of these debt arrangements vary but generally extend beyond five years.

Indemnification Agreements

In the ordinary course of the Corporation’s business, the Corporation enters into a variety of agreements, some of which may provide for indemnifications to counterparties that may require the Corporation to pay for costs and/or losses incurred by such counterparties. The Corporation cannot reasonably estimate the potential amount, if any, it could be required to pay under such indemnifications. Such amount would also depend on the outcome of future events and conditions, which cannot be predicted. While certain agreements specify a maximum potential exposure, certain others do not specify a maximum amount or a limited period. Historically, the Corporation has not made any significant payments under these indemnifications.

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

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

When the Corporation, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, the Corporation has from time to time agreed to indemnify the service provider against certain liabilities that arise from third party claims, which may relate to services performed by the service provider.

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

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

19. INVESTMENTS IN AVEOS

In 2012, as a result of Aveos Fleet Performance Inc. ("Aveos") ceasing operations and filing for court protection pursuant to the *Companies' Creditors Arrangements Act* ("CCAA"), Air Canada reduced the carrying value of its investment in Aveos Holding Company, Aveos' parent company, as well as the carrying value of a long term note receivable from Aveos to nil and recorded an aggregate loss on investments of $65 in Non-operating expense. In addition, Air Canada recorded a liability of $55, which was charged to Discontinued Operations, related to Air Canada's commitment under a separation program. For the twelve months ended December 31, 2013, a cash outflow of $29 was generated in relation to this separation program ($26 in 2012).

A settlement and termination agreement pertaining to operating amounts owing between Air Canada and Aveos, including disputed invoices, was concluded during 2013. This agreement resulted in the set-off, settlement and release of all outstanding invoices between Air Canada and Aveos. Settlement of the Pension and Benefits Agreement was concluded in October 2013 with payment in trust to Aveos, for distribution to identified Aveos eligible recipients. The letter of credit of $20 previously issued in favour of Aveos was returned to Air Canada. Following this, obligations under the other post-retirement and post-employment benefit plans pertaining to transferred unionized Aveos employees are no longer included in the Corporation's consolidated financial statements as at December 31, 2013. In 2012, OSFI ordered the termination of Aveos' defined benefit pension plan and, as a result, the assets and liabilities accruing prior to July 14, 2011 in respect of transferred Aveos employees could not be transferred to Aveos' plans and remain under Air Canada's pension plans.

20. GEOGRAPHIC INFORMATION

A reconciliation of the total amounts reported by geographic region for Passenger revenues and Cargo revenues on the Consolidated Statement of Operations is as follows:

Passenger Revenues	2013	2012
Canada	$ 4,237	$ 4,178
US Transborder	2,176	2,130
Atlantic	2,263	2,114
Pacific	1,618	1,568
Other	727	747
	$ 11,021	**$ 10,737**

Cargo Revenues	2013	2012
Canada	$ 63	$ 68
US Transborder	18	17
Atlantic	171	177
Pacific	185	184
Other	37	42
	$ 474	**$ 488**

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 and Australia. Other passenger and cargo revenues refer to flights with origins and destinations principally in South America and the Caribbean.

Other operating revenues are principally derived from customers located in Canada and consist primarily of revenues from the sale of the ground portion of vacation packages, ground handling services, and other airline-related services, as well as revenues related to the lease or sublease of aircraft to third parties.

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21. CAPITAL DISCLOSURES

The Corporation views capital as the sum of Long-term debt and finance leases, capitalized operating leases, Non-controlling interests, and the market value of the Corporation's outstanding shares ("market capitalization"). The Corporation 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 7.0, 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. Market capitalization is based on the closing price of Air Canada's shares multiplied by the number of outstanding shares. This definition of capital is used by management and may not be comparable to measures presented by other public companies.

The Corporation also monitors its adjusted net debt. Adjusted net debt is calculated as the sum of Long-term debt and finance lease obligations and capitalized operating leases less Cash and cash equivalents and Short-term investments.

The Corporation's main objectives when managing capital are:

- To structure repayment obligations in line with the expected life of the Corporation's principal revenue generating assets;
- To ensure the Corporation has access to capital to fund contractual obligations as they become due and to ensure adequate cash levels to withstand deteriorating economic conditions;
- To maintain an appropriate balance between debt supplied capital versus investor supplied capital; and
- To monitor the Corporation's credit ratings to facilitate access to capital markets at competitive interest rates.

In order to maintain or adjust the capital structure, the Corporation 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, issuing debt or equity securities, and repurchasing outstanding shares, all subject to market conditions and the terms of the underlying agreements or other legal restrictions.

The total capital and adjusted net debt as at December 31 is calculated as follows:

	2013	2012
Long-term debt and finance leases	$ 3,959	$ 3,259
Current portion of long-term debt and finance leases	374	499
	4,333	3,758
Capitalized operating leases	2,226	2,352
Adjusted debt	6,559	6,110
Non-controlling interests	63	59
Market capitalization	2,108	480
Total Capital	**$ 8,730**	**$ 6,649**
Adjusted debt	$ 6,559	$ 6,110
Less Cash and cash equivalents and Short-term investments	(2,208)	(1,973)
Adjusted net debt	**$ 4,351**	**$ 4,137**

Total capital has increased by $2,081, which reflects an increase in market capitalization due to a higher Air Canada share price.

22. RELATED PARTY TRANSACTIONS

Compensation of Key Management

Compensation of key management is reported on the accrual basis of accounting consistent with the amounts recognized on the consolidated statement of operations. Key management includes Air Canada's Board of Directors, President and Chief Executive Officer, Executive Vice-President and Chief Operating Officer, Executive Vice-President and Chief Financial Officer, and Executive Vice-President and Chief Commercial Officer. Compensation awarded to key management is summarized as follows:

	2013	2012
Salaries and other benefits	$ 8	$ 8
Post-employment benefits	1	2
Other long-term benefits	-	-
Share-based compensation	7	4
	$ 16	**$ 14**