2015

Consolidated
Financial Statements and Notes

February 17, 2016

A STAR ALLIANCE MEMBER

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, 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 16, 2016

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, 2015 and December 31, 2014 and the consolidated statement of operations, statement of comprehensive income, statement of changes in equity and statement of cash flow for the years then ended, 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 as issued by the International Accounting Standards Board, 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 audit 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, 2015 and December 31, 2014 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

PricewaterhouseCoopers LLP[1]

Montreal, Quebec
February 16, 2016

[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, 2015	December 31, 2014
ASSETS			
Current			
Cash and cash equivalents		$ 572	$ 661
Short-term investments		2,100	1,614
Total cash, cash equivalents and short-term investments		2,672	2,275
Restricted cash	Note 2P	91	89
Accounts receivable		654	656
Promissory notes receivable	Note 4	143	-
Aircraft fuel inventory		68	72
Spare parts and supplies inventory	Note 2Q	114	91
Prepaid expenses and other current assets		383	295
Total current assets		4,125	3,478
Property and equipment	Note 4	7,030	5,998
Pension	Note 8	851	-
Intangible assets	Note 5	314	305
Goodwill	Note 6	311	311
Deposits and other assets		496	556
Total assets		**$ 13,127**	**$ 10,648**
LIABILITIES			
Current			
Accounts payable and accrued liabilities		$ 1,487	$ 1,259
Advance ticket sales		1,818	1,794
Current portion of long-term debt and finance leases	Note 7	524	484
Total current liabilities		3,829	3,537
Long-term debt and finance leases	Note 7	5,870	4,732
Pension and other benefit liabilities	Note 8	2,245	2,403
Maintenance provisions	Note 9	892	796
Other long-term liabilities		251	313
Total liabilities		**$ 13,087**	**$ 11,781**
EQUITY			
Shareholders' equity			
Share capital	Note 11	825	835
Contributed surplus		76	77
Hedging reserve		(11)	-
Deficit		(877)	(2,113)
Total shareholders' equity		13	(1,201)
Non-controlling interests		27	68
Total equity		40	(1,133)
Total liabilities and equity		**$ 13,127**	**$ 10,648**

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)		2015	2014
Operating revenues			
Passenger	Note 18	$ 12,420	$ 11,804
Cargo	Note 18	506	502
Other		942	966
Total revenues		**13,868**	**13,272**
Operating expenses			
Aircraft fuel		2,464	3,247
Regional airlines expense	Note 19	2,279	2,324
Wages, salaries and benefits		2,324	2,201
Airport and navigation fees		802	755
Aircraft maintenance		773	678
Depreciation, amortization and impairment		655	526
Sales and distribution costs		608	560
Ground package costs		415	377
Aircraft rent		353	302
Food, beverages and supplies		314	294
Communications and information technology		211	199
Special items	Note 20	8	(11)
Other		1,166	1,005
Total operating expenses		**12,372**	**12,457**
Operating income		**1,496**	**815**
Non-operating income (expense)			
Foreign exchange loss		(762)	(307)
Interest income		46	39
Interest expense		(402)	(322)
Interest capitalized		70	30
Net financing expense relating to employee benefits	Note 8	(105)	(134)
Fuel and other derivatives	Note 15	(17)	(1)
Other		(18)	(15)
Total non-operating expense		(1,188)	(710)
Income before income taxes		**308**	**105**
Income taxes	Note 10	-	-
Net income		**$ 308**	**$ 105**
Net income attributable to:			
Shareholders of Air Canada		303	100
Non-controlling interests		5	5
Net income		**$ 308**	**$ 105**
Net income per share attributable to shareholders of Air Canada	Note 13		
Basic earnings per share		$ 1.06	$ 0.35
Diluted earnings per share		$ 1.03	$ 0.34

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)		2015	2014
Comprehensive income			
Net income		$ 308	$ 105
Other comprehensive income, net of taxes of nil:			
Items that will not be reclassified to net income			
Remeasurements on employee benefit liabilities	Note 8	1,015	167
Items that will be reclassified to net income			
Loss on derivatives designated as cash flow hedges, net	Note 15	(11)	-
Total comprehensive income		**$ 1,312**	**$ 272**
Comprehensive income attributable to:			
Shareholders of Air Canada		$ 1,307	**$** 267
Non-controlling interests		5	5
Total comprehensive income		**$ 1,312**	**$ 272**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Canadian dollars in millions)	Share capital	Contributed surplus	Hedging reserve	Deficit	Total shareholders' equity	Non-controlling interests	Total equity
January 1, 2014	$ 827	$ 80	$ -	$ (2,367)	$ (1,460)	$ 63	$ (1,397)
Net income	-	-	-	100	100	5	105
Remeasurements on employee benefit liabilities	-	-	-	167	167	-	167
Total comprehensive income	-	-	-	267	267	5	272
Share-based compensation	-	2	-	(13)	(11)	-	(11)
Shares issued (Note 11)	2	(1)	-	-	1	-	1
Shares vested for employee recognition award (Note 11)	6	(4)	-	-	2	-	2
December 31, 2014	$ 835	$ 77	$ -	$ (2,113)	$ (1,201)	$ 68	$ (1,133)
Net income	-	-	-	303	303	5	308
Remeasurements on employee benefit liabilities	-	-	-	1,015	1,015	-	1,015
Loss on derivatives designated as cash flow hedges, net	-	-	(11)	-	(11)	-	(11)
Total comprehensive income	-	-	(11)	1,318	1,307	5	1,312
Share-based compensation	-	1	-	(35)	(34)	-	(34)
Shares issued (Note 11)	6	(2)	-	-	4	-	4
Shares purchased and cancelled under issuer bid (Note 11)	(16)	-	-	(47)	(63)	-	(63)
Distributions	-	-	-	-	-	(46)	(46)
December 31, 2015	$ 825	$ 76	$ (11)	$ (877)	$ 13	$ 27	$ 40

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)		2015	2014
Cash flows from (used for)			
Operating			
Net income		$ 308	$ 105
Adjustments to reconcile to net cash from operations			
Depreciation, amortization and impairment		671	543
Foreign exchange loss	Note 15	835	351
Employee benefit funding (greater) less than expense	Note 8	6	(117)
Fuel and other derivatives	Note 15	(5)	(12)
Change in maintenance provisions		42	76
Changes in non-cash working capital balances		191	40
Other		(36)	(32)
Net cash flows from operating activities		**2,012**	**954**
Financing			
Proceeds from borrowings	Note 7	905	1,178
Reduction of long-term debt and finance lease obligations	Note 7	(694)	(677)
Distributions related to aircraft special purpose leasing entities		(51)	-
Issue of common shares		4	1
Shares purchased for cancellation	Note 11	(63)	-
Financing fees	Note 7	(32)	-
Net cash flows from financing activities		**69**	**502**
Investing			
Short-term investments		(398)	(100)
Additions to property, equipment and intangible assets		(1,815)	(1,501)
Proceeds from sale of assets		23	72
Other		2	(3)
Net cash flows used in investing activities		**(2,188)**	**(1,532)**
Effect of exchange rate changes on cash and cash equivalents		**18**	**(13)**
Decrease in cash and cash equivalents		**(89)**	**(89)**
Cash and cash equivalents, beginning of year		661	750
Cash and cash equivalents, end of year		**$ 572**	**$ 661**

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

For the years ended December 31, 2015 and 2014
(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 doing business under the brand name Air Canada Vacations® ("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, U.S. transborder and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-U.S. 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-U.S. 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, a 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.

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 16, 2016.

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

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

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 17 aircraft (22 aircraft as at December 31, 2014). 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.

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 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. 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, pass-through costs, which are direct costs incurred by the regional carrier and charged to the Corporation, and other costs incurred by the Corporation which are directly related to regional carrier operations. Prior to 2015, these expenses were recorded in the applicable category within Operating expenses with capacity purchase fees presented as a separate line item. As of 2015, expenses incurred related to capacity purchase agreements are now presented in a separate line item in the consolidated statement of operations titled Regional airlines expense which reflects the inclusion of all expenses related to the third-party capacity purchase agreements, including capacity purchase fees, pass-through costs and other costs. This change in presentation has been adopted to provide improved presentation of the economic costs associated with regional carrier operations. Prior period amounts have been reclassified to conform to the current period presentation. Refer to Note 19 for a reconciliation of previously reported amounts to the current year presentation.

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, which are accounted for as passenger revenues by Air Canada when transportation is provided. 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.

In certain subleases of aircraft to Jazz and Sky Regional, 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 in the period of a plan amendment, irrespective of whether the benefits have vested. Gains and losses on curtailments or settlements are recognized in the period in which the curtailment or settlement occurs.

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

The liability in respect of minimum funding requirements, if any, 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.

Recognized pension assets are limited to the present value of any reductions in future contributions or any future refunds.

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 payments under the plans.

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, performance share units ("PSUs") and restricted share units ("RSUs"), as further described in Note 12. PSUs and RSUs are notional share units which are exchangeable, on a one-to-one basis, as determined by the Board of Directors as described in Note 12, for Air Canada shares, or the cash equivalent.

Options are expensed using a graded vesting model over the vesting period. 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.

Grants of PSUs and RSUs 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 and RSUs that are expected to vest. Refer to Note 15 for a description of derivative instruments used by the Corporation to economically hedge the cash flow exposure to PSUs and RSUs.

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 2R.

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. 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 are recorded in Aircraft maintenance.

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, and other expenses. Other operating expenses are recognized as incurred.

L) FINANCIAL INSTRUMENTS

New accounting standard adopted by the Corporation

The Corporation has early adopted IFRS 9 – Financial Instruments with a date of initial application of January 1, 2015. IFRS 9 introduces new requirements for the classification and measurement of financial assets. IFRS 9 requires all recognized financial assets to be measured at amortized cost or fair value in subsequent accounting periods following initial recognition. IFRS 9 also amends the requirements around hedge accounting, and introduces a single, forward-looking expected loss impairment model.

All financial assets, other than Accounts receivable, Promissory notes receivable, and Aircraft related and other deposits, are included in the measurement category of fair value through profit and loss. Financial assets previously allocated to Loans and receivables are now allocated to the amortized cost category. There was no change to the measurement category for financial liabilities at amortized cost.

The adoption of IFRS 9 had no impact on the Corporation's consolidated financial statements on the date of adoption. There was no change in the carrying amounts on the basis of allocation from original measurement categories under IAS 39 to the new measurement categories under IFRS 9.

Recognition

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated statement of financial position when the Corporation becomes a party to the financial instrument or derivative contract.

Classification

From January 1, 2015, the Corporation classifies its financial assets and financial liabilities in the following measurement categories i) those to be measured subsequently at fair value (either through other comprehensive income or through profit or loss and ii) those to be measured at amortized cost. The classification of financial assets depends on the business model for managing the financial assets and the contractual terms of the cash flows. Financial liabilities are classified as those to be measured at amortized cost unless they are designated as those to be measured subsequently at fair value through profit or loss (irrevocable election at the time of recognition). For assets and liabilities measured at fair value, gains and losses are either recorded in profit or loss or other comprehensive income.

The Corporation reclassifies financial assets when and only when its business model for managing those assets changes. Financial liabilities are not reclassified.

The Corporation has implemented the following classifications:

- Cash and cash equivalents, Short-term investments, and Restricted cash are classified as assets at fair value and any period change in fair value is recorded through Interest income in the consolidated statement of operations, as applicable.
- Accounts receivable and Aircraft related and other deposits are classified as assets at amortized cost and are measured using the effective interest rate method. Interest income is recorded in the consolidated statement of operations, as applicable.
- Accounts payable, credit facilities, and long term debt 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.

Measurement

All financial instruments are required to be measured at fair value on initial recognition, plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly

attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Financial assets and financial liabilities with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

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 the subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods, with any changes taken through profit and loss or other comprehensive income (irrevocable election at the time of recognition). The requirements for classification and measurement of financial liabilities 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, under IFRS 9, generally be recorded in other comprehensive income.

Impairment

The Corporation assesses all information available, including on a forward looking basis the expected credit losses associated with its assets carried at amortized cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk. To assess whether there is a significant increase in credit risk, the Corporation compares the risk of a default occurring on the asset as at the reporting date with the risk of default as at the date of initial recognition based on all information available, and reasonable and supportive forward looking information. For trade receivables only, the Corporation applies the simplified approach as permitted by IFRS 9 which requires expected lifetime losses to be recognized from initial recognition of receivables.

Derivatives and Hedge Accounting

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured to their fair value at the end of each reporting period. The accounting for subsequent changes in fair value depends on whether the derivatives is designated as a hedging instrument, and if so, the nature of the item being hedged and the type of hedge relationship designated. The Corporation documents at the inception of the hedging transaction the economic relationship between hedging instruments and hedged items including whether the hedging instrument is expected to offset changes in cash flows of hedged items. The Corporation documents its risk management objective and strategy for undertaking various hedge transactions at the inception of each hedging relationship.

The Corporation began to apply hedge accounting for certain designated fuel derivatives prospectively from April 1, 2015. Crude oil prices, while not contractually specified in the Corporation's jet fuel purchase contracts, are economically related to jet fuel prices. The Corporation enters into option contracts on crude oil and designates the contracts in cash flow hedges of the crude oil component of its future jet fuel purchases. The Corporation has established a hedge ratio of 1:1 for its hedging relationships. Under hedge accounting, to the extent effective, the gain or loss on fuel hedging derivatives is recorded in other comprehensive income. Premiums paid for option contracts and the time value of the option contracts are deferred as a cost of the hedge in other comprehensive income. Amounts accumulated in other comprehensive income are presented as hedging reserve in equity and are reclassified to Aircraft fuel expense when the underlying hedged jet fuel is used. Any ineffective gain or loss on fuel hedging derivatives is recorded in non-operating expense in Fuel and other derivatives. Refer to Note 15 for the results from fuel hedge accounting since the Corporation began applying hedge accounting in 2015.

When a hedging instrument expires, is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative deferred gain or loss and deferred costs of hedging in equity at that time remains in equity until the forecast transaction occurs. When the forecast transaction is no longer expected to occur, the cumulative gain or loss and deferred costs of hedging that were reported in equity are immediately reclassified to profit or loss.

If the hedge ratio for risk management purposes is no longer optimal but the risk management objective remains unchanged and the hedge continues to qualify for hedge accounting, the hedge relationship will be rebalanced by adjusting either the volume of the hedged instrument or the volume of the hedged item so that the hedge ratio

aligns with the ratio used for risk management purposes. Any hedge ineffectiveness is calculated and accounted for in profit or loss at the time of the hedge relationship rebalancing.

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), except for effective changes for designated fuel derivatives under hedge accounting as described above. 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, and Accounts payable and accrued 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.

Accounting policy prior to January 1, 2015

The Corporation has applied IFRS 9 retrospectively, but has elected not to restate comparatives in accordance with the transition requirements. As a result, the comparative information provided continues to be accounted for in accordance with the Corporation's previous accounting policy.

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 other comprehensive income 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. 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 common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive potential common shares. The Corporation's potentially dilutive common shares are comprised of stock options. The number of shares included with respect to time vesting options 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 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 is 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) 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 agreements, 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.

Q) AIRCRAFT FUEL INVENTORY AND SPARE PARTS AND SUPPLIES INVENTORY

Inventories of aircraft fuel, spare parts and supplies are measured at cost being determined using a weighted average formula, net of related obsolescence provision, as applicable.

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 $68 related to spare parts and supplies consumed during the year (2014 – $55).

R) 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. Airframes and engines are depreciated over 20 to 25 years, with 10% to 20% estimated residual values. 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 are depreciated over the lesser of eight years or the remaining useful life of the aircraft. 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.

S) 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 such assets, 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.

T) 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.

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.

U) 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, 2015**
International route rights and slots	Indefinite	not applicable
Marketing based trade names	Indefinite	not applicable
Contract and customer based	10 years	Nil
Technology based (internally developed)	5 years	1 to 5 years

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 sale 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 continually re-invest in, 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.

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.

V) 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 AA).

No impairment losses have been recorded against the value of goodwill since its acquisition.

W) 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 dispose 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.

X) 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, such assets are available for immediate sale in present condition, and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to dispose.

Y) PROVISIONS

Provisions are recognized when there exists 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, interest accretion on the provision is recorded in Other non-operating expense.

Z) SPECIAL ITEMS

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

AA) 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.

BB) 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 continues to evaluate the impact of these standards on its consolidated financial statements.

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 replaces IAS 18 Revenue and related interpretations. The core principle of the new standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard is intended to enhance disclosures about revenue, provide more comprehensive guidance for transactions that were not previously addressed and improve guidance for multiple-element arrangements. IFRS 15 is effective for annual periods beginning on January 1, 2018, with early adoption permitted.

IFRS 16 – Leases

IFRS 16 replaces IAS 17 Leases and related interpretations. The core principle is that a lessee recognize assets and liabilities for all leases with a lease term of more than 12 months. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. Assets and liabilities arising from a lease are initially measured on a present value basis. The measurement includes non-cancellable lease payments (including inflation-linked payments), and also includes payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease, or not to exercise an option to terminate the lease. The new standard is intended to provide a faithful representation of leasing transactions, in particular those that do not currently require the lessees to recognize an asset and liability arising from an operating lease. IFRS 16 is effective for annual periods beginning on January 1, 2019, with early adoption permitted for entities that would also apply IFRS 15 Revenue from Contracts with Customers.

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 8 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 $15 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
  - When required, 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 dispose 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 9(a) for additional information.

- Income taxes
  - Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available to realize them. In making this assessment, consideration is given to available positive and negative evidence and relevant assumptions. Consideration is given to, among other things, future projections of taxable income, overall business environment, historical financial results, and industry-wide trends and outlook. At December 31, 2015, no deferred income tax assets have been recorded.

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, 2014					
At January 1, 2014	$ 4,208	$ 352	$ 157	$ 356	$ 5,073
Additions	1,011	6	36	468	1,521
Reclassifications	259	76	2	(337)	-
Disposals	(94)	-	-	-	(94)
Depreciation	(440)	(35)	(27)	-	(502)
At December 31, 2014	$ 4,944	$ 399	$ 168	$ 487	$ 5,998
At December 31, 2014					
Cost	$ 7,264	$ 742	$ 397	$ 487	$ 8,890
Accumulated depreciation	(2,320)	(343)	(229)	-	(2,892)
At December 31, 2014	$ 4,944	$ 399	$ 168	$ 487	$ 5,998
Year ended December 31, 2015					
At January 1, 2015	$ 4,944	$ 399	$ 168	$ 487	$ 5,998
Additions	1,255	-	34	556	1,845
Reclassifications	199	50	24	(273)	-
Disposals	(181)	-	(1)	-	(182)
Depreciation	(543)	(39)	(35)	-	(617)
Impairment	(14)	-	-	-	(14)
At December 31, 2015	$ 5,660	$ 410	$ 190	$ 770	$ 7,030
At December 31, 2015					
Cost	$ 8,278	$ 791	$ 451	$ 770	$ 10,290
Accumulated depreciation	(2,618)	(381)	(261)	-	(3,260)
	$ 5,660	**$ 410**	**$ 190**	**$ 770**	**$ 7,030**

In 2015, an impairment charge of $14 was recorded in Depreciation, amortization and impairment expense related to two A340-300 aircraft (neither of which was operated by Air Canada). The lease agreements relating to these aircraft expired, with one aircraft returned while the other was purchased and will be resold. The impairment charge was calculated on the amount carrying value exceeded the net proceeds expected upon disposal of the aircraft. The total carrying amount of the remaining aircraft is nominal as at December 31, 2015.

As at December 31, 2015, property and equipment included finance leased assets including 18 aircraft (2014 – 17) with a net book value of $170 (2014 – $145) and facilities with a net book value of $39 (2014 – $42).

Included in aircraft and flight equipment are 21 aircraft and 5 spare engines (2014 – 28 aircraft and 5 spare engines) which are leased to Sky Regional, Jazz and third parties with a cost of $349 (2014 – $361) less accumulated depreciation of $97 (2014 – $118) for a net book value of $252 (2014 – $243). Depreciation expense for 2015 for this aircraft and flight equipment amounted to $14 (2014 – $22).

Promissory notes receivable of $143 represent certain proceeds from the sale of Embraer 190 aircraft, with each of the notes due within 90 days of delivery of the aircraft.

Certain property and equipment are pledged as collateral as further described under the applicable debt instrument in Note 7.

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, 2014					
At January 1, 2014	$ 97	$ 88	$ 3	$ 116	$ 304
Additions	-	-	-	33	33
Amortization	-	-	(3)	(29)	(32)
At December 31, 2014	$ 97	$ 88	$ -	$ 120	$ 305
At December 31, 2014					
Cost	$ 97	$ 88	$ 20	$ 396	$ 601
Accumulated amortization	-	-	(20)	(276)	(296)
	$ 97	**$ 88**	**$ -**	**$ 120**	**$ 305**
Year ended December 31, 2015					
At January 1, 2015	**$ 97**	**$ 88**	**$ -**	**$ 120**	**$ 305**
Additions	-	-	-	38	38
Amortization	-	-	-	(29)	(29)
At December 31, 2015	$ 97	$ 88	$ -	$ 129	$ 314
At December 31, 2015					
Cost	$ 97	$ 88	$ 20	$ 419	$ 624
Accumulated amortization	-	-	(20)	(290)	(310)
	$ 97	**$ 88**	**$ -**	**$ 129**	**$ 314**

In 2015, technology based assets with cost of $15 and accumulated amortization of $15 were retired.

Certain international route rights and slots are pledged as security for senior secured notes as described in Note 7(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. The allocation of the indefinite lived intangible assets to the cash-generating units was $144 to international and $41 to North American.

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 applicable 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 the Corporation's fleet plans and industry growth assumptions. The 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 cash-generating unit being tested.

Due to the recoverable amount exceeding the cash generating units carrying value by a significant margin, the most recent calculation made in the preceding period was carried forward and used in the impairment test in the current period. Key assumptions used for the value in use calculations in fiscal 2014 were as follows:

	2014
Discount rate	10.7%
Long-term growth rate	2.5%
Jet fuel price range per barrel	$128 – $133

The recoverable amount of both cash-generating units based on value in use exceeded their respective carrying values by approximately $3,900. If the discount rate were increased by 240 basis points, the excess of recoverable amount over carrying value would be reduced to nil for one of the cash-generating units.

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 dispose 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, 2015 and 2014. Reasonably possible changes in key assumptions would not cause the recoverable amount of goodwill to fall below the carrying value.

7. LONG-TERM DEBT AND FINANCE LEASES

	Final Maturity	Weighted Average Interest Rate (%)	2015	2014
Aircraft financing (a)				
Fixed rate U.S. dollar financing	2016 - 2027	5.12	$ 2,718	$ 2,029
Floating rate U.S. dollar financing	2017 - 2026	1.61	573	582
Floating rate CDN dollar financing	2026 – 2027	1.49	398	310
Floating rate Japanese yen financing	2020	0.21	91	94
Senior secured notes – U.S. dollar	2019 – 2020	7.61	968	812
Senior secured notes – CDN dollar	2019	7.63	300	300
Senior unsecured notes – U.S. dollar (c)	2021	7.75	554	464
Other secured financing – U.S. dollar (b),(d) and (g)	2018 - 2019	4.44	513	433
Other secured financing – CDN dollar (e)	2018	8.15	45	-
Long-term debt		**5.20**	**6,160**	**5,024**
Finance lease obligations (f)	2016 - 2033	9.65	330	283
Total debt and finance leases		**5.43**	**6,490**	**5,307**
Unamortized debt issuance costs			(96)	(91)
Current portion			(524)	(484)
Long-term debt and finance leases			**5,870**	**4,732**

(a) Aircraft financing (US$2,379, CDN $398 and JPY7,878) (2014 – US$2,250, CDN $310 and JPY9,677) is secured primarily by specific aircraft with a carrying value of $4,335 (2014 – $3,835). 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$428, CDN $398 and JPY7,878 of the financing is supported by a loan guarantee by the Export-Import Bank of the United States ("EXIM").

In March 2015, in connection with the financing of one Boeing 787-8 delivered in January 2015 and eight new Boeing 787-9 aircraft, of which four were delivered in 2015 with the remaining scheduled for delivery by March 2016, Air Canada announced the closing of a private offering of three tranches of enhanced equipment trust certificates ("EETC") with a combined aggregate face amount of US$1,031. The private offering was comprised of Class A certificates, Class B certificates and Class C certificates with final expected maturity dates between 2020 and 2027. The three tranches of certificates have a combined weighted average interest rate of 3.81%. Proceeds from the offering relating to each aircraft are held in escrow until the delivery of the aircraft.

In connection with the financing of the first five aircraft, an amount of US$564 was drawn from the proceeds held in escrow and is included in fixed rate U.S. dollar financing in the table above.

Financing fees paid in conjunction with the offering were $18 and are reported in Financing on the consolidated statement of cash flow.

In December 2015, in connection with the financing of three Boeing 787-9 and two Boeing 777-300ER aircraft, which are currently scheduled for delivery in April and May 2016, the Corporation completed a private offering of three tranches of enhanced equipment trust certificates with a combined aggregate face amount of US$537. The private offering was comprised of Class AA certificates, Class A certificates and Class B certificates with final expected distribution dates between 2023 and 2027. The three tranches of certificates have a combined weighted average interest rate of 4.044%. The Corporation will use the proceeds from the sale of the equipment notes to the trusts to finance the acquisition of these new aircraft. Proceeds from the offering relating to each aircraft are held in escrow until the delivery of the Boeing 787-9 or B777-300ER aircraft.

In connection with the acquisition of a Boeing 787-8 aircraft in February 2015, an amount of $118 was financed and included in floating rate CDN dollar financing. Interest and principal is payable quarterly until maturity and the financing is supported by a loan guarantee by EXIM.

While the funds from the EETC financings are held in escrow, they are not assets of Air Canada and are not reported as assets and the certificates relating thereto are not reported as debt on Air Canada's condensed consolidated statement of financial position.

In addition, the equipment notes issuable at each drawn-down are structured to be secured by the respective aircraft delivered and the security interest in each aircraft is structured to benefit 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.

During 2015, principal of US$126 was prepaid relating to the financing of fourteen Embraer 190 aircraft. An amount of $13 is included in interest charges related to the prepayment of fixed rate debt.

(b) Private offerings of senior secured notes, consist 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 "Senior First Lien Notes") and (ii) US$300 principal amount of 8.750% senior secured second lien notes due 2020 (the "Senior Second Lien Notes" and together with the Senior First Lien Notes, the " Senior Notes"). The Corporation also has a US$510 senior secured (first lien) credit facility, comprised of a US$300 term loan maturing in 2019 and a US$210 revolving credit facility (collectively, the " Credit Facility"). The term loan is included in Other secured financing in the table above. As at December 31, 2015, the Corporation had not drawn on the revolving credit facility.

The Senior Notes and the Corporation's obligations under the 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 Senior First Lien Notes and Air Canada's obligations in the Credit Facility, and on a second lien basis with respect to the 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.

(c) In April 2014, the Corporation completed a private offering of US$400 of 7.75% senior unsecured notes due 2021, with interest payable semi-annually. The Corporation received net proceeds of approximately $432 from the sale of these notes.

(d) Other U.S. dollar secured financings are fixed and floating rate financings that are secured by certain assets including assets described in b) above relating to the Credit Facility. It also includes a revolving credit facility for the financing of jet fuel. Financial covenants under this revolving credit facility require the Corporation to maintain certain minimum operating results and cash balances.

During 2015, the Corporation re-negotiated the interest rate terms of its US$510 Credit Facility maturing in 2019, comprised of a US$300 term loan and a US$210 revolving credit facility. The applicable margin with respect to loans under the revolving credit facility in the Credit Facility is 3.25% with respect to LIBOR loans and banker's acceptances and 2.25% with respect to the Index Rate loans or Canadian Prime Rate loans. The applicable margin with respect to term loans under the Credit Facility is 3.25% with respect to LIBOR loans and 2.25% with respect to the Index Rate loans. As at December 31, 2015, the Corporation had not drawn on the revolving credit facility and the outstanding term loan principal was US$296.

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

(f) Finance leases, related to facilities and aircraft, total $330 ($71 and US$187) (2014 - $283 ($73 and US$181)). During 2015, the Corporation recorded interest expense on finance lease obligations of $27 (2014 – $32). The

carrying value of aircraft and facilities under finance leases amounted to $170 and $39 respectively (2014 – $145 and $42).

Air Canada has aircraft leasing transactions with a number of structured entities (Note 2). The debt amount of these leasing transactions includes any guarantee by Air Canada in the residual value of the aircraft upon expiry of the lease. The related aircraft are 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 2016, assuming the collateral is worth nil, is $135 (US$98) (2014 - $212 (US$183)). The maximum amount payable declines over time in relation to the outstanding principal. Total collateral as at December 31, 2015 is $4 (US$3) (2014 - $12(US$11)) 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 2015 by the Corporation was $328 (2014 – $287).

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2015 on Long-term debt and finance lease obligations are as follows:

Principal	**2016**	**2017**	**2018**	**2019**	**2020**	**Thereafter**	**Total**
Long-term debt obligations	$ 482	$ 619	$ 627	$ 1,712	$ 757	$ 1,963	**$ 6,160**
Finance lease obligations	42	44	52	49	53	90	**330**
	$ 524	**$ 663**	**$ 679**	**$ 1,761**	**$ 810**	**$ 2,053**	**$ 6,490**

Interest	**2016**	**2017**	**2018**	**2019**	**2020**	**Thereafter**	**Total**
Long-term debt obligations	$ 299	$ 294	$ 243	$ 212	$ 104	$ 170	**$ 1,322**
Finance lease obligations	28	25	20	15	10	25	**123**
	$ 327	**$ 319**	**$ 263**	**$ 227**	**$ 114**	**$ 195**	**$ 1,445**

Principal repayments in the table above exclude transaction costs of $96 which are offset against Long-term debt and finance leases in the consolidated statement of financial position.

8. 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.

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 U.S. 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 pension 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.

Pension Plan Cash Funding Obligations

Pension funding obligations (including projected funding obligations) under normal funding rules may vary significantly based on a wide variety of factors, including the assumptions used in the most recently filed actuarial valuation reports (including the applicable discount rate used or assumed in the actuarial valuation), the plan demographics at the valuation date, the existing plan provisions, legislative and regulatory developments and changes in economic conditions (mainly the return on fund assets and changes in interest rates) and other factors. Actual contributions that are determined on the basis of future valuation reports 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, legislation and other factors.

In the second quarter of 2015, the Corporation elected to opt out of the *Air Canada Pension Plan Funding Regulations, 2014*, (the "2014 Regulations"). The 2014 Regulations became effective on January 1, 2014 and under their terms, the Corporation was required to make solvency deficit payments of $200 per year, on average, over a seven-year period. The agreement with the Government of Canada entered into in connection with these regulations contained several restrictions, including a prohibition on dividends and share repurchases. However, the agreement allowed the Corporation to opt out at any time.

As at January 1, 2015, the aggregate solvency surplus in the domestic registered pension plans was $660. The next required valuation to be made as at January 1, 2016, will be completed in the first half of 2016. Total employer pension funding contributions during 2015 amounted to $312, which includes solvency deficit payments of $96 versus the $200 that would have been required under the 2014 Regulations. Assuming final valuations confirm that the Corporation's domestic registered pension plans are in a solvency surplus position as at January 1, 2016, the Corporation does not expect any past service cost payments in 2016. In addition, for plans funded at 105% or more on a solvency basis, as permitted by legislation, no contributions are required for current service as long as the solvency position is not reduced to less than 105%. Based on that information, the pension funding obligations for 2016 are expected to be $76.

Benefit Obligation and Plan Assets

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

	Pension Benefits		Other Employee Future Benefits		Total	
	2015	**2014**	**2015**	**2014**	**2015**	**2014**
Non-current assets						
Pension	$ 851	$ -	$ -	$ -	$ 851	$ -
Current liabilities						
Accounts payable and accrued liabilities	-	-	64	65	64	65
Non-current liabilities						
Pension and other benefit liabilities	1,021	1,183	1,224	1,220	2,245	2,403
Net benefit obligation	**$ 170**	**$ 1,183**	**$ 1,288**	**1,285**	**$ 1,458**	**$ 2,468**

Certain pension plans are in a net asset position and, as a result, those plans are required to be reported as Pension assets on the consolidated statement of financial position. The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2016.

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	
	2015	2014	2015	2014
Change in benefit obligation				
Benefit obligation at beginning of year	$ 18,352	$ 16,147	$ 1,285	$ 1,183
Current service cost	249	213	37	55
Past service cost	3	(13)	(19)	-
Interest cost	731	783	51	56
Employees' contributions	78	73	-	-
Benefits paid	(886)	(844)	(49)	(51)
Settlement payments for transfer to Aeroplan	-	(68)	-	-
Remeasurements:				
Experience loss (gain)	4	(9)	(29)	(110)
Loss (gain) from change in demographic assumptions	(11)	(66)	(1)	(1)
Loss (gain) from change in financial assumptions	(338)	2,117	(21)	137
Plan settlements	-	(10)	-	-
Foreign exchange loss	104	29	34	16
Total benefit obligation	18,286	18,352	1,288	1,285
Change in plan assets				
Fair value of plan assets at beginning of year	17,433	14,745	-	-
Return on plan assets, excluding amounts included in Net financing expense	734	2,353	-	-
Interest income	687	714	-	-
Employer contributions	312	445	49	51
Employees' contributions	78	73	-	-
Benefits paid	(886)	(844)	(49)	(51)
Plan settlements for transfer to Aeroplan	-	(68)	-	-
Administrative expenses paid from plan assets	(10)	(8)	-	-
Foreign exchange gain	90	23	-	-
Total plan assets	18,438	17,433	-	-
(Surplus) deficit at end of year	**(152)**	**919**	**1,288**	**1,285**
Asset ceiling / additional minimum funding liability	322	264	-	-
Net benefit obligation	**$ 170**	**$ 1,183**	**$ 1,288**	**$ 1,285**

The actual return on plan assets was $1,421 (2014 – $3,067).

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

	2015	2014
Domestic registered plans	$ 2	$ 52
U.S., UK, and Japan	80	102
Supplementary plans	939	952
	$ 1,021	**$ 1,106**

The weighted average duration of the defined benefit obligation is 13.9 years (2014 – 14.1 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	
	2015	2014	2015	2014
Consolidated Statement of Operations				
Components of cost				
Current service cost	$ 249	$ 213	$ 37	$ 55
Past service cost	3	(13)	(19)	(1)
Gain on settlements	-	(10)	-	-
Administrative and other expenses	10	8	-	-
Actuarial gains	-	-	(18)	(15)
Total cost recognized in Wages, salaries and benefits	**$ 262**	**$ 198**	**$ -**	**$ 39**
Net financing expense relating to employee benefits	**$ 54**	**$ 78**	**$ 51**	**$ 56**
Total cost recognized in statement of operations	**$ 316**	**$ 276**	**$ 51**	**$ 95**
Consolidated Other Comprehensive (Income) Loss				
Remeasurements:				
Experience loss (gain), including foreign exchange	18	(3)	24	(87)
Loss (gain) from change in demographic assumptions	(11)	(66)	(1)	(1)
Loss (gain) from change in financial assumptions	(338)	2,117	(21)	146
Return on plan assets	(734)	(2,353)	-	-
Minimum funding liability	48	80	-	-
Total cost (income) recognized in OCI	**$ (1,017)**	**$ (225)**	**$ 2**	**$ 58**

In 2015, the Corporation refined the method to estimate the current service cost for pension and other post-retirement benefits. Previously, the current service cost was estimated utilizing a single weighted-average discount rate derived from the yield curve used to measure the defined benefit obligation at the beginning of the year. Under the refined method, different discount rates are derived from the same yield curve, reflecting the different timing of benefit payments for past service (the defined benefit obligation) and future service (the current service cost). Differentiating in this way represents a refinement in the basis of estimation applied in prior periods. This change does not affect the measurement of the total defined benefit obligation recorded on the consolidated statement of financial position as at December 31, 2014 or any other period. The refinement compared to the previous method resulted in a decrease in the current service cost and interest components with an equal offset to actuarial gains (losses) with no net impact on the total benefit obligation. The refinement did not have a material impact on the 2015 consolidated statement of operations. This change is accounted for prospectively as a change in accounting estimate.

The funding of employee benefits as compared to the expense recorded in the consolidated statement of operations is summarized in the table below.

	2015	2014
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations		
Wages, salaries and benefits	$ 262	$ 245
Net financing expense relating to employee benefit liabilities	105	134
	$ 367	**$ 379**
Employee benefit funding by Air Canada		
Pension benefits	$ 312	$ 445
Other employee benefits	49	51
	$ 361	**$ 496**
Employee benefit funding (greater) less than expense	**$ 6**	**$ (117)**

Composition of Pension Plan Assets

Domestic Registered Plans

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

	2015	2014	2015 Target Allocation
Bonds	60%	54%	60%
Canadian equities	6%	10%	7%
Foreign equities	14%	21%	13%
Alternative investments	20%	15%	20%
	100%	**100%**	**100%**

For the Domestic Registered Plan assets, approximately 80% of assets as of December 31, 2015 have a quoted market price in an active market. Assets that do not have a quoted market price in

an active market are mainly investments in privately held entities. The asset composition in the table represents the allocation of plan assets to each asset type.

Included in plan assets, for determining the net benefit obligation for accounting purposes, are 17,647,059 shares of Air Canada which were issued to a trust in 2009 in connection with pension funding agreements reached with all of the Corporation's Canadian-based unions. The trust arrangement provides that proceeds of any sale of the trust shares will be retained and applied to reduce future pension solvency deficits, if any should materialize. With the impact of the opt out as described above, and with the Corporation's domestic registered pension plans now in a surplus position on a solvency basis, the accounting rules prevent the recognition of the value of the shares held in trust as part of the pension assets. The shares held in trust have a fair value of $180 at December 31, 2015 (2014 - $209), however after giving effect to the asset ceiling, the recognized accounting value of the trust asset is nil.

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Funds. 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 Replicating Portfolio. The Liability Replicating Portfolio, which is referenced to widely used Canadian fixed income indices (FTSE TMX Canada), 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 mitigate 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 plan assets in a prudent and diversified manner to mitigate 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 pension funds:

- Equities are required to be diversified among regions, industries and economic sectors. Limitations are places on the overall allocation to any individual security.

- 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. Alternative investments are required to be diversified by asset class, strategy, sector and geography.

- Canadian bonds are 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. The Corporation manages interest rate risk related to its actuarial liabilities through a combination of financial instruments including, but not limited to, bonds, bond repurchase and reverse repurchase agreements, bond forwards, bond futures and interest rate swaps. As at December 31, 2015, taking into account the effect of such financial instrument risk management tools, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate risk). Counterparty credit risk associated with such financial

instruments is mitigated by receiving collateral from counterparties based on collateralization agreements, as well as by monitoring the counterparties' credit ratings and ensuring compliance with the investment policy. The fair value of these derivative instruments is included in the Bonds in the asset composition table and is not a significant component of the aggregate bond fair values of the portfolio.

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

Asset risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market price. Asset risk comprises currency risk, credit risk, and other price risk. Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. This risk is mitigated through implementation of hedging strategies. Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. This risk is mitigated by receiving collateral from counterparties based on collateralization agreements and by monitoring the issuers' credit risk. Other price risk is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. This risk is mitigated through proper diversification of plan assets.

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. 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. As at December 31, 2015, approximately 75% of Air Canada's pension liabilities (including the effect of financial instrument risk management tools) were matched with fixed income products to mitigate a significant portion of the interest rate risk (discount rate risk).

Funding risk

Adverse changes in the value of plan assets or in interest rates, and therefore in the discount rate used to value liabilities, could have a significant impact on pension plan solvency valuations and cash funding requirements.

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.

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	
	2015	**2014**	**2015**	**2014**
Discount rate used to determine:				
Net interest on the net defined benefit obligation for the year ended December 31	4.0%	4.9%	3.9%	4.8%
Service cost for the year end December 31	4.2%	4.9%	4.1%	4.8%
Accrued benefit obligation as at December 31	4.1%	4.0%	4.1%	3.9%
Rate of future increases in compensation used to determine:				
Accrued benefit cost and service cost for the year ended December 31	2.5%	2.5%	not applicable	not applicable
Accrued benefit obligation as at December 31	2.5%	2.5%	not applicable	not applicable

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 consolidated statement of financial position.

Sensitivity analysis on 2015 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	$ 19	$ (18)
Net financing expense relating to pension benefit liabilities	17	(13)
	$ 36	**$ (31)**
Increase (decrease) in pension obligation	**$ 639**	**$ (618)**

The increase (decrease) in the pension obligation for a 0.25 percentage point change in the discount rate relates to the gross amount of the pension liabilities and is before the impact of any change in plan assets. As at December 31, 2015, approximately 75% of Air Canada's pension liabilities were matched with fixed income products to mitigate a significant portion of the interest rate (discount rate) risk.

An increase of one year in life expectancy would increase the pension benefit obligation by $445.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 5.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2015 (2014 – 5.5%). The rate is assumed to decrease gradually to 5% by 2019. 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 $64. 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 $62.

A 0.25 percentage point decrease in discount rate would have increased the total of current and interest costs by $1 and the obligation by $51. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by $1 and the obligation by $40.

Defined Contribution Pension Plans

Certain of the Corporation's management, administrative and unionized employees participate in a defined contribution pension plan or a multi-employer plan which are accounted for as defined contribution plans. The Corporation contributes an amount expressed as a percentage of employees' contributions with such percentage varying by group and for some groups, based on the number of years of service.

The Corporation's expense for these pension plans amounted to $10 for the year ended December 31, 2015 (2014 – $6). Expected total employer contributions for 2016 are $11.

9. PROVISIONS FOR OTHER LIABILITIES

The following table provides a continuity schedule of all recorded provisions. Refer to Note 16 for additional information on Litigation provisions. Current provisions are recorded in Accounts payable and accrued liabilities.

	Maintenance (a)	**Asset retirement** (b)	**Litigation**	**Total provisions**
At December 31, 2014				
Current	$ -	$ -	$ 29	$ 29
Non-current	796	19	-	815
	$ 796	**$ 19**	**$ 29**	**$ 844**
Provisions arising during the year	$ 96	$ -	$ -	$ 96
Amounts disbursed	(23)	-	-	(23)
Changes in estimated costs	(144)	2	(10)	(152)
Accretion expense	16	-	-	16
Foreign exchange loss	151	-	-	151
At December 31, 2015	**$ 892**	**$ 21**	**$ 19**	**$ 932**
Current	$ -	$ -	$ 19	$ 19
Non-current	892	21	-	913
	$ 892	**$ 21**	**$ 19**	**$ 932**

(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 2016 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 $44 at December 31, 2015 and an increase to maintenance expense in 2016 of approximately $7. 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 $19 at December 31, 2015. 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 2016 to 2056. 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.

10. INCOME TAXES

Income Tax Expense

	2015	2014
Current income tax	$ -	$ -
Deferred income tax	-	-
Income tax	**$ -**	**$ -**

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

	2015	2014
Income before income taxes	$ 308	$ 105
Statutory income tax rate based on combined federal and provincial rates	26.87%	26.81%
Income tax expense based on statutory tax rates	83	28
Effects of:		
Non-deductible portion of capital losses	97	21
Non-deductible expenses	10	13
Income not subject to tax	(17)	-
Tax rate changes on deferred income taxes	(9)	(13)
Recognition of previously unrecognized deferred income tax assets	(155)	(53)
Adjustment in respect of deferred income tax of prior years	(8)	-
Other	(1)	4
Income tax	**$ -**	**$ -**

The applicable statutory tax rate is 26.87% (2014 – 26.81%). The Corporation's applicable tax rate is the Canadian combined rates applicable in the jurisdictions in which the Corporation operates. The increase is mainly due to changes in the level of activity by province.

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

	2015	2014
Net gain on remeasurements on employee benefit liabilities	$ 273	$ 65
Derivatives designated as cash flow hedges	(3)	-
Tax rate changes on deferred income taxes	(1)	(3)
Recognition of previously unrecognized deferred income tax assets	(269)	(62)
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 (2014 - $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 $42, 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 temporary differences and tax loss carryforwards 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 temporary differences and tax loss carryforwards for which no deferred income tax assets could be recognized:

	2015	2014
Other deductible temporary differences	$ 4,349	$ 5,345
Non-capital losses carryforwards	316	946
Net capital losses carryforwards	24	2
Total unrecognized temporary differences	**$ 4,689**	**$ 6,293**

The following are the Federal non-capital tax losses expiry dates:

	Tax Losses
2029	$ 293
2030	11
2031	6
2032	1
2033	1
2034	4
Non-capital losses carryforwards	**$ 316**

Cash income taxes paid in 2015 by the Corporation were nil (2014 – $1 recovered).

11. SHARE CAPITAL

	Number of shares	Value
At January 1, 2014	**284,532,439**	**827**
Shares issued on the exercise of stock options	619,478	2
Shares issued under the 2011 employee recognition award	1,337,377	6
At December 31, 2014	**286,489,294**	**$ 835**
Shares issued on the exercise of stock options	1,876,819	6
Shares purchased and cancelled under issuer bid	(5,583,935)	(16)
At December 31, 2015	**282,782,178**	**$ 825**

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

		2015	2014
Issued and outstanding			
Class A variable voting shares		98,059,765	69,232,535
Class B voting shares		184,722,413	217,256,759
Total issued and outstanding		**282,782,178**	**286,489,294**
Potential common shares			
Stock options	Note 12	8,735,634	10,002,975
Total outstanding and potentially issuable shares		**291,517,812**	**296,492,269**

Common Shares

As at December 31, 2015, the common shares issuable by Air Canada consist of an unlimited number of Class A Variable Voting Shares ("Variable Voting Shares") and an unlimited number of Class B Voting Shares ("Voting Shares"). The two classes of common shares have equivalent rights as common shareholders except for voting rights. Holders of Variable Voting Shares are entitled to one vote per share unless (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.

Shareholder Rights Plan

Under the terms of the shareholder rights plan agreement (the "Rights Plan"), effective until 2017, 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.

Issuer Bid

In May 2015, following receipt of approval from the Toronto Stock Exchange, the Corporation implemented a normal course issuer bid to purchase, for cancellation, up to 10,000,000 Shares, representing, at that time, 3.49% of the total issued and outstanding Shares. The repurchase program is in effect until May 28, 2016.

Since commencing the normal course issuer bid, the Corporation purchased and cancelled 5,583,935 Shares for cash at an average cost of $11.28 per Share for aggregate consideration of $63. The excess of the cost over the average book value of $47 was charged to the deficit.

12. 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, performance share units and restricted share units to senior management and officers of Air Canada. 20,011,623 shares are authorized for issuance under the Long-term Incentive Plan in respect of either of stock options, performance or restricted 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 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 common 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:

	2015	2014
Compensation expense ($ millions)	$ 4	$ 3
Number of stock options granted to Air Canada employees	984,878	1,170,710
Weighted average fair value per option granted ($)	$ 5.65	$ 2.18
Aggregated fair value of options granted ($ millions)	$ 6	$ 3
Weighted average assumptions:		
Share price	$ 12.48	$ 5.56
Risk-free interest rate	0.57%-1.10%	1.44%-2.06%
Expected volatility	52.0%-58.5%	53.0%-72.4%
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:

	2015		2014	
	Options	**Weighted Average Exercise Price/Share**	**Options**	**Weighted Average Exercise Price/Share**
Beginning of year	10,002,975	$ 2.54	10,079,694	$ 2.47
Granted	984,878	12.57	1,170,710	5.41
Exercised	(1,906,472)	2.13	(619,478)	1.99
Expired	(5,500)	8.51	(237,661)	14.71
Forfeited	(340,247)	4.30	(390,290)	2.77
Outstanding options, end of year	**8,735,634**	**3.69**	**10,002,975**	**$ 2.54**
Options exercisable, end of year	**2,854,413**	**2.30**	**2,112,883**	**$ 1.93**

Options exercised include 29,653 options that were exercised with shares issued in 2016. The weighted average share price on the date of exercise for options exercised in 2015 was $11.80 (2014 - $9.20).

		2015 Outstanding Options			2015 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**
$1.59	2016	18,750	1	1.59	18,750	1.59
$1.78 – $1.91	2017	-	2	–	–	–
$2.34	2018	1,222,059	3	2.34	1,222,059	2.34
$0.96 - $1.28	2019	2,154,196	4	0.96	705,515	0.97
$2.49 – $5.69	2020	3,386,598	5	2.94	784,898	2.96
$5.35 – $8.27	2021	1,013,522	6	5.42	123,191	5.42
$12.27 - $12.64	2022	940,509	7	12.57	-	-
		8,735,634		**$ 3.69**	**2,854,413**	**$ 2.30**

		2014 Outstanding Options			2014 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**
$8.51	2015	5,500	1	$ 8.51	5,500	8.51
$0.97 – $1.59	2016	325,000	2	1.21	325,000	1.21
$1.78 – $1.91	2017	-	3	1.85	–	–
$2.34	2018	2,332,237	4	2.34	710,353	2.34
$0.96 - $1.28	2019	2,464,775	5	0.98	608,750	1.00
$2.49 – $5.69	2020	3,767,719	6	2.95	463,280	2.96
$5.35 – $8.27	2021	1,107,744	7	5.42	-	-
		10,002,975		**$ 2.54**	**2,112,883**	**$ 1.93**

Performance and Restricted Share Units

The Long-term Incentive Plan also includes performance share units ("PSUs") and restricted share units ("RSUs"), which are accounted for as equity settled instruments. The vesting of PSUs is based on the Corporation achieving its cumulative annual earnings target over a three-year period, while RSUs will vest after three years from their date of grant. The terms of the plan specify that upon the retirement of an employee, the number of units that vest are prorated based on the total number of completed months of active service during the vesting term. The PSUs and RSUs 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 and RSUs in 2015 was $9 (2014 – $8).

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

	2015	2014
Beginning of year	7,553,010	9,437,970
Granted	778,154	1,280,922
Settled	(4,114,133)	(2,948,874)
Forfeited	(286,980)	(217,008)
Outstanding share units, end of year	**3,930,051**	**7,553,010**

Refer to Note 15 for a description of derivative instruments used by the Corporation to mitigate the cash flow exposure to the PSUs and RSUs granted.

Employee Share Purchase Plan

Eligible employees can participate in the employee share purchase plan under which employees can invest between 2% and 10% 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 2015, the Corporation recorded compensation expense of $7 (2014 – $5) related to the Employee Share Purchase Plan.

13. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted EPS:

(in millions, except per share amounts)	2015	2014
Numerator:		
Numerator for basic and diluted earnings per share:		
Net income attributable to shareholders of Air Canada	$ 303	$ 100
Denominator:		
Weighted-average shares	285	286
Effect of potential dilutive securities:		
Stock options	7	7
Total potential dilutive securities	7	7
Adjusted denominator for diluted earnings per share	**292**	**293**
Basic EPS	**$ 1.06**	**$ 0.35**
Diluted EPS	**$ 1.03**	**$ 0.34**

The calculation of EPS 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.

Excluded from the 2015 calculation of diluted EPS were 1,512,000 (2014 – 2,680,000) outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year.

14. COMMITMENTS

Capital Commitments and Operating Leases

Capital commitments consist of the future firm aircraft deliveries and commitments related to acquisition of other property and equipment. 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 U.S. LIBOR rate at December 31, 2015. The Corporation has various operating lease agreements for aircraft, equipment and other property. U.S. dollar amounts are converted using the December 31, 2015 closing rate of CDN$1.384. Minimum future commitments under these contractual arrangements are shown below.

	2016	2017	2018	2019	2020	Thereafter	Total
Capital commitments	$ 2,506	$ 2,002	$ 1,708	$ 1,273	$ 799	$ 461	**$ 8,749**
Operating leases							
Aircraft	452	422	373	308	210	181	**1,946**
Other property	84	55	47	25	18	165	**394**
Total	**$ 3,042**	**$ 2,479**	**$ 2,128**	**$ 1,606**	**$ 1,027**	**$ 807**	**$ 11,089**

Flow-through Leases

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 20 Bombardier CRJ-200 aircraft and 15 Bombardier CRJ-705 aircraft which have final maturities ranging from 2016 to 2024. The sublease revenue and lease expense related to these aircraft each amounted to $95 in 2015 (2014 – $84). The operating lease commitments under these aircraft, which are recovered from Jazz, are not included in the aircraft operating lease commitments table above but are summarized, with U.S. dollar amounts converted using the December 31, 2015 closing rate of CDN$1.384, as follows:

	2016	2017	2018	2019	2020	Thereafter	Total
Jazz flow – through leases	$ 84	$ 75	$ 71	$ 72	$ 72	$ 158	**$ 532**

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 five Bombardier Q400 aircraft and twenty Embraer 175 aircraft. The lease and sublease revenue and expense related to these aircraft each amount to $48 in 2015 (2014 – $41).

Other Contractual Commitments

The CPSA between the Corporation and Aeroplan imposes a requirement for the Corporation to purchase a minimum number of Aeroplan Miles® from Aeroplan. The estimated minimum requirement for 2016 is $208. 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 2015, the Corporation purchased $245 of Aeroplan Miles® from Aeroplan.

The future minimum non-cancellable commitment for the next 12 months under the Jazz CPA is approximately $1,151 and under the capacity purchase agreements with other regional carriers is $157.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

	Carrying Amounts				
	December 31, 2015				December 31, 2014
	Financial instruments classification				
	Fair value through profit and loss	Assets at amortized cost	Liabilities at amortized cost	Total	
Financial Assets					
Cash and cash equivalents	$ 572	$ -	$ -	**$ 572**	$ **661**
Short-term investments	2,100	-	-	**2,100**	**1,614**
Restricted cash	91	-	-	**91**	**89**
Accounts receivable	-	654	-	**654**	**656**
Promissory notes receivable		143		**143**	-
Deposits and other assets					
Restricted cash	209	-	-	**209**	**192**
Aircraft related and other deposits	-	138	-	**138**	**135**
Prepayment option on senior secured notes	5	-	-	**5**	**4**
Derivative instruments					
Fuel derivatives	10	-	-	**10**	**4**
Share forward contracts	41	-	-	**41**	**85**
Foreign exchange derivatives	94	-	-	**94**	**30**
Interest rate swaps	4	-	-	**4**	**8**
	$ 3,126	**$ 935**	**$ -**	**$ 4,061**	**$ 3,478**
Financial Liabilities					
Accounts payable	$ -	$ -	$ 1,399	**$ 1,399**	$ **1,165**
Foreign exchange derivatives	5	-	-	**5**	**-**
Current portion of long-term debt and finance leases	-	-	524	**524**	**484**
Long-term debt and finance leases	-	-	5,870	**5,870**	**4,732**
	$ 5	**$ -**	**$ 7,793**	**$ 7,798**	**$ 6,381**

Summary of Gain (loss) on Fuel and other derivatives

	2015	2014
Fuel derivatives	$ (11)	$ (36)
Share forward contracts	(9)	31
Prepayment option on senior secured notes	1	2
Interest rate swaps	2	2
Fuel and other derivatives	**$ (17)**	**$ (1)**

Risk Management

Under its risk management policy, the Corporation manages its market risk through the use of various financial derivative instruments. The Corporation uses these instruments solely 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 of the relevant risk being hedged.

As noted below, the Corporation uses derivative instruments to provide economic hedges to mitigate various risks. The fair values of these instruments 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. The 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 as well as the credit risk of the counterparty.

Market Risks

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk can be further divided into the following sub-classifications related to the Corporation: commodity price risk for jet fuel, foreign exchange risk, interest rate risk, and shared-based compensation risk.

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 may use 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 2015:

- The Corporation recorded a loss of $11 in Fuel and other derivatives related to fuel derivatives ($36 loss in 2014). These derivatives were not designated as hedges for accounting purposes.
- The Corporation purchased crude-oil call options covering a portion of 2015 and 2016 fuel exposure. The cash premium related to these contracts was $39 ($44 in 2014 for 2014 and 2015 exposures).
- Fuel derivative contracts cash settled with a fair value of $1 in favour of the Corporation ($24 in favour of the Corporation in 2014).
- The Corporation applied fuel hedge accounting for certain designated fuel derivatives prospectively from April 1, 2015. In 2015, the fair value decrease of $21 for derivatives under hedge accounting was deferred as a cost of the hedged item in other comprehensive income and will be reclassified to Aircraft fuel expense when underlying hedged jet fuel is used. Fuel hedging loss of $10 was reclassified from other comprehensive income to Aircraft fuel expense in 2015.

A summary of amounts related to fuel derivatives designated as hedging instruments at December 31, 2015 is presented below.

	Carrying amount of the hedging instrument				
	Nominal amount of the hedging instrument (in barrels)	Assets	Liabilities	Consolidated statement of financial position classification	Changes in fair value used for calculating hedge ineffectiveness
Cash flow hedge					
Fuel price risk – option contracts	5,646,000	$ 10	$ -	Prepaid expenses and other current assets	$ -

As of December 31, 2015, approximately 18% of the Corporation's anticipated purchases of jet fuel for 2016 are hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US$48 per barrel for WTI prices up to US$51 per barrel and an average equivalent capped price of US$51 per barrel for WTI prices above US$53 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the 2016 period are comprised of call options with notional volumes of 5,646,000 barrels. The fair value of the fuel derivatives portfolio at December 31, 2015 is $10 in favour of the Corporation ($4 in favour of the Corporation in 2014) and is recorded within Prepaid expenses and other current assets.

Foreign Exchange Risk

The Corporation's financial results are reported in Canadian dollars, while a large portion of its expenses, debt obligations and capital commitments are in foreign currencies, primarily in U.S. dollars. Foreign exchange risk is the risk that fluctuations in foreign exchange rates may have on operating results and cash flows. The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows.

Air Canada generates sales in U.S. dollars and in other foreign currencies which are converted to U.S. dollars under the Corporation's risk management program. In 2015, these net cash inflows totaled approximately US$3.1 billion. Also in 2015, U.S. denominated non-fuel operating costs amounted to approximately US$2.6 billion and U.S. dollar interest costs amounted to approximately US$250. The Corporation views U.S. dollar revenues largely as a natural hedge against non-fuel U.S. dollar costs. Fuel expenses, which are based in U.S. dollars, amounted to US$2.2 billion. For 2015, this resulted in a U.S. dollar net cash flow exposure of approximately $2.0 billion as it relates to the statement of operations. In addition, the majority of principal payments on long-term debt are denominated in U.S. dollars.

The Corporation has a target coverage of 70% on a rolling 18 month basis to manage the net U.S. dollar cash flow exposure described above utilizing the following risk management strategies:

- Holding U.S. dollar cash reserves as an economic hedge against changes in the value of the U.S. dollar. U.S. dollar cash and short-term investment balances as at December 31, 2015 amounted to $490 (US$358) ($717 (US$620) as at December 31, 2014). A portion of the cash and investment reserves are an economic hedge against net long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the 18 month net U.S. dollar cash flow exposure. In 2015, a gain of $123 (gain of $58 in 2014) was recorded in Foreign exchange gain (loss) reflecting

the change in Canadian equivalent market value of the U.S. dollar cash and short-term investment balances held.

- 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 U.S. dollar net outflows.

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, U.S. dollar net cash outflows, as well as the amount attributed to aircraft and debt payments. Based on the notional amount of currency derivatives outstanding at December 31, 2015, as further described below, approximately 85% of net U.S. cash outflows are hedged for 2016 and 24% for 2017, resulting in derivative coverage of 67% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 68% coverage.

As at December 31, 2015, the Corporation had outstanding foreign currency options and swap agreements, settling in 2016 and 2017, to purchase at maturity $3,234 (US$2,337) of U.S. dollars at a weighted average rate of $1.2683 per US$1.00 (2014 – $2,658 (US$2,292) with settlements in 2015 and 2016 at a weighted average rate of $1.0884 per $1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, Sterling, YEN, YUAN and AUD (EUR $42, GBP $9, JPY $2,052, CNY $288, and AUD$18) which settle in 2016 at weighted average rates of $1.1663, $1.6150, $0.0088, $0.1562 and $0.7230 per $1.00 U.S. dollar, respectively (2014 - EUR $35, GBP $27 with settlement in 2015 at weighted average rates of $1.2806 and $1.6217 respectively per $1.00 U.S. dollar).

The hedging structures put in place have various option pricing features, such as knock-out terms and profit cap limitations, and based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at December 31, 2015 was $89 in favour of the Corporation (2014 – $30 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2015, a gain of $164 was recorded in Foreign exchange gain (loss) related to these derivatives (2014 – $75 gain). In 2015, foreign exchange derivative contracts cash settled with a net fair value of $104 in favour of the Corporation ($58 in 2014 in favour of the Corporation). The total combined gain, related to U.S. cash, investments and foreign exchange derivatives recorded by the Corporation in 2015 was $287 ($133 gain in 2014)

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 cash and 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, 2015 is 79% fixed and 21% floating, including the effects of interest rate swap positions (75% and 25%, respectively as at December 31, 2014).

Share-based Compensation Risk

The Corporation issues share-based compensation to certain of its employees in the form of stock options, RSUs and PSUs as described in Note 12. Each RSU and PSU entitles the employees to receive a payment in the form of one Air Canada common share, cash in the amount equal to market value of one common share, or a combination thereof, at the discretion of the Board of Directors.

Share-based compensation risk refers to the risk that future cash flows to settle the RSUs and PSUs will fluctuate because of changes in the Corporation's share price. To hedge the exposure, the Corporation entered into share forward contracts to hedge PSUs and RSUs that may vest between 2016 and 2018, 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 4,017,899 PSUs and RSUs from 2016 to 2018. These contracts were not designated as hedging instruments for accounting purposes. Accordingly, changes in the fair value of these contracts are recorded in Fuel and other derivatives in the period in which they arise. During 2015, a loss of $9 was recorded (2014 – gain of $31). Share forward contracts cash settled with a fair value of $35 in favour of the Corporation in 2015 (2014 – $7). As at December 31, 2015, the fair value of the share forward contracts is $41 in favour of the Corporation (2014 – $85 in favour of the Corporation), with those contracts maturing in 2016 valued at $15 recorded in Prepaid expenses and other current assets and the remainder of $26 is recorded in Deposits and other assets.

Liquidity risk

The Corporation manages its liquidity needs through a variety of strategies including by seeking to sustain and improve cash from operations, sourcing committed financing for new and existing aircraft, and through other financing activities.

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations, including pension funding obligations as described in Note 8 and covenants in credit card and other 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 cash, cash equivalents and short-term investments of at least $1,700. This minimum target level was determined in conjunction with the Corporation's liquidity risk management strategy. At December 31, 2015, unrestricted liquidity was $2,968 comprised of Cash and cash equivalents and Short-term investments of $2,672 and undrawn lines of credit of $296.

Cash and cash equivalents include $91 pertaining to investments with original maturities of three months or less at December 31, 2015 ($234 as at December 31, 2014).

A maturity analysis of the Corporation's principal and interest repayment requirements on long-term debt is set out in Note 7, and fixed operating commitments and capital commitments are set out in Note 14.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. As at December 31, 2015, the Corporation's credit risk exposure consists mainly of the carrying amounts of Cash and cash equivalents, Short-term investments, Accounts receivable and derivative instruments. Cash and cash equivalents and Short-term investments are in place with major financial institutions, various levels of 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 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.

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, 2015. The sensitivity analysis is based on certain movements in the relevant risk factor. These assumptions may not be representative of actual movements in these risks and may not be relied upon. Given potential volatility in the financial and commodity markets, the actual movements and related percentage changes may differ significantly from those 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; however, changes in one factor may result in changes in one or more several other factors, 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, 2015 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	$ 6	$ (7)	$ 7	$ -	$ -
Short-term investments	$ 21	$ (17)	$ 17	$ -	$ -
Aircraft related deposits	$ -	$ (5)	$ 5	$ -	$ -
Long-term debt and finance leases	$ (16)	$ 284	$ (284)	$ -	$ -
Fuel derivatives	$ -	$ -	$ -	$ 8	$ (5)
Share forward contracts	-	-	-	4	(4)
Foreign exchange derivatives	$ -	$ (53)	$ 48	$ -	$ -

(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 $5 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. Under hedge accounting, the effective gain or loss would be recorded in other comprehensive income. 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's principal credit card processing agreements for credit card processing services in Canada 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 2015, the Corporation made no cash deposits under these agreements (nil in 2014).

Air Canada also has agreements with another processor for the provision of certain credit card processing services requirements for markets other than Canada and for its cargo operations worldwide where such agreements also contain deposit obligations. In 2015, Air Canada made no cash deposits under these agreements (nil in 2014).

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 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 information where available, 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 and finance leases is $6,494 compared to its carrying value of $6,394.

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.

Recurring measurements	December 31, 2015	Fair value measurements at reporting date using: Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Assets				
Held–for–trading securities				
Cash equivalents	$ 91	$ -	$ 91	$ -
Short–term investments	2,100	-	2,100	-
Deposits and other assets				
Prepayment option on senior secured notes	5	-	-	5
Derivative instruments				
Fuel derivatives	10	-	10	-
Share forward contracts	41	-	41	-
Foreign exchange derivatives	94	-	94	-
Interest rate swaps	4	-	4	-
Total	**$ 2,345**	**$ -**	**$ 2,340**	**$ 5**

Recurring measurements	December 31, 2015	Fair value measurements at reporting date using: Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	5	-	5	-
Total	**$ 5**	**$ -**	**$ 5**	**$ -**

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 2015.

In measuring the fair value of the prepayment option on the Senior Notes issued in 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 fair value of the prepayment option is $5 (2014 - $4).

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 $65 as at December 31, 2015 ($67 as at December 31, 2014). 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, 2015 and 2014, 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, 2015					
Derivative assets	$ 149	$ -	$ 149	$ -	$ 149
Accounts receivable	97	(45)	52	(2)	50
	$ 246	**$ (45)**	**$ 201**	**$ (2)**	**$ 199**
December 31, 2014					
Derivative assets	$ 138	$ (11)	$ 127	$ -	$ 127
Accounts receivable	137	(49)	88	(38)	50
	$ 275	**$ (60)**	**$ 215**	**$ (38)**	**$ 177**

	Amounts offset			Amounts not offset	Net
Financial liabilities	Gross liabilities	Gross assets offset	Net amounts presented	Financial instruments	
December 31, 2015					
Derivative liabilities	**$** 5	**$** -	**$** 5	**$** -	**$** 5
Accounts payable	86	(45)	41	(2)	39
	91	**(45)**	**46**	**(2)**	**44**
December 31, 2014					
Derivative liabilities	**$** 11	**$** (11)	**$** -	**$** -	**$** -
Accounts payable	113	(49)	64	(38)	26
	124	**(60)**	**64**	**(38)**	**26**

16. CONTINGENCIES, GUARANTEES AND INDEMNITIES

Contingencies and Litigation Provisions

Investigations by Competition Authorities Relating to Cargo

The European Commission, the United States Department of Justice and the Competition Bureau in Canada investigated 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 cooperated with these investigations, which 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 or is otherwise involved in, and may become further implicated, in a number of class action lawsuits and other proceedings in Canada, Europe and the United States in connection with these allegations. The investigations instituted by the U.S. Department of Justice and by the Competition Bureau in Canada concluded with no proceedings having been instituted against Air Canada. 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 $29) was imposed on Air Canada. Air Canada appealed the 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. On December 16, 2015, the European General Court granted Air Canada's appeal and annulled the decision of the European Union with regard to Air Canada and certain other airlines. As a result of the European General Court's decision, the European Commissions was required to refund to Air Canada the fine of 21 Euros ($30), which amount has been recorded as a receivable as at December 31, 2015 and received in February 2016. There can be no assurance however that the decision of the European General Court will not be challenged or reversed.

As at December 31, 2015, Air Canada has a provision of $17 ($27 as at December 31, 2014) relating to outstanding claims in this matter, which is recorded in Accounts payable and accrued liabilities. The provision was reduced by $10 in 2015 reflecting a change in estimated costs. 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 remaining proceedings and investigations. Based on the outcome of any developments regarding proceedings and investigations, Air Canada 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.

Guarantees

Guarantees in Fuel Facilities and De-Icing Arrangements

The Corporation participates in fuel facility arrangements operated through eight Fuel Facility Corporations, and one aircraft de-icing service facility, along with other airlines that contract for fuel and de-icing services at various major airports in Canada. These entities operate on a cost recovery basis. The aggregate debt of these entities that has not been consolidated by the Corporation under IFRS 10 Consolidated Financial Statements is approximately $425 as at December 31, 2015 (December 31, 2014 - $399), 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 these entities 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, such as real estate leases or operating agreements, aircraft financing or leasing agreements, technical service agreements with service providers, and director/officer contracts, and other commercial 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 expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities.

17. 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, including aircraft rent expense related to regional carrier operations, 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 and financial leverage ratio. 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. Financial leverage is calculated as adjusted net debt over 12 months trailing earnings before interest, taxes, depreciation, amortization and aircraft rent.

The Corporation's main objectives when managing capital are:

- To maintain financial leverage at or below a target leverage ratio of 2.2 by 2018 as set by the Corporation;
- 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:

	2015	2014
Long-term debt and finance leases	$ 5,870	$ 4,732
Current portion of long-term debt and finance leases	524	484
	6,394	5,216
Capitalized operating leases	2,569	2,191
Adjusted debt	8,963	7,407
Non-controlling interests	27	68
Market capitalization	2,887	3,401
Total Capital	**$ 11,877**	**$ 10,876**
Adjusted debt	$ 8,963	$ 7,407
Less Cash and cash equivalents and Short-term investments	(2,672)	(2,275)
Adjusted net debt	**$ 6,291**	**$ 5,132**

18. 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	**2015**	**2014**
Canada	$ 4,379	$ 4,381
U.S. Transborder	2,685	2,379
Atlantic	2,775	2,554
Pacific	1,762	1,710
Other	819	780
	$ 12,420	**$ 11,804**

Cargo Revenues	**2015**	**2014**
Canada	$ 67	$ 66
U.S. Transborder	24	20
Atlantic	188	191
Pacific	188	190
Other	39	35
	$ 506	**$ 502**

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.

19. REGIONAL AIRLINES EXPENSE

The Corporation has capacity purchase agreements with Jazz, Sky Regional and certain other regional carriers. Expenses associated with these arrangements are classified as regional airlines expense on the consolidated statement of operations. Regional airlines expense consists of the following:

	2015	2014
Capacity purchase fees	$ 1,156	$ 1,182
Aircraft fuel	359	500
Airport and navigation	278	276
Sales and distribution costs	126	112
Other operating expenses	360	254
Regional airlines expense	**$ 2,279**	**$ 2,324**

Effective January 1, 2015, Air Canada and Jazz amended the terms of their capacity purchase agreement and extended its term to December 31, 2025. As a result of the amendments, certain costs that were previously capacity purchase agreement fees are now pass-through costs. Other costs that were pass-through costs are now costs directly incurred by Air Canada.

Comparative Figures

As described in Note 2D, expenses incurred related to capacity purchase agreements with its third-party regional carriers are now presented in a separate line item in the consolidated statement of operations titled Regional airlines expense. A reconciliation of operating expenses as previously reported for the year ending 2014 is provided below.

	2014	Adjustment	2014 Reclassified
Operating expenses			
Aircraft fuel	$ 3,747	$ (500)	$ 3,247
Regional airlines expense	-	2,324	2,324
Wages, salaries and benefits	2,282	(51)	2,231
Capacity purchase agreements	1,182	(1,182)	-
Airport and navigation fees	1,031	(276)	755
Aircraft maintenance	728	(50)	678
Sales and distribution costs	672	(112)	560
Depreciation, amortization and impairment	543	(17)	526
Ground package costs	377	-	377
Aircraft rent	313	(11)	302
Food, beverages and supplies	309	(15)	294
Communications and information technology	204	(5)	199
Other	1,069	(105)	964
Total operating expenses	$ 12,457	$ -	$ 12,457

Refer to Note 20 for reclassification of 2014 expenses related to Special items.

20. SPECIAL ITEMS

Special items consist of the following:

	2015	2014
Labour agreement payments	$ 62	$ 30
Litigation	(40)	-
Other, net	(14)	(41)
Special items	**$ 8**	**$ (11)**

In 2015, the Corporation recorded $62 in labour agreement costs related to one-time payments for Air Canada's collective agreements with CUPE and IAMAW. In 2014, one-time payments of $30 related to Air Canada's collective agreement with ACPA were previously recorded in Wages, salaries and benefits.

Litigation is related to cargo investigations, as described in Note 16, and includes a favorable provision adjustment of $10 related to a change in estimated costs and recovery of the $30 fine previously paid to the European Commission.

Other net items are mainly related to a tax-related provision adjustment of $23. In 2014, tax-related provision adjustments of $41 were previously recorded in Other operating expenses.

21. RELATED PARTY TRANSACTIONS

Compensation of Key Management

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 the President, Passenger Airlines. Compensation awarded to key management is summarized as follows:

	2015	2014
Salaries and other benefits	$ 10	$ 8
Pension and post-employment benefits	2	4
Share-based compensation	5	8
	$ 17	**$ 20**