



2018 Consolidated Financial Statements and Notes February 15, 2019



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, as issued by the International Accounting Standards Board. 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 provides its recommendations, in respect of the approval of the financial statements, 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, audit-related, and non-audit fees and expenses. The Board of Directors approves the Corporation's consolidated financial statements and management's discussion and analysis 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 as a whole 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

(signe<u>d) Michael Rousseau</u>

Michael Rousseau

Deputy Chief Executive Officer and Chief Financial Officer

February 14, 2019



Independent auditor's report

To the Shareholders of Air Canada

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Air Canada and its subsidiaries (together, the Corporation) as at December 31, 2018 and 2017 and January 1, 2017, and its financial performance and its cash flows for the years ended December 31, 2018 and 2017 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

What we have audited

The Corporation's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 31, 2018 and 2017 and January 1, 2017;
- the consolidated statements of operations for the years ended December 31, 2018 and 2017;
- the consolidated statements of comprehensive income for the years ended December 31, 2018 and 2017;
- the consolidated statements of changes in equity for the years ended December 31, 2018 and 2017;
- the consolidated statements of cash flow for the years ended December 31, 2018 and 2017; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

Independence

We are independent of the Corporation in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

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Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis, which we obtained prior to the date of this auditor's report and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express an opinion or any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard. When we read the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Corporation's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Corporation or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Corporation's financial reporting process.



Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Corporation's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Corporation's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Corporation to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Corporation to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.



We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Michael Trudeau.

Montreal, Quebec February 14, 2019

¹CPA auditor, Public accountancy permit NO. A113048

Pricewaterhouse Coopers U.P.



CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Canadian dollars in millions)		De	cember 31, 2018	Re	ember 31, 2017 estated - Note 2	January 1, 2017 Restated - Note 2		
ASSETS								
Current								
Cash and cash equivalents		\$	630	\$	642	\$	787	
Short-term investments			4,077		3,162		2,192	
Total cash, cash equivalents and short-term investments			4,707		3,804		2,979	
Restricted cash	Note 2P		161		148		126	
Accounts receivable	Note 18		796		814		707	
Aircraft fuel inventory			109		91		79	
Spare parts and supplies inventory	Note 2Q		111		115		107	
Prepaid expenses and other current assets	Note 18		417		425		447	
Total current assets			6,301		5,397		4,445	
Deposits and other assets			444		465		468	
Property and equipment	Note 4		9,729		9,252		8,520	
Pension assets	Note 8		1,969		1,583		1,153	
Deferred income tax	Note 10		39		456		-	
Intangible assets	Note 5		404		318		315	
Goodwill	Note 6		311		311		311	
Total assets		\$	19,197	\$	17,782	\$	15,212	
LIABILITIES								
Current								
Accounts payable and accrued liabilities		\$	1,927	\$	1,961	\$	1,644	
Advance ticket sales	Note 18		2,717		2,469		2,119	
Current portion of long-term debt and								
finance leases	Note 7		455		671		707	
Total current liabilities			5,099		5,101	<u>-</u>	4,470	
Long-term debt and finance leases	Note 7		6,197		5,448		5,911	
Pension and other benefit liabilities	Note 8		2,547		2,592		2,436	
Maintenance provisions	Note 9		1,118		1,003		922	
Other long-term liabilities			151		167		153	
Deferred income tax	Note 10		52		49		49	
Total liabilities		\$	15,164	\$	14,360	\$	13,941	
SHAREHOLDERS' EQUITY								
Share capital	Note 11		798		799		797	
Contributed surplus			75		69		83	
Hedging reserve			-		-		3	
Retained earnings			3,160		2,554		388	
Total shareholders' equity			4,033		3,422		1,271	
Total liabilities and shareholders' equity		\$	19,197	\$	17,782	\$	15,212	

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

On behalf of the Board of Directors:

(signed) Vagn Sørensen

(signed) Christie J.B. Clark

Vagn Sørensen

Chair of the Audit F

Chairman

Chair of the Audit, Finance and Risk Committee



CONSOLIDATED STATEMENTS OF OPERATIONS

For the year ended December 31 (Canadian dollars in millions except per share figures)		2018	2017 Restated - Note 2
Operating revenues			
Passenger	Note 18	\$ 16,223	\$ 14,593
Cargo	Note 18	803	708
Other		1,039	951
Total revenues		18,065	16,252
Operating expenses			
Aircraft fuel		3,969	2,927
Regional airlines expense	Note 19	2,842	2,617
Wages, salaries and benefits		2,873	2,671
Airport and navigation fees		964	905
Aircraft maintenance		1,003	938
Depreciation, amortization and impairment		1,080	956
Sales and distribution costs		807	770
Ground package costs		602	538
Aircraft rent		518	503
Catering and onboard services		433	383
Communications and information technology		294	254
Special items	Note 20	-	30
Other		1,506	1,389
Total operating expenses	•	16,891	14,881
Operating income		1,174	1,371
Non-operating income (expense)			
Foreign exchange gain (loss)		(317)	120
Interest income		108	60
Interest expense		(331)	(311)
Interest capitalized		35	36
Net financing expense relating to employee benefits	Note 8	(50)	(65)
Gain (loss) on financial instruments recorded at fair value	Note 15	(1)	23
Gain on sale and leaseback of assets	Note 21	-	52
Gain on debt settlements and modifications	Note 7	9	21
Loss on disposal of assets	Note 21	(188)	-
Other		(34)	(21)
Total non-operating expense		(769)	(85)
Income before income taxes		405	1,286
Income tax (expense) recovery	Note 10	(238)	743
Net income		\$ 167	\$ 2,029
Net income per share	Note 13		
Basic earnings per share		\$ 0.61	\$ 7.44
Diluted earnings per share		\$ 0.60	\$ 7.31

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



CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the year ended December 31					2017		
(Canadian dollars in millions)			2018	Restated - Note 2			
Comprehensive income			-				
Net income		\$	167	\$	2,029		
Other comprehensive income, net of tax expense:	Note 10						
Items that will not be reclassified to net income							
Remeasurements on employee benefit liabilities	Note 8		503		189		
Items that will be reclassified to net income							
Fuel derivatives designated as cash flow hedges, net		-		(3)			
Total comprehensive income	otal comprehensive income						

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars in millions)	Sha	re capital	 tributed urplus	Hedging reserve		Retained earnings		Total shareholders' equity	
January 1, 2017 ⁽¹⁾	\$	797	\$ 83	\$	3	\$	388	\$	1,271
Net income		_	-		-		2,029		2,029
Remeasurements on employee benefit liabilities		_	_		_		189		189
Fuel derivatives designated as cash flow hedges, net		_	_		(3)		_		(3)
Total comprehensive income		-	-		(3)		2,218		2,215
Share-based compensation		-	-		-		9		9
Shares issued (Note 11)		14	(5)		-		-		9
Shares purchased and cancelled under issuer bid (Note 11)		(12)	_		_		(59)		(71)
Reclassification of equity settled award to cash settled award (Note 2I)		-	(9)		_		(2)		(11)
December 31, 2017 ⁽¹⁾	\$	799	\$ 69	\$	-	\$	2,554	\$	3,422
Net income		-	-		-		167		167
Remeasurements on employee benefit liabilities		_	_		_		503		503
Fuel derivatives designated as cash flow hedges, net		_	_		-		_		-
Total comprehensive income		_	_		-		670		670
Share-based compensation		_	9		_		_		9
Shares issued (Note 11)		8	(3)		-		-		5
Shares purchased and cancelled under issuer bid (Note 11)		(9)	_		_		(64)		(73)
December 31, 2018	\$	798	\$ 75	\$	-	\$	3,160	\$	4,033

⁽¹⁾ Amounts for prior periods as restated – Refer to Note 2

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



CONSOLIDATED STATEMENTS OF CASH FLOW

For the year ended December 31 (Canadian dollars in millions)		2018	2017 Restated
· · · · · · · · · · · · · · · · · · ·			- Note 2
Cash flows from (used for)			
Operating			
Net income		\$ 167	\$ 2,029
Adjustments to reconcile to net cash from operations			
Deferred income tax Not	te 10	232	(759)
Depreciation, amortization and impairment		1,118	984
Foreign exchange (gain) loss Not	te 15	328	(183)
Gain on sale and leaseback of assets Not	te 21	-	(52)
Gain on debt settlements and modifications Not	te 7	(9)	(21)
Loss on disposal of assets Not	te 21	188	-
Employee benefit funding less than expense Not	te 8	257	237
Financial instruments recorded at fair value Not	te 15	14	(14)
Change in maintenance provisions		98	125
Changes in non-cash working capital balances		267	342
Other	Ì	35	50
Net cash flows from operating activities		2,695	2,738
Financing			
Proceeds from borrowings Not	te 7	1,210	733
Reduction of long-term debt and finance lease obligations Not	te 7	(1,170)	(814)
Shares purchased for cancellation Not	te 11	(73)	(71)
Issue of shares		5	9
Financing fees Not	te 7	(12)	(26)
Net cash flows used in financing activities		(40)	(169)
Investing			
Short-term investments		(848)	(998)
Additions to property, equipment and intangible assets		(2,197)	(2,422)
Proceeds from sale of assets		11	5
Proceeds from sale and leaseback of assets Not	te 21	293	740
Other		47	(16)
Net cash flows used in investing activities		(2,694)	(2,691)
Effect of exchange rate changes on cash and cash equivalents		27	(23)
Decrease in cash and cash equivalents		(12)	(145)
Cash and cash equivalents, beginning of year		642	787
Cash and cash equivalents, end of year		\$ 630	\$ 642

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



For the years ended December 31, 2018 and 2017 (Canadian dollars in millions – except per share amounts)

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").

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 also 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.



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 14, 2019.

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, 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 intercompany balances and transactions are eliminated.

C) PASSENGER AND CARGO REVENUES

The Corporation adopted IFRS 15 Revenue from Contracts with Customers on January 1, 2018 and applied it retrospectively to the previous periods. The impact of the new standard on the consolidated financial statements is summarized in Note 2BB.

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 when the transportation is 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"). Under the CPSA, Aeroplan purchases passenger tickets from Air Canada, which are accounted for as passenger revenues by Air Canada when transportation is provided. As further discussed in Note 23, Air Canada acquired Aimia Canada Inc., owner and operator of the Aeroplan loyalty business, from Aimia Inc. in January 2019.

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 when transportation is provided. Operating expenses under capacity purchase agreements, which are



aggregated in a separate line item in the consolidated statement of operations titled Regional airlines expense, 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.

E) AEROPLAN LOYALTY PROGRAM

Air Canada purchases Aeroplan Miles® from Aeroplan. Air Canada is an Aeroplan partner providing certain of Air Canada's customers, who are also members of Aeroplan, with Aeroplan Miles®, which they can redeem as Aeroplan members for air travel or other rewards offered by Aeroplan pursuant to its program.

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.

As further discussed in Note 23, Air Canada acquired Aimia Canada Inc., owner and operator of the Aeroplan loyalty business, from Aimia Inc. in January 2019.

F) OTHER REVENUES

Other revenue is primarily comprised of revenues from the sale of the ground portion of vacation packages, ground handling services, on-board sales, lounge pass sales and loyalty program marketing fees. 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, 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 Retained earnings without subsequent reclassification to income.

The current service cost is estimated utilizing different discount rates derived from the yield curve used to measure the defined benefit obligation at the beginning of the year, reflecting the different timing of benefit payments for past service (the defined benefit obligation) and future service (the current service cost).

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 Retained earnings 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.

A prospective change in accounting for PSUs and RSUs was made in 2017 from equity settled instruments to cash settled instruments based on settlement experience. In accounting for cash settled instruments, compensation expense is adjusted for subsequent changes in the fair value of the PSUs and RSUs taking into account forfeiture estimates. The liability related to cash settled PSUs and RSUs is recorded in Other long-term liabilities. 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 and retain their shares 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

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

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 through profit and loss 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 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).

<u>Impairment</u>

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 derivative 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 applies hedge accounting for designated fuel derivatives. 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 Gain on financial instruments recorded at fair value. Refer to Note 15 for the results from fuel hedge accounting.

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 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.

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 for the period attributable to the shareholders of Air Canada by the weighted average number of shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of shares outstanding for dilutive potential shares. The Corporation's potentially dilutive 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 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 \$57 related to spare parts and supplies consumed during the year (2017 – \$54).

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 periods not exceeding 25 years, with residual values initially estimated at 10% of the original cost and updated for changes in estimates over time. Spare engines and related parts ("rotables") are depreciated over the average remaining useful life of the fleet to which they relate with residual values initially estimated at 10%. 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 lesser of eight years or 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 power-by-the-hour fleet maintenance contract costs 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. Borrowings made specifically for the purpose of obtaining a qualifying asset are excluded from this calculation until substantially all the activities necessary to prepare the asset for its intended use are complete.

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, 2018
International route rights and slots	Indefinite	not applicable
Marketing based trade names	Indefinite	not applicable
Technology based (internally developed)	5 -10 years	1 to 10 years

Air Canada has international route rights and slots 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).

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 cashgenerating 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 narrowbody and widebody 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. 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

Air Canada is managed as one operating segment based on how financial information is produced internally for the purposes of making operating decisions. The operating segment is 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.

BB) ACCOUNTING STANDARDS ADOPTED ON JANUARY 1, 2018

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 entity 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.

The Corporation adopted the standard effective January 1, 2018 using the full retrospective method, which requires each prior reporting period presented to be restated. The main changes are explained below.

Accounting for costs to obtain a contract

Under IFRS 15, incremental costs of obtaining passenger revenues, such as credit card fees and global distribution system charges, are capitalized at time of sale and expensed at the time of passenger revenue recognition. Prior to adoption of IFRS 15, these costs were expensed as incurred at the time the flight ticket was sold. With this change in accounting policy for contract costs, the timing of expense recognition is impacted.

The impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Prepaid expenses and other current assets of \$58 and an equivalent increase to opening Retained earnings (\$65 as at December 31, 2017). In addition, deferred commission costs in the amount of \$40



as at January 1, 2017, previously recorded net against the Advance ticket sales liability, were reclassified to Prepaid expenses and other current assets (\$35 as at December 31, 2017).

Accounting for change fees

Revenue arising from change fees which are collected by travel agents on Air Canada's behalf are deferred and recognized in passenger revenue at the time of the related flight, rather than at time of collection. The impact on the consolidated statement of financial position as at January 1, 2017 is an increase to Advance ticket sales of \$6 and an equivalent decrease to opening Retained earnings (\$6 as at December 31, 2017).

Presentation

Certain passenger and cargo related fees and surcharges were reclassified from Other to Passenger revenue and to Cargo revenue on the consolidated statement of operations to better reflect the nature and aggregation of similar revenue items. This reclassification has no impact on total operating revenues.

Impact to previously reported results

Selected adjusted financial statement information, which reflect the adoption of IFRS 15, is presented below. Line items that were not affected by the change in accounting policy have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. In summary, the following adjustments were made to the amounts recognized in the consolidated statement of financial position for the date of initial application on January 1, 2017 and at the end of the comparative period, December 31, 2017.

(Canadian dollars in millions)	pi	ember 31, 2016 as reviously eported	Reclassification Remeasurements		anuary 1, 2017 as restated	
Prepaid expenses and other current assets	\$	349	\$	40	\$ 58	\$ 447
Total assets	\$	15,114	\$	40	\$ 58	\$ 15,212
Advance ticket sales		2,073		40	6	2,119
Total current liabilities	\$	4,424	\$	40	\$ 6	\$ 4,470
Retained earnings		336		-	52	388
Total shareholders' equity	\$	1,219	\$	-	\$ 52	\$ 1,271
Total liabilities and shareholders' equity	\$	15,114	\$	40	\$ 58	\$ 15,212

(Canadian dollars in millions)	C	December 31, 2017 as previously reported		classification	Re	emeasurements	December 31, 2017 as restated		
Prepaid expenses and other current assets	\$	325	\$	35	\$	65	\$	425	
Deferred income tax		472		-		(16)		456	
Total assets	\$	17,698	\$	35	\$	49	\$	17,782	
Advance ticket sales		2,428		35		6		2,469	
Total current liabilities	\$	5,060	\$	35	\$	6	\$	5,101	
Retained earnings		2,511		-		43		2,554	
Total shareholders' equity	\$	3,379	\$	-	\$	43	\$	3,422	
Total liabilities and shareholders' equity	\$	17,698	\$	35	\$	49	\$	17,782	

No deferred income tax was recorded on the restatement as of January 1, 2017 due to deferred income tax assets not being recognized at that time. Starting in the third quarter of 2017, the adjustments



include their corresponding income tax effect resulting in a \$16 decrease of the tax recovery previously recorded in the consolidated statement of operations.

Adoption of the standard impacted the Corporation's previously reported consolidated statement of operations as follows.

(Canadian dollars in millions)	Year ended December 31, 2017 as previously reported	Reclassification	Remeasurements	Year ended December 31, 2017 as restated
Operating revenues				
Passenger	\$ 14,471	\$ 122	\$ -	\$ 14,593
Cargo	650	58	-	708
Other	1,131	(180)	-	951
Total revenues	16,252	-	-	16,252
Operating expenses				
Sales and distribution costs	777	-	(7)	770
Total operating expenses	14,888	-	(7)	14,881
Operating income	1,364	-	7	1,371
Income tax (expense) recovery	759	-	(16)	743
Net income	\$ 2,038	\$ -	\$ (9)	\$ 2,029
Basic earnings per share	\$ 7.48	\$ -	\$ (0.04)	\$ 7.44
Diluted earnings per share	\$ 7.34	\$ -	\$ (0.03)	\$ 7.31

Adoption of IFRS 15 did not have any net impact on the consolidated statement of cash flows.

CC) 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 16 - Leases

IFRS 16 replaces IAS 17 Leases and related interpretations. The core principle is that a lessee recognizes 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 of the lease liability 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. Purchase options which are reasonably certain of being exercised are also included in the measurement of the lease liability. Lease payments will not include variable lease payments other than those that depend on an index or rate. The right-of-use asset will be derived from the calculation of the lease liability and will also include any provisions the lessee will owe for return conditions on leased assets.

The new standard is intended to provide an improved representation of leasing transactions, in particular those that do not currently require the lessee to recognize an asset and liability arising from an operating lease. IFRS 16 is effective for annual periods beginning on January 1, 2019. Entities have the option of adopting a full retrospective approach or a modified retrospective approach on transition to IFRS 16.

The Corporation will apply the standard effective January 1, 2019 and will transition with a full retrospective approach with restatement to each prior reporting period presented. The Corporation has elected the package of practical expedients to not reassess prior conclusions related to contracts



containing leases and to apply the recognition exemption for short term leases and contracts for which the underlying asset has a low value.

This standard will have a significant impact on the Corporation's consolidated balance sheet, along with a change to the recognition, measurement and presentation of lease expenses in the consolidated statement of operations.

Aircraft Leases

As of December 31, 2018 the Corporation had 126 aircraft under operating leases (111 aircraft as at December 31, 2017), and Air Canada will record such aircraft as right-of-use assets and lease liabilities of Air Canada in accordance with the requirements of the new standard. Additionally, the Corporation has identified that, under IFRS 16, Air Canada is the lessee in respect of aircraft used by regional carriers providing services under the respective capacity purchase agreements ("CPA"), and will record such aircraft as right-of-use assets and lease liabilities of Air Canada. As at December 31, 2018, there were 132 aircraft (134 aircraft as at December 31, 2017) operating under these arrangements on behalf of Air Canada.

Property Leases

The Corporation has leases related to airport terminal operations space and other real estate leases. For leases related to terminal operations space, there are generally effective substitution rights in the hands of the lessor and therefore these are not considered lease contracts under the standard. Leases with reciprocal termination rights with a notice period of less than 12 months would be considered short-term leases and therefore would be excluded from balance sheet recognition under the practical expedient. Finally, those airport terminal contracts with variable lease payments will also be excluded since variable lease payments, other than those based on an index or rate, are excluded from the measurement of the lease liability. This results in a portfolio of property leases that are expected to be recorded as right-of-use assets and lease liabilities under the standard which relate to dedicated space in Air Canada's hub locations of Toronto, Montreal and Vancouver, lease contracts on building space dedicated to Air Canada for offices, airport and maintenance operations, Maple Leaf Lounges and land leases.

Accounting for Leases and Right-of-Use Assets

Leases are recognized as a right-of-use asset and corresponding liability at the date of which the leased asset is available for use by the Corporation. Each lease payment is allocated between the liability and interest expense. The interest cost is charged to the consolidated statement of operations over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Right-of-use assets will be accounted for under IAS 16 Property, Plant and Equipment. Aircraft recorded as right-of-use assets will have the same accounting policies as directly owned aircraft, meaning the right-of-use assets will be componentized and depreciated over the lease term. Consistent with owned aircraft, any qualifying maintenance events will be capitalized and depreciated over the lesser of the lease term and expected maintenance life.

Maintenance provisions for end-of-lease return obligations will be recorded, as applicable, on aircraft leases as a maintenance expense over the term of the lease. Any changes to the provision for end-of-lease conditions will be recognized as an adjustment to the right-of-use asset and subsequently amortized to the income statement over the remaining term of the lease.

The application of IFRS 16 requires assumptions and estimates in order to determine the value of the right-of-use assets and the lease liabilities which mainly relate to the implicit interest rate for aircraft leases and the incremental borrowing rate at commencement date of the contract for property leases. Judgement must also be applied as to whether renewal options are reasonably certain of being exercised.



Income Statement Impacts

The impacts on the income statement will be an elimination of aircraft rent and building rent, which is recorded in other operating expenses, for those contracts which are recognized as leases, and instead will be replaced by an amortization of the right-of-use asset and interest costs on the lease liability. Maintenance expense is expected to decrease under the standard as qualifying maintenance events for the former operating leases will be capitalized as part of the right-of-use asset and depreciated over their expected maintenance life. This will be partially offset by higher maintenance provision expense recorded on all aircraft right-of-use assets which contain end of lease maintenance return conditions. Regional airlines expense is expected to decrease to the extent aircraft rent is removed and recorded in depreciation and interest expense outside of the Regionals airlines expense.

Since all the aircraft lease contracts are denominated in US dollars, there may be additional volatility in the foreign exchange recognized in the income statement due to the revaluation of the lease liabilities and maintenance provisions to the rate of exchange in effect at the date of the balance sheet.

Anticipated impact to 2018 results

Select adjusted financial statement information, which reflects the anticipated impact of adoption of IFRS 16 on January 1, 2018, is presented below. Line items that are not expected to be affected by the change in accounting policy have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. In summary, the following adjustments are anticipated to be made to the amounts recognized in the consolidated statement of financial position for the date of initial application on January 1, 2018.

(Canadian dollars in millions)	December 31, 2017 as previously reported		Air Canada aircraft		Regional aircraft		Property leases		Expected January 1, 2018 as restated	
Accounts receivable	\$	814	\$	(3)	\$	-	\$	-	\$	811
Deposits and other assets		465		(63)		-		-		402
Property and equipment		9,252		1,649		766		160		11,827
Deferred income tax		456		71		144		13		684
Total assets	\$	17,782	\$	1,654	\$	910	\$	173	\$	20,519
Accounts payable and accrued liabilities		1,961		(22)		(12)		-		1,927
Current portion of long-term debt and lease liabilities		671		357		146		12		1,186
Total current liabilities		5,101		335		134		12		5,582
Long-term debt and lease liabilities		5,448		1,452		1,092		198		8,190
Maintenance provisions		1,003		70		78		-		1,151
Other long-term liabilities		167		(8)		-		-		159
Total liabilities	\$	14,360	\$	1,849	\$	1,304	\$	210	\$	17,723
Retained earnings		2,554		(195)		(394)		(37)		1,928
Total shareholders' equity	\$	3,422	\$	(195)	\$	(394)	\$	(37)	\$	2,796
Total liabilities and shareholders' equity	\$	17,782	\$	1,654	\$	910	\$	173	\$	20,519



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 and judgements 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 and estimates 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 value of the assets based on the estimated current and future fair values 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 \$14 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. Fair value less costs to dispose may be calculated based upon a discounted cash flow analysis, which requires management to make a number of significant market participant assumptions including assumptions relating to future operating plans, discount rates and future growth rates.

· 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 Aircraft 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 Aircraft maintenance expense in the period. Refer to Note 9(a) for additional information.



Income taxes

Income tax assets and liabilities are measured at the amount that is expected to be realized or incurred upon ultimate settlement with taxation authorities. Such assessments are based upon the applicable income tax legislation, regulations and interpretations, all of which may be subject to change and interpretation. Deferred income tax assets and liabilities are composed of the tax effect of temporary differences between the carrying amount and tax basis of assets and liabilities, as well as the income tax effect of undeducted income tax losses. The timing of the reversal of temporary differences is estimated and the income tax rate substantively enacted for the periods of reversal is applied to the temporary difference. The carrying amounts of assets and liabilities are subject to the accounting estimates that are inherent in those balances. Assumptions as to the timing of reversal of temporary differences include expectations about the future results of operations and future cash flows. Changes in tax laws, tax rates or expected timing of reversal may have a significant impact on the amounts recorded for deferred income tax assets and liabilities. Refer to Note 10 Income taxes for additional information.



4. PROPERTY AND EQUIPMENT

	an	Aircraft nd flight uipment	lea	Buildings and leasehold improvements		Ground and other equipment		Purchase deposits and assets under development		Total
Year ended December 31, 2017										
At January 1, 2017	\$	7,030	\$	409	\$	184	\$	897	\$	8,520
Additions		1,769		8		29		573		2,379
Reclassifications		309		62		36		(407)		-
Disposals		(713)		-		-		-		(713)
Depreciation		(852)		(41)		(41)		-		(934)
At December 31, 2017	\$	7,543	\$	438	\$	208	\$	1,063	\$	9,252
At December 31, 2017										
Cost	\$	11,320	\$	899	\$	545	\$	1,063	\$	13,827
Accumulated depreciation		(3,777)		(461)		(337)		-		(4,575)
	\$	7,543	\$	438	\$	208	\$	1,063	\$	9,252
Year ended December 31, 2018										
At January 1, 2018	\$	7,543	\$	438	\$	208	\$	1,063	\$	9,252
Additions		1,579		-		31		429		2,039
Reclassifications		517		42		-		(559)		-
Disposals		(496)		-		-		-		(496)
Depreciation		(980)		(44)		(42)		-		(1,066)
At December 31, 2018	\$	8,163	\$	436	\$	197	\$	933	\$	9,729
At December 31, 2018										
Cost	\$	12,123	\$	924	\$	567	\$	933	\$	14,547
Accumulated depreciation		(3,960)		(488)		(370)		-		(4,818)
	\$	8,163	\$	436	\$	197	\$	933	\$	9,729

As at December 31, 2018, property and equipment included finance leased assets including 8 aircraft (2017 - 9) with a net book value of \$96 (2017 - \$104) and facilities with a net book value of \$32 (2017 - \$34).

Included in aircraft and flight equipment are 21 aircraft and 16 spare engines (2017 - 21 aircraft and 14 spare engines) which are leased to CPA carriers with a cost of \$395 (2017 - \$387) less accumulated depreciation of \$157 (2017 - \$142) for a net book value of \$238 (2017 - \$245). Depreciation expense for 2018 for these aircraft and flight equipment amounted to \$25 (2017 - \$21).

As further described in Note 21, during 2018, the Corporation sold 25 Embraer 190 aircraft with a cost of \$789 less accumulated depreciation of \$308 for a net book value of \$481.

Certain property and equipment are pledged as collateral as further described under the applicable debt instrument in Note 7. There are no impairments recorded as at December 31, 2018.



INTANGIBLE ASSETS

	route	oute rights based trade (ir		l (in	Technology based (internally developed)		Total	
Very anded December 21, 2017								
Year ended December 31, 2017	*	07	.	00	+	120	<u>_</u>	215
At January 1, 2017	\$	97	\$	88	\$	130	\$	315
Additions		-		-		41		41
Amortization		-		-		(38)		(38)
At December 31, 2017	\$	97	\$	88	\$	133	\$	318
At December 31, 2017								
Cost	\$	97	\$	88	\$	458	\$	643
Accumulated amortization		-		-		(325)		(325)
	\$	97	\$	88	\$	133	\$	318
Year ended December 31, 2018								
At January 1, 2018	\$	97	\$	88	\$	133	\$	318
Additions		-		-		122		122
Amortization		-		-		(36)		(36)
At December 31, 2018	\$	97	\$	88	\$	219	\$	404
At December 31, 2018								
Cost	\$	97	\$	88	\$	579	\$	764
Accumulated amortization		-		-		(360)		(360)
	\$	97	\$	88	\$	219	\$	404

In 2018, technology-based assets with cost of \$1 (2017 - \$38) and accumulated amortization of \$1 (2017 - \$38) were retired.

Certain international route rights and slots are pledged as security for senior secured notes as described in Note 7.

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 cash-generating unit level. On this basis, an impairment review was performed at the narrowbody and widebody 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 \$138 to widebody and \$47 to narrowbody.

The recoverable amount of the cash-generating units has been measured based on the fair value less cost to dispose, using a discounted cash flow model. The discounted cash flow model would represent a level 3 fair value measurement within the IFRS 13 fair value hierarchy. 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 five-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 five-year period are projected to increase consistent with the long-term growth assumption of the airline industry 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 market participant assumptions regarding 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 carrying value of the cash generating units by a significant margin, the most recent calculation from the 2017 period was carried forward and used in the impairment test in the current period. Key assumptions used for the fair value less costs to dispose calculations in fiscal 2017 were as follows:

	2017
Discount rate	12.6%
Long-term growth rate	2.5%
Jet fuel price range per barrel	US\$66 - US\$79

The recoverable amount of both cash-generating units exceeded their respective carrying values by an aggregate amount of approximately \$7,400. Reasonably possible changes in key assumptions would not cause the recoverable amount of each CGU to be less than the carrying value.



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, and it is the lowest level at which goodwill is monitored for internal management purposes.

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 losses have been recorded against the value of goodwill since its acquisition.

No impairment charges have arisen as a result of the reviews performed as at December 31, 2018 and 2017. Reasonably possible changes in key assumptions would not cause the recoverable amount of goodwill to fall below the carrying value.



LONG-TERM DEBT AND FINANCE LEASES

	Final Maturity	Weighted Average Interest Rate (%)	2018	2017
Aircraft financing (a)				
Fixed rate U.S. dollar financing	2020 - 2030	3.84	\$ 3,592	\$ 2,828
Floating rate U.S. dollar financing	2020 - 2027	4.39	676	871
Fixed rate CDN dollar financing	2026 - 2030	3.76	287	-
Floating rate CDN dollar financing	2026 - 2027	2.89	298	332
Fixed rate Japanese yen financing	2027	1.84	146	131
Floating rate Japanese yen financing	2020 - 2027	0.88	42	61
Senior secured notes – CDN dollar (b)	2023	4.75	200	200
Senior unsecured notes – U.S. dollar (c)	2021	7.75	546	503
Other secured financing – U.S. dollar (b)	2023	4.52	786	1,073
Long-term debt		4.22	6,573	5,999
Finance lease obligations (d)	2020 - 2033	9.27	187	223
Total debt and finance leases		4.36	6,760	6,222
Unamortized debt issuance costs			(108)	(103)
Current portion			(455)	(671)
Long-term debt and finance leases			\$ 6,197	\$ 5,448

(a) Aircraft financing (US\$3,130, CDN \$585 and JPY \pm 15,155) (2017 - US\$2,943, CDN \$332 and JPY \pm 17,208) is secured primarily by specific aircraft with a carrying value of \$5,575 (2017 - \$5,230). 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\$222, CDN \$298 and JPY \pm 2,482 of the financing is supported by a loan guarantee by the Export-Import Bank of the United States ("EXIM").

In 2018, in connection with the financing of the acquisition of one new Boeing 787-9 aircraft and four new Boeing 737 MAX-8 aircraft, Air Canada entered into a certificate purchase agreement for a private offering of two tranches of enhanced equipment trust certificates with a combined aggregate face amount of \$301 and a weighted average interest rate of 3.76% per annum, and a final expected maturity date of 2030. Proceeds from the offering were disbursed following delivery of the aircraft. These proceeds are included in fixed rate CDN dollar financing in the table above.

In 2017, in connection with the financing of four new Boeing 787-9 and nine new Boeing 737 MAX-8 aircraft, Air Canada completed the closing of a private offering of three tranches of enhanced equipment trust certificates ("EETC") with a combined aggregate face amount of US\$719. The private offering was comprised of Class AA certificates, Class A certificates, and Class B certificates with final expected maturity dates between 2026 and 2030. The three tranches of certificates have a combined weighted average interest rate of 3.42%. Proceeds from the offering were disbursed during 2018 following delivery of the aircraft. The principal amount of US\$719 is included in fixed rate U.S. dollar financing in the table above. Financing fees paid in conjunction with the offering in 2017 were \$10 and are reported in Financing on the consolidated statement of cash flow.

In 2017, in connection with the acquisition of four Boeing 787-9 aircraft, the Corporation completed a financing, maturing in 2027 and comprised of a principal of US\$439 subject to a floating rate, JPY \$11,743 subject to a fixed rate and JPY \$1,247 subject to a floating rate. These financings were secured using Japanese Operating Leases with a Call Option ("JOLCO") structures with the transactions recorded as loans and the aircraft as owned for accounting purposes in the Corporation's consolidated financial statements. Financing fees paid in 2017 in connection with the JOLCO structures were \$13 and are reported in Financing on the consolidated statement of cash flow.



In connection with the sales transaction described in Note 21, long-term debt of \$144 (US\$109) related to the Embraer 190 aircraft was repaid in 2018. The loss recorded in Gain (loss) on debt settlements and modifications in respect of the prepayment of such debt was \$2.

During 2018, principal of US\$35 was prepaid relating to the financing of three Boeing 777 aircraft. The loss recorded in Gain (loss) on debt settlements and modifications in respect of the prepayment of such debt was less than \$1.

During 2017, principal of US\$27 was prepaid relating to the financing of one A330 aircraft and principal of US\$25 relating to the financing of four Embraer 190 aircraft. A loss of \$5 is included in Gain (loss) on debt settlements and modifications related to the prepayment of such fixed rate debt.

(b) In October 2016, as part of a refinancing transaction, Air Canada entered into a purchase agreement with a syndicate of initial purchasers relating to a private offering of \$200 aggregate principal amount of 4.75% senior secured first lien notes due 2023 (the "2016 Senior Notes"), which were sold at par. Air Canada also received proceeds of a US\$800 term loan, maturing in 2023, and entered into a new US\$300 revolving credit facility expiring in 2021 (collectively with the term loan, the "2016 Credit Facility"). The revolving credit facility had an initial interest rate of 275 basis points over LIBOR (subject to a LIBOR floor of 75 basis points).

In June 2017, Air Canada completed a repricing of its US\$1.1 billion 2016 Credit Facility, reducing the interest rate by 50 basis points, to an interest rate of 225 basis points over LIBOR (subject to a LIBOR floor of 75 basis points). The Corporation recorded a \$27 Gain on debt settlements and modifications related to this transaction.

In February 2018, Air Canada completed a second repricing of its US\$1.1 billion 2016 Credit Facility, reducing the interest rate by 25 basis points, to an interest rate of 200 basis points over LIBOR (subject to a LIBOR floor of 75 basis points). The Corporation recorded an \$11 Gain on debt settlements and modifications related to this transaction.

In December 2018, Air Canada amended the 2016 Credit Facility. The amendment had the effect of increasing the revolving credit facility to US\$600, reducing the outstanding term loan to US\$600, concurrent with the additional repayment of US\$192 of outstanding term loan, and extending the revolving loan commitment termination date to 2023. This repayment was made within the initial terms of the loan agreement.

In December 2018, Air Canada entered into a new \$200 revolving credit facility. The facility is available until 2021 and, if drawn, would be secured by certain designated aircraft. No amounts have been drawn on the facility at December 31, 2018.

Air Canada may redeem some or all of the 2016 Senior Notes at any time on or after October 6, 2019 at certain established redemption prices, plus accrued and unpaid interest. At any time prior to October 6, 2019, Air Canada may redeem some or all of the 2016 Senior Notes at a price equal to 100% of their principal amount redeemed plus a "make-whole" premium and accrued and unpaid interest. At any time prior to October 6, 2019, Air Canada may redeem up to 35% of the aggregate principal amount of the 2016 Senior Notes with the proceeds of certain equity offerings, at established redemption prices, plus accrued and unpaid interest. In addition, at any time and from time to time prior to October 6, 2021, Air Canada may redeem, during any twelve-month period, up to 10% of the original aggregate principal amount of the 2016 Senior Notes at a redemption price of 103% of the principal amount, plus accrued and unpaid interest.

The 2016 Senior Notes and the Corporation's obligations under the 2016 Credit Facility are senior secured obligations of Air Canada, secured on a first lien basis, subject to certain permitted liens and exclusions, by certain real estate interests, 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.

Other U.S. dollar secured financings are floating rate financings that are secured by certain assets including assets described above relating to the 2016 Credit Facility. As described above, during 2018, the Corporation prepaid US\$192 of the outstanding term loan. As at December 31, 2018, the Corporation



had not drawn on the revolving credit facility and the outstanding term loan principal was US\$598 (2017 - US\$798 principal).

- (c) Private offering of US\$400 of 7.75% senior unsecured notes due 2021, with interest payable semi-annually. Air Canada may at any time and from time to time redeem some or all of the senior unsecured notes at a redemption price equal to the greater of (i) 100% of the principal amount of the notes being redeemed and (ii) a "make-whole" amount, if any, plus, in either case accrued and unpaid interest.
- (d) Finance leases, related to facilities and aircraft, total \$187 (\$61 and US\$92) (2017 \$223 (\$64 and US\$126)). During 2018, the Corporation recorded interest expense on finance lease obligations of \$19 (2017 \$23). The carrying value of aircraft and facilities under finance leases amounted to \$96 and \$32 respectively (2017 \$104 and \$34).

Cash interest paid on Long-term debt and finance leases in 2018 by the Corporation was \$281 (2017 – \$287).

Maturity Analysis

Principal and interest repayment requirements as at December 31, 2018 on Long-term debt and finance lease obligations are as follows. U.S. dollar amounts are converted using the December 31, 2018 closing rate of CDN\$1.3637.

Principal	2	019	2020		2021		2022		2023		Thereafter		Total
Long-term debt obligations	\$	407	\$	640	\$ 1,003	\$	342	\$	1,450	\$	2,731	\$	6,573
Finance lease obligations		48		50	17		15		16		41		187
	\$	455	\$	690	\$ 1,020	\$	357	\$	1,466	\$	2,772	\$	6,760

Interest	2	019	2020		2021		2022		2023		Thereafter		Total
Long-term debt obligations	\$	273	\$	258	\$	214	\$	176	\$	151	\$	346	\$ 1,418
Finance lease obligations		14		10		6		5		4		10	49
	\$	287	\$	268	\$	220	\$	181	\$	155	\$	356	\$ 1,467

Principal repayments in the table above exclude transaction costs of \$108 which are offset against Longterm debt and finance leases in the consolidated statement of financial position.



Cash flows from financing activities

Information on the change in liabilities for which cash flows have been classified as financing activities in the statement of cash flows is presented below.

		Cash Flows						Non-Cash Changes							
	an. 1, 2018	Borrowings		Repayments		Financing Fees		Foreign exchange adjustments		Amortization of Financing Fees		Other Non-Cash Adjustments			ec. 31, 2018
Long term debt	\$ 5,999	\$	1,210	\$	(1,122)	\$	_	\$	492	\$	-	\$	(6)	\$	6,573
Lease liabilities	223		_		(45)		_		9		-		_		187
Unamortized debt issuance costs	(103)		_		_		(12)		_		20		(13)		(108)
Total liabilities from financing activities	\$ 6,119	\$	1,210	\$	(1,167)	\$	(12)	\$	501	\$	20	\$	(19)	\$	6,652

		Cash Flows							Non-Cash Changes						
	an. 1, 2017	Borr	owings	Rep	Repayments		Financing Fees		Foreign exchange adjustments		Amortization of Financing Fees		Other Non-Cash Adjustments		ec. 31, 2017
Long term debt	\$ 6,447	\$	733	\$	(766)	\$	_	\$	(392)	\$	-	\$	(23)	\$	5,999
Lease liabilities	275	,	_		(42)		_		(10)		-		-		223
Unamortized debt issuance costs	(104)		-		-		(16)		-		17		-		(103)
Total liabilities from financing activities	\$ 6,618	\$	733	\$	(808)	\$	(16)	\$	(402)	\$	17	\$	(23)	\$	6,119

In 2017, financing fees of \$10 paid in conjunction with the 2017 EETC offering were reported in Financing on the consolidated statement of cash flow but excluded from this table. These fees were recorded in Deposits and other assets until delivery of the aircraft and related recognition of long-term debt. Loss on debt settlements of \$3 (2017 - \$6) is included in Reduction of long-term debt and finance lease obligations on the consolidated statement of cash flow but excluded from this table.



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 eight 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. 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 Human Resources and Compensation 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.

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) 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 plan 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.

As at January 1, 2018, the aggregate solvency surplus in the domestic registered pension plans was \$2.6 billion. The next required valuation to be made as at January 1, 2019 will be completed in the first half of 2019. With the Corporation's domestic registered pension plans in a solvency surplus position as at January 1, 2018, past service cost payments were not required in 2018. In addition, in accordance with legislation and applicable plan rules, the excess over 105% on a solvency basis can be used to reduce current service contributions under the defined benefit component or to fund the employer contribution to a defined contribution component within the same pension plan. Based on that, and including the international and supplemental plans, the total employer pension funding contributions during 2018 amounted to \$83 (\$94 employer contribution net of \$11 used to fund employer contribution in defined contribution components of the same plans). Pension funding obligations for 2019 are expected to be \$93.



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 E Future		Total				
		2018		2017		2018		2017		2018		2017
Non-current assets												
Pension assets	\$	1,969	\$	1,583	\$	-	\$	-	\$	1,969	\$	1,583
Current liabilities												
Accounts payable and accrued liabilities		-		-		60		61		60		61
Non-current liabilities												
Pension and other benefit liabilities		1,328		1,311		1,219		1,281		2,547		2,592
Net benefit obligation (asset)	\$	(641)	\$	(272)	\$	1,279	\$	1,342	\$	638	\$	1,070

The current portion of the net benefit obligation represents an estimate of other employee future benefits claims to be paid during 2019.



The following table presents financial information related to the changes in the pension and other post-employment benefits plans:

	Pension	Benefits		oyee Future efits
	2018	2017	2018	2017
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 20,260	\$ 19,135	\$ 1,342	\$ 1,301
Current service cost	304	265	35	30
Past service cost	5	-	(8)	-
Interest cost	723	739	48	51
Employees' contributions	82	81	-	-
Benefits paid	(862)	(845)	(48)	(47)
Remeasurements:				
Experience loss (gain)	(11)	34	(28)	(45)
Loss (gain) from change in demographic assumptions	(262)	-	(14)	_
Loss (gain) from change in financial assumptions	(583)	855	(56)	64
Plan settlements		-	(6)	-
Foreign exchange loss (gain)	34	(4)	14	(12)
Total benefit obligation	19,690	20,260	1,279	1,342
Change in plan assets				
Fair value of plan assets at beginning of year	21,191	19,438	-	-
Return on plan assets, excluding amounts included in Net financing expense	(399)	1,708	-	-
Interest income	745	739	-	-
Employer contributions	83	81	51	47
Employees' contributions	82	81	-	-
Benefits paid	(862)	(845)	(48)	(47)
Settlements	-	-	(3)	-
Administrative expenses paid from plan assets	(12)	(12)	-	-
Foreign exchange gain (loss)	29	1	-	-
Total plan assets	20,857	21,191	-	-
(Surplus) deficit at end of year	(1,167)	(931)	1,279	1,342
Asset ceiling / additional minimum funding liability	526	659	-	-
Net benefit obligation (asset)	\$ (641)	\$ (272)	\$ 1,279	\$ 1,342

The actual return on plan assets was \$346 (2017 - \$2,447).



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

	2018	2017		
Domestic registered plans	\$ 4	\$	3	
International plans	85		78	
Supplementary plans	1,239		1,230	
	\$ 1,328	\$	1,311	

The weighted average duration of the defined benefit obligation is 14.2 years (2017 – 14.3 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			
		2018		2017	2018		2017	
Consolidated Statement of Operations								
Components of cost								
Current service cost	\$	304	\$	265	\$	35	\$	30
Past service cost		5		-		(8)		-
Plan settlements		-		-		(3)		-
Administrative and other expenses		12		12		-		-
Actuarial gains, including foreign exchange		-		-		(4)		(7)
Total cost recognized in Wages, salaries and benefits	\$	321	\$	277	\$	20	\$	23
Net financing expense relating to employee benefits	\$	2	\$	14	\$	48	\$	51
Total cost recognized in statement of operations	\$	323	\$	291	\$	68	\$	74
Consolidated Other Comprehensive (Income) Loss								
Remeasurements:								
Experience loss (gain), including foreign exchange		(6)		29		(10)		(50)
Loss (gain) from change in demographic assumptions		(262)		-		(14)		-
Loss (gain) from change in financial assumptions		(583)		855		(56)		64
Return on plan assets		399		(1,708)		-		-
Change in asset ceiling		(159)		299		-		-
Total cost (income) recognized in OCI	\$	(611)	\$	(525)	\$	(80)	\$	14

In 2018, the Corporation offered a voluntary buyout program for retiree life and health benefits. The accepted offers were recognized as a plan amendment and settlement for a combined gain of \$8.

Certain plan amendments made in conjunction with the 2014 ACPA collective agreement were or are conditional on meeting defined business plan targets tied to the number of operating aircraft in the fleet by 2020 and 2023. During the year ended December 31, 2018, actuarial losses of \$43 (2017 - actuarial losses of \$35) were recognized in other comprehensive income related to changes in assumptions associated with cost of pension increases applicable to affected members of ACPA.



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

		2018	2017
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations	1		
Wages, salaries and benefits	\$	341	\$ 300
Net financing expense relating to employee benefit liabilities		50	65
	\$	391	\$ 365
Employee benefit funding by Air Canada			
Pension benefits	\$	83	\$ 81
Other employee benefits		51	47
	\$	134	\$ 128
Employee benefit funding less than expense	\$	257	\$ 237

Composition of Defined Benefit Pension Plan Assets

Domestic Registered Plans

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

	2018	2017	Target Allocation
Bonds	71%	70%	60%
Canadian equities	3%	3%	7%
Foreign equities	6%	7%	13%
Alternative investments	20%	20%	20%
	100%	100%	100%

For the Domestic Registered Plan assets, approximately 80% of assets as of December 31, 2018 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 17,646,765 (2017 - 17,646,765) 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 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 \$458 at December 31, 2018 (2017 - \$457), 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. As permitted under the investment policy, the actual asset mix may deviate from the target allocation from time to time. The deviations at December 31, 2018 are within the limits established in the investment policy. 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 placed 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 or the U.S. Government, 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, 2018, taking into account the effect of such financial instrument risk management tools, approximately 81% 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, 2018, approximately 81% 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 future 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

Estimates surrounding assumptions of future increases in compensation are based upon the current compensation policies, the Corporation's long range-plans, labour and employment 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	•	oyee Future efits	
	2018	2017	2018	2017	
Discount rate used to determine:					
Net interest on the net defined benefit obligation for the year ended December 31	3.60%	3.90%	3.60%	3.90%	
Service cost for the year end December 31	3.70%	4.10%	3.70%	4.10%	
Accrued benefit obligation as at December 31	3.81%	3.60%	3.81%	3.60%	
Rate of future increases in compensation used to determine:					
Accrued benefit cost and service cost for the year ended December 31	2.50%	2.50%	not applicable	not applicable	
Accrued benefit obligation as at December 31	2.50%	2.50%	not applicable	not applicable	



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 2018 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					
	De	ecrease	I	ncrease			
Discount rate on obligation assumption							
Pension expense	\$	22	\$	(21)			
Net financing expense relating to pension benefit liabilities		23		(21)			
	\$	45	\$	(42)			
Increase (decrease) in pension obligation	\$	703	\$	(680)			

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, 2018, approximately 81% 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 \$478.

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 2018 (2017 – 5.8%). The rate is assumed to decrease gradually to 5% by 2020 (2017 – assumed to decrease gradually to 5% by 2020). A one percentage point increase in assumed health care trend rates would have increased the total of current service and interest costs by \$4 and the obligation by \$55. A one percentage point decrease in assumed health care trend rates would have decreased the total of current service and interest costs by \$4 and the obligation by \$58.

A 0.25 percentage point decrease in discount rate for other employee future benefits would have increased the total of current and interest costs by less than \$1 and the obligation by \$47. A 0.25 percentage point increase in discount rate would have decreased the total of current and interest costs by less than \$1 and the obligation by \$44.

Defined Contribution Pension Plans

Certain of the Corporation's management, administrative and unionized employees participate in a defined contribution pension plan, a defined contribution component of a plan which also includes a defined benefit component 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. As permitted by legislation and applicable plan rules, surplus in the defined benefit component can be used to cover the employer contributions in the defined contribution component of such plan. As such, \$11 of surplus in the defined benefit components of the domestic registered pension plans was used to cover the employer contributions in the defined contribution components during 2018 (2017 – \$9).

The Corporation's expense for these pension plans amounted to \$30 for the year ended December 31, 2018 (2017 – \$21). Taking into account available surplus in the defined benefit components of applicable plans which may be expected to be used, expected total employer contributions for 2019 are \$22.



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.

	Mai	Maintenance (a) ret		Asset tirement (b)	Litigation		Tot	al provisions
At December 31, 2017								
Current	\$	68	\$	-	\$	17	\$	85
Non-current		1,003		30		-		1,033
	\$	1,071	\$	30	\$	17	\$	1,118
Provisions arising during the year	\$	145	\$	-	\$	2	\$	147
Amounts disbursed		-		-		(2)		(2)
Changes in estimated costs		(72)		-		-		(72)
Accretion expense		25		1		-		26
Foreign exchange loss		96		-		-		96
At December 31, 2018	\$	1,265	\$	31	\$	17	\$	1,313
Current	\$	147	\$	-	\$	17	\$	164
Non-current		1,118		31		-		1,149
	\$	1,265	\$	31	\$	17	\$	1,313

- (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 2019 to 2029 with the average remaining lease term of approximately three 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 \$62 at December 31, 2018 and an increase to maintenance expense in 2019 of approximately \$6. Expected future cash flows to settle the obligation are discounted. 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 \$21 at December 31, 2018. An equivalent but opposite movement in the discount rate would result in a similar impact in the opposite direction.
- (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 2019 to 2078. 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 noncurrent provision is recorded in Other long-term liabilities.



10. INCOME TAXES

Income Tax Expense

Income tax recorded in the consolidated statement of operations is presented below.

	2018	2017 Restated - Note 2		
Current income tax	\$ (6)	\$	(16)	
Deferred income tax	(232)		759	
Income tax (expense) recovery	\$ (238)	\$	743	

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:

	2018	R	2017 estated Note 2
Income before income taxes	\$ 405	\$	1,286
Statutory income tax rate based on combined federal and provincial rates	26.78%	2	26.60%
Income tax expense based on statutory tax rates	(108)		(342)
Effects of:			
Non-taxable (non-deductible) portion of capital gains (losses)	(55)		52
Unrecognized deferred income tax assets on capital losses	(55)		-
Non-deductible expenses	(21)		(24)
Tax rate changes on deferred income taxes	2		(9)
Recognition of previously unrecognized deferred income tax assets	-		1,062
Other	(1)		4
Income tax (expense) recovery	\$ (238)	\$	743

The applicable statutory tax rate is 26.78% (2017 - 26.60%). The Corporation's applicable tax rate is the Canadian combined rates applicable in the jurisdictions in which the Corporation operates. The increase to the statutory tax rate is mainly due to the net result of corporate income tax rate decreases in Quebec and the Yukon, and an increase in Saskatchewan, as well as changes in the level of activity by province.



Income tax recorded in the consolidated statement of comprehensive income is presented below.

	2018	2017
Remeasurements on employee benefit liabilities - deferred income tax	\$ (188)	\$ (322)
Income tax expense	\$ (188)	\$ (322)

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

		2018	2017
Other comprehensive income before income taxes	\$	691	\$ 508
Statutory income tax rate based on combined federal and provincial rates	l	26.78%	26.60%
Income tax expense based on statutory tax rates		(185)	(135)
Effects of:			
Recognition of previously unrecognized deferred income tax liability		-	(184)
Other		(3)	(3)
Income tax expense	\$	(188)	\$ (322)

Income tax recorded in shareholders' equity is presented below.

	2018	2017
Share-based compensation	\$ -	\$ 19
Income tax recovery	\$ -	\$ 19

Deferred Income Tax

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, including, historical financial results, and expectations relating to future taxable income, the overall business environment, and industry-wide trends.

During 2017, Air Canada determined that it was probable that substantially all of the deferred income tax assets, which include non-capital losses, would be realized.

Deferred tax assets and liabilities of \$39 are recorded net as a noncurrent deferred income tax asset and deferred tax liabilities of \$52 are recorded as a noncurrent deferred income tax liability on the consolidated statement of financial position. 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 (2017 - \$49) is not expected to reverse until the assets are disposed of, become impaired or amortizable and as a result is included as part of the noncurrent deferred income tax liability.



The significant components of deferred income tax assets and liabilities were as follows:

		2018	_	2017 Restated · Note 2
Deferred income tax assets				
Non-capital losses	\$	353	\$	649
Post-employment obligations		171		286
Accounting provisions not currently deductible for tax		67		61
Investment tax credits and recoverable taxes		37		31
Other		28		34
		656		1,061
Deferred income tax liabilities	,			
Property, equipment and technology-based intangibles		(555)		(554)
Indefinite-lived intangible assets		(49)		(49)
Other		(65)		(51)
		(669)		(654)
Net recognized deferred income tax assets (liabilities)		(13)		407
Balance sheet presentation				
Deferred income tax assets		39		456
Deferred income tax liabilities		(52)		(49)
Net recognized deferred income tax assets (liabilities)		(13)		407

The following table presents the variation of the components of deferred income tax balances:

	January 1, 2018 2018 income statement Mote 2 movement		2018 OCI movement	December 31, 2018
Non-capital losses	\$ 649	\$ (296)	\$ -	\$ 353
Post-employment obligations	286	73	(188)	171
Accounting provisions not currently deductible for tax	61	6	-	67
Investment tax credits and recoverable taxes	31	6	-	37
Other deferred tax assets	34	(6)	-	28
Property, equipment and technology-based intangibles	(554)	(1)	-	(555)
Indefinite-lived intangible assets	(49)	-	-	(49)
Other deferred tax liabilities	(51)	(14)	-	(65)
Total recognized deferred income tax assets (liabilities)	\$ 407	\$ (232)	\$ (188)	\$ (13)

At December 31, 2018, the Corporation has deductible temporary differences of a capital nature for which no deferred income tax asset has been recognized at this time as the ability to utilize these tax attributes is limited to future taxable capital gains. Net capital losses do not have an expiry date.

The following are the temporary differences and tax loss carryforwards for which no deferred income tax assets could be recognized:



	2018	2017
Unrealized foreign exchange losses	\$ 230	\$ 62
Unrecognized net capital losses carryforwards	84	40
Total unrecognized net temporary differences	\$ 314	\$ 102
Deferred income tax rate based on combined federal and provincial rates	26.75%	26.79%
Total unrecognized net deferred income tax assets	84	27

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

	Tax	x Losses
2029	\$	36
2030		39
2031		6
2032		489
2033		403
2034		3
2035		244
2036		3
2037		2
2038		2
Non-capital losses carryforwards	\$	1,227

Cash income taxes paid in 2018 by the Corporation were \$32 (2017 - \$1).



11. SHARE CAPITAL

	Number of shares	Value
At January 1, 2017	273,212,802	\$ 797
Shares issued on the exercise of stock options	3,906,662	14
Shares purchased and cancelled under issuer bid	(4,042,818)	(12)
At December 31, 2017	273,076,646	\$ 799
Shares issued on the exercise of stock options	667,087	8
Shares purchased and cancelled under issuer bid	(3,013,822)	(9)
At December 31, 2018	270,729,911	\$ 798

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

		2018	2017
Tanadandandina		·	·
Issued and outstanding			
Class A variable voting shares		125,214,350	115,986,084
Class B voting shares		145,515,561	157,090,562
Total issued and outstanding		270,729,911	273,076,646
Potential shares			
Stock options	Note 12	6,014,464	6,121,252
Total outstanding and potentially issuable shares		276,744,375	279,197,898

Shares

As at December 31, 2018, the 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 shares have equivalent rights as 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 is 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 is 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 the day after Air Canada's 2020 annual meeting of shareholders, one right (a "Right") is issued with respect to each share of Air Canada issued and outstanding. 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 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 105 days (or such shorter minimum period determined in accordance with National Instrument 62-104 - Take-Over Bids and Issuer Bids ("NI 62-104"), (iii) provide that no shares shall be taken up unless more than 50% of the then outstanding shares, 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 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 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 2017, Air Canada received approval from the Toronto Stock Exchange ("TSX") for the renewal of its normal course issuer bid, authorizing, between May 31, 2017 and May 30, 2018, the purchase of up to 22,364,183 shares, representing 10% of the public float as at May 17, 2017. The renewal followed the conclusion of the 2016 normal course issuer bid which expired on May 29, 2017.

In 2017, the Corporation purchased, for cancellation, 4,042,818 shares at an average cost of \$17.49 per share for aggregate consideration of \$71. The excess of the cost over the average book value of \$59 was charged to Retained earnings.

In May 2018, Air Canada received approval from the TSX for the renewal of its normal course issuer bid, authorizing, between May 31, 2018 and May 30, 2019, the purchase of up to 24,040,243 shares, representing 10% of Air Canada's public float as at May 17, 2018. The renewal followed the conclusion of the 2017 normal course issuer bid which expired on May 30, 2018.

In 2018, the Corporation purchased, for cancellation, 3,013,822 shares at an average cost of \$24.11 per share for aggregate consideration of \$73. The excess of the cost over the average book value of \$64 was charged to Retained earnings. At December 31, 2018, a total of 21,940,639 shares remain available for repurchase under the existing issuer bid.



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 stock options, performance share units and restricted share units to senior management and officers of Air Canada. With respect to the stock options, 19,381,792 shares were initially authorized for issuance under the Long-term Incentive Plan of which 9,046,974 remain available for future issuance. The outstanding performance share units and restricted share units will not result in the issuance of new shares as these share units will be redeemed for shares purchased on the secondary market (and not issued from treasury) and/or equivalent cash, at the discretion of the Corporation.

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, which 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 share at the stated exercise price. The Long-term Incentive Plan specifies 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:

	2018	2017
Compensation expense (\$ millions)	\$ 9	\$ 6
Number of stock options granted to Air Canada employees	1,293,091	1,219,976
Weighted average fair value per option granted (\$)	\$ 9.27	\$ 6.14
Aggregated fair value of options granted (\$ millions)	\$ 12	\$ 7
Weighted average assumptions:		
Share price	\$ 26.28	\$ 14.85
Risk-free interest rate	1.95%-2.48%	0.86%-1.89%
Expected volatility	38.2%	39.6%-49.3%
Dividend yield	0%	0%
Expected option life (years)	5.25	5.25

Expected volatility was determined at the time of grant using the 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:

	20	18	20	17
	Options Weighted Average Exercise Price/Share		Options	Weighted Average Exercise Price/Share
Beginning of year	6,121,252	\$ 8.46	8,985,958	\$ 4.92
Granted	1,293,091	26.28	1,219,976	14.73
Exercised	(667,087)	7.90	(3,906,662)	2.30
Expired or cancelled	-	-	(35,148)	4.89
Forfeited	(732,792)	16.32	(142,872)	8.36
Outstanding options, end of year	6,014,464	\$ 11.40	6,121,252	\$ 8.46
Options exercisable, end of year	2,800,327	\$ 5.18	2,348,815	\$ 4.29

The weighted average share price on the date of exercise for options exercised in 2018 was \$26.59 (2017 - \$19.77).

		2018 (Outstanding O	2018 Exercisable Option		
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
\$0.96	2019	22,952	1	\$ 0.96	22,952	\$ 0.96
\$2.49 - \$5.69	2020	1,603,605	2	2.88	1,603,605	2.88
\$5.35 - \$8.27	2021	578,680	3	5.39	578,680	5.39
\$12.27 - \$12.64	2022	583,830	4	12.64	193,481	12.64
\$9.23 - \$9.61	2023	1,186,834	5	9.26	283,691	9.26
\$12.83 - \$26.40	2024	954,568	6	14.39	117,919	14.26
\$22.53 - \$27.75	2025	1,083,995	7	26.49	ı	-
		6,014,464		\$ 11.40	2,800,328	\$ 5.18

		2017 (Outstanding O	2017 Exercisable Option		
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
\$0.96	2019	40,604	2	\$ 0.96	40,604	\$ 0.96
\$2.49 - \$5.69	2020	1,711,049	3	2.89	1,711,049	2.89
\$5.35 - \$8.27	2021	818,126	4	5.43	257,165	5.44
\$12.27 - \$12.64	2022	852,965	5	12.56	157,649	12.64
\$9.23 - \$9.61	2023	1,481,246	6	9.27	182,348	9.27
\$12.83 - \$26.40	2024	1,217,262	7	14.74	-	-
		6,121,252		\$ 8.46	2,348,815	\$ 4.29



Performance and Restricted Share Units

The Long-term Incentive Plan also includes performance share units ("PSUs") and restricted share units ("RSUs"). 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 2018 was \$21 (2017 - \$33).

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

	2018	2017
Beginning of year	2,706,261	3,052,028
Granted	772,536	922,716
Settled	(694,111)	(1,098,067)
Forfeited	(283,922)	(170,416)
Outstanding share units, end of year	2,500,764	2,706,261

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. For 2018 contributions, Air Canada will match 33.33% of the contributions made by employees. During 2018, the Corporation recorded compensation expense of \$12 (2017 – \$8) related to the Employee share Purchase Plan.



13. EARNINGS PER SHARE

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

(in millions, except per share amounts)	2018	R	2017 estated Note 2
Numerator:			
Numerator for basic and diluted earnings per share:			
Net income	\$ 167	\$	2,029
Denominator:			
Weighted-average shares	272		273
Effect of potential dilutive securities:			
Stock options	4		5
Total potential dilutive securities	4		5
Adjusted denominator for diluted earnings per share	276		278
Basic earnings per share	\$ 0.61	\$	7.44
Diluted earnings per share	\$ 0.60	\$	7.31

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

Excluded from the 2018 calculation of diluted earnings per share were 749,000 (2017 - 101,000) outstanding options where the options' exercise prices were greater than the average market price of the shares for the year.



14. COMMITMENTS

Capital Commitments and Operating Leases

Capital commitments consist of the future firm aircraft deliveries and commitments related to the 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, 2018. The Corporation has various operating lease agreements for aircraft, equipment and other property. U.S. dollar amounts are converted using the December 31, 2018 closing rate of CDN\$1.3637. Minimum future commitments under these contractual arrangements are shown below.

	2019		2020		2020		2020		2020		2020		2020		2021		2022		2023		2023 T		Thereafter		Гotal
Capital commitments	\$ 2,382	\$	1,556	\$	815	\$	753	\$	375	\$	195	\$	6,076												
Operating leases																									
Aircraft	561		435		316		243		194		625		2,374												
Other property	118		92		67		51		36		243		607												
Total	\$ 3,061	\$	2,083	\$	1,198	\$	1,047	\$	605	\$	1,063	\$	9,057												

The Corporation leases and subleases certain aircraft and spare engines to Jazz, Sky Regional and Air Georgian, which are charged back to Air Canada through their respective CPAs. These are reported net on the consolidated statement of operations. The leases and subleases relate to five Bombardier Q400 aircraft, twelve CRJ-200 aircraft, twenty-five Embraer 175 aircraft, and sixteen spare engines. The lease and sublease revenue and expense related to these aircraft and engines each amount to \$95 in 2018 (2017 – \$92).

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. The subleases with Jazz have the same terms and maturity as the Corporation's corresponding lease commitments to the lessors. These subleases relate to five Bombardier Q400 aircraft, ten Bombardier CRJ-200 aircraft, and fifteen Bombardier CRJ-705 aircraft which have final maturities ranging from 2021 to 2025. The sublease revenue and lease expense related to these aircraft each amounted to \$77 in 2018 (2017 – \$81). 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, 2018 closing rate of CDN\$1.3637, as follows:

	2019	2020	2021	2022	2023	Thereafter	Total
Jazz flow – through leases	\$ 81	\$ 81	\$ 72	\$ 56	\$ 47	\$ 22	\$ 359

Other Contractual Commitments

The future minimum non-cancellable commitment for the next 12 months under the Jazz CPA is approximately \$1,218 and under the capacity purchase agreements with other regional carriers is \$284. As further discussed in Note 23, the Corporation concluded an agreement to amend and extend its CPA with Jazz in February 2019.



15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

			De	cember	31,	2018			Dec	ember 31,
		Finan	cial i	nstrume	nts	classifica	tion	1		2017
	th	ir value nrough ofit and loss	ame	sets at ortized cost	am	abilities at nortized cost	1	Гotal		
Financial Assets										
Cash and cash equivalents	\$	630	\$	-	\$	-	\$	630	\$	642
Short-term investments		4,077		-		-		4,077		3,162
Restricted cash		161		-		-		161		148
Accounts receivable		-		796		-		796		814
Prepaid expenses and other current assets										
Collateral on aircraft financing		-		-		-		-		24
Deposits and other assets										
Restricted cash		171		-		-		171		186
Aircraft related and other deposits		-		135		-		135		128
Derivative instruments										
Share forward contracts		43		-		-		43		54
Foreign exchange derivatives		24		-		-		24		-
	\$	5,106	\$	931	\$	-	\$	6,037	\$	5,158
Financial Liabilities										
Accounts payable	\$	-	\$	-	\$	1,793	\$	1,793	\$	1,668
Foreign exchange derivatives		57		-		-		57		215
Current portion of long-term debt and finance leases		-		-		455		455		671
Long-term debt and finance leases		-		-		6,197		6,197		5,448
	\$	57	\$	-	\$	8,445	\$	8,502	\$	8,002

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

	2018	2	2017
Share forward contracts	\$ -	\$	26
Fuel derivatives	(1)		(3)
Gain (loss) on financial instruments recorded at fair value	\$ (1)	\$	23



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 an economic hedge and offset by changes in cash flows of the relevant risk being hedged.

The fair values of derivative 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 such as discounted cash flow analysis are applied. 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: fuel price risk, foreign exchange risk, interest rate risk, and share-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 current calendar year, 50% of the projected jet fuel purchases for the next calendar year, and 25% of projected jet fuel purchases for any calendar year thereafter. 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 2018:

- Hedging losses on the settlement of fuel derivatives of \$19 and the associated premium costs of \$17, for a hedging loss of \$36 were reclassified from other comprehensive income to Aircraft fuel expense (net fuel hedging loss of \$2 was reclassified from other comprehensive income to Aircraft fuel expense in 2017). No hedge ineffectiveness was recorded.
- The Corporation purchased crude-oil call options and swaps covering a portion of 2018 fuel exposure. The cash premium related to these contracts was \$17 (\$18 in 2017 for 2017 exposures).
- Fuel derivative contracts cash settled with a fair value of \$19 in favour of the counterparties (\$26 in favour of the Corporation in 2017).

There were no outstanding fuel derivatives as at December 31, 2018 and December 31, 2017.



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 certain 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 2018, these net operating cash inflows totaled approximately US\$4.2 billion and U.S. denominated operating costs amounted to approximately US\$6.4 billion. Non-operating cash outflows in U.S. dollars, primarily related to interest payments on U.S. dollar denominated debt and net financing outflows, amounted to approximately US\$1.9 billion. For 2018, this resulted in a U.S. dollar net cash flow exposure of approximately US\$4.1 billion.

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, 2018 amounted to \$863 (US\$635) (\$686 (US\$542) as at December 31, 2017). A portion of the cash and investment reserves are an economic hedge against long-term U.S. dollar debt while the remainder of the cash is operational cash and investment reserves which are applied against the rolling 18 month net U.S. dollar cash flow exposure. In 2018, a gain of \$62 (loss of \$58 in 2017) 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, 2018, as further described below, approximately 77% of net U.S. cash outflows are hedged for 2019 and 48% for 2020, resulting in derivative coverage of 68% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 75% coverage.

As at December 31, 2018, the Corporation had outstanding foreign currency options and swap agreements, settling in 2019 and 2020, to purchase at maturity \$4,987 (US\$3,659) of U.S. dollars at a weighted average rate of \$1.2645 per US\$1.00 (2017 − \$3,400 (US\$2,704) with settlements in 2018 and 2019 at a weighted average rate of \$1.2703 per \$1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, Sterling, YEN, and AUD (EUR €103, GBP £208, JPY ¥25,922, and AUD \$105) which settle in 2019 and 2020 at weighted average rates of €1.1910, £1.3567, ¥0.0092, and AUD \$0.7448 per \$1.00 U.S. dollar, respectively (as at December 31, 2017 - EUR €101, GBP £105, JPY ¥8,623, CNY ¥41, and AUD \$32 with settlement in 2018 at weighted average rates of €1.1664, £1.3259, ¥0.0090, ¥0.1468 and AUD \$0.7576 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, 2018 was \$33 in favour of the counterparties (2017 – \$215 in favour of the counterparties). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During 2018, a gain of \$245 was recorded in Foreign exchange gain (loss) related to these derivatives (2017 – \$274 loss). In 2018, foreign exchange derivative contracts cash settled with a net fair value of \$63 in favour of the Corporation (2017 – \$55 in favour of the counterparties).



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 to adjust to prevailing market conditions. The ratio at December 31, 2018 is 81% fixed and 19% floating (73% and 27%, respectively as at December 31, 2017).

Share-based Compensation Risk

The Corporation issues RSUs and PSUs to certain of its employees, as described in Note 12, which entitles the employees to receive a payment in the form of one share, cash in the amount equal to market value of one share, or a combination thereof, at the discretion of the Board of Directors.

To hedge the share price exposure, the Corporation entered into share forward contracts to hedge PSUs and RSUs that may vest between 2019 and 2021, subject to the terms of vesting including realization of performance vesting criteria. The forward dates for the share forward contracts coincide with the vesting terms and planned settlement dates of 1,664,142 PSUs and RSUs from 2019 to 2021. These contracts were not designated as hedging instruments for accounting purposes. Accordingly, changes in the fair value of these contracts are recorded in Gain on financial instruments recorded at fair value in the period in which they arise. During 2018, a gain of less than \$1 was recorded (2017 – gain of \$26). Share forward contracts cash settled with a fair value of \$17 in favour of the Corporation in 2018 (2017 – \$12), with new contract purchases of \$6 for 2021 hedges. As at December 31, 2018, the fair value of the share forward contracts is \$43 in favour of the Corporation (2017 – \$54 in favour of the Corporation), with those contracts maturing in 2019 valued at \$26 recorded in Prepaid expenses and other current assets and the remainder of \$17 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. 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. At December 31, 2018, unrestricted liquidity was \$5,725 comprised of Cash and cash equivalents and Short-term investments of \$4,707 and undrawn lines of credit of \$1,018. Another important aspect of managing liquidity risk relates to managing the Corporation's financial leverage. Refer to Note 17 Capital Disclosures for a discussion on financial leverage targets.

Cash and cash equivalents include \$39 pertaining to investments with original maturities of three months or less at December 31, 2018 (\$30 as at December 31, 2017).

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, 2018, 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 government in Canada, and major corporations. Accounts receivable are generally the result of sales of passenger tickets to individuals, largely through the use of major credit cards, through geographically dispersed travel agents, corporate outlets, or other airlines. Similarly, accounts receivable related to cargo revenues relate to accounts from a large number of geographically dispersed customers. Credit rating guidelines are used in determining derivative counterparties. 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, 2018. 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, 2018 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.

	Int	erest ı	ate ı	risk	Fo	reign excl risk		Other price risk ⁽²⁾				
		Inco	me			Inco	me		Income			
		% ease		% rease	in	5% crease		5% crease)% ease		l 0 % crease
Cash and cash equivalents	\$	6	\$	(6)	\$	(10)	\$	10	\$		\$	-
Short-term investments	\$	41	\$	(41)	\$	(33)	\$	33	\$	-	\$	-
Aircraft related deposits	\$	-	\$	-	\$	(5)	\$	5	\$	-	\$	-
Long-term debt and finance leases	\$	(18)	\$	18	\$	297	\$	(297)	\$	-	\$	-
Share forward contracts	\$	-	\$	_	\$	-	\$	-	\$	4	\$	(4)
Foreign exchange	\$	-	\$	-	\$	(240)	\$	234	\$	-	\$	-

⁽¹⁾ 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 \$9 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.

⁽²⁾ 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 contain triggering events upon which the Corporation is required to provide the applicable credit card processor with cash deposits. The obligations 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 2018, the Corporation made no cash deposits under these agreements (nil in 2017).

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 including discounted cash flows, taking into account market information and traded values 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 unobservable inputs (Level 3 in the fair value hierarchy), the estimated fair value of debt and finance leases approximates its carrying value.

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

			Fair value measurements at reporting date usin										
Recurring measurements	Dec	ember 31, 2018	m ide	oted prices in active arkets for ntical assets (Level 1)		nificant other observable outs (Level 2)	un	Significant nobservable uts (Level 3)					
Financial Assets													
Held-for-trading securities													
Cash equivalents	\$	39	\$	-	\$	39	\$	-					
Short-term investments		4,077		-		4,077		-					
Derivative instruments													
Share forward contracts		43		-		43		-					
Foreign exchange derivatives		24		-		24		-					
Total	\$	4,183	\$	-	\$	4,183	\$	-					
Financial Liabilities													
Derivative instruments													
Foreign exchange derivatives		57		-		57		-					
Total	\$	57	\$	-	\$	57	\$	-					

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 2018.



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 \$70 as at December 31, 2018 (\$75 as at December 31, 2017). 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, 2018 and 2017, 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.

		Amo	ounts offs	_	unts not offset	Net		
Financial assets	Gross assets	liabilities		Net amounts presented		Financial instruments		
December 31, 2018								
Derivative assets	\$ 93	\$	(69)	\$	24	\$	43	\$ 67
Accounts receivable	113		(47)		66		-	66
	\$ 206	\$	(116)	\$	90	\$	43	\$ 133
December 31, 2017								
Derivative assets	\$ -	\$	-	\$	-	\$	54	\$ 54
Accounts receivable	114		(48)		66		-	66
	\$ 114	\$	(48)	\$	66	\$	54	\$ 120

		Am	ounts offs		ounts not offset	Net		
Financial liabilities	Gross abilities	Gross assets offset		Net amounts presented		Financial instruments		
December 31, 2018								
Derivative liabilities	\$ 317	\$	(260)	\$	57	\$	-	\$ 57
	\$ 317	\$	(260)	\$	57	\$	-	\$ 57
December 31, 2017								
Derivative liabilities	\$ 286	\$	(71)	\$	215	\$	-	\$ 215
	\$ 286	\$	(71)	\$	215	\$	-	\$ 215



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, among others investigated alleged anti-competitive cargo pricing activities, including the levying of certain fuel surcharges, of a number of airlines and cargo operators. The investigations conducted by the U.S. Department of Justice and by the Competition Bureau in Canada concluded with no proceedings against Air Canada.

After having rendered a decision against a number of airlines, including Air Canada in 2010, which was overturned by the European General Court in December 2015, in March 2017, the European Commission rendered another decision finding that 12 air cargo carriers, including Air Canada, had infringed European Union competition law in the setting of certain cargo charges and rates for various periods between 1999 and 2006, imposing a fine of 21 Euros (approximately \$29) on Air Canada. Air Canada paid the fine as required in the second quarter of 2017, pending the outcome of an appeal to the European General Court. While Air Canada cannot predict with certainty the outcome of its appeal or any related proceedings, Air Canada believes it has reasonable grounds to challenge the European Commission's ruling.

Air Canada is also named as a defendant or is otherwise involved in a number of class action lawsuits and other proceedings in Canada, Europe and the United States in connection with these allegations. The class action proceeding in the United States were settled by Air Canada in 2012, and certain third-party proceedings in the United Kingdom relating to the same allegations were settled in 2018.

As at December 31, 2018, Air Canada has a provision of \$17 (\$17 as at December 31, 2017) relating to outstanding claims in these matters, which is recorded in Accounts payable and accrued liabilities. This provision is an estimate based upon the status of investigations and proceedings at this time and Air Canada's assessment as to the potential outcome for certain of them. The provision does not address the proceedings and investigations in all jurisdictions, but only where there is sufficient information to do so. Air Canada has determined it is not possible at this time to predict with any degree of certainty the outcome of all 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-ACPA 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 three aircraft de-icing service facilities, 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 \$571 as at December 31, 2018 (December 31, 2017 - \$529), 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, 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, and the book value of Shareholders' equity less excess cash not required to run its core business operations. The Corporation uses Advance ticket sales as a proxy for the minimum cash required for ongoing core business operations. Previously, the Corporation used the market value of its outstanding shares in the calculation of total capital. Following a significant increase in the book value of its equity, the Corporation decided to change its methodology to use book value. 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.

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 targeted leverage ratios determined by management to be prudent;
- To ensure capital allocation decisions generate sufficient returns and to assess the efficiency with which the Corporation allocates its capital to generate returns.
- 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 or amount of capital utilized, including purchase versus debt financing versus lease decisions, defer or cancel aircraft expenditures by not exercising available options or selling aircraft options, redeeming or issuing debt securities, issuing equity securities, and repurchasing outstanding shares, all subject to market conditions and the terms of the underlying agreements (or any consents required) or other legal restrictions.



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

	2018	2017
Long-term debt and finance leases	\$ 6,197	\$ 5,448
Current portion of long-term debt and finance leases	455	671
	6,652	6,119
Capitalized operating leases	3,913	3,801
Adjusted debt	10,565	9,920
Shareholders' equity, net of excess cash	2,043	2,087
Total Capital	\$ 12,608	\$ 12,007
Adjusted debt	\$ 10,565	\$ 9,920
Less Cash and cash equivalents and Short-term investments	(4,707)	(3,804)
Adjusted net debt	\$ 5,858	\$ 6,116



18. REVENUE

Disaggregation of revenue

The Corporation disaggregates revenue from contracts with customers according to the nature of the air transportation services. The nature of services is presented as passenger, cargo and other revenue on its consolidated statement of operations. The Corporation further disaggregates air transportation service revenue according to geographic market segments.

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	2018	2017 Restated - Note 2
Canada	\$ 4,894	\$ 4,637
U.S. Transborder	3,504	3,195
Atlantic	4,237	3,539
Pacific	2,430	2,195
Other	1,158	1,027
	\$ 16,223	\$ 14,593

Cargo Revenues	2018	2017 Restated - Note 2
Canada	\$ 95	\$ 84
U.S. Transborder	43	39
Atlantic	278	245
Pacific	325	280
Other	62	60
	\$ 803	\$ 708

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, India, the Middle East and North Africa. 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 Central and South America and the Caribbean and Mexico.

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, buy on board and related passenger ancillary services and charges, and other airline-related services.

Contract balances

The following table provides information about receivables, contract assets, and contract liabilities from contracts with customers.

	December 31, 2018	December 31, 2017 Restated - Note 2	January 1, 2017 Restated - Note 2
Receivables, which are included in Accounts receivable	\$ 575	\$ 587	\$ 540
Contract costs which are included in Prepaid expenses and other current assets	115	100	98
Contract liabilities – Advance ticket sales	2,717	2,469	2,119



Receivables include passenger, cargo and other receivables from contracts with customers. The Corporation sells passenger ticket and related ancillary services via cash, credit card or other card-based forms of payment with payment generally collected in advance of the performance of related transportation services. Passenger ticket and ancillary receivables are amounts due from other airlines for interline travel, travel agency payment processing intermediaries or credit card processors associated with sales for future travel and are included in Accounts receivable on the consolidated statement of financial position. Cargo and other accounts receivable relate to amounts owing from customers, including from freight forwarders and interline partners for cargo and other services provided.

Contract costs include credit card fees, commissions and global distribution system charges on passenger tickets. These costs are capitalized at time of sale and expensed at the time of passenger revenue recognition.

Airline passenger advance sales and the ground portion of vacation packages are deferred and included in Current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan. The deferred revenue is recognized when the related flight occurs or over the period of the vacation. The Corporation performs regular evaluations on the advance ticket sales liability. The Corporation records an estimate of breakage revenue for tickets that will expire unused. These estimates are based on historical experience.

Depending on the fare class, passengers may exchange their tickets up to the time of the flight or obtain a refund, generally in exchange for the payment of a fee. For non-refundable tickets that remain unused at the time of flight, the Corporation recognizes the full amount into revenue at time when transportation was to be provided. For refundable tickets that remain unused at the time of the flight, the Corporation recognizes the net revenue as they expire after any refund amount is issued to the passenger.

The practical expedient in IFRS 15 allows entities not to disclose the amount of the remaining transaction prices and its expected timing of recognition for performance obligations if the contract has an original expected duration of one year or less. The Corporation elects to use this practical expedient for the passenger travel performance obligation as passenger tickets expire within a year if unused.

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:

	2018	2017
Capacity purchase fees	\$ 1,333	\$ 1,267
Aircraft fuel	531	412
Airport and navigation fees	296	293
Sales and distribution costs	153	146
Other operating expenses	529	499
Regional airlines expense	\$ 2,842	\$ 2,617



20. SPECIAL ITEMS

In 2017, the Corporation recorded \$30 related to cargo investigations, as described in Note 16, and paid the fine to the European Commission as required, pending the outcome of its appeal.

21. SALE-LEASEBACK

In 2018, the Corporation entered into a sale and leaseback arrangement for 25 Embraer 190 aircraft for net proceeds of \$293, which resulted in the recognition of a loss on disposal of \$188. The aircraft will continue to be operated under leases entered into under such sale-leaseback agreement until they fully exit the fleet progressively through 2019 and 2020, in line with the Corporation's current fleet plans. The leases are accounted for as operating leases.

During 2017, the Corporation took delivery of four 787 aircraft that were financed under sale-leaseback transactions with proceeds of \$740. The sales were at fair value and accordingly the resulting gain on sale of \$52 was recognized in non-operating income. The leases are accounted for as operating leases with 12 year terms, paid monthly.

22. RELATED PARTY TRANSACTIONS

Compensation of Key Management

Key management includes Air Canada's Board of Directors, President and Chief Executive Officer, Deputy Chief Executive Officer and Chief Financial Officer, and Executive Vice-President and Chief Commercial Officer. The President, Passenger Airlines is also included in the 2017 period. Amounts reported are based upon the expense as reported in the consolidated financial statements. Compensation to key management is summarized as follows:

	2018		2017	
Salaries and other benefits	\$	8	\$	11
Pension and post-employment benefits		1		5
Share-based compensation		10		18
	\$	19	\$	34



23. SUBSEQUENT EVENTS

Acquisition of Aimia's Aeroplan Loyalty Business

On January 10, 2019, Air Canada completed the closing of its purchase of Aimia Canada Inc., owner and operator of the Aeroplan loyalty business, from Aimia Inc. The aggregate purchase price for the acquisition consisted of \$450 in cash plus \$47 in cash for pre-closing adjustments. The purchase price is subject to post-closing adjustments and the acquisition also includes the assumption of the Aeroplan Miles liability. Air Canada received payments from The Toronto-Dominion Bank ("TD") and Canadian Imperial Bank of Commerce ("CIBC") in the aggregate amount of \$822. Visa Canada Corporation ("Visa") also made a payment to Air Canada and assuming completion of the Amex Bank of Canada ("AMEX") agreement referred to below, AMEX will do likewise.

Concurrently with the conclusion of the Aeroplan purchase, Air Canada, TD, CIBC, and Visa finalized various commercial agreements relating to and in support of the acquisition, including credit card loyalty program and network agreements for future participation in Air Canada's new loyalty program. In addition, TD and CIBC made payments to Aimia Canada Inc., now Air Canada's subsidiary, in the aggregate amount of \$400 as prepayments to be applied towards future monthly payments in respect of Aeroplan Miles. Air Canada also has entered into an agreement in principle with AMEX, which also issues Aeroplan co-branded products, to secure its continued participation in Air Canada's loyalty program after 2020. Following the closing of the acquisition, Aimia Canada Inc. changed its name to Aeroplan Inc.

Air Canada, as the acquirer, will perform business combination accounting as of the acquisition date, which generally requires that the acquirer measure the identifiable assets acquired and liabilities assumed at their fair values, subject to certain exceptions. The Corporation is evaluating the impact of the business combination accounting requirements, which results will be reported on in Air Canada's interim unaudited condensed consolidated financial statements and notes for the first quarter of 2019.

Capacity Purchase Agreement with Jazz and Equity Investment in Chorus

In February 2019, Air Canada concluded an agreement to amend and extend its capacity purchase agreement ("CPA") with Jazz, a wholly-owned subsidiary of Chorus Aviation Inc. The amendments provide an extension of the CPA term by ten years from January 1, 2026 to December 31, 2035. The amendments include various minimum levels of covered aircraft at different points in time, providing Air Canada the flexibility to optimize its fleet within its network strategy. The amendments became effective retroactively as at January 1, 2019.

Concurrently with the CPA amendments, Air Canada subscribed for 15,561,600 class B voting shares in the capital of Chorus, representing, at time of issuance, approximately 9.99% of the issued and outstanding class A variable voting shares and class B voting shares of Chorus on a combined basis. This represents an investment of \$97 by Air Canada. The Chorus shares were issued to Air Canada at a price of \$6.25 per share, representing a 5% premium to the five-day volume weighted average price of the shares as of the close of trading on January 10, 2019. Air Canada and Chorus entered into an investor rights agreement under which, among other things, Air Canada will hold the investment shares for a period of at least 60 months, subject to certain limited exceptions.