



Second Quarter 2016

INTERIM UNAUDITED

Condensed Consolidated
Financial Statements and Notes

July 29, 2016



CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Unaudited (Canadian dollars in millions)	June 30, 2016	December 31, 2015
ASSETS		
Current		
Cash and cash equivalents	\$ 882	\$ 572
Short-term investments	2,266	2,100
Total cash, cash equivalents and short-term investments	3,148	2,672
Restricted cash	55	91
Accounts receivable	815	654
Promissory notes receivable	50	143
Aircraft fuel inventory	68	68
Spare parts and supplies inventory	102	114
Prepaid expenses and other current assets	216	383
Total current assets	4,454	4,125
Property and equipment	8,611	7,030
Pension	402	851
Intangible assets	311	314
Goodwill	311	311
Deposits and other assets	450	496
Total assets	\$ 14,539	\$ 13,127
LIABILITIES		
Current		
Accounts payable and accrued liabilities	\$ 1,705	\$ 1,487
Advance ticket sales	2,696	1,818
Current portion of long-term debt and finance leases Note 3	549	524
Total current liabilities	4,950	3,829
Long-term debt and finance leases Note 3	6,401	5,870
Pension and other benefit liabilities	2,795	2,245
Maintenance provisions	845	892
Other long-term liabilities	221	251
Total liabilities	\$ 15,212	\$ 13,087
EQUITY		
Shareholders' equity		
Share capital	806	825
Contributed surplus	78	76
Hedging reserve	10	(11)
Deficit	(1,567)	(877)
Total shareholders' equity	(673)	13
Non-controlling interests	-	27
Total equity	(673)	40
Total liabilities and equity	\$ 14,539	\$ 13,127

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

CONSOLIDATED STATEMENT OF OPERATIONS

Unaudited (Canadian dollars in millions except per share figures)	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Operating revenues				
Passenger	\$ 3,143	\$ 3,082	\$ 6,007	\$ 5,868
Cargo	111	123	227	252
Other	204	209	567	543
Total revenues	3,458	3,414	6,801	6,663
Operating expenses				
Aircraft fuel	527	648	973	1,240
Regional airlines expense	578	594	1,147	1,146
Wages, salaries and benefits Note 4	611	568	1,219	1,136
Airport and navigation fees	211	201	409	386
Aircraft maintenance	239	190	456	378
Depreciation, amortization and impairment	202	177	384	330
Sales and distribution costs	170	152	352	306
Ground package costs	85	84	316	265
Aircraft rent	112	84	224	166
Food, beverages and supplies	86	80	163	142
Communications and information technology	59	52	126	109
Special items Note 9	-	(23)	-	(23)
Other	301	284	601	559
Total operating expenses	3,181	3,091	6,370	6,140
Operating income	277	323	431	523
Non-operating income (expense)				
Foreign exchange gain (loss) Note 8	(17)	56	33	(352)
Interest income	13	12	23	21
Interest expense	(99)	(94)	(201)	(184)
Interest capitalized	15	21	38	30
Net financing expense relating to employee benefits Note 4	(17)	(25)	(35)	(50)
Gain (loss) on financial instruments recorded at fair value Note 8	(1)	5	(11)	6
Gain on sale and leaseback of assets Note 10	19	-	19	-
Other	(4)	(2)	(10)	(7)
Total non-operating expense	(91)	(27)	(144)	(536)
Income (loss) before income taxes	186	296	287	(13)
Income taxes	-	-	-	-
Net income (loss) for the period	\$ 186	\$ 296	\$ 287	\$ (13)
Net income (loss) attributable to:				
Shareholders of Air Canada	186	295	287	(15)
Non-controlling interests	-	1	-	2
	\$ 186	\$ 296	\$ 287	\$ (13)
Net income (loss) per share attributable to shareholders of Air Canada Note 6				
Basic earnings (loss) per share	\$ 0.67	\$ 1.03	\$ 1.03	\$ (0.06)
Diluted earnings (loss) per share	\$ 0.66	\$ 1.00	\$ 1.01	\$ (0.06)

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

Unaudited (Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Comprehensive income (loss)				
Net income (loss) for the period	\$ 186	\$ 296	\$ 287	\$ (13)
Other comprehensive income (loss), net of taxes of nil:				
Items that will not be reclassified to net income				
Remeasurements on employee benefit liabilities Note 4	(108)	542	(927)	790
Items that will be reclassified to net income				
Fuel derivatives designated as cash flow hedges, net Note 8	18	(1)	21	(1)
Total comprehensive income (loss)	\$ 96	\$ 837	\$ (619)	\$ 776
Comprehensive income (loss) attributable to:				
Shareholders of Air Canada	\$ 96	\$ 836	\$ (619)	\$ 774
Non-controlling interests	-	1	-	2
	\$ 96	\$ 837	\$ (619)	\$ 776

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Unaudited (Canadian dollars in millions)	Share capital	Contributed surplus	Hedging reserve	Deficit	Total shareholders' equity	Non-controlling interests	Total equity
January 1, 2015	\$ 835	\$ 77	\$ -	\$ (2,113)	\$ (1,201)	\$ 68	\$ (1,133)
Net income (loss)	-	-	-	(15)	(15)	2	(13)
Remeasurements on employee benefit liabilities	-	-	-	790	790	-	790
Fuel derivatives designated as cash flow hedges, net	-	-	(1)	-	(1)	-	(1)
Total comprehensive income	-	-	(1)	775	774	2	776
Share-based compensation	-	(1)	-	(22)	(23)	-	(23)
Shares issued	3	(1)	-	-	2	-	2
Shares purchased and cancelled under issuer bid	-	-	-	(1)	(1)	-	(1)
Distributions	-	-	-	-	-	(9)	(9)
June 30, 2015	\$ 838	\$ 75	\$ (1)	\$ (1,361)	\$ (449)	\$ 61	\$ (388)
January 1, 2016	\$ 825	\$ 76	\$ (11)	\$ (877)	\$ 13	\$ 27	\$ 40
Net income	-	-	-	287	287	-	287
Remeasurements on employee benefit liabilities	-	-	-	(927)	(927)	-	(927)
Fuel derivatives designated as cash flow hedges, net	-	-	21	-	21	-	21
Total comprehensive income (loss)	-	-	21	(640)	(619)	-	(619)
Share-based compensation	-	2	-	(12)	(10)	-	(10)
Shares issued	1	-	-	-	1	-	1
Shares purchased and cancelled under issuer bid	(20)	-	-	(38)	(58)	-	(58)
Distributions	-	-	-	-	-	(27)	(27)
June 30, 2016	\$ 806	\$ 78	\$ 10	\$ (1,567)	\$ (673)	\$ -	\$ (673)

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

CONSOLIDATED STATEMENT OF CASH FLOW

Unaudited (Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Cash flows from (used for)				
Operating				
Net income (loss) for the period	\$ 186	\$ 296	\$ 287	\$ (13)
Adjustments to reconcile to net cash from operations				
Depreciation, amortization and impairment	208	181	395	338
Foreign exchange loss (gain)	(34)	(48)	(111)	370
Gain on sale and leaseback of assets Note 10	(19)	-	(19)	-
Employee benefit funding less (greater) than expense Note 4	36	(13)	72	(23)
Financial instruments recorded at fair value Note 8	(7)	(15)	11	(17)
Change in maintenance provisions	39	9	75	2
Changes in non-cash working capital balances	250	132	906	706
Other	(2)	(30)	9	(41)
Net cash flows from operating activities	657	512	1,625	1,322
Financing				
Proceeds from borrowings	692	7	1,308	289
Reduction of long-term debt and finance lease obligations	(157)	(147)	(381)	(262)
Shares purchased for cancellation Note 5	(24)	(1)	(58)	(1)
Distributions related to aircraft special purpose leasing entities	-	-	(32)	(9)
Issue of common shares	-	2	-	3
Financing fees	(1)	(7)	(2)	(22)
Net cash flows from (used in) financing activities	510	(146)	835	(2)
Investing				
Short-term investments	(229)	(139)	(193)	(290)
Additions to property, equipment and intangible assets	(1,452)	(210)	(2,568)	(635)
Proceeds from sale of assets	150	9	294	10
Proceeds from sale-leaseback transactions Note 10	351	-	351	-
Other	(8)	19	(8)	16
Net cash flows used in investing activities	(1,188)	(321)	(2,124)	(899)
Effect of exchange rate changes on cash and cash equivalents	(5)	(3)	(26)	(5)
Increase (decrease) in cash and cash equivalents	(26)	42	310	416
Cash and cash equivalents, beginning of period	908	1,035	572	661
Cash and cash equivalents, end of period	\$ 882	\$ 1,077	\$ 882	\$ 1,077
Cash payments of interest Note 3	\$ 114	\$ 114	\$ 158	\$ 149
Cash payments of income taxes	\$ -	\$ -	\$ -	\$ -

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

Notes to the interim condensed consolidated financial statements (unaudited)
 (Canadian dollars in millions – except per share amounts and where otherwise noted)

1. GENERAL INFORMATION

The accompanying unaudited interim condensed consolidated financial statements (the “financial statements”) are of Air Canada (the “Corporation”). The term “Corporation” also refers to, as the context may require, Air Canada and/or one or more of its subsidiaries, including its principal wholly-owned operating subsidiaries, Touram Limited Partnership doing business under the brand name Air Canada Vacations® (“Air Canada Vacations”) and Air Canada Rouge LP doing business under the brand name Air Canada Rouge® (“Air Canada Rouge”). These financial statements also include certain aircraft leasing entities, which are consolidated under IFRS 10 Consolidated Financial Statements.

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

The Corporation historically experiences greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months. The Corporation has substantial fixed costs in its cost structure that do not meaningfully fluctuate with passenger demand in the short term.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation prepares its financial statements in accordance with generally accepted accounting principles in Canada ("GAAP") as set out in the CPA Canada Handbook – Accounting ("CPA Handbook") which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). These financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting". In accordance with GAAP, these financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the Corporation's annual consolidated financial statements for the year ended December 31, 2015. In management's opinion, the financial statements reflect all adjustments that are necessary for a fair presentation of the results for the interim period presented.

These financial statements were approved for issue by the Board of Directors of the Corporation on July 28, 2016.

These financial statements are based on the accounting policies consistent with those disclosed in Note 2 to the 2015 annual consolidated financial statements of the Corporation.

3. LONG-TERM DEBT AND FINANCE LEASES

	Final Maturity	Weighted Average Interest Rate (%)	June 30 2016	December 31 2015
Aircraft financing				
Fixed rate U.S. dollar financing	2017 – 2027	4.61	\$ 3,596	\$ 2,718
Floating rate U.S. dollar financing	2017 – 2026	1.81	487	573
Floating rate CDN dollar financing	2026 – 2027	1.55	382	398
Floating rate Japanese yen financing	2020	0.11	87	91
Senior secured notes – U.S. dollar	2019 – 2020	7.61	904	968
Senior secured notes – CDN dollar	2019	7.63	300	300
Senior unsecured notes – U.S. dollar	2021	7.75	517	554
Other secured financing – U.S. dollar	2018 – 2019	4.50	477	513
Other secured financing – CDN dollar	2018	8.15	20	45
Long-term debt		4.96	6,770	6,160
Finance lease obligations	2018 – 2033	9.63	285	330
Total debt and finance leases		5.14	7,055	6,490
Unamortized debt issuance costs			(105)	(96)
Current portion			(549)	(524)
Long-term debt and finance leases			\$ 6,401	\$ 5,870

The above table provides terms of instruments disclosed in Note 7 to the 2015 annual consolidated financial statements of the Corporation as well as terms of instruments concluded during the six months ended June 30, 2016 described below.

In connection with the acquisition of seven Boeing 787 aircraft and two Boeing 777 aircraft in the first six months of 2016, principal of US\$1,004 is included in fixed rate U.S. dollar financing in the table above. The acquisition of these aircraft was financed with proceeds from the sale of the enhanced equipment trust certificates that were issued through private offerings in 2015 as described in Note 7 to the 2015 annual consolidated financial statements of the Corporation.

During the second quarter of 2016, principal of US\$9 was prepaid relating to the financing of one Embraer 190 aircraft (principal of US\$49 was prepaid relating to the financing of six Embraer 190 aircraft for the six month period ended June 30, 2016). During the second quarter of 2016, an amount of \$1 (\$7 for the six month period ended June 30, 2016) is included in interest charges related to the prepayment of the fixed rate debt.

Maturity Analysis

Principal and interest repayment requirements as at June 30, 2016 on Long-term debt and finance lease obligations are as follows. U.S. dollar amounts are converted using the June 30, 2016 closing rate of CDN\$1.2917.

Principal	Remainder of 2016	2017	2018	2019	2020	Thereafter	Total
Long-term debt obligations	\$ 212	\$ 646	\$ 629	\$ 1,674	\$ 882	\$ 2,726	\$ 6,769
Finance lease obligations	18	40	48	45	48	87	286
	\$ 230	\$ 686	\$ 677	\$ 1,719	\$ 930	\$ 2,813	\$ 7,055

Interest	Remainder of 2016	2017	2018	2019	2020	Thereafter	Total
Long-term debt obligations	\$ 162	\$ 319	\$ 274	\$ 242	\$ 134	\$ 322	\$ 1,453
Finance lease obligations	13	23	19	14	10	24	103
	\$ 175	\$ 342	\$ 293	\$ 256	\$ 144	\$ 346	\$ 1,556

4. PENSIONS AND OTHER BENEFIT LIABILITIES

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

	Three Months Ended June 30		Six Months Ended June 30	
	2016	2015	2016	2015
Consolidated Statement of Operations				
Operating expenses				
Wages, salaries and benefits				
Pension benefits	\$ 62	\$ 65	\$ 124	\$ 129
Other employee benefits (a)	(6)	(13)	(2)	(9)
	\$ 56	\$ 52	\$ 122	\$ 120
Non-operating income (expense)				
Net financing expense relating to employee benefit liabilities				
Pension benefits	\$ (4)	\$ (12)	\$ (9)	\$ (25)
Other employee benefits	(13)	(13)	(26)	(25)
	\$ (17)	\$ (25)	\$ (35)	\$ (50)
Consolidated Other Comprehensive Income (Loss)				
Remeasurements on employee benefit liabilities				
Pension benefits	\$ (44)	\$ 478	\$ (805)	\$ 778
Other employee benefits	(64)	64	(122)	12
	\$ (108)	\$ 542	\$ (927)	\$ 790

(a) During the second quarter of 2016, a gain of \$10 was recorded on post-employment liabilities related to long-term disability benefits. During the second quarter of 2015, as a result of a plan amendment which included a reduction in post-retirement benefits for both current and future retirees and increased member contributions towards the cost of the benefits, a benefit plan amendment credit of \$19 was recorded.

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

	Three Months Ended June 30		Six Months Ended June 30	
	2016	2015	2016	2015
Net defined pension and other future employee benefits expense recorded in the consolidated statement of operations				
Wages, salaries and benefits	\$ 56	\$ 52	\$ 122	\$ 120
Net financing expense relating to employee benefit liabilities	17	25	35	50
	\$ 73	\$ 77	\$ 157	\$ 170
Employee benefit funding by Air Canada				
Pension benefits	\$ 26	\$ 81	\$ 63	\$ 174
Other employee benefits	11	9	22	19
	\$ 37	\$ 90	\$ 85	\$ 193
Employee benefit funding less (greater) than expense	\$ 36	\$ (13)	\$ 72	\$ (23)

5. SHARE CAPITAL

Issuer Bid

As described in Note 11 to the 2015 annual consolidated financial statements, in 2015, the Corporation implemented a normal course issuer bid to purchase, for cancellation, up to 10 million Class B Voting Shares and Class A Variable Voting Shares of the Corporation ("Shares"). This maximum allotment was completed in the first quarter of 2016. In March 2016, the Board of Directors of the Corporation approved the purchase for cancellation of up to an additional 5 million Shares as part of and before the expiry of that normal course issuer bid on May 28, 2016.

In May 2016, the Board of Directors of the Corporation approved a new normal course issuer bid, authorizing, between May 30, 2016 and May 29, 2017, the purchase of up to 22,785,511 Shares, representing 10 percent of the public float as at May 16, 2016. This renewal followed the conclusion of the 2015 normal course issuer bid which expired May 28, 2016 and under which the Corporation purchased and cancelled a total of 11,300,000 Shares since May 29, 2015 for aggregate consideration of \$110.

In the second quarter of 2016, the Corporation purchased, for cancellation, 2,498,000 Shares at an average cost of \$9.51 per Share for aggregate consideration of \$24 (6,914,065 Shares at an average cost of \$8.41 per Share for aggregate consideration of \$58 for the six months ended June 30, 2016). The excess of the cost over the average book value of \$17 (\$38 for the six months ended June 30, 2016) was charged to the deficit. At June 30, 2016, a total of 22,187,511 Shares remain available for repurchase under the existing issuer bid.

6. EARNINGS PER SHARE

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

in millions, except per share amounts	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Numerator:				
Numerator for basic and diluted earnings per share:				
Net income (loss) attributable to shareholders of Air Canada	\$ 186	\$ 295	\$ 287	\$ (15)
Denominator:				
Weighted-average shares - basic	278	287	279	287
Effect of potential dilutive securities:				
Stock options	5	8	5	8
Total potential dilutive securities	5	8	5	8
Remove anti-dilutive impact	-	-	-	(8)
Adjusted denominator for diluted earnings per share	283	295	284	287
Basic earnings (loss) per share	\$ 0.67	\$ 1.03	\$ 1.03	\$ (0.06)
Diluted earnings (loss) per share	\$ 0.66	\$ 1.00	\$ 1.01	\$ (0.06)

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 calculation of diluted earnings per share were outstanding options where the exercise prices were greater than the average market price of the shares for the period.

7. COMMITMENTS

Capital Commitments

In June 2016, Air Canada finalized a firm purchase agreement with Bombardier Inc. which includes a firm order for 45 Bombardier C Series CS300 aircraft and options for an additional 30 Bombardier C Series CS300 aircraft. Deliveries are scheduled to begin in late 2019 and extend to 2022.

Capital commitments consist of the future firm Boeing 787, Boeing 737 Max and Bombardier C Series aircraft deliveries and commitments related to acquisition of other property and equipment. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at June 30, 2016. U.S. dollar amounts are converted using the June 30, 2016 closing rate of CDN\$1.2917. Minimum future commitments under these contractual arrangements are shown below.

	Remainder of 2016	2017	2018	2019	2020	Thereafter	Total
Capital commitments	\$ 275	\$ 1,923	\$ 1,675	\$ 1,324	\$ 1,381	\$ 1,604	\$ 8,182

8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Refer also to Note 15 to the 2015 annual consolidated financial statements for information on the Corporation's risk management strategy.

Summary of gain (loss) on financial instruments recorded at fair value

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Fuel derivatives	\$ -	\$ -	\$ -	\$ (4)
Share forward contracts	(1)	5	(6)	9
Prepayment option on senior secured notes	-	-	(5)	-
Interest rate swaps	-	-	-	1
Gain (loss) on financial instruments recorded at fair value	\$ (1)	\$ 5	\$ (11)	\$ 6

Fuel Price Risk Management

During the second quarter of 2016:

- In the second quarter of 2016, hedging gains on the settlement of fuel derivatives offset the associated premium costs, with a net hedging gain of nil reclassified from other comprehensive income to Aircraft fuel expense (\$10 loss for the six months ended June 30, 2016; in 2015, loss of nil and \$4 recorded in Gain (loss) on financial instruments recorded at fair value related to fuel derivatives not designated as hedges for accounting purposes for the three and six month periods ended June 30, 2015, respectively).
- The Corporation purchased crude-oil call options covering a portion of 2016 fuel exposure. The cash premium related to these contracts was \$10 (\$24 for the six months ended June 30, 2016; \$9 and \$17 respectively for the three and six month periods ended June 30, 2015, respectively, for 2015 exposures).
- Fuel derivative contracts cash settled at \$12 in favour of the Corporation (\$12 for the six months ended June 30, 2016; \$1 and \$1 in favour of the Corporation, respectively, for the three and six month periods ended June 30, 2015).

As of June 30, 2016, approximately 40% of the Corporation's anticipated purchases of jet fuel for the remainder of 2016 are hedged at an average West Texas Intermediate ("WTI") equivalent capped price of US\$48 per barrel for WTI prices up to US\$51 per barrel and an average equivalent capped price of US\$53 per barrel for WTI prices above US\$51 per barrel. The Corporation's contracts to hedge anticipated jet fuel purchases over the remainder of 2016 are comprised of call options with notional volumes of 6,471,000 barrels. The fair value of the fuel derivatives portfolio at June 30, 2016 is \$35 in favour of the Corporation (\$10 in favour of the Corporation as at December 31, 2015) and is recorded within Prepaid expenses and other current assets.

A summary of amounts related to fuel derivatives designated as hedging instruments at June 30, 2016 is presented below.

	Carrying amount of the hedging instrument			Consolidated statement of financial position classification	Changes in fair value used for calculating hedge ineffectiveness
	Nominal amount of the hedging instrument (in barrels)	Assets	Liabilities		
Cash flow hedge					
Fuel price risk – option contracts	6,471,000	\$ 35	\$ -	Prepaid expenses and other current assets	\$ -

Foreign Exchange Risk Management

Based on the notional amount of currency derivatives outstanding at June 30, 2016, as further described below, approximately 76% of net U.S. cash outflows are hedged for the remainder of 2016 and 54% for 2017, resulting in derivative coverage of 62% over the next 18 months. Operational U.S. dollar cash and investment reserves combined with derivative coverage results in 69% coverage.

As at June 30, 2016, the Corporation had outstanding foreign currency options and swap agreements, settling in 2016 and 2017, to purchase at maturity \$2,832 (US\$2,192) of U.S. dollars at a weighted average rate of \$1.3054 per US\$1.00. (as at December 31, 2015 – \$3,234 (US\$2,337) with settlements in 2016 and 2017 at a weighted average rate of \$1.2683 per \$1.00 U.S. dollar). The Corporation also has protection in place to sell a portion of its excess Euros, YUAN, YEN and AUD (EUR €14, CNY ¥117, JPY ¥8,618 and AUD \$23) which settle in 2016 and 2017 at weighted average rates of €1.1185, ¥0.1534, ¥0.0084, and \$0.7362 per \$1.00 U.S. dollar respectively (as at December 31, 2015 - EUR €42, GBP £9, JPY ¥2,052, CNY ¥288, and AUD \$18 with settlement in 2016 at weighted average rates of €1.1663, £1.6150, ¥0.0088, ¥0.1562 and \$0.7230 respectively per \$1.00 U.S. dollar). Based on the assumed volatility used in the fair value calculation, the net fair value of these foreign currency contracts as at June 30, 2016 was \$187 in favour of the counterparties (as at December 31, 2015 – \$89 in favour of the Corporation). These derivative instruments have not been designated as hedges for accounting purposes and are recorded at fair value. During the second quarter of 2016, a loss of \$39 was recorded in Foreign exchange gain (loss) related to these derivatives (\$303 loss for the six month period ended June 30, 2016; \$13 loss and \$41 gain for the three and six month periods ended June 30, 2015). In the second quarter of 2016, foreign exchange derivative contracts cash settled with a net fair value of \$29 in favour of the counterparties (\$27 for the six month period ended June 30, 2016 in favour of the counterparties; \$9 and \$60 for the three and six month periods ended June 30, 2015 in favour of the Corporation). The total combined loss, related to U.S. cash, investments and foreign derivatives recorded by the Corporation in the second quarter of 2016 was \$45 (\$356 loss for the six month period ended June 30, 2016; \$25 loss and \$100 gain for the three and six month periods ended June 30, 2015).

The Corporation also holds U.S. 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 June 30, 2016 amounted to \$958 (US\$741) (\$490 (US\$358) as at December 31, 2015). During the second quarter of 2016, a loss of \$6 (\$53 loss for the six month period ended June 30, 2016; \$12 loss and \$59 gain for the three and six month periods ended June 30, 2015) 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.

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. The carrying amounts of derivatives are equal to their fair value, which is based on the amount at which they could be settled based on estimated market rates at June 30, 2016.

Based on significant observable inputs (Level 2 in the fair value hierarchy), the estimated fair value of debt and finance leases is \$7,039 compared to its carrying value of \$6,950.

The 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. There are no changes in classifications or methods of measuring fair value from those disclosed in Note 15 to the 2015 annual consolidated financial statements. There were no transfers within the fair value hierarchy during the three months ended June 30, 2016.

		Fair value measurements at reporting date using:		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	June 30, 2016			
Financial Assets				
Held-for-trading securities				
Cash equivalents	\$ 207	\$ -	\$ 207	\$ -
Short-term investments	2,266	-	2,266	-
Deposits and other assets				
Prepayment option on senior secured notes	-	-	-	-
Derivative instruments				
Fuel derivatives	35	-	35	-
Share forward contracts	27	-	27	-
Foreign exchange derivatives	3	-	3	-
Total	2,538	-	2,538	-
Financial Liabilities				
Derivative instruments				
Foreign exchange derivatives	190	-	190	-
Total	\$ 190	\$ -	\$ 190	\$ -

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. In measuring the fair value of the prepayment option on the Senior Notes issued in 2013, which is categorized as Level 3 in the fair value hierarchy, the Corporation takes into account various factors including the prepayment terms in the notes, market rates of interest, the conditions in credit markets and the estimated credit margin applicable to the Corporation at June 30, 2016. The fair value of the prepayment option is nil (\$5 as at December 31, 2015).

9. SPECIAL ITEMS

In the second quarter of 2015, the Corporation recorded a special item of \$23 related to a tax-related provision adjustment.

10. SALE-LEASEBACK

In the second quarter of 2016, the Corporation took delivery of two 787 aircraft that were financed under sale-leaseback transactions with proceeds of \$351. The sales were at fair value and accordingly the resulting gain on sale of \$19 was recognized in non-operating income. The leases are accounted for as operating leases with 12 year terms, paid monthly.