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Report to the Congress; by Elmer B. Staats, Comptroller General.

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Authority: Budget and Impoundment Control Act (P.L. 93-344). 2 Canal Zone Code, sec. 412(b). 2 Canal Zone Code, sec. 62.

The Panama Canal Treaty terminates all prior agreements between the United States and the Republic of Panama for the operation of the Panama Canal. When the treaty comes into force about October 1, 1979, the present organization consisting of the Panama Canal Company and the Canal Zone Government, now responsible for administering the Canal, will be superseded by a Panama Canal Commission supervised by a Board of U.S. and Panamanian nationals. Implementing U.S. legislation, subsequent to the new treaty, is still under development, and there are uncertainities as to the full financial impact that the treaty could have on the Canal organization. The financial statements have been prepared under the assumption that the Canal organization will continue to operate without material change in the scope of its operations. Findings/Conclusions: Subject to uncertainities relating to the implementation of the 1977 Panama Canal Treaty, the financial statements of the Panama Canal Company and the Canal Zone Government present fairly their respective financial positions at September 30, 1977 (FY 1977), September 30, 1976 (transition quarter), and June 30, 1976 (FY 1976), and the results of their respective operations, changes in the investment of the United States, and changes in the financial positions for the fiscal periods then ended, in conformity with generally accepted accounting principles which, except for specific noted exceptions, have been applied on a consistent basis. (Author/SC)

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

8511

Examination Of The Financial Statements Of The Panama Canal Company And The Canal Zone Government For Fiscal Periods 1977, Transition Quarter, And 1976

The Panama Canal Treaty terminates all prior agreements between the United States and the Republic of Panama for the operation of the Panama Canal. Signed on September 7, 1977, the Treaty comes into force about October 1, 1979. The present organization--the Panama Canal Company and Canal Zone Government, the agencies responsible for administering the Canal--then will be superseded by a Panama Canal Commission supervised by a Board of U.S. and Panamanian nationals.

Implementing U.S. legislation, subsequent to the new Treaty, still is under development and there are uncertainties as to the full financial effect that the Treaty could have on the Canal organization.

The financial statements have been prepared under the assumption that the Canal organization will continue without material change in the scope of its operations.

UNITED STATES GENERAL ACCOUNTING OFFICE

ID-78-61
NOVEMBER 30, 1978

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114839

To the President of the Senate and the
Speaker of the House of Representatives

Pursuant to the Government Corporation Control Act (31 U.S.C. 841), we have examined the financial statements of the Panama Canal Company for the fiscal periods ended September 30, 1977, September 30, 1976, and June 30, 1976. We also examined the Canal Zone Government's financial statements for the fiscal periods ended September 30, 1977, September 30, 1976, and June 30, 1976, because the Company and the Government are closely related in terms of purpose and organization and because the Company is required by law to absorb the net cost of the Canal Zone Government.

Chapter 3 of the report highlights the treaty impact on Canal operating costs.

We are sending copies of this report to the Director, Office of Management and Budget; Secretary of the Army; and President of the Panama Canal Company.

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

FINANCIAL STATEMENTS OF THE PANAMA CANAL COMPANY AND THE CANAL ZONE GOVERNMENT FOR FISCAL PERIODS 1977, TRANSITION QUARTER, AND 1976

DIGEST

For a clear understanding of GAO's assessment of the financial statements of the Panama Canal Company and the Canal Zone Government--the interrelated U.S. agencies charged with administering the Canal--this summary begins with definitions and recent development.

The Company

--transits ships through the Canal,

--provides services to shipping interests,

--maintains and operates the locks,

--provides support services, and

--carries out various administrative functions for the Canal Zone Government.

The Canal Zone Government operates and administers a variety of services, such as

--education,

--health,

--sanitation,

--protection, and

--postal (in the Canal Zone).

On September 7, 1977, the United States and the Republic of Panama signed treaties to terminate all prior agreements for the operation of the Panama Canal and agreed to

Tear Sheet. Upon removal, the report cover date should be noted hereon.

ID-78-61

enter into a new relationship for its future operation. The Panama Canal Treaty and Permanent Neutrality and Operation Treaty were ratified by the U.S. Senate on April 18, 1978, and March 16, 1978, respectively. The Panama Canal Treaty dissolves the present Canal organization and creates a New Panama Canal Commission supervised by a Board composed of U.S. and Panamanian nationals. It is anticipated that the Commission will become effective on October 1, 1979.

U.S. legislation has been drafted to implement the treaties. Thus, financial statements have been prepared under the assumption that the Canal organization will continue to operate without material change in the scope of its operations. (See p. 10.)

The Canal operation is self-sustaining except for the cost of facilities acquired for national defense, interest on (1) interest capitalized during the construction of the Canal, and (2) U.S. investment in the Canal Zone Government, and some other costs. (See p. 10.)

As of September 30, 1977, the United States has recovered about \$1.2 billion of \$1.9 billion invested. Recovery of a part of the balance of \$753.1 million is precluded by congressional action. (See p. 12.)

The Company's Board of Directors approved a change in accounting policy and the Company exercised its legal right in fiscal year 1976 to defer payments to the U.S. Treasury for unearned costs included in operations. These costs amounted to \$9.3 million for fiscal periods 1976 and the transition quarter but were fully recovered and paid to the U.S. Treasury during fiscal years 1977 and 1978. (See p. 13.)

Another change in the method of accounting was to recognize the accrued liability for employees' leave on an actual basis in lieu of using estimates.

The Company's principal source of revenue comes from tolls collected. Vessel measurement rule changes, a toll rate increase, crude oil transits from Alaska, and expected modest increases in other transits have or will increase toll revenue. (See p. 15.)

Certain unaudited financial statements prepared by the Canal organization show the effect of inflation by restating historical dollars in terms of purchasing power at September 30, 1977. (See p. 17.)

GAO reviewed a Company-prepared study addressing the impact the Treaty will have on the cost of operating the Canal. Estimates show that operating costs will increase by $46 million in the first year and that, had there had been no Treaty, a profit of $9.3 million would have been realized in 1980. (See p. 19.)

In GAO's opinion, subject to uncertainties relating to the implementation of the 1977 Panama Canal Treaty, the Company's financial statements (schedules 1 through 5) present fairly its financial position at September 30, 1977 (FY 1977), September 30, 1976 (transition quarter), and June 30, 1976 (FY 1976), and the results of its operations, changes in the investment of the United States, and changes in financial position for the fiscal periods then ended, in conformity with generally accepted accounting principles which--except for the accounting policy changes described in note 3 to the financial statements with which GAO concurs--have been applied on a consistent basis. (See p. 25.)

In GAO's opinion, subject to uncertainties relating to the implementation of the 1977 Panama Canal Treaty, the Canal Zone Government's financial statements (schedules 6 through 13) present fairly its financial position at September 30, 1977 (FY 1977), September 30, 1976 (transition quarter), and June 30, 1976

(FY 1976), and the results of its operations and changes in the investment of the United States for the fiscal periods then ended, in conformity with the principles and standards of accounting prescribed by the Comptroller General which--except for the accounting policy change described in note 3 to the financial statements with which GAO concurs--have been applied on a consistent basis. (See p. 26.)

Contents

CHAPTER 1

INTRODUCTION

The Panama Canal enterprise consists of the Panama Canal Company and the Canal Zone Government, both U.S. Government agencies charged with maintaining and administering the Panama Canal. These agencies are closely interrelated in terms of purpose, organization, and operation.

The Company is a wholly owned U.S. Government corporation managed by a Board of Directors. The Canal Zone Government is administered by the Governor of the Canal Zone who is also president of the Company.

The Secretary of the Army, in an independent capacity, is the direct representative of the President of the United States as the sole stockholder of the Company and as supervisor of the administration of the Canal Zone Government. He also appoints the Company's Board of Directors. The Company was without a Board of Directors from April to September 1977, because, as is customary when a new U.S. President is elected, the previous board members submitted resignations effective April 1, 1977. The new board members appointed by the Secretary of the Army are listed in appendix I.

The Panama Canal Company transits ships through the Canal, provides services to shipping interests, maintains and operates the locks, and provides support services. Support services include vessel repairs and operation of the harbor terminal, operation of a railroad, electric power system, communication system, and water system. It also provides services essential to employee welfare, such as operation and maintenance of rental housing, retail stores, and service and recreational facilities. In addition, under the terms of an interagency agreement, the Company administers the legal, personnel, and budget and accounting operations of the Canal Zone Government.

The Canal Zone Government operates, administers, and conducts a variety of functions associated with civil government, including education, health, sanitation, protection, and postal services in the Canal Zone. The accounting system of the Canal Zone Government was approved by the Comptroller General in June 1964.

The United States and the Republic of Panama, by treaties dated September 7, 1977, agreed to terminate prior treaties pertaining to the operation of the Panama Canal and to enter into a new relationship for operating the Canal. The new treaties, referred to as the Panama Canal Treaty and the Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal, were ratified by the Senate on April 18, 1978, and March 16, 1978, respectively, and set forth new terms and arrangements for managing, operating, maintaining, improving, protecting, and defending the Canal.

When the new Panama Canal Treaty enters into force, the current organization will be dissolved and a new U.S. agency, called the Panama Canal Commission, will be established. It will be supervised by a Board composed of nine members, five U.S. nationals and four Panamanian nationals. Until December 31, 1989, a U.S. national will act as Administrator of the Commission, with a Deputy Administrator from Panama. After that time, these positions will reverse. Chart 1 shows the Canal organization (the Company and the Government) and chart 2 the proposed Panama Canal Commission organization. The four photographs on the following pages were furnished by the Company and illustrate some of the functions or activities of the Canal organization.

FINANCING OF ACTIVITIES

As prescribed by law (2 C.Z.C. sections 62 and 412), the Company is expected to (1) recover all costs of operating and maintaining its facilities, including depreciation, (2) pay interest to the U.S. Treasury on the U.S. Government's net direct investment in the Company, and (3) reimburse the U.S. Treasury for (a) annuity payments to the Republic of Panama under the Convention of 1903, as later modified, and (b) the net costs of operating the Canal Zone Government, including depreciation on fixed assets. The Company returns any funds in excess of working and forseeable capital requirements to the U.S. Treasury as dividends.

The Canal organization is designed to be self-sustaining. The Panama Canal Company finances its operating and capital expenditures with revenue from transit tolls and support service operations. The Canal Zone Government, on the other hand, receives annual appropriations to finance its operating and capital expenditures. These are returned to the U.S. Treasury through (1) recovery of charges for services rendered by the Government and (2) payments by the Company for the net cost of the Government (i.e., operating cost, including depreciation and other non-fund expenses in excess of recoveries for services rendered).

Tolls from canal transits are the Company's major source of revenue. The toll rates are established by the Company subject to the approval of the U.S. President (2 C.Z.C. sections 411 and 412(a)). The basis of the toll rates is prescribed by section 412(b) of title 2 of the Canal Zone Code.

> "Tolls shall be prescribed at rates calculated to cover, as nearly as practicable, all costs of maintaining and operating the Panama Canal, together with the facilities and appurtenances related thereto, including interest and depreciation, and an appropriate share of the net costs of operation of the agency known as the Canal Zone Government."

Canal toll rates, initially established in 1914, remained the same through fiscal year 1974, except for a slight adjustment in 1938. Since 1974, the effective rate of toll increases has been about 43 percent, including the latest increase in November 1976 of 19.5 percent. Vessel measurement rules were also revised in 1976 and became effective in March of that year.

The effect of the November 1976 toll increase and rules changes on toll revenue is discussed further in chapter 2.

Chart 1

PANAMA CANAL COMPANY / CANAL ZONE GOVERNMENT

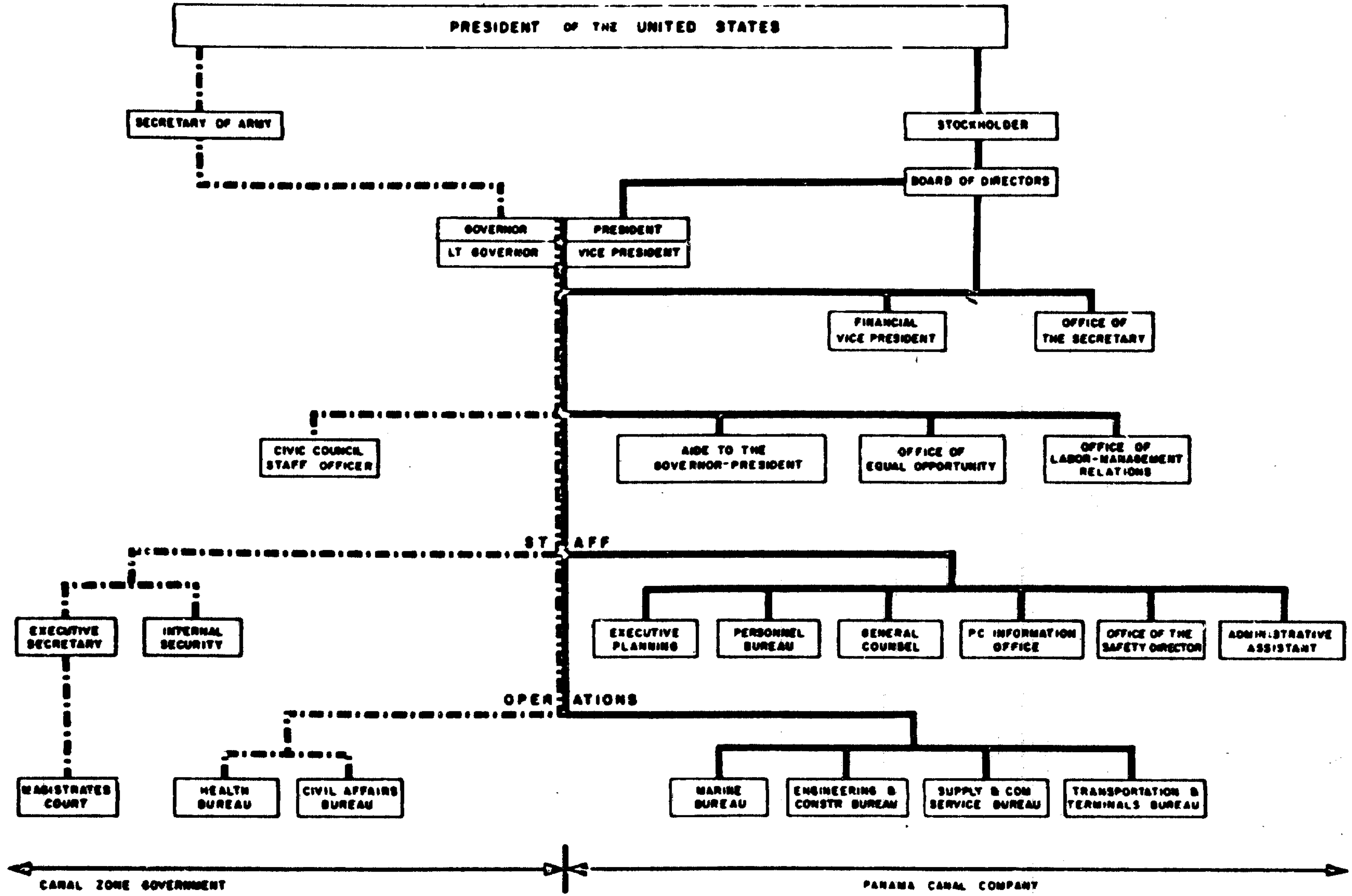
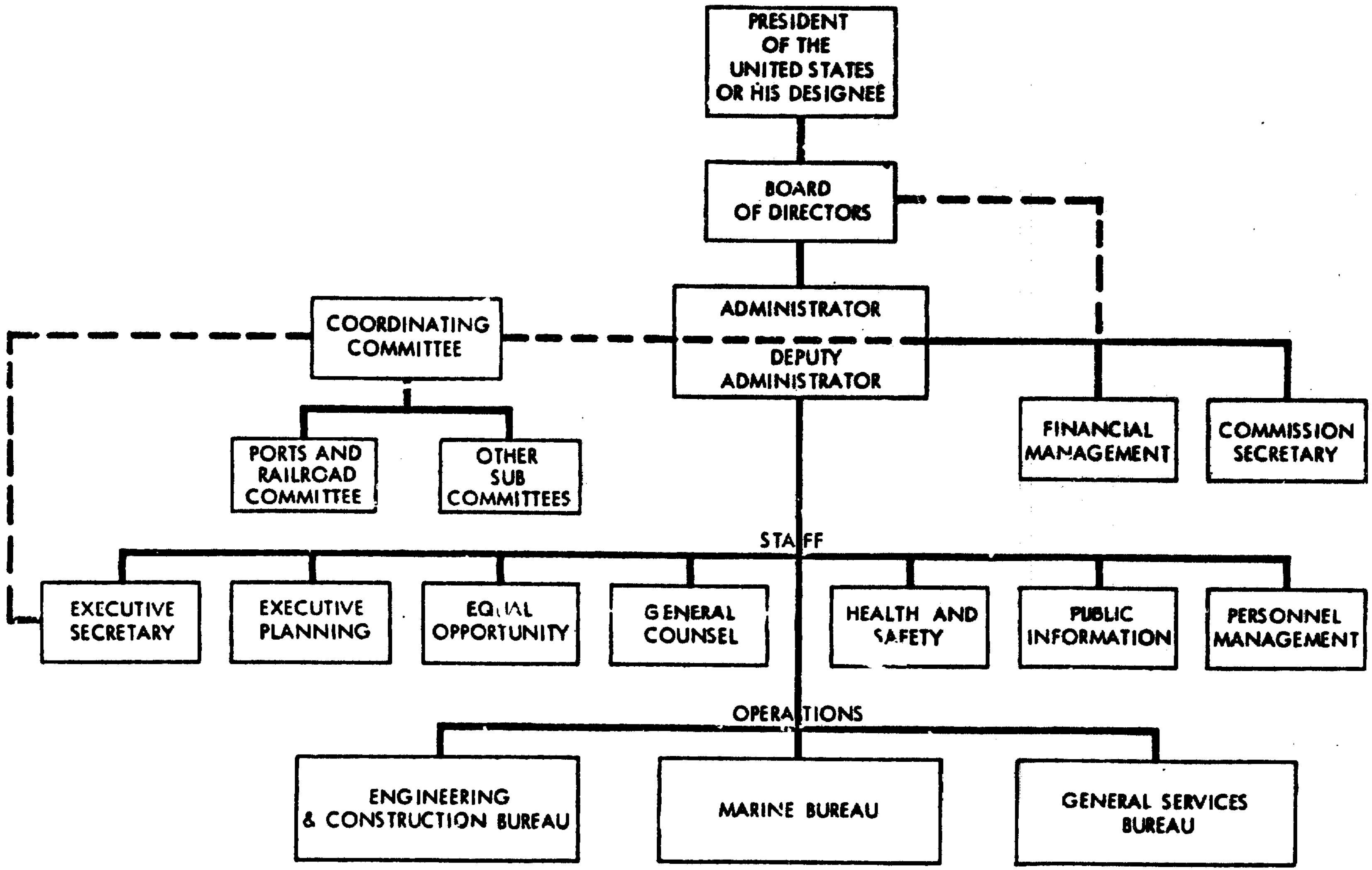
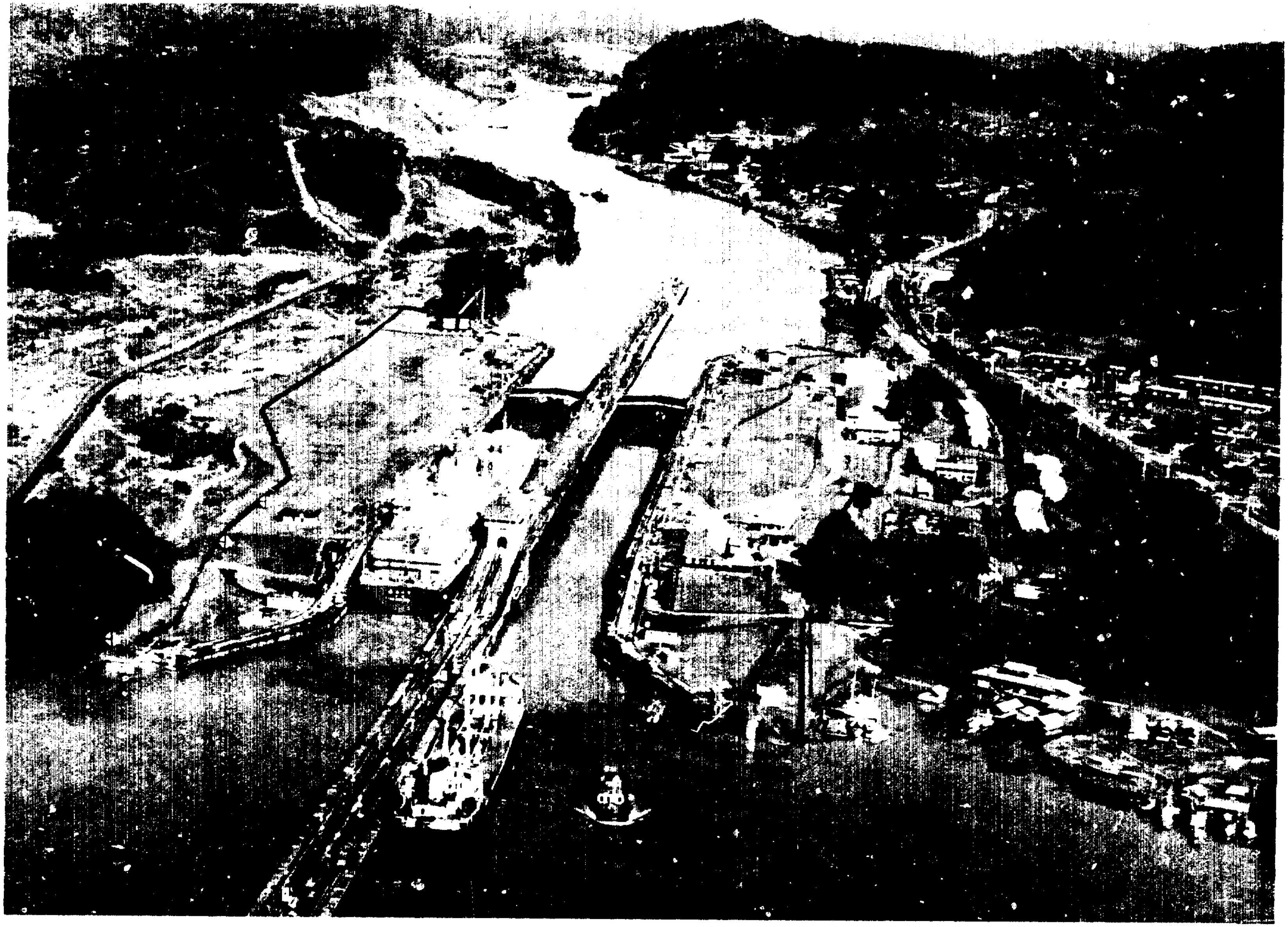


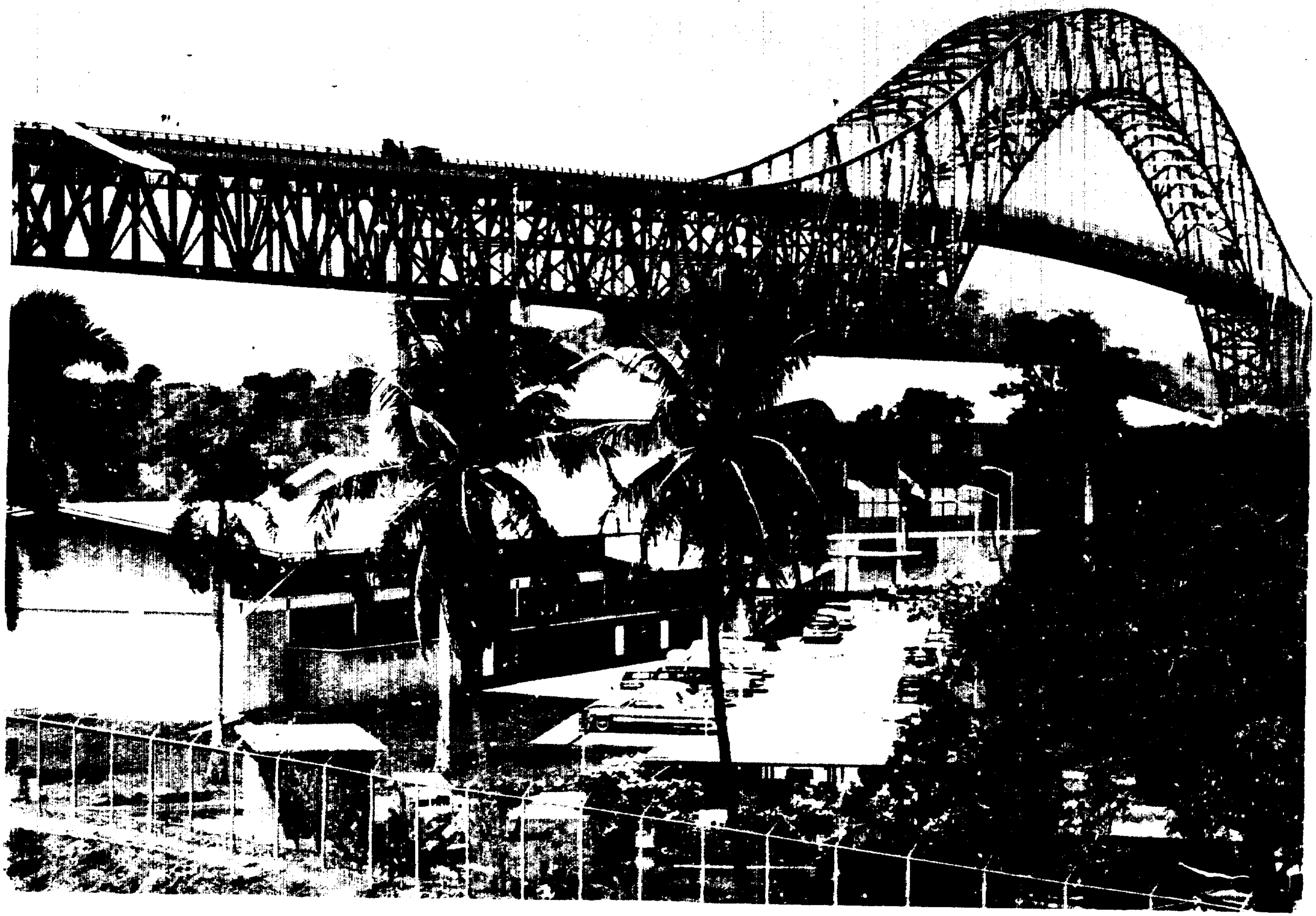
Chart 2

PROPOSED PANAMA CANAL COMMISSION

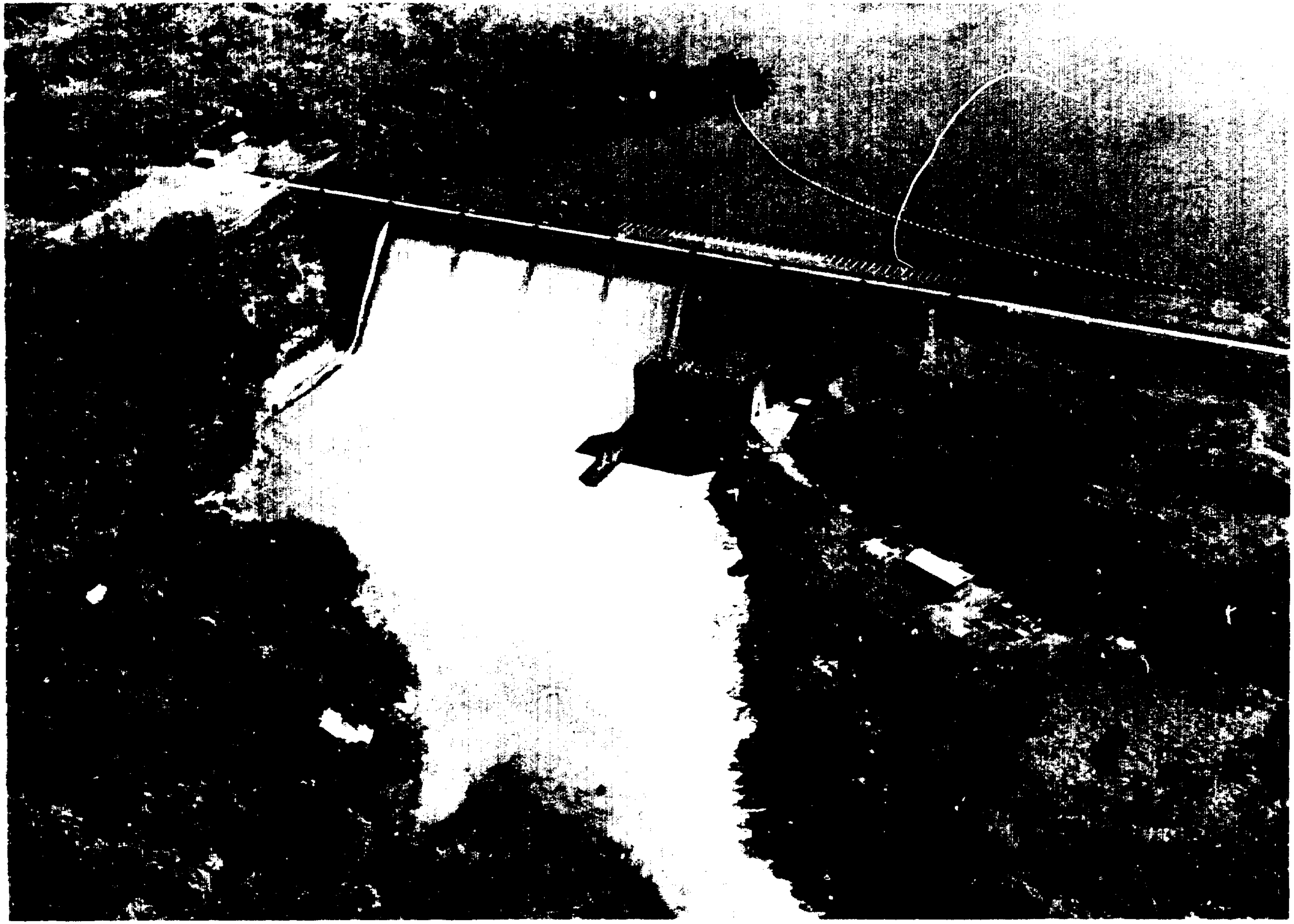




SHIP TRANSIT - PEDRO MIGUEL LOCKS WITH GAILLARD CUT IN THE BACKGROUND



EDUCATIONAL SERVICES - CANAL ZONE COLLEGE WITH THATCHER FERRY BRIDGE IN THE BACKGROUND



ELECTRICAL POWER - MADDEN DAM HYDROELECTRIC POWER STATION

HEALTH SERVICES - GORGAS HOSPITAL COMPLEX

CHAPTER 2

COMMENTS ON FINANCIAL STATEMENTS

UNCERTAINTIES THAT COULD AFFECT THE FINANCIAL STATEMENTS

The September 7, 1977, Treaties referred to as the Panama Canal Treaty and the Treaty concerning the Permanent Neutrality and Operation of the Panama Canal, were ratified by the Senate on April 18, 1978, and March 16, 1978, respectively. Legislation has been drafted to implement the Treaties and uncertainties still exist as to the full financial effect of the Treaties on the Canal organization. Thus, as stated in the Panama Canal Company's and the Canal Zone Government's financial statements (footnotes 12 and 11 respectively), the financial statements have been prepared as if the Canal organization would continue to operate without material change in the scope of its operations.

Chapter 3 further discusses the financial impact the Panama Canal Treaty may have upon Canal operations in the future.

COSTS EXCLUDED FROM THE COMPANY'S FINANCIAL STATEMENTS PURSUANT TO LAW

Legislation and related hearings indicate that the Canal organization is designed to be operationally self-sustaining and impose no burden on the U.S. taxpayer except for:

--The cost of facilities acquired for national defense.

--Interest on (1) interest capitalized during construction of the Canal and (2) the U.S. investment in the Canal Zone Government.

--Extraordinary expenditures on losses incurred through directives based on national policy and not related to the Company's operations.

The Company is not legally required to reimburse the U.S. Government for certain other costs incurred annually on behalf of the Canal organization. Comments on these costs, which totaled over $2.1 million in fiscal year 1977, are presented below.

Annuity to Republic of Panama

Article I of the 1955 treaty between the United States and the Republic of Panama increased the annual annuity payable to Panama from $430,000 to $1,930,000. It also required adjusting the annuity as the relationship between the U.S. dollar and gold changed; in accordance with this, the annuity was increased to $2,328,200 in fiscal year 1974 and has remained the same through fiscal year 1977.

The U.S. Treasury pays the annuity from appropriations received by the Department of State. However, title 2, section 62 (g) of the Canal Zone Code, requires the Company to reimburse the U.S. Treasury for the original annuity of $430,000 plus adjustments. Thus, the Company's portion of the annuity paid in both fiscal years 1976 and 1977 was $518,718; the remaining $1,809,482 was borne by the U.S. Government in each year. Total annuity payments from U.S. Government funds were more than $34.8 million through fiscal year 1977.

Recurring annuities and compensation payments to certain former employees

Construction annuities and injury and death compensations are paid annually to certain employees of predecessor agencies of the Canal organization. During fiscal year 1976, the transition quarter, and fiscal year 1977, these payments amounted to $902,987 and were made from funds provided by other U.S. Government agencies.

Construction annuities are paid by the U.S. Civil Service Commission to U.S. citizens (and their widows) who helped to construct the Canal between 1904 to 1914. These annuities are paid pursuant to the act of May 29, 1944 (58 Stat. 257), as amended.

The Company pays injury and death compensations to employees (and their dependents) of predecessor agencies of the Canal organization. It is reimbursed for these payments by the U.S. Department of Labor.

As shown below, payments totaled $58,263,164 through fiscal year 1977.

Period	Construction annuity	Injury and death compensation	Total
Through fiscal year 1975	$51,565,991	$5,794,185	$57,360,176
Fiscal year 1976	302,476	135,480	437,956
Transition quarter	62,962	34,354	97,316
Fiscal year 1977	226,647	141,069	367,716
Total	$52,158,076	$6,105,088	$58,263,164

EQUITY OF THE U.S. GOVERNMENT

As of September 30, 1977, the U.S. Government had invested $1,921 million 1/ to facilitate the operation of the Panama Canal as an international public utility. At the same time, it had recovered about $1,168 million 1/, leaving an unrecovered investment of $753.1 million. This is an increase of $16.7 million since June 30, 1975.

Of the $753.1 million unrecovered, $577.8 million (see schedules 1 and 10) is regarded as the U.S. investment in the equity of the Panama Canal enterprise. Of the remaining $175.3 million, $128.9 million represents U.S. investment prior to the reorganization of the enterprise in 1951.

Recovery of a large part of the $175.3 million is precluded by specific congressional actions. For example, specific laws exempt interest charges on capital invested in the Canal Zone Government and on the Thatcher Ferry Bridge, which totalled $57.4 million at September 30, 1977. Therefore, the interest costs for these exempt items have not been recovered. Also, under the 1955 Treaty and other Treaty commitments, the United States has transferred property valued at about $34.7 million to the Republic of Panama without reimbursement.

Return of U.S. Government investment

The Company currently is not required to make regular repayments of the U.S. investment. Dividends are declared only when the Board of Directors determines that funds in

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1/These amounts do not include $868 million in appropriations made for Canal Zone Government operations, since they are merely advances that are returned to the U.S. Treasury.

excess of working capital and capital requirements are available.

Since its incorporation in 1951, the Company has paid $40 million in dividends, with the last payment in 1969. Reimbursement for the Canal Zone Government operating costs, including depreciation, is made to the U.S. Treasury annually, which results in a systematic recovery of the U.S. investment in the Canal Zone Government.

Neither the new Treaty nor the draft implementing legislation contain provisions concerning repayment of the unrecovered investment. Thus, if any of it is to be recovered over the life of the Treaty, the extent and method of repayment should be prescribed by law; a major consideration is the extent to which the shipper and the taxpayer should share the cost of the unrecovered investment.

Although only $40 million has been recovered in dividends, about $291.6 million in interest on the net direct investment of the U.S. Government has been paid to the U.S. Treasury since 1951. According to the draft legislation for implementing the new Treaty, the requirement to pay this would be eliminated; it was considered that eliminating this obligation would be needed to help make the new Commission self-sustaining. This matter is still open, however, due to a reservation adopted by the U.S. Senate while considering the Treaty for ratification. In essence, the reservation provides that, unless otherwise enacted by the U.S. Congress, the Panama Canal Commission will be obligated to continue to pay to the U.S. Treasury the cost of interest on the U.S. Government investment.

ACCOUNTING CHANGES

The Company's Board of Directors approved a change in accounting policy beginning in fiscal year 1976, under which the Company exercised its legal right (2 C.Z.C., section 62) to defer payment to the U.S. Treasury of certain unearned costs included in operations. The method of accounting for these deferred payments, which represent costs not earned and therefore recoverable from subsequent earnings, is included in footnotes 1 and 3 to the financial statements. We concur in this change in accounting policy.

Before fiscal year 1976, net income or loss each year was recorded as an increase or decrease of earned capital reinvested in conformity with generally accepted accounting principles. About $21.3 million of losses had been so charged to earned capital reinvested for fiscal years 1973 through 1975. Withholding the payments to the U.S. Treasury for fiscal year 1976 and the transition quarter, however, required the Company to regard the unearned costs as deferred charges to be recovered from future earnings. This is in conformity with generally accepted accounting principles as applied to a rate-regulated enterprise and is consistent with the Company's treatment of other costs to be recovered from future operations through the rate-making process.

The amount deferred for the two periods totaled $9.3 million; $4.5 million of this amount was recovered in fiscal year 1977 and $4.8 million in fiscal year 1978. The total was paid into the U.S. Treasury during these years.

The accounting policy change was not implemented until fiscal year 1976, although the Company incurred consecutive annual operating losses beginning in fiscal year 1973 and extending through the transition quarter ending September 30, 1976. Losses totaled $30.6 million during the period; $21.3 million prior to fiscal year 1976, when the policy change was implemented, and $9.3 million subsequently.

As reported by the Company in footnote 3 to its financial statements, net income or loss was recorded before implementation of the policy as an increase or decrease of earned capital reinvested. As shown below, this resulted in earned capital decreasing from $196.7 million at the end of fiscal year 1972 to $175.4 million at the end of fiscal year 1975. The table also shows what the effect on earned capital reinvested would have been under the prior policy.

Fiscal year	Net income or loss	Earned capital reinvested under prior policy	new policy
	(000 omitted)		
1972	$1,247	$196,720	-
1973	-1,327	195,393	-
1974	-11,798	183,595	-
1975	-8,219	175,376	-
1976	-7,357	168,019	$175,376
Transition quarter	-1,946	166,073	175,376
1977	4,463	170,536	175,376

As shown, by deferring losses recoverable from subsequent earnings, earned capital reinvested is not reduced. As long as this policy is applied, earned capital reinvested will not be reduced. It will, however, increase due to net income once the outstanding loss deferrals have been fully recovered. This should occur in fiscal year 1978, because, as reported in footnote 3, the balance of the loss deferral ($4.8 million) has been recovered and paid into the U.S. Treasury during that fiscal year.

The Company changed its method of accounting beginning in fiscal year 1976, under which the accrued liability for employees' leave will be stated on an actual rather than estimated basis. As stated in footnote 3 to the Company's financial statements, this change, with which we concur, provides a more accurate matching of revenues and expenses on a fiscal year basis.

The change decreased the Company's liability and net loss in fiscal year 1976 by about $1.3 million, of which about $0.9 million was applicable to operations of prior years. The Company's net loss was further decreased by about $0.6 million, representing the effect of the change on the net cost of the Canal Zone Government, an operating cost borne by the Company. Of this amount, about $0.3 million was applicable to operations prior to fiscal year 1976.

TOLL RATE CHANGES AND OTHER ECONOMIC CONDITIONS AFFECTING TOLL REVENUE

The Company's principal source of revenue is tolls collected from vessels passing through the Canal. The following table shows the results of transit operations for the fiscal periods 1974 through 1977.

Fiscal year (note a)	Number of transits (note b)	Tons of cargo	Toll revenue (note c)
		(millions)	
1974	15,269	149.7	$121.3
1975	14,735	140.6	143.3
1976	13,201	117.4	135.0
Transition quarter	3,313	30.9	35.5
1977	13,087	123.2	164.7

a/ Fiscal years ended on June 30 for 1974 through 1976; transition quarter included July 1 through September 30, 1976; fiscal year ended September 30 for 1977.

b/ Includes Colombian and Panamanian Government vessels and ships transiting for repairs.

c/ Toll revenue equals tolls and toll credits.

The March 1976 changes in the vessel measurement rule, November 1976 toll rate increase, North Slope crude oil transits, and an expected modest increase in basic transits have had or will have a direct impact on the transit operations.

Effective March 23, 1976, changes in the rules of measurement increased the average tolls paid by vessels using the Canal by 4.5 percent. The rules changes adopted by the Company, subject to approval by the U.S. President, would have increased toll payments by an estimated average of 9 percent, but the President withheld approval of a proposed new rule which would have included space occupied by deck cargo in net tonnage. The changes in measurement rules did not result in uniform increases in tolls paid by various types of vessels. The average amount of the increases varied from 0.9 percent for dry-liquid bulk carriers to 8.5 percent for general cargo ships and 27.7 percent for passenger vessels.

Effective November 18, 1976, rates of tolls were increased as shown on the next page.

	Old rate	New rate	Amount of increase
Per Panama Canal net ton:			
Laden	$1.08	$1.29	$0.21
Ballast	.86	1.03	.17
Per displacement ton	.60	.72	.12

Crude oil from Alaska's North Slope was first shipped through the Canal on August 31, 1977; during June 1978, these transits averaged 3.1 daily with average daily tolls of about $87,000. Vessels transiting from the Atlantic to the Pacific are in ballast (empty). These vessels receive Alaska crude oil from super tankers anchored off the coast of Panama in The Bay of Parita and then transit to the Atlantic laden. Daily average transits consider both ballast and laden vessels.

Based on shipments through June 30, 1978, the Company estimated that toll revenue from North Slope crude oil traffic during fiscal year 1978 would be about $20 million. An International Research Associates' study dated January 1978 estimated that such 1978 traffic would produce about $19.8 million in toll revenue, or 11 percent of the total estimate of $182.3 million. GAO agrees that this is a reasonable estimate.

INFLATION-ADJUSTED STATEMENTS

Certain financial statements of the Canal organization which were presented on the conventional basis of historical costs have been restated to show the impact of changed price levels on financial condition and the results of operation (schedules 1A, 2A, 6A, and 7A). Although these supplementary statements are based on the conventional statements, neither we nor the Company's General Audit Division have audited them. We have, however, reviewed and concurred with the concepts and methods employed in their preparation.

Historical dollars have been restated in terms of purchasing power at the end of fiscal year 1977. The change in the value of money has been measured by using the Gross National Product Implicit Price Deflators provided by the U.S. Department of Commerce, a generally accepted index. Replacement costs were not considered.

The restatement of revenues and expenses reflects, except for depreciation, the change in purchasing power of the dollar during the fiscal year. Depreciation was restated based on the investment in the plant, reflecting the age of plant in service. Plant and equipment and the investment of the United States were restated from July 1, 1951, the date the Panama Canal Company was organized, although, in fact, the major portion of the plant facilities, e.g., locks and canal, came into service in 1914.

According to the Accounting Principles Board's Statement Number 3:

> "* * * comparison of current prices during and prior to World War II would probably not be reliable enough for accounting purposes because of the dissimilarity of goods and services exchanged then and now. * * * 1945 is probably the earliest point that offers reasonable comparability of goods and services with later periods. All assets acquired, liabilities incurred, or owners' equity accumulated prior to 1945 should generally be treated as if they had originated during 1945."

Accordingly, the restated value of the Company's assets and related depreciation at September 30, 1977, are necessarily understated.

While the statements are subject to refinement, they are sufficient to provide an understanding of the impact of inflation on the Company's financial condition and operation results.

CHAPTER 3

TREATY IMPACT ON CANAL OPERATING COSTS

Provisions of the new Panama Canal Treaty generally prohibit the Panama Canal Commission from providing commercial services to private individuals or organizations.

The Treaty also calls for dissolving the present Canal organization which provides education, police protection, postal and custom services, and health and medical services. This will have a substantial effect on the organization and staffing of the new Panama Canal Commission.

Upon entry into force of the Treaty, some of the discontinued services will be transferred to Department of Defense agencies and others will be assumed by the Republic of Panama or private persons subject to its authority. Functions necessary for the efficient management, operation, and maintenance of the Canal will continue for this purpose only.

This chapter highlights the impact some of these changes may have upon the cost of Canal operations, employment levels, and other related issues. The data presented is based on our review of the Canal Organization's Treaty implementation plan. We evaluated the methodology and reasonableness of the Company's planning assumptions, mission statements, and impact or actions required.

COMPANY'S TREATY IMPLEMENTATION PLAN

On October 17, 1977, the Panama Canal Company and Canal Zone Government initiated a study to assess the impact of the Panama Canal Treaty on the cost of operating the Panama Canal and the level of toll rates required for the Canal to operate on a self-sustaining basis. This was done to ensure that preparations would be well underway, should both Treaties be ratified at an early date.

A Treaty Planning Committee composed of top Company officials was provided with data by all operating units concerning organizational, functional, staffing, and facility changes determined necessary as a result of the Treaty. Budget projections were submitted as well. Formal input from Panamanian Government or other organizations of the Republic of Panama was not obtained.

The Committee established the planning period, general assumptions, and guidelines necessary to ensure uniformity in approach and completeness of the implementation plan.

The plan covers three important dates or periods: (1) the date of Treaty ratification, (2) the following 6-month period until the Treaty enters into force, and (3) the 30-month transition period after the Treaty enters into force. The plan is also based on a number of assumptions which, if not realized, could materially affect results; foremost among them are that:

1. The Treaty will enter into force on October 1, 1978.

2. Both parties will comply with the implementation schedules imposed by the Treaty.

3. The period to be planned for commences with the exchange of instruments of ratification and will terminate 3 years later.

4. The organization of the Panama Canal Commission will be patterned after that of the Panama Canal Company to the extent possible.

The Company's estimate assumed the Treaty would enter into force in fiscal year 1979, however, with the passage of Reservation Number 4 to the Treaty Resolution for Ratification it now appears likely that the Treaty will not enter into force until fiscal year 1980. Nevertheless, the factors which result in increased or decreased costs or revenues appear to be about the same whether the Treaty enters into force in fiscal 1979 or 1980.

The study represents a draft proposal, and some revisions have been made and others are anticipated as further review is completed by the Company.

CHANGE IN SCOPE OF OPERATION WILL RESULT IN OPERATING DEFICITS

The plan estimates that in the first year of operation under the Treaty, gross costs of operating the Canal would be reduced by about $170.7 million because certain Company and Government activities and the obligation to pay interest on the U.S. investment in the Canal would be eliminated. Since many of the activities to be eliminated are income-producing, however, there would also be a loss of income during the period of about $142.1 million, for a net reduction of $28.6 million.

This, however, will be more than offset by (1) required payments to Panama of about $66.8 million and (2) Treaty transition costs of $7.8 million. Thus, the net result would be to increase the cost of operations the first year (1980) by $46 million.

It was also estimated that, had there been no Treaty, a profit of $9.3 million would have been realized in the first year. Adjusting the $46 million by this amount produces an estimated net operating deficit of $36.7 million in the first year of operation under the Treaty.

The plan also projected the following deficits for fiscal years 1981 through 1984.

	Expenses not covered by revenues (millions)
1981	$38.2
1982	36.2
1983	39.1
1984	59.0

As a result of the above deficits it is estimated that, for the Commission to remain self-sustaining, toll rates would have to be increased by 19.5 percent under the first year of the Treaty. This increase would be sufficient to cover expenses through 1982, but further increases would be required to provide an additional $2.9 million in 1983 and $23.2 million in 1984 to cover projected deficits.

OTHER TREATY-RELATED ISSUES MAY HAVE AN IMPACT ON OPERATING COSTS

The following issues have not been fully resolved by the implementing legislation or are subject to uncertainties which make it difficult to assess their impact on the financial operations of the Canal.

Treaty impact on personnel costs

Several Treaty-related costs must be borne by the Commission or other Federal agencies because of personnel changes. These changes involve the transfer of former Canal organization employees to other Federal agencies, recruiting qualified people to operate the Canal, early retirements, and reductions in force.

Transfers to other agencies

The Federal agencies that acquire employees from the Canal organization in accordance with the Treaty will assume the liability for the cost of accrued leave and/or repatriation of these employees. Since this cost has generally been recovered through tolls from shippers using the Panama Canal, the Commission will retain funds equal to the estimated liability and reduce this liability with a concurrent increase in capital. Therefore, the burden of the costs when paid in some future year will shift from the shipper to the taxpayer because the acquiring Federal agency will have to request appropriations to cover the payments.

One alternative would be to have the Company deposit in the U.S. Treasury an amount equal to the estimated costs of accrued leave and repatriation of transferring employees so that this expense will not be passed to the American taxpayer. Company officials have advised us that a policy has not been formulated on this matter. Current draft legislation does not address this issue.

Recruitment and personnel levels

Once the Treaty enters into force, the living and working environment for the Commission employees will change significantly and may adversely affect the Commission's ability to retain or recruit qualified personnel for key positions. For example, the turnover for U.S. employees was reported as considerably higher in 1976 and 1977 than in the past. This was believed to be due partly to Treaty-related uncertainties and a general fear of the change in benefits and living and working conditions that might result.

The Company estimates that the total work force will decline from 14,563 in fiscal year 1979 to about 8,055 in 1984. U.S. citizen employment will decline by 1,836 during the same period, of which 1,205 will be transferred to other Government agencies. Non-U.S. citizen employment will decline by 4,672, of which 1,515 are subject to transfer to other U.S. Government agencies.

The Company has identified 1,300 positions as essential for efficient continuity of operations and management under the new Treaty, including skilled craft, technical, professional, supervisory, and managerial positions. About 400 positions are considered as nonrecruitable or nontransferrable because they are not readily available from local sources or because they require extensive on-the-job training or experience. Many of these positions have been difficult to fill in the past. Unless implementing legislation adequately addresses the means of retaining and recruiting qualified personnel for key positions, the efficiency and effectiveness of Canal operations may be adversely affected.

Early retirement and reductions in force

The cost of early retirement and reduction in force actions that would occur upon entry into force of the Treaty could be significant. The Company, because of uncertainties concerning the number of people that mav be affected, did not estimate the cost. However, a preliminary estimate by the Civil Service Commission calculated the cost of early retirement at $135 million, to be financed by congressional appropriations. Implementation of the Treaty will displace approximately 6,500 U.S. and non-U.S. citizen employees from their existing employment with the Company. However, it is not known how many employees will transfer to other agencies, retire early, or seek other employment. Most U.S. citizen employees would be eligible for repatriation, and some non-U.S. citizens would be eligible for repatriation back to their place of hire.

Elimination of interest payments to Treasury on U.S. investment

The Company is currently required to pay interest to the U.S. Treasury on a portion of the U.S. investment in the Company. The interest-bearing investment amounts to about $319 million as of September 30, 1977, on which the Company paid $18.1 million in interest expense for fiscal year 1977. Total interest payments to the Treasury, since the establishment of the Company in 1951 through September 30, 1977, have been about $292 million.

Although the Treaty makes no mention of interest payments, the Company, based on knowledge that draft legislation to implement to Treaty would eliminate the requirement for an interst payment to Treasury, did not consider such payment in its estimates. The payment is projected to be about $20 million for the first year under the Treaty. However, in view of Reservation Number 6 enacted by the Senate in the Treaty ratification processes, it appears less likely that interest expense will be foregone.

Reservation 6 to the Treaty, adopted by the Senate 90 to 10 during Treaty ratification deliberations, provides that, unless otherwise directed by congressional legislation, the Panama Canal Commission be obligated to reimburse the U.S. Treasury for the interest cost on the net direct investment in the Panama Canal Commission.

Eliminating the interest payments will relieve some of the pressure to increase toll rates, but it will also reduce Treasury receipts and will, thereby, indirectly be a cost to the U.S. taxpayer. If the interest payments to Treasury are required to be made, the estimates of cost under the Treaty are understated. How much the interest expense will be depends on the interest rate to be determined by the Treasury and the interpretation of what comprised the net direct investment.

CHAPTER 4

SCOPE OF EXAMINATION AND OPINION ON FINANCIAL STATEMENTS

We have examined the Company's Balance Sheet as of September 30, 1977, September 30, 1976, and June 30, 1976, and its related statements of operations, changes in investment of the United States, and statement of changes in financial position for the fiscal years and the transition quarter then ended.

Because the Company is required to assume the net cost of the Canal Zone Government as an operating expense and because it acts as an agent for the Canal Zone Government in advancing funds for its monthly operations, construction, and other activities and collecting its revenue, we also examined the Canal Zone Government's Balance Sheet as of September 30, 1977, September 30, 1976, and June 30, 1976, and its related, statements of operations and changes in the investment of the United States for the fiscal years and the transition quarter then ended.

We made our examination in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. During our examination, we gave consideration to the financial audit work performed by the Company's internal auditors. Because of the extent of coverage and adequacy of the internal auditors' work, we were able to limit the extent of our tests of the Canal organization's accounting records.

PANAMA CANAL COMPANY

In our opinion, subject to uncertainties relating to the implementation of the 1977 Panama Canal Treaty as described in note 12 to the financial statements, the accompanying financial statements (schedules 1 through 5) present fairly the financial position of the Panama Canal Company at September 30, 1977, September 30, 1976, and June 30, 1976, and the results of its operations, changes in the investment of the United States, and statement of changes in financial position for the fiscal years and transition quarter then ended, in conformity with generally accepted accounting principles which--except for the accounting policy changes described in note 3 to the financial statements with which we concur--have been applied on a consistent basis.

CANAL ZONE GOVERNMENT

In our opinion, subject to the uncertainties relating to the implementation of the 1977 Panama Canal Treaty as described in note 11 to the financial statements, the accompanying financial statements (schedule 6 through 13) present fairly the financial position of the Canal Zone Government at September 30, 1977, September 30, 1976, and June 30, 1976, and the results of its operations and changes in the investment of the United States for the fiscal years and transition quarter then ended, in conformity with the principles and standards of accounting prescribed by the Comptroller General--except for the accounting policy change described in note 3 to the financial statements with which we concur--have been applied on a consistent basis.

FINANCIAL STATEMENTS

SCHEDULE 1

PANAMA CANAL COMPANY
Balance Sheet
September 30, 1977, September 30, 1976, and June 30, 1976

ASSETS	1977	Transition Quarter	1976
PROPERTY, PLANT AND EQUIPMENT:			
At cost	$892,460,659	$868,843,595	$864,566,192
Less accumulated depreciation and valuation allowances (Notes 4 and 5)	383,408,880	367,074,799	362,753,503
	509,051,779	501,768,796	501,812,689
CURRENT ASSETS:			
Cash (Note 6):			
Fund balance in U.S. Treasury checking account	44,500,116	43,449,723	41,307,402
Cash in commercial banks, on hand, and in transit	2,642,598	2,707,036	3,375,279
	47,142,714	46,156,759	44,682,681
Accounts receivable, less allowance for doubtful accounts of $8,936,071; $8,027,347, and $7,591,989, respectively (Note 7)	12,436,576	9,918,228	10,809,185
Inventories:			
Merchandise held for resale	9,818,261	8,664,311	8,692,150
Materials and supplies, less allowance for obsolete and excess inventory of $574,776, $608,611, and $624,177, respectively	16,755,107	15,649,021	16,452,525
	26,573,368	24,313,332	25,144,675
Other current assets	1,579,378	1,465,798	427,432
	87,732,036	81,854,117	81,063,973
OTHER ASSETS:			
Deferred charges:			
Retirement benefits to certain former employees	9,665,000	10,181,000	10,561,000
Other	2,408,222	3,205,901	3,489,802
Unearned costs recoverable from subsequent earnings (Note 3a)	4,840,065	9,302,768	7,356,656
	16,913,287	22,689,669	21,407,458
TOTAL ASSETS	$613,697,102	$606,312,582	$604,284,120

The accompanying notes are an integral part of this statement.

PANAMA CANAL COMPANY

SCHEDULE 1

Balance Sheet

September 30, 1977, September 30, 1976, and June 30, 1976

LIABILITIES	1977	Transition Quarter	1976
INVESTMENT OF THE UNITED STATES:			
Contributed capital:			
Interest-bearing (5.677%, 5.591%, and 5.199%, respectively)	$318,905,112	$318,898,623	$319,005,661
Non-interest-bearing	18,051,630	18,051,630	18,051,630
Earned capital reinvested	175,376,040	175,376,040	175,376,040
	512,332,782	512,326,293	512,433,331
CURRENT LIABILITIES:			
Accounts payable:			
U.S. Government agencies	4,591,326	4,565,023	6,089,069
Other	5,113,677	4,319,997	3,802,635
	9,705,003	8,885,020	9,891,704
Accrued liabilities:			
Employees' leave (Note 3b)	26,535,663	23,083,404	23,018,730
Salaries and wages	5,340,257	4,318,530	3,573,566
Retirement benefits to certain former employees	1,460,000	1,431,000	1,457,000
Employees' repatriation	895,000	881,000	904,000
Claims for damages to vessels	10,604,305	6,266,588	6,443,788
U.S. Treasury (Note 8)	9,040,085	7,967,858	7,838,987
Other	2,325,690	2,115,731	2,298,259
	56,201,000	46,064,111	45,534.330
Other current liabilities	1,459,320	902,319	1,183,714
	67,365,323	55,851,450	56,609,748
OTHER LIABILITIES AND RESERVES:			
U.S. Treasury (Note 3a)	4,840,065	9,302,768	7,356,656
Retirement benefits to certain former employees	8,205,000	8,750,000	9,104,000
Employees' repatriation	6,862,000	6,959,000	6,850,000
Lock overhauls	8,162,669	7,620,516	6,880,319
Casualty losses (Note 9)	750,987	896,006	591,009
Other (Note 7)	5,178,276	4,606,549	4,459,057
	33,998,997	38,134,839	35,241,041
TOTAL LIABILITIES	$613,697,102	$606,312,582	$604,284.120

The accompanying notes are an integral part of this statement.

SCHEDULE 2

PANAMA CANAL COMPANY

Statement of Operations and Earned Capital Reinvested

Fiscal Year Ended September 30, 1977, Transition Quarter Ended September 30, 1976, and Fiscal Year Ended June 30, 1976

SCHEDULE 2

	1977	Transition Quarter	1976
OPERATING REVENUES:			
Tolls.............................	$164,685,365	$ 35,465,477	$134,987,867
Other.............................	121,755,040	29,464,616	115,124,255
Total operating revenues......	286,440,405	64,930,093	250,112,122
OPERATING EXPENSES:			
Maintenance of channels and harbors.......................	23,947,616	6,257,884	17,506,636
Navigation service and control..	35,779,842	8,188,699	32,499,795
Locks operation.................	22,588,537	5,325,635	21,901,454
General repair, storehouse, engineering and maintenance services......................	7,408,408	1,973,793	7,527,910
Marine terminal operations......	18,232,917	4,342,212	16,255,821
Transportation and utilities....	23,112,753	5,882,240	19,884,866
Retail and housing operations, including cost of goods sold of $27,532,161, $6,056,297, and $26,058,450, respectively..	47,928,640	10,853,428	45,349,348
General and administrative......	45,652,076	11,223,615	44,369,569
Interest........................	18,106,470	4,457,359	16,627,119
Net cost of Canal Zone Government	21,037,302	4,463,548	22,649,145
Other...........................	18,183,142	3,907,792	14,147,763
Total operating expenses......	281,977,703	66,876,205	258,719,426
Net loss before recognition of cumulative effect of change in accounting for employees' leave liability......................	-	-	(8,607,304)
Cumulative effect on prior years of change in accounting for employees' leave liability (Note 3b):			
Company operations...........	-	-	938,715
Net cost of Canal Zone Government	-	-	311,933
NET REVENUE OR (UNEARNED COSTS) (Note 3a)......................	4,462,702	(1,946,112)	(7,356,656)
EARNED CAPITAL REINVESTED:			
Unearned costs (Note 3a):			
Transferred to other assets...	-	1,946,112	7,356,656
Recovered from operations.....	(4,462,702)	-	-
Balance at beginning of period..	175,376,040	175,376,040	175,376,040
Balance at end of period........	$175,376,040	$175,376,040	$175,376,040

The accompanying notes are an integral part of this statement.

SCHEDULE 3

SCHEDULE 3

PANAMA CANAL COMPANY
Statement of Contributed Capital
Fiscal Year Ended September 30, 1977, Transition Quarter Ended September 30, 1976, and Fiscal Year Ended June 30, 1976

	Interest-bearing	Non-interest-bearing
Balance June 30, 1975	$318,866,812	$18,051,630
Plant reactivations and transfers, net	138,849	-
Balance June 30, 1976	319,005,661	18,051 [illegible]
Plant reactivations and transfers, net	(107,038)	-
Balance September 30, 1976	318,898,623	18,051,630
Plant reactivations and transfers, net	6,489	-
Balance September 30, 1977	$318,905,112	$18,051,630

The accompanying notes are an integral part of this statement.

SCHEDULE 4

PANAMA CANAL COMPANY
Statement of Changes in Financial Position
Fiscal Year Ended September 30, 1977, Transition Quarter Ended September 30, 1976 and Fiscal Year Ended June 30, 1976

	1977	Transition Quarter	1976
SOURCE OF FUNDS:			
From Operations:			
Revenue	$286,440,405	$64,930,093	$250,112,122
Less operating expenses:			
Net cost of Canal Zone Government	21,037,302	4,463,548	22,649,1[illegible]5
Interest on net direct investment	18,106,470	4,457,359	16,627,119
Annuity to Republic of Panama	518,718	129,680	518,718
Other expenses	242,315,213	57,825,618	218,924,444
Extraordinary credits - prior years' leave liability adjustment	-	-	(1,250,648)
Total operating expenses	281,977,703	66,876,205	257,468,778
Net revenue or (unearned costs) (Note 3a)	4,462,702	(1,946,112)	(7,356,656)
Add transactions not requiring outlay of funds:			
Deferred payments to U.S. Treasury (Note 3a)	(4,462,702)	1,946,112	7,356,656
Depreciation	18,895,979	4,701,051	18,377,329
Provision for Canal lock overhauls	2,530,000	744,000	2,975,000
Provision for casualty losses	5,154,255	549,384	2,190,999
Assumption of liability to Canal Zone Government for doubtful accounts receivable, net of amounts written off.	571,726	147,492	558,061
Amortization and adjustment of deferred charges	956,477	364,179	894,545
Total funds from operations	28,108,437	6,506,106	24,995,934
Net change in working capital other than cash	6,621,911	(74,363)	1,177,405
TOTAL	$ 34,730,348	$ 6,431,743	$ 26,173,339
APPLICATION OF FUNDS:			
Canal lock overhauls expenditures	$ 1,987,846	$ 3,804	$ 2,433,647
Casualty losses	5,299,274	244,386	2,0[illegible]7,5[illegible]
Capital expenditures	26,431,952	5,087,214	19,9[illegible]9,3[illegible]2
Other	25,320	(377,738)	(853,000)
Increase in cash	985,956	1,474,077	2,545,742
TOTAL	$ 34,730,348	$ 6,431,743	$ 26,173,339

The accompanying notes are an integral part of this statement.

PANAMA CANAL COMPANY
Statement of Property, Plant and Equipment
September 30, 1977, September 30, 1976 and June 30, 1976

	1977		Transition Quarter		1976	
	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances
Titles and treaty rights........	$ 14,728,889	$ 1,564,945	$ 14,728,889	$ 1,196,722	$ 14,728,889	$ 1,104,667
Interest during construction....	50,892,311	50,892,311	50,892,311	50,892,311	50,892,311	50,892,311
Canal excavation, fills and embankments....................	328,545,632	34,605,737	324,918,345	26,487,967	323,784,429	24,458,771
Canal structures and equipment..	209,105,876	122,115,522	200,025,871	119,063,838	199,902,286	118,322,768
Other maritime facilities.......	30,356,904	21,317,140	28,986,275	20,839,051	28,714,415	20,855,830
Supporting and general facilities.....................	184,121,874	97,190,640	176,111,202	93,617,499	174,924,253	92,391,130
Minor items of plant and equipment......................	10,268,165	10,268,165	10,268,165	9,524,892	10,268,165	9,277,135
Facilities held for future use..	5,401,992	5,308,622	5,411,402	5,306,721	5,411,402	5,305,093
Plant additions in progress.....	18,893,218	--	17,355,337	-	15,794,244	-
Suspended construction projects.	40,145,798	40,145,798	40,145,798	40,145,798	40,145,798	40,145,798
TOTAL.....................	$892,460,659	$383,408,860	$868,843,595	$367,074,799	$864,566,192	$362,753,503

The accompanying notes are an integral part of this statement.

SCHEDULE 5

BLANK

PANAMA CANAL COMPANY

Notes to Financial Statements

1. Summary of Significant Accounting Policies.

The application of generally accepted accounting principles to the Panama Canal Company, a Government corporation established by the Congress comparable to a public utility, determines the manner in which costs are recognized. The basis for toll rates is prescribed in Section 412(b) of Title 2 of the Canal Zone Code, which provides:

> Tolls shall be prescribed at rates calculated to cover, as nearly as practicable, all costs of maintaining and operating the Panama Canal, together with the facilities and appurtenances related thereto, including interest and depreciation, and an appropriate share of the net costs of operation of the agency known as the Canal Zone Government.

Under Section 62 of Title 2 of the Canal Zone Code, certain payments to the U.S. Treasury for the cost of interest, a portion of the annuity, and net costs of the Canal Zone Government included in costs of operation are required to be made annually to the extent earned, and if not earned shall be made from subsequent earnings. The amount for recovery from subsequent earnings is transferred from "Earned Capital" to an account within the "Other Assets" classification. To the extent subsequent annual revenue realized exceeds annual costs incurred, the amount of unearned costs recovered is charged back to "Earned Capital" and equivalent payment made to the U.S. Treasury.

a. Property, plant and equipment. Property, plant and equipment are recorded at cost or, if acquired from another Government agency, at original cost to such agency. Administrative and other general expenses and the cost of funds used during construction are not capitalized. The cost of minor items of property, plant and equipment is charged to expense.

b. Depreciation. Depreciation is provided using a straight-line method applied on a composite basis. This method provides straight-line depreciation plus additional annual depreciation, identified as composite, to provide for premature plant retirements.

c. Accounts receivable. An allowance for losses arising from uncollectible accounts receivable is provided by a charge to expense.

d. Inventories. Operating materials and supplies are restated annually at last receipt cost. An allowance to reflect the estimated cost of obsolete and excess materials and supplies is established by an annual charge to expense. Merchandise held for resale is stated at average cost.

e. Retirement benefits. Employer payments to the contributory Civil Service Retirement System covering substantially all employees are charged to expense. The Company has no liability for future payments to employees under this system.

Non-United States citizens employees who retired prior to October 5, 1958 are not covered by the Civil Service Retirement System but do receive benefits under a separate annuity plan. The amounts of the payments made under this annuity plan are recorded as a current-year expense. The liability of the Company for future annuity payments to these former employees or their eligible widows is reflected in the Balance Sheet as "Retirement Benefits to Certain Former Employees" and an equal amount is recorded as a Deferred Charge.

f. Deferred costs. The incremental costs of major systems and engineering studies, and extraordinary maintenance costs, except for lock overhauls, are deferred until completion and then amortized on a straight-line basis over periods not exceeding five years.

g. Reserve for lock overhauls. A reserve is provided through an annual charge to expense to cover the estimated cost of periodic lock overhauls.

h. Reserve for casualty losses. A reserve is provided through an annual charge to expense to cover the estimated cost of marine accidents, fire, and other casualty losses.

2. Transition Quarter.

The Budget and Impoundment Control Act, Public Law No. 93-344, established a new fiscal year beginning October 1 and ending September 30, effective with fiscal year 1977 (October 1, 1976 through September 30, 1977). The Act also established a transition quarter of July 1 through September 30, 1976 as a bridge between fiscal years 1976 and 1977. These statements report the financial condition and results of operations for fiscal year 1977, the transition quarter, and fiscal year 1976.

3. Accounting Changes During Fiscal Year 1976.

a. Beginning in fiscal year 1976, the Company exercised its right under Section 62 of Title 2 of the Canal Zone Code to defer payment to the U.S. Treasury of certain liabilities to the extent not earned from current operations. The method of accounting for the deferred payments and the unearned costs recoverable from subsequent earnings is described in Note 1.

Before fiscal year 1976 the net income or loss each year was recorded as an increase or decrease of earned capital reinvested in conformity with generally accepted accounting principles. About $21.3 million had been so charged to earned capital reinvested for fiscal years 1973 through 1975.

However, the withholding of the payments to the U.S. Treasury for fiscal year 1976 and the transition quarter required the Company to regard the unearned costs as deferred charges to be recovered from future earnings. This is in conformity with generally accepted accounting principles as applied to a rate-regulated enterprise and is consistent with the Company's treatment of other costs to be recovered from future operations through the rate-making process.

Thus, the amount deferred for the two periods totaled $9.3 million. $4.5 million of this amount was recovered in fiscal year 1977 and the balance, $4.8 million, was recovered in fiscal year 1978. The total was paid into the U.S. Treasury during these years.

The following table illustrates the balances of earned capital reinvested as they would have been reported if the Company had not changed its accounting for unearned costs.

	FY 1977	Transition Quarter	FY 1976
	(In millions of dollars)		
Balance at beginning of period	$166.1	$168.0	$175.4
Net revenue (unearned costs)	4.5	(1.9)	(7.4)
Balance at end of period	$170.6	$166.1	$168.0

b. Commencing in fiscal year 1976 the accounting for the accrued liability for employees' leave was changed from an estimated to an actual obligation basis. The change was made to properly recognize and disclose the leave liability and to provide a more accurate matching of revenues and expenses on a fiscal year basis.

The change decreased the Company's liability and net loss in fiscal year 1976 by $1,344,526 of which $938,715 was applicable to operations of prior years. The Company's net loss was further decreased by $623,831 representing the effect of the change on the net cost of the Canal Zone Government, an operating cost borne by the Company. Of this amount, $311,933 was applicable to operations prior to fiscal year 1976.

4. Plant Valuation Allowances.

Valuation allowances have been established as follows: (a) $14.6 million at September 30, 1977, $14.7 million at September 30, 1976, and $14.8 million at June 30, 1976 to reduce to usable value the cost of property, plant and equipment transferred to the Company from the Panama Canal (agency) at July 1, 1951, and from other Government agencies subsequent to that date; (b) $50.9 million at September 30, 1977, September 30, 1976, and June 30, 1976 to offset interest costs imputed for the original construction period; and (c) $65.3 million at September 30, 1977, September 30, 1976, and June 30, 1976 to offset the cost of defense facilities and suspended construction projects, the latter being principally the partial construction of a third set of locks abandoned in the early part of World War II.

Property, plant and equipment offset by valuation allowances, when fully or partially reactivated, are reinstated by a reduction in the valuation allowance and by an increase to the interest-bearing contributed capital account.

5. Depreciation as Percent of Average Cost of Plant.

The provisions for depreciation, expressed as percentages of average cost of depreciable plant exclusive of valuation allowances, were 2.52% for fiscal year 1977, 0.64% for the transition quarter ended September 30, 1976, and 2.54% for fiscal year 1976.

6. Cash.

The large cash balances are maintained to satisfy solvency requirements as defined by Office of Management and Budget instructions on budget execution. All cash exceeding current operating requirements is kept on deposit with the U.S. Treasury.

7. Accounts Receivable.

The accounts receivable include doubtful Canal Zone Government receivables, for which the Panama Canal Company is guarantor, amounting to \$5.2 million at September 30, 1977; \$4.6 million at September 30, 1976; and \$4.5 million at June 30, 1976. Corresponding amounts are recorded in the allowance for doubtful accounts. Other liabilities and reserves include a liability to the Canal Zone Government equal to these receivables.

8. Accrued Liabilities - U.S. Treasury.

Accrued liabilities - U.S. Treasury consists of \$6.9 million and \$2.1 million for a total of \$9.0 million withheld from the U.S. Treasury to cover Canal Zone Government employees' leave accrual and repatriation liabilities, respectively, until these amounts are appropriated from the U.S. Treasury to the Canal Zone Government. This withholding excludes leave liability of \$1.2 million assumed by the Canal Zone Government from the predecessor agency and \$2.2 million repatriation liability incurred but not accrued prior to 1966. The total leave liability of \$8.1 million and total repatriation liability of \$4.3 million is shown in the Canal Zone Government Balance Sheet.

9. Reserve for Casualty Losses.

The reserve for marine accidents had a debit balance at the end of fiscal year 1977 which was charged to current year operating expenses. Charges of \$5.3 million during the year to the reserve exceeded the accumulated provision of \$4.3 million due to the number and size of ship accidents for which the Company was responsible. In view of the fiscal year 1977 experience, the annual rate of accrual was reevaluated and increased to \$6.0 million in fiscal year 1978.

10. Contingent Liabilities and Commitments.

The estimated maximum liability, in addition to liabilities taken into the accounts, which could result from pending claims and lawsuits was \$8.1 million at September 30, 1977. In the opinion of management and Company counsel, these pending claims and lawsuits will be resolved with no material adverse effect on the financial condition of the corporation.

Commitments under uncompleted construction contracts and unfilled purchase orders amounted to $26.6 million at September 30, 1977. Of this amount, $1.3 million in unfilled purchase orders were prepaid. In addition, the Panama Canal Company is liable for an indeterminable amount with respect to death and disability payments under the Federal Employees' Compensation Act.

The Company held as custodian negotiable securities in the face amount of $6.1 million at September 30, 1977 to guarantee payment by third parties of their obligations.

Effective May 9, 1969, the Company entered into a 25-year contract with the Instituto de Recursos Hidraulicos y Electrificacion, an autonomous agency of the Republic of Panama, for the purchase of electric power to be produced by that agency. The contract was suspended by mutual agreement from September 1, 1972 through December 31, 1976, a period of four years and four months. As of September 30, 1977, the Company's minimum liability over the remaining period of the contract amounted to approximately $71.3 million.

11. Borrowing Authority.

The Company has authority to borrow funds from the U.S. Treasury not to exceed $40 million outstanding at any time at interest rates to be determined by the Secretary of the Treasury. At September 30, 1977 none of this amount had been borrowed.

12. Uncertainties Which Impact on Financial Statements.

On September 7, 1977 the President of the United States and the Chief of Government of the Republic of Panama signed the Panama Canal Treaty of 1977 and a Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal. The treaties have been ratified in accordance with the constitutional procedures of the United States and the Republic of Panama and will enter into force six calendar months from the date of the exchange of the instruments of ratification which shall not be effective earlier than March 31, 1979, unless legislation necessary to implement the provisions of the Panama Canal Treaty shall have been enacted by the Congress of the United States of America before March 31, 1979. These treaties will terminate all existing treaties between the two countries pertaining to the Panama Canal and produce major changes in the civil authority and the organization, scope of activities, and ownership of property of the Panama Canal enterprise.

Until the treaties enter into force, the Panama Canal Company will continue to operate without material changes in the scope of its activities. These financial statements, therefore, do not purport to reflect the effect of the treaties on the assets, liabilities, investment of the United States Government, or the operating results of the Panama Canal Company.

SCHEDULE 1A

PANAMA CANAL COMPANY
General Price-Level Balance Sheet
September 30, 1977
(Unaudited)

ASSETS	Historical Dollars	General Price-Level Dollars
	(Thousands of dollars)	
PROPERTY, PLANT AND EQUIPMENT:		
At cost	$892,461	$2,094,666
Less accumulated depreciation and valuation allowances	383,409	934,171
	509,052	1,160,495
CURRENT ASSETS:		
Cash:		
Fund balance in U.S. Treasury checking account	44,500	44,500
Cash in commercial banks, on hand, and in transit	2,643	2,643
	47,143	47,143
Accounts receivable - net	12,437	12,437
Inventories:		
Merchandise held for resale	9,818	9,818
Materials and supplies - net	16,755	17,107
	26,573	26,925
Other current assets	1,579	1,579
	87,732	88,084
OTHER ASSETS:		
Deferred charges		
Retirement benefits to certain former employees	9,665	9,665
Other	2,408	3,293
Unearned cost recoverable from subsequent earnings	4,840	4,840
	16,913	17,798
TOTAL ASSETS	$613,697	$1,266,377

The accompanying notes summarize the methods employed in the preparation of this statement.

PANAMA CANAL COMPANY **SCHEDULE 1A**

General Price-Level Balance Sheet

September 30, 1977

(Unaudited)

L I A B I L I T I E S	Historical Dollars	General Price-Level Dollars
	(Thousands of dollars)	
INVESTMENT OF THE UNITED STATES:		
Contributed capital:		
Interest-bearing..........................	$318,905	$ 807,303
Non-interest-bearing......................	18,052	38,850
Earned capital reinvested.................	175,376	315,879
	512,333	1,162,032
CURRENT LIABILITIES:		
Accounts payable:		
U.S. Government agencies..................	4,591	4,591
Other.....................................	5,114	5,114
	9,705	9,705
Accrued liabilities:		
Employees' leave..........................	26,536	26,536
Salaries and wages........................	5,340	5,340
Retirement benefits to certain former employees..................................	1,460	1,460
Employees' repatriation...................	895	895
Claims for damages to vessels.............	10,604	10,604
U.S. Treasury.............................	9,040	9,040
Other.....................................	2,326	2,326
	56,201	56,201
Other current liabilities.................	1,459	1,459
	67,365	67,365
OTHER LIABILITIES AND RESERVES:		
U.S. Treasury.............................	4,840	4,840
Retirement benefits to certain former employees..................................	8,205	8,205
Employees' repatriation...................	6,862	6,862
Lock overhauls............................	8,163	10,943
Casualty losses...........................	751	952
Other.....................................	5,178	5,178
	33,999	36,980
TOTAL LIABILITIES.....................	$613,697	$1,266,377

PANAMA CANAL COMPANY

General Price-Level Income Statement for the Year Ended September 30, 1977 (Unaudited)

	Historical Dollars	General Price-Level Dollars
	(Thousands of dollars)	
Operating revenues	$286,440	$292,455
Operating expenses:		
Cost of goods sold	29,542	30,162
Interest	18,106	18,486*
Operating expense	149,045	152,175
Administrative expense	45,351	46,303
Net cost of Canal Zone Government	21,037	24,497
Depreciation	18,896	41,883
	281,977	313,506
Operating revenue or (loss)	4,463	(21,051)
General price-level loss	-	(2,180)
Net revenue or (loss)	$ 4,463	$(23,231)

The accompanying notes summarize the methods employed in the preparation of this statement.

*Reflects only actual interest paid and no imputed costs of equity capital.

PANAMA CANAL COMPANY
Notes to Price Level Financial Statements

1. Methods employed in the preparation of the general price-level financial statements:

a. Historical dollars are restated in terms of purchasing power at the end of fiscal year 1977. The change in the value of money has been measured by using the gross national product implicit price deflators provided by the U.S. Department of Commerce.

b. The restatement of revenues and expenses, except for depreciation, reflects the change in purchasing power of the dollar during the current fiscal year. The restatement of depreciation expenses for the year is based upon the investment in property, plant and equipment revalued to reflect their ages. Property, plant and equipment and the investment of the United States are restated from July 1, 1951, the date of reorganization of the enterprise although the major proportion of the plant facilities, e. g., the Canal itself and the locks, were placed in service in 1914.

c. The net change in valuation of assets and liabilites, normally an increase during a period of inilation, is credited to the investment.

d. Generally accepted accounting principles have been followed except to reflect the change in the purchasing power of the dollar.

2. Price-level-adjusted cost of property, plant and equipment does not purport to be replacement cost.

SCHEDULE 6

CANAL ZONE GOVERNMENT
Balance Sheet
September 30 1977, September 30, 1976, and June 30, 1976

ASSETS	1977	Transition Quarter	1976
PROPERTY, PLANT AND EQUIPMENT:			
At cost........................	$113,000,264	$109,501,453	$108,297,309
Less accumulated depreciation and valuation allowances (Notes 4 and 5)...............	52,090,952	49,376,639	48,653,213
	60,909,312	60,124,814	59,644,096
CURRENT ASSETS:			
Fund balances and cash:			
Fund balance in U.S. Treasury	7,546,833	7,992,707	11,858,250
Cash on hand and in transit..	224,859	215,645	250,232
	7,771,692	8,208,352	12,108,482
U.S. Treasury securities (at par)......................	690,000	690,000	990,000
Accounts receivable:			
Panama Canal Company (Note 6)	5,178,276	4,606,549	4,459,057
Other......................	3,581,243	6,569,262	4,399,740
	8,759,519	11,175,811	8,858,797
Inventories (at average cost)..	982,240	936,512	879,040
Other current assets...........	12,214	13,345	13,067
	18,215,665	21,024,020	22,849,386
SUMS DUE FROM FUTURE APPROPRIATIONS (Note 7)......................	13,144,261	12,123,034	12,023,163
TOTAL ASSETS.....................	$ 92,269,238	$ 93,271,868	$ 94,516,645

The accompanying notes are an integral part of this statement.

CANAL ZONE GOVERNMENT **SCHEDULE 6**

Balance Sheet

September 30, 1977, September 30, 1976, and June 30, 1976

LIABILITIES	1977	Transition Quarter	1976
INVESTMENT OF THE UNITED STATES:			
Invested capital (Note 4)..........	$61,891,552	$61,061,326	$60,523,136
Unobligated capital fund...........	1,747,160	1,244,799	1,469,164
Unobligated operating funds........	-	-	3,531,505
Obligated funds....................	1,794,178	3,230,983	3,662,277
	65,432,890	65,537,108	69,186,082
CURRENT LIABILITIES:			
Accounts payable:			
U.S. Government agencies.........	10,397,087	12,805,560	11,213,567
Postal money orders payable......	808,346	770,168	863,019
Less deposits with U.S. Postal Service........................	42,862	250,412	532,290
	765,484	519,756	330,729
Other..........................	436,304	417,534	259,420
	11,598,875	13,742,850	11,803,716
Accrued liabilities:			
Employees' leave (Note 3)........	8,132,261	7,125,034	7,087,163
Salaries and wages...............	2,038,844	1,812,167	1,452,259
Retirement benefits to certain former employees................	114,000	112,000	117,000
Employees' repatriation..........	620,000	516,000	476,000
Other..........................	54,368	56,709	51,425
	10,959,473	9,621,910	9,183,847
	22,558,348	23,364,760	20,987,563
OTHER LIABILITIES:			
Retirement benefits to certain former employees..................	548,000	601,000	625.000
Employees' repatriation...........	3,730,000	3,769,000	3,718,000
	4,278,000	4,370,000	4,343,000
TOTAL LIABILITIES....................	$92,269,238	$93,271,868	$94,516,645

CANAL ZONE GOVERNMENT

SCHEDULE 7

Statement of Operations
Fiscal Year Ended September 30, 1977

	Operating Expenses: Funded Costs	Operating Expenses: Accrued Depreciation	Operating Expenses: Other Non-Fund Charges and Credits	Operating Expenses: Total	Recoveries	Net Cost of Operations Borne by Panama Canal Company
CIVIL FUNCTIONS:						
Office of director	$ 517,359	$ 287	$ (7,437)	$ 510,209	$ -	$ 510,209
Customs and immigration	1,357,278	197	14,025	1,371,500	3,109	1,368,391
Postal service	2,441,343	15,064	67,593	2,524,000	1,729,751	794,249
Police protection	8,327,854	83,120	241,352	8,652,326	48,423	8,603,903
Fire protection	3,277,397	61,170	112,641	3,451,208	4,305,716	(854,508)
Judicial system	318,991	437	5,783	325,211	165,402	159,809
Education	20,830,511	670,880	90,397	21,591,788	24,750,464	(3,158,676)
Public areas and facilities	3,394,613	903,522	-	4,298,135	-	4,298,135
Internal security	349,710	130	(12,145)	337,695	-	337,695
Civil defense	60,506	8,056	(846)	67,716	-	67,716
Licenses and other fees	241,650	2,715	1,582	245,947	802,421	(556,474)
Total Civil Functions	41,117,212	1,745,578	512,945	43,375,735	31,805,286	11,570,449
HEALTH AND SANITATION:						
Office of director	380,295	162	(5,635)	374,822	6,001	368,821
Hospitals and medical services:						
Gorgas hospital and clinics	15,889,980	400,139	281,746	16,571,865	18,865,461	(2,293,596)
Coco Solo hospital and clinics	4,494,086	99,204	55,543	4,648,833	4,982,198	(333,365)
Canal Zone mental health center	3,022,373	22,839	61,289	3,106,501	3,555,415	(448,914)
Palo Seco Hospital	454,687	5,971	264	460,922	451,282	9,640
Other public health services:						
Sanitation	999,635	2,669	14,709	1,017,013	11,061	1,005,952
Garbage collection	307,279	-	-	307,279	-	307,279
Preventive medicine and quarantine	866,415	414	5,091	871,920	32,871	839,049
School health unit	190,777	-	-	190,777	-	190,777
Veterinarian services	578,378	3,426	2,840	584,644	282,955	301,689
Cemeteries	207,942	1,164	-	209,106	101,478	107,628
Dental clinics	379,228	2,531	16,138	397,897	248,210	149,687
Care of dead	106,650	9,798	4,290	120,738	92,884	27,854
Total Health and Sanitation	27,877,725	548,317	436,275	28,862,317	28,629,816	232,501
GENERAL EXPENSES:						
Office of the Governor	292,864	-	6,150	299,014	-	299,014
Recruitment and repatriation	615,605	-	-	615,605	-	615,605
Employees' home leave travel	636,725	-	-	636,725	-	636,725
Transportation of employees' vehicles	111,762	-	-	111,762	-	111,762
Government buildings and sites	694,267	87,076	-	781,343	46,634	734,709
Relief payments to former employees and their widows	118,101	-	-	118,101	-	118,101
Net increase in accrued liability for employees' repatriation	-	-	65,000	65,000	-	65,000
Miscellaneous charges and credits	1,705,682	739,376	174,833	2,619,891	(4,033,545)	6,653,436
Total General Expenses	4,175,006	826,452	245,983	5,247,441	(3,986,911)	9,234,352
TOTAL	$73,169,943	$3,120,347	$1,195,203	$77,485,493	$56,448,191	$21,037,302

The accompanying notes are an integral part of this statement.

SCHEDULE 8

CANAL ZONE GOVERNMENT

SCHEDULE 8

Statement of Operations
Transition Quarter Ended September 30, 1976

	Operating Expenses: Funded costs	Operating Expenses: Accrued depreciation	Operating Expenses: Other non-fund charges and credits	Total	Recoveries	Net Cost of Operations Borne by Panama Canal Company
CIVIL FUNCTIONS:						
Office of director	$ 117,345	$ 132	$ (5,139)	$ 112,338	$ -	$ 112,338
Customs and immigration	314,610	49	5,565	320,224	2,360	317,864
Postal service	593,740	3,546	(4,175)	593,111	390,329	202,782
Police protection	1,961,281	16,825	(3,068)	1,975,038	10,137	1,964,901
Fire protection	775,164	14,949	823	790,936	975,213	(184,277)
Judicial system	64,725	-	1,218	65,943	57,942	8,001
Education	3,938,070	169,178	(14,666)	4,092,582	4,735,667	(643,085)
Public areas and facilities	759,229	215,592	-	974,821	-	974,821
Internal security	81,737	6	10,417	92,160	-	92,160
Civil Defense	16,826	2,010	1,373	20,209	-	20,209
Licenses and other fees	52,020	679	2,757	55,456	99,504	(44,048)
Total Civil Functions	$ 8,674,747	$422,966	$ (4,895)	$ 9,092,818	$ 6,271,152	$ 2,821,666
HEALTH AND SANITATION:						
Office of director	$ 96,914	$ 49	$ (839)	$ 96,124	$ 1,298	$ 94,826
Hospitals and medical services:						
Gorgas hospital and clinics	3,906,208	91,778	(40,877)	3,957,109	4,950,832	(993,723)
Coco Solo hospital and clinics	1,130,387	24,420	3,744	1,158,551	1,294,414	(135,863)
Canal Zone mental health center	693,786	5,548	5,736	705,070	940,094	(235,024)
Palo Seco hospital	106,531	1,008	427	107,966	106,072	1,894
Other public health services:						
Sanitation	243,187	528	82	243,797	2,318	241,479
Garbage collection	75,000	-	-	75,000	-	75,000
Preventive medicine and quarantine	209,225	103	(8[illegible]1)	200,347	9,461	190,886
School health unit	45,786	-	-	45,786	-	45,786
Veterinarian services	138,982	930	4,895	144,807	67,623	77,184
Cemeteries, operation and maintenance	51,286	291	-	51,577	27,226	24,351
Dental clinics	88,851	518	(2,364)	87,005	45,803	41,202
Care of dead	27,678	2,623	(788)	29,513	13,656	15,857
Total Health and Sanitation	$ 6,813,821	$127,796	$(38,965)	$ 6,902,652	$ 7,458,797	$ (556,145)
GENERAL EXPENSES:						
Office of the Governor	$ 70,192	$ -	$ 1,800	$ 71,992	$ -	$ 71,992
Recruitment and repatriation	159,305	-	-	159,305	-	159,305
Employees' home leave travel	94,970	-	-	94,970	-	94,970
Transportation of employees' vehicles	38,194	-	-	38,194	-	38,194
Government buildings and sites	141,628	18,508	-	160,136	12,084	148,052
Relief payments to former employees and their widows	29,237	-	-	29,237	-	29,237
Net increase in accrued liability for employees' repatriation	-	-	91,000	91,000	-	91,000
Miscellaneous charges and credits	364,714	236,254	83,160	684,128	(881,149)	1,565,277
Total General Expenses	$ 898,240	$254,762	$175,960	$ 1,328,962	$ (869,065)	$ 2,198,027
TOTAL	$16,386,808	$805,524	$132,100	$17,324,432	$12,860,884	$ 4,463,548

The accompanying notes are an integral part of this statement.

CANAL ZONE GOVERNMENT

SCHEDULE 9

Statement of Operations
Fiscal Year Ended June 30, 1976

	Operating Expenses					
	Funded costs	Accrued depreciation	Other non-fund charges and credits	Total	Recoveries	Net Cost of Operations Borne by Panama Canal Company
CIVIL FUNCTIONS:						
Office of director	$ 462,132	$ 1,310	$ (2,397)	$ 461,045	$ -	$ 461,045
Customs and immigration	1,298,956	1,684	24,637	1,325,277	22,564	1,302,713
Postal service	2,469,598	15,117	45,837	2,530,552	1,729,261	801,291
Police protection	7,224,027	74,893	141,156	7,440,076	45,741	7,394,335
Fire protection	2,918,041	56,009	94,817	3,068,867	3,371,851	(302,984)
Judicial system	261,904	-	15,158	277,062	201,251	75,811
Education	20,088,922	664,214	186,235	20,939,371	22,131,322	(1,191,951)
Public areas and facilities	2,970,498	831,554	26,907	3,828,959	-	3,828,959
Internal security	329,528	24	(17,402)	312,150	-	312,150
Civil defense	43,938	8,080	10,268	62,286	-	62,286
Licenses and other fees	239,263	2,715	(2,743)	239,235	762,588	(523,353)
Total Civil Functions	$38,306,807	$1,655,600	$ 522,473	$40,484,880	$28,264,578	$12,220,302
HEALTH AND SANITATION:						
Office of director	$ 376,636	$ 196	(13,572)	$ 363,260	$ 5,359	$ 357,901
Hospitals and medical services:						
Gorgas hospital and clinics	14,753,993	337,349	300,033	15,391,375	16,478,269	(1,086,894)
Coco Solo hospital and clinics	4,204,723	94,624	92,599	4,391,946	4,486,186	(94,240)
Canal Zone mental health center	2,597,246	21,335	97,917	2,716,498	2,954,539	(238,041)
Palo Seco hospital	473,700	3,714	812	478,226	467,358	10,868
Other public health services:						
Sanitation	932,316	2,111	25,105	959,532	6,729	952,803
Garbage collection	301,600	-	-	301,600	-	301,600
Preventive medicine and quarantine	751,776	2,059	24,037	777,872	19,012	758,860
School health unit	191,010	-	-	191,010	-	191,010
Veterinarian services	518,673	3,879	19,697	542,249	237,329	304,920
Cemeteries, operation and maintenance	200,922	776	-	201,698	110,138	91,560
Dental clinics	393,998	2,019	13,161	409,178	266,405	142,773
Care of dead	104,209	7,304	4,856	116,369	98,394	17,975
Total Health and Sanitation	$25,800,802	$ 475,366	$ 564,645	$26,840,813	$25,129,718	$ 1,711,095
GENERAL EXPENSES:						
Office of the Governor	$ 268,137	$ -	$ 6,997	$ 275,134	$ -	$ 275,134
Recruitment and repatriation	487,654	-	-	487,654	-	487,654
Employees home leave travel	632,270	-	-	632,270	-	632,270
Transportation of employees' vehicles	87,064	-	-	87,064	-	87,064
Government buildings and sites	532,778	71,093	9,970	613,841	42,204	571,637
Relief payments to former employees and their widows	123,323	-	-	123,323	-	123,323
Net increase in accrued liability for employees' repatriation	-	-	342,000	342,000	-	342,000
Miscellaneous charges and credits	1,583,220	950,529	25,526	2,559,275	(3,639,391)	6,198,666
Total General Expenses	$ 3,714,446	$1,021,622	$ 384,493	$ 5,120,561	$(3,597,187)	$ 8,717,748
Net cost of Canal Zone Government before recognition of cumulative effect of change in accounting for employees' leave liability	$67,822,055	$3,152,588	$1,471,611	$72,446,254	$49,797,109	$22,649,145
Less cumulative effect on prior years of change in accounting for employees' leave liability (Note 2)	-	-	311,933	311,933	-	311,933
Net cost of Canal Zone Government payable by the Panama Canal Company for fiscal year 1976	$67,822,055	$3,152,588	$1,159,678	$72,134,321	$49,797,109	$22,337,212

The accompanying notes are an integral part of this statement.

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Statement of Changes in the Investment of the United States
Fiscal Year Ended September 30, 1977

	Invested capital	Operating funds	Capital funds	Total investment
Investment at September 30, 1976	$61,061,326	$ 303,055	$ 4,172,727	$ 65,537,108
Appropriation by the Congress for Fiscal Year 1977	-	65,900,000	3,150,000	69,050,000
Investment at October 1, 1976	61,061,326	66,203,055	7,322,727	134,587,108
Increases of investment:				
Reimbursements from other U.S. Government agencies applied to operations (Note 8)	-	11,800,000	-	11,800,000
Decreases of investment:				
Funded costs	-	73,169,942	-	73,169,942
Unobligated operating funds withdrawn by U.S. Treasury (net of restorations $681)	-	4,522,996	-	4,522,996
Depreciation	3,120,347	-	-	3,120,347
Miscellaneous plant adjustments	140,933	-	-	140,933
	3,261,280	77,692,938	-	80,954,218
Transfer between funds:				
Capital expenditures	4,045,778	-	(4,045,778)	-
Increase in inventories	45,728	(45,728)	-	-
	4,091,506	(45,728)	(4,045,778)	-
Investment at September 30, 1977	$61,891,552	$ 264,389	$ 3,276,949	$ 65,432,890

Investment by Commitment of Funds

	Invested capital	Operating funds	Capital funds	Total investment
Unobligated funds	$ -	$ -	$ 1,747,160	$ 1,747,160
Obligated funds	-	264,389	1,529,789	1,794,178
Invested capital:				
Property, plant and equipment (Note 4)	60,909,312	-	-	60,909,312
Inventories	982,240	-	-	982,240
	$61,891,552	$ 264,389	$ 3,276,949	$ 65,432,890

The accompanying notes are an integral part of this statement.

Statement of Changes in the Investment of the United States
Transition Quarter Ended September 30, 1976

	Invested capital	Operating funds	Capital funds	Total investment
Investment at June 30, 1976...	$60,523,136	$ 3,866,819	$ 4,796,127	$ 69,186,082
Appropriations by The Congress for transition quarter	-	16,200,000	560,000	16,760,000
Investment at July 1, 1976....	$60,523,136	$20,066,819	$ 5,356,127	$ 85,946,082
Increases of investment:				
Reimbursements from other U.S. Government agencies applied to operations (Note 8)........................	$ -	$ 1,486,000	$ -	$ 1,486,000
Transfer from other agencies	107,038	-	-	107,038
	$ 107,038	$ 1,486,000	$ -	$ 1,593,038
Decreases of investment:				
Funded costs.................	$ -	$16,386,808	$ -	$ 16,386,808
Unobligated operating funds withdrawn by U.S. Treasury net of restorations $10,224	-	4,805,484	-	4,805,484
Depreciation................	805,524	-	-	805,524
Miscellaneous plant adjustments......................	4,196	-	-	4,196
	$ 809,720	$21,192,292	$ -	$ 22,002,012
Transfer between funds:				
Capital expenditures........	$ 1,183,400	$ -	$(1,183,400)	$ -
Increase in inventories.....	57,472	(57,472)	-	-
	$ 1,240,872	$ (57,472)	$(1,183,400)	$ -
Investment at September 30, 1976........................	$61,061,326	$ 303,055	$ 4,172,727	$ 65,537,108
Investment by commitment of funds:				
Unobligated funds...........	$ -	$ -	$ 1,244,799	$ 1,244,799
Obligated funds.............	-	303,055	2,927,928	3,230,983
Invested capital:				
Property, plant and equipment (Note 4)............	60,124,814	-	-	60,124,814
Inventories...............	936,512	-	-	936,512
	$61,061,326	$ 303,055	$ 4,172,727	$ 65,537,108

The accompanying notes are an integral part of this statement.

CANAL ZONE GOVERNMENT
Statement of Changes in the Investment
of the United States
Fiscal Year Ended June 30, 1976

SCHEDULE 12

	Invested capital	Operating funds	Capital funds	Total investment
Investment at June 30, 1975....	$58,119,708	$ 554,819	$ 7,910,997	$66,585,524
Appropriations by The Congress for Fiscal Year 1976........	-	60,150,000	2,240,000	62,390,000
Investment at July 1, 1975.....	$58,119,708	$60,704,819	$10,150,997	$128,975,524
Increases of investment:				
Reimbursements from other U.S. Government agencies applied to operations (Note 8)........................	$ -	$11,291,000	$ -	$ 11,291,000
Transfer from other agencies.	21,485	-	-	21,485
	$ 21,485	$11,291,000	$ -	$ 11,312,485
Decreases of investment:				
Funded costs..................	$ -	$67,822,055	$ -	$ 67,822,055
Depreciation..................	3,152,588	-	-	3,152,588
Miscellaneous plant adjustments.......................	127,284	-	-	127,284
	$ 3,279,872	$67,822,055	$ -	$ 71,101,927
Transfer between funds:				
Capital expenditures..........	$ 5,354,870	$ -	$(5,354,870)	$ -
Increase in inventories......	306,945	(306,945)	-	-
	$ 5,661,815	$ (306,945)	$(5,354,870)	$ -
Investment at June 30, 1976 ...	$60,523,136	$ 3,866,819	$ 4,796,127	$ 69,186,082
Investment by commitment of funds:				
Unobligated funds.............	$ -	$ 3,531,505	$ 1,469,164	$ 5,000,669
Obligated funds..............	-	335,314	3,326,963	3,662,277
Invested capital:				
Property, plant and equipment (Note 4)........	59,644,096	-	-	59,644,096
Inventories.................	879,040	-	-	879,040
	$60,523,136	$ 3,866,819	$ 4,796,127	$ 69,186,082

The accompanying notes are an integral part of this statement.

CANAL ZONE GOVERNMENT

Statement of Property, Plant and Equipment
September 30, 1977, September 30, 1976 and June 30, 1976

	1977		Transition Quarter		1976	
	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances
CIVIL FUNCTION FACILITIES:						
Customs and Immigration........	$ 9,825	$ 246	$ 9,825	$ 49	$ 9,825	$ -
Postal Division................	478,905	178,043	461,327	162,980	461,327	159,434
Police Division................	1,562,921	564,999	1,053,234	490,589	1,105,688	493,003
Fire Division..................	1,146,353	475,380	1,102,937	510,607	1,102,937	497,139
Fire Hydrant System............	242,279	186,194	241,165	180,250	240,062	178,769
Magistrates' Courts............	1,166	437	-	-	-	-
Division of Schools............	28,734,947	9,114,111	29,275,652	9,061,336	29,212,478	8,901,232
Roads, Streets, Sidewalks......	22,876,146	12,198,624	21,674,672	11,743,311	21,462,433	11,658,787
Sewer System...................	7,639,379	3,981,163	7,571,384	3,816,993	7,450,335	3,776,670
Permanent Townsites............	7,748,426	4,980,081	7,737,216	4,829,358	7,737,138	4,791,780
Experimental Gardens...........	52,769	18,887	52,769	16,969	52,769	16,489
Street Lighting System.........	2,726,212	1,135,589	2,669,703	1,059,564	2,651,858	1,036,238
Libraries - Museum.............	8,400	2,690	6,652	2,247	6,652	2,136
Internal Security..............	8,128	6,260	360	48	360	42
License Section................	24,064	15,090	24,064	12,375	24,064	11,696
Civil Affairs Director's Office	1,031,754	297,986	796,159	209,226	802,189	203,995
Total Civil Function Facilities	74,291,674	33,155,780	72,677,119	32,095,904	72,320,115	31,727,410

SCHEDULE 13

C A N A L Z O N E G O V E R N M E N T

Statement of Property, Plant and Equipment

September 30, 1977, September 30, 1976 and June 30, 1976

	1 9 7 7		Transition Quarter		1 9 7 6	
	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances
HEALTH AND SANITATION FACILITIES:						
Gorgas Hospital - Clinics.....	15,453,456	4,294,223	12,055,899	3,946,895	11,986,168	3,863,947
Coco Solo Hospital - Clinics..	3,978,079	1,500,266	3,508,635	1,421,098	3,473,289	1,396,677
Canal Zone Mental Health......	1,668,907	441,523	1,012,641	421,888	1,007,887	416,340
Palo Seco Hospital............	217,633	141,853	161,636	135,881	151,636	134,873
Division of Public Health.....	6,213	2,227	6,212	1,813	5,032	1,710
Sanitation Division...........	101,757	56,301	96,183	53,632	96,183	53,104
Division of Veterinary Medicine.....................	136,595	100,412	136,596	96,986	136,595	96,057
Dental and Care of Dead.......	408,639	150,469	402,959	143,838	402,172	141,217
Office of Health Director.....	68,454	29,219	68,454	27,893	68,454	27,553
Total Health and Sanitation Facilities.................	22,039,733	6,716,493	17,449,215	6,249,924	17,337,416	6,131,478
GENERAL FACILITIES:						
Civil Defense.................	217,692	59,707	225,625	63,321	225,626	61,311
Government Buildings..........	5,225,081	3,054,495	4,143,213	2,483,540	4,104,740	2,456,068
Total General Facilities....	5,442,773	3,114,202	4,368,838	2,546,861	4,330,366	2,517,379
MINOR ITEMS OF PLANT AND EQUIPMENT.....................	6,359,822	6,359,822	6,359,822	5,742,902	6,359,822	5,537,263
FACILITIES HELD FOR FUTURE USE..	2,794,741	2,744,655	2,796,591	2,741,048	2,796,591	2,739,683
PLANT ADDITIONS IN PROGRESS. ...	2,071,521	-	5,849,869	-	5,152,999	-
TOTAL.........	$113,000,264	$52,090,952	$109,501,454	$49,376,639	$108,297,309	$48,653,213

The accompanying notes are an integral part of this statement.

SCHEDULE 13

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CANAL ZONE GOVERNMENT

Notes to Financial Statements

1. Summary of Significant Accounting Policies.

a. Property, plant and equipment. Property, plant and equipment are recorded at cost or, if acquired from another Government agency, at original cost to such agency. Administrative and other general expenses and the costs of funds used during construction are not capitalized. The cost of minor items of property, plant and equipment is charged to expense.

b. Depreciation. Depreciation is provided using a straight-line method applied on a composite basis. This method provides straight-line depreciation plus additional annual depreciation, identified as composite, to provide for premature plant retirements.

c. Retirement benefits. Employer payments to the contributory Civil Service Retirement System covering substantially all employees are charged to expense. The Canal Zone Government has no liability for future payments to employees under this system.

Non-United States citizen employees who retired prior to October 5, 1958 are not covered by the Civil Service Retirement System but do receive benefits under a separate annuity plan. The amounts of the payments made under this annuity plan are recorded as a current-year expense. The liability of the Canal Zone Government for future annuity payments to these former employees or their eligible widows is reflected in the Balance Sheet as "Retirement Benefits to Certain Former Employees" and an equal amount is recorded in "Sums Due from Future Appropriations".

2. Transition Quarter.

The Budget and Impoundment Control Act, Public Law No. 93-344, established a new fiscal year beginning October 1 and ending September 30 effective with fiscal year 1977 (October 1, 1976 through September 30, 1977). The Act also established a transition quarter of July 1 through September 30, 1976 as a bridge between fiscal years 1976 and 1977. These statements report the financial condition for fiscal year 1977, the transition quarter, and fiscal year 1976.

3. Accounting Change During Fiscal Year 1976.

Commencing in fiscal year 1976 the accounting for the accrued liability for employees' leave was changed from an estimated to an actual obligation basis. The change was made to more properly recognize and disclose the leave liability and to provide a more accurate matching of revenues and expenses on a fiscal year basis. The change resulted in a decrease of $623,831 in the net cost of Canal Zone Government of which $311,933 was applicable to operations of prior years.

4. Plant Valuation Allowances.

Valuation allowances have been established at $1.8 million at September 30, 1977, September 30, 1976, and June 30, 1976 to reduce to usable value the cost of property, plant and equipment transferred to the Canal Zone Government from the Panama Canal (agency) at July 1, 1951, and from other U.S. Government agencies subsequent to that date.

Property, plant and equipment offset by valuation allowances, when fully or partially reactivated, are reinstated by a reduction in the valuation allowance and by an increase to the invested capital account..

5. Depreciation as Percent of Average Cost of Plant.

The provisions for depreciation, expressed as percentages of average cost of depreciable plant exclusive of valuation allowances, were 2.85% for fiscal year 1977, 0.75% for the transition quarter ended September 30, 1976, and 3.03% for fiscal year 1976.

6. Accounts Receivable.

The doubtful Canal Zone Government accounts receivable were assumed by the Panama Canal Company as guarantor at June 30, 1973, and recorded in its accounts. The stated value of these receivables is shown in the Canal Zone Government Balance Sheet as receivable from the Company.

7. Sums Due from Future Appropriations.

Sums due from future appropriations consist of the unfunded portions of the employees' leave, repatriation and retirement benefits to former employees who do not qualify under the U.S. Civil Service retirement system. Annual variation in the sums due from future appropriations results from changes in these liabilities.

8. Reimbursements Applied to Operations.

Reimbursements received from other U.S. Government agencies for Canal Zone Government services amounting to $11.8 million in fiscal year 1977, $1.5 million in the transition quarter, and $11.3 million in fiscal year 1976 were utilized during the respective years to partially finance operations, as authorized in the Department of Transportation and Related Agencies Appropriations Bill, Public Law 94-387 for fiscal year 1977 and Public Law 94-134 for the transition quarter and for fiscal year 1976.

9. Contingent Liabilities and Commitments.

Commitments under uncompleted construction contracts and unfilled purchase orders amounted to $1.8 million at September 30, 1977. In addition, the Canal Zone Government is liable for an indeterminable amount with respect to death and disability payments under the Federal Employees' Compensation Act. The maximum liability which could result from outstanding claims and lawsuits is estimated at $1.0 million at September 30, 1977.

10. Administrative Services.

Under the terms of an interagency agreement, the Panama Canal Company provides certain general and administrative support to the Canal Zone Government. As the cost of providing this support cannot be readily determined, no reimbursement is made.

11. Uncertainties Which Impact on Financial Statements.

On September 7, 1977 the President of the United States and the Chief of Government of the Republic of Panama signed the Panama Canal Treaty of 1977 and a Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal. The treaties have been ratified in accordance with the constitutional procedures of the United States and the Republic of Panama and will enter into force six calendar months from the date of the exchange of the instruments of ratification which shall not be effective earlier than March 31, 1979, unless legislation necessary to implement the provisions of the Panama Canal Treaty shall have been enacted by the Congress of the United States of America before March 31, 1979. These treaties will terminate all existing treaties between the two countries pertaining to the Panama Canal and produce major changes in the civil authority and the organization, scope of activities, and ownership of property of the Panama Canal enterprise.

Until the treaties enter into force, the Canal Zone Government will continue to operate without material changes in the scope of its activities. These financial statements, therefore, do not purport to reflect the effect of the treaties on the assets, liabilities, and investment of the United States Government in the Canal Zone Government.

SCHEDULE 6A

CANAL ZONE GOVERNMENT
General Price-Level Balance Sheet
September 30, 1977
(Unaudited)

ASSETS	Historical Dollars (Thousands	General Price-Level Dollars of dollars)
PROPERTY, PLANT AND EQUIPMENT:		
At cost	$113,000	$235,728
Less accumulated depreciation and valuation allowances	52,091	119,344
	60,909	116,384
CURRENT ASSETS:		
Fund balances and cash	7,772	7,772
U.S. Treasury securities (at par)	690	690
Accounts receivable:		
Panama Canal Company	5,179	5,179
Other	3,581	3,581
	8,760	8,760
Inventories (at average cost)	982	982
Other current assets	12	12
	18,216	18,216
SUMS DUE FROM FUTURE APPROPRIATIONS	13,144	13,144
TOTAL ASSETS	$ 92,269	$147,744

The accompanying notes summarize the methods employed in the preparation of this statement.

CANAL ZONE GOVERNMENT

SCHEDULE 6A

General Price-Level Balance Sheet
September 30, 1977
(Unaudited)

LIABILITIES	Historical Dollars	General Price-Level Dollars
	(Thousands of dollars)	
INVESTMENT OF THE UNITED STATES:		
Invested capital	$61,892	$117,367
Unobligated capital fund	1,747	1,747
Obligated funds	1,794	1,794
	65,433	120,908
CURRENT LIABILITIES:		
Accounts payable:		
U.S. Government agencies	10,397	10,397
Postal money orders payable	808	808
Less deposits with U.S. Postal Service	42	42
	766	766
Other	436	436
	11,599	11,599
Accrued liabilities:		
Employees' leave	8,132	8,132
Salaries and wages	2,039	2,039
Retirement benefits to certain former employees	114	114
Employees' repatriation	620	620
Other	54	54
	10,959	10,959
	22,558	22,558
OTHER LIABILITIES:		
Retirement benefits to certain former employees	548	548
Employees' repatriation	3,730	3,730
	4,278	4,278
TOTAL LIABILITIES	$92,269	$147,744

CANAL ZONE GOVERNMENT

SCHEDULE 7A

- General Price-Level Income Statement for the Year Ended
September 30, 1977
(Unaudited)

	Historical Dollars	General Price-Level Dollars
	(Thousands of dollars)	
Recoveries	$ 56,448	$ 57,634
Operating expenses:		
Funded costs.....................................	73,170	74,707
Other non-fund charges and credits.............	1,195	1,220
Depreciation....................................	3,120	6,118
	77,485	82,045
Operating revenue or (loss)......................	(21,037)	(24,411)
General price-level loss.........................	-	(86)
Net cost of Canal Zone Government..............	$(21,037)	$(24,497)

The accompanying notes summarize the methods employed in the preparation of this statement.

CANAL ZONE GOVERNMENT

Notes to Price Level Financial Statements

1. Methods employed in the preparation of the general price-level financial statements:

a. Historical dollars are restated in terms of purchasing power at the end of fiscal year 1977. The change in the value of money has been measured by using the gross national product implicit price deflators provided by the U.S. Department of Commerce.

b. The restatement of revenues and expenses, except for depreciation, reflects the change in purchasing power of the dollar during the current fiscal year. The restatement of depreciation expenses for the year is based upon the investment in property, plant and equipment revalued to reflect their ages. Property, plant and equipment and the investment of the United States are restated from July 1, 1951, the date of reorganization of the enterprise.

c. The net change in valuation of assets and liabilities, normally an increase during a period of inflation, is credited to the investment.

d. Generally accepted accounting principles have been followed except to reflect the change in the purchasing power of the dollar.

2. Price-level-adjusted cost of property, plant and equipment does not purport to be replacement cost.

BOARD OF DIRECTORS, PANAMA CANAL COMPANY

	APPOINTED
Chairman of the Board: The Honorable Clifford L. Alexander, Jr. Secretary of the Army	Aug. 1977
Members:	
The Honorable Lucy Wilson Benson Under Secretary of State for Security Assistance	Aug. 1977
Mr. Michael Blumenfeld Deputy Under Secretary of the Army	April 1978
Honorable Robert Carswell Deputy Secretary of the Treasury	July 1978
The Honorable Richard N. Cooper Under Secretary of State for Economic Affairs	Aug. 1977
Mr. Charles R. Ford Executive Assistant to the Administrator Environmental Protection Agency	Aug. 1977
The Honorable David E. McGiffert Assistant Secretary of Defense for International Security Affairs	Aug. 1977
The Honorable H.R. Parfitt Governor of the Canal Zone	April 1975
The Honorable Ersa H. Poston Commissioner, U.S. Civil Service Commission	Aug. 1977
Admiral Owen W. Siler, (Retired) Commandant, U.S. Coast Guard	Aug. 1977
Honorable Viron P. Vaky Assistant Secretary of State for Inter-American Affairs	July 1978

*U.S. GOVERNMENT PRINTING OFFICE: 1978 620-167/330 1-3