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

June 19, 1985

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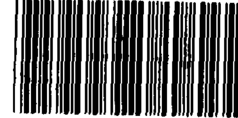

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The Honorable Lawton Chiles
United States Senate

Dear Senator Chiles:

Subject: Transfer of Interest on U.S. Investment in the Panama Canal (GAO/AFMD-85-63)

Your letter of March 6, 1985, requested that we review the cash flow requirements of the Panama Canal Commission (Commission) to determine the most appropriate repayment schedule for interest earned on the U.S. government's investment in the Canal. As of April 30, 1985, $56.3 million in interest on the U.S. investment in the Canal had been accrued as an expense, charged to Commission operations, and collected through tolls, but had not been transferred to the general fund of the U.S. Treasury. We estimate that the Commission will collect and accrue an additional $7.8 million by September 30, 1985.

Our report on the Examination of the Panama Canal Commission's Financial Statements for the Years Ended September 30, 1983 and 1982 (GAO/NSIAD-85-26, April 17, 1985) included a qualified opinion due to the nonpayment of interest on U.S. investment in the Canal. Based on the Commission's interpretation of the Panama Canal Act of 1979, the Commission does not transfer interest collections to the Treasury. Although the Act does not expressly state what the Commission should do with respect to interest collections after they are deposited into the Commission's Fund (Fund), the legislative history indicates that the Commission should transfer the collections to the general fund of the U.S. Treasury.

The effect of transferring interest collections will be to reduce the Commission's available Fund balance and increase the general fund of the U.S. Treasury. While this transfer has no effect on total cash held in the U.S. Treasury, it does increase general fund revenue which is available for other appropriations. Transfer of interest earned on an annual basis will not be detrimental to Canal operations and would prevent a future buildup of collections in the Commission's Fund.

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Our analysis of the Fund's cash and its obligational requirements showed that the Commission could pay the interest due the Treasury without detrimentally affecting Canal operations. The Commission's position is that the interest accumulated through fiscal year 1984 ($52 million) is needed to cover operational obligations arising at the beginning of each fiscal year. Under the special budgetary fund concept used by the Commission, the Fund must have a balance on deposit before funds are made available to the Commission for obligation. The administrative delay in using such a mechanism within the Commission and the Treasury takes 30-45 days to issue a warrant for the authority to disburse funds. The Commission contends that a lack of adequate funding authority the first two months each fiscal year would be a problem unless a working capital base is allowed to remain. However, the manager of Treasury Finance and Funding informed us that the warrant is not an immediate necessity, and the Commission can obligate at any time against the Fund balance as long as it does not exceed the Fund balance on hand and appropriation limitations. OMB agreed that this procedure was acceptable. However, a warrant is necessary to eventually expend the funds. We believe this process is appropriate.

During our review, we found some obligations being recorded at the beginning of each fiscal year that need not be recorded. We calculated the Commission's funding authority requirements at the beginning of each fiscal year to be about $39.9 million less than what had been previously recorded, and we concluded that there is no potential for a shortfall of obligational authority. Therefore, we found that on both a cash and obligational basis, repayment of the interest would be possible in 1986 at the beginning of the fiscal year in one lump sum and would not cause operational difficulties for the Commission.

OBJECTIVES, SCOPE, AND METHODOLOGY

In response to your request to determine the most appropriate repayment schedule for the interest, we reviewed various aspects of the Commission's financial operations. Our review was made in accordance with generally accepted government auditing standards and included such tests of the accounting records and other auditing procedures as we considered necessary in the circumstances. We performed our review in March and April 1985 at the Panama Canal Commission in Panama. We also met with Treasury and OMB officials.

First, we analyzed the Commission's cumulative cash requirements to determine whether the Commission had sufficient cash to repay the interest and to continue operations. Second, we analyzed the obligational requirements to determine if the Commission could meet them after repaying the interest. Treasury requires the Commission to have funds on deposit in the Fund before obligational authority is provided. Obligational authority is an

important consideration because the interest repayment would reduce the Fund balance and, consequently, the Commission's obligational authority. Incurring obligations does not necessarily cause immediate cash expenditures. If the interest is to be transferred to the Treasury, we wanted to make sure that the Commission not only would have sufficient cash for its payments, but also that sufficient obligational authority would be available for normal operating and capital requirements.

Our analysis of the cash and funding requirements was based on data provided by the Commission and included only the first 2 months of each of the past 3 fiscal years. Although the Commission receives a constant flow of revenues from Canal operations, we reviewed the Fund balance at September 30 for the past 3 fiscal years to ensure that it was adequate to repay the interest due and finance Canal operations during the first 2 months of the fiscal year exclusive of any revenues that would be received during that period. We used a 2-month period because of the Commission's contention that, owing to delays associated with obtaining a warrant, the Commission has a lack of funding authority during this period. Therefore, the Commission contends that it must meet its obligational and cash needs by relying on funds remaining from its original appropriation and the interest collected on U.S. investment. As requested, we have provided our views on the Commission's practice of recording obligations on the first day of the fiscal year.

PANAMA CANAL COMMISSION FUND

The Fund was established by the Panama Canal Act of 1979 as an account in the U.S. Treasury. It is composed of appropriated funds and receipts from tolls and Canal operations and is used exclusively to pay the Commission's expenses. The Congress established the Fund to ensure that the Canal's operations would be self-sustaining (i.e., revenues would cover expenses to operate the Canal). To facilitate the Canal's operations on a self-sustaining basis, the Fund operates in effect as a revolving fund, except that the Congress controls Commission expenditures from the Fund through the appropriations process with an annual appropriation. The Act requires the Commission to deposit all revenues into the Fund. The Fund is administratively maintained by the U.S. Treasury and has two accounts: a special fund receipts account to record all collections and a special fund expenditure account to record amounts appropriated to the Commission as funds available to obligate.

The Treasury Department transfers funds from the receipt account to the expenditure account monthly--using the receipt account balance as the maximum amount to be transferred and the Commission's annual congressionally approved appropriation amount as the maximum cumulative amount authorized for obligations and expenditures during a fiscal year. Treasury requires the Commission to have funds on deposit in the receipts account sufficient to

cover any obligation it may make. Except for the initial fiscal year of the Commission (1980) when approximately $464 million was appropriated from the general fund of the U.S. Treasury to remain available until expended, all appropriations necessary to operate the Canal have been issued from the Fund. As of September 30, 1984, the Commission held a constant balance of $85.6 million since the fiscal year 1980 appropriation, which is available to cover Canal operating obligations for the first 2 months each year. This balance, which functions as working capital, is replenished each year from toll revenues.

At the beginning of the past 3 fiscal years, the Fund balances were:

October 1, 1982	$143.9 million
October 1, 1983	146.3 million
October 1, 1984	171.2 million

On October 1, 1984, the Fund balance of $171.2 million included $85.6 million that, according to the Commission, is due to the U.S. Treasury from the fiscal year 1980 appropriation; $52 million in interest that has not been transferred to the Treasury's general fund; $33.6 million in reserves for casualty losses, lock overhauls, and future repairs of floating equipment; and any profit payments due to Panama. The reserve amounts have been collected as part of the toll base. The interest collected as of April 30, 1985, is $56.3 million, and we estimate an additional $7.8 million will be collected and accrued by September 30, 1985.

CASH REQUIREMENTS

The Commission requires cash to fund its operating and capital expenditures. The following table shows the cash required by the Commission to operate the Canal during the first 2 months of each of the past 3 fiscal years. According to the Commission, the first 2 months of a fiscal year are considered the most critical, as (1) appropriations are not available until the end of the second month and (2) revenues collected during the 2 months cannot be used for expenditures, until an appropriation warrant is received.

	Cash Available to the Commission (in millions)		
	1983	1984	1985
Fund balance, beginning of fiscal year[a]	$143.9	$146.3	$171.2
Less: collected and accrued interest	32.3	42.2	52.0
Balance less interest	111.6	104.1	119.2
Less: reserves and other	26.0	18.5	33.6
Cash available from original 1980 appropriation	85.6	85.6	85.6
Less:			
October cash required	31.2	27.6	28.9
November cash required	37.2	31.9	31.2
Cash required first 2 months	68.4	59.5	60.1
Excess of cash available over requirements	$ 17.2	$ 26.1	$ 25.5

[a]In addition to the Fund balance shown, toll revenues are available for cash disbursements once the warrant is received.

As previously noted, the Fund has $85.6 million from its original appropriation and, as shown above, the Commission's cumulative cash requirements during the first 2 months of each of the last 3 fiscal years have not exceeded the $85.6 million. Therefore, even after the Commission transfers the interest to the U.S. Treasury, it would still have sufficient cash to cover its needs if it were to draw upon the $85.6 million being held from its original appropriation. In commenting on a draft of this report, the Commission did not contest our conclusions on the sufficiency of its cash to transfer interest to the U.S. Treasury.

OBLIGATIONAL REQUIREMENTS

In addition to determining whether the Commission would have sufficient cash for its operations during the first 2 months of each fiscal year, we also studied whether the Commission would have sufficient authority to cover the obligations normally incurred during the same time period. As discussed earlier, Treasury requires the Commission to have funds on deposit in the

receipts account before obligational authority is provided. The Commission cannot commit or obligate funds until it has an appropriation, and it cannot commit or obligate funds in excess of the appropriations received. However, because the Commission believed it could not obligate funds until it had received an appropriation warrant from Treasury, we reviewed the obligations the Commission records on the first day of a fiscal year. Next, we analyzed the Commission's cumulative obligations during the first 2 months of a fiscal year for both its operating appropriation and its capital appropriation.

Obligations recorded the first day of the fiscal year

On the first day of each fiscal year, the Commission records obligations for Department of Defense schools, the early retirement program, and payments to Panama for public services and a fixed annuity. On October 1, 1984, the obligations recorded were:

	(millions)[a]
Defense schools	$ 6.9
Early retirement	19.6
Public services	10.0
Fixed annuity	10.0
	$46.5

[a]The amount obligated for Defense schools was approximately the same for all three fiscal years. The remaining amounts were the same during all 3 years.

Only about $6.6 million of the $46.5 million needed to be recorded the first day of the fiscal year for the October and November obligations. This leaves $39.9 million which need not be recorded the first day of the fiscal year. The $26.5 million for Defense schools and early retirement is paid throughout the year and, according to an OMB budget examiner, need not be obligated in full the first day of the fiscal year. Obligations for these payments can be recorded monthly or quarterly. On a quarterly basis, obligations on the first day of fiscal year 1985 would have been reduced by about $19.9 million. In addition, the $20 million paid annually to the Republic of Panama should not be recorded as a new obligation each year.

Based on the Panama Canal Treaty and the implementing United States legislation, the Panama Canal Act of 1979, the United States has made a firm commitment to the Republic of Panama to pay it $20 million each year for the life of the Treaty. The Commission believes that it must record a new obligation of $20 million at the beginning of every fiscal year. We were specifically requested to comment on the propriety of that practice. As explained below, we do not believe the Commission's practice is correct.

An "obligation," in budget terms, is a binding commitment or legal liability to make payments to another at some future time.

It arises at the time the commitment is made. Normally, no obligations may be incurred unless there are sufficient appropriations available at the time they are incurred to cover the full amount that will be required to pay the obligations (31 U.S.C. §1341(a)).

Occasionally, the Congress chooses to provide an exception to that prohibition and specifically confers authority to incur obligations in advance of appropriations to liquidate (pay) the obligations. This is precisely the effect of the Panama Canal Act of 1979. It incorporated the payment obligations of the Panama Canal Treaty to make payments to the Republic of Panama for the entire life of the Treaty at the rate of $20 million a year. In other words, on the date of enactment, the United States was obligated for a total sum of $400 million--$20 million a year for 20 years. The annual payments are to be made from operating revenues collected and deposited in the Commission's operating fund. They are made available through the appropriation process to liquidate the previously made obligations. But, authority to "liquidate" an obligation should not be recorded as an obligation itself.

In summary, the obligation to the Republic of Panama arose in 1979 when the commitments of the Treaty were endorsed and incorporated into the enabling Panama Canal Act. That is the time the entire amount of the obligation should have been recorded. However, whether it was formally recognized as an obligation on the books of the Treasury or not is immaterial. The obligation automatically arose at that time by virtue of the Treaty and the subsequent enabling legislation.

Operating appropriation requirements

The Commission has one-year operating appropriations--the authority to incur obligations during a single fiscal year. Any unused appropriations revert to the Fund and cannot be used until a new appropriation is granted. After reducing the operating obligations the Commission recorded during the first 2 months each year by the obligations not required to be recorded on the first day, the Commission would have excess funds available even after paying the interest to the Treasury. Of the 3 years we reviewed, fiscal year 1983 had the most operating obligations in October and November--$96.0 million. Excluding the $39.9 million in obligations not required to be recorded left $56.1 million in operating obligations which was more than covered by the $85.6 million the Commission has from the initial appropriation. Enclosure I shows that sufficient funds were available for obligations from operations for the first 2 months of each of the past 3 fiscal years.

The $85.6 million the Commission has from the initial appropriation has proven to be sufficient to cover the Commission's operational obligation requirements during the first 2 months of the past 3 fiscal years.

Capital appropriation requirements

The Commission also has no-year capital appropriations that cannot be used for operational obligations. No-year appropriations permit unused funds to be carried forward and become available for use in subsequent years. The following table shows the capital appropriations available as of October 1 and the cumulative obligations for the first 2 months of each of the past 3 fiscal years.

	Funds Available for Capital Obligations (in millions)		
	1983	1984	1985
Funds available October 1	$5.7	$10.5	$9.2
October obligations	1.9	.4	.5
November obligations	.6	1.0	1.5
	2.5	1.4	2.0
Excess funds available over capital obligations	$3.2	$ 9.1	$7.2

As shown above, the initial 2 months' capital obligations are covered by the no-year appropriation carried forward each year.

Future operational obligational authority shortfalls

The Commission expressed its concerns over the potential future shortfall of funds needed to cover operational obligations. The Commission contended that the $85.6 million from the original appropriation will eventually be insufficient to cover normal operational obligations and that the $52 million in interest accumulated as of September 30, 1984, will be needed to cover obligations during the critical first 2 months of each fiscal year. The Commission's position is predicated on the 30-45 day delay in receiving an appropriation warrant from Treasury and the Commission's understanding that it cannot obligate until funds are available as evidenced by a signed warrant. However, Treasury officials informed us that the Commission does not need to wait for a warrant before obligating its funds. The issuance of the warrant is not an immediate necessity and the Commission can obligate an amount at any time up to the balance in the Fund as long as the obligation does not exceed its annual appropriation.

The Commission has sufficient appropriations each year, and there is a constant flow of revenues from Canal operations. Once these revenues have been deposited in the receipt account, they--as well as the $85.6 million 1980 appropriation balance--are available to cover all projected obligational needs. As explained by Treasury officials, there is no need to wait for completion of

the warrant process to record obligations, although, of course, a warrant is necessary to eventually expend the funds. Therefore, both Treasury procedures and our analyses of the Commission's obligational requirements demonstrate that there is no need for the Commission to retain the interest collected.

AGENCY COMMENTS

As you requested, we obtained the Commission's comments (enclosure II) on a draft of this report. The Commission's comments have been considered in preparing our report and are included where appropriate. Our original draft report included using the Emergency Fund to supplement the $85.6 million temporarily helping the Commission cover its obligational requirements. However, the Commission, in its comments, disagreed with us on the availability of the Emergency Fund for this purpose. Since we have determined that (1) the $20 million obligations for payments to Panama need not be recorded each year, (2) $19.9 million of other obligations need not be recorded on the first day of the fiscal year, and (3) a warrant from Treasury is not necessary to record obligations, it is not necessary to consider whether the Emergency Fund could be used and that proposal has been omitted from this report. As agreed with the requestor, we did not obtain the Commission's official comments on these three issues because to do so would have unduly delayed issuance of the report beyond the date it was required by the requestor. However, we have apprised Commission officials of our position on these issues.

The Commission contends that paying the interest to the Treasury would be unfair to Canal users because such payment would retroactively change the law with respect to the treatment of interest and thereby impose an unexpected cost burden on the shipping industry. We disagree, however, because toll rates already include the interest on the U.S. investment in the Canal, and the Commission has already collected from users and deposited in the Fund the interest we believe should be paid to the Treasury. Accordingly, no toll rate increase is necessary to pay the Treasury. Also, while we agree that the Panama Canal Act does not expressly state what the Commission should do with respect to interest collections after they are deposited into the Fund, the legislative history indicates that interest should be transferred from the Fund into miscellaneous receipts of the Treasury. The Congress intended the interest collections to inure to the benefit of the U.S. taxpayer and not be available only to the Commission for the purpose of paying the Canal's expenses.

Not addressed in this report is how the investment of the U.S. in the Canal will be affected by the payment of the interest. This issue was addressed in our report on the Examination of the Panama Canal Commission's Financial Statements for the Years Ended September 30, 1983 and 1982 (GAO/NSIAD-85-26, April 17, 1985). This issue involved the method of accounting for interest which has resulted in an additional cumulative amount of interest due to the U.S. of $9.2 million for the period October 1, 1979, to September 30, 1983. The additional interest issue will be

specifically addressed in our report on the Commission's financial statements for the years ended September 30, 1984 and 1983.

CONCLUSIONS

Based on our analysis of cash availability, the Commission has sufficient cash to cover its requirements using the $85.6 million from its original appropriations. Treasury and OMB officials stated that the Commission did not need to wait for an appropriation warrant to record obligations as long as sufficient amounts were in the Fund balance. Also, to finance its operational requirements, the Commission has adequate obligational authority by using the $85.6 million plus any accumulated toll collections deposited in the receipts account and reducing the cumulative operating obligations by $39.9 million. Accordingly, we believe the Commission can transfer the interest collected and now due to the U.S. Treasury in one lump sum.

RECOMMENDATIONS

We recommend that in the fiscal year 1986 Panama Canal appropriation legislation, the Congress require that

--$56.3 million collected as of April 30, 1985 plus interest collected during the remainder of fiscal year 1985 be transferred from the Commission's Fund to the general fund of the U.S. Treasury by October 1, 1985, or shortly thereafter, and

--future interest earned be transferred annually to the general fund of the Treasury to prevent accumulation of interest in the Commission's Fund.

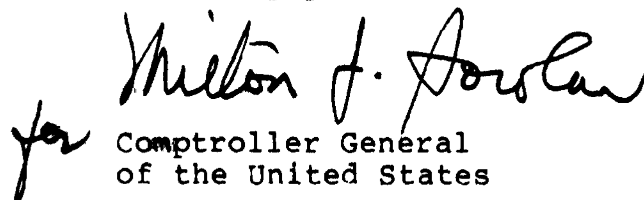
We also recommend that the Commission

--discontinue recording the annual payments to Panama as new obligations, and

--record obligations for Defense schools and early retirement either monthly or quarterly.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,



Comptroller General
of the United States

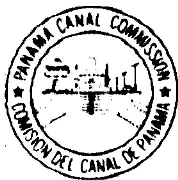
Enclosures

Funds Available for Operational Obligations
(in millions)

	1983	1984	1985
Fund balance, beginning fiscal year[a]	$143.9	$146.3	$171.2
Less: collected and accrued interest	32.3	42.2	52.0
Balance less interest	111.6	104.1	119.2
Less: reserves and other	26.0	18.5	33.6
Funds available from the original 1980 appropriation	85.6	85.6	85.6
Obligations recorded during October and November	96.0	92.0	90.0
Less obligations not required to be recorded on the first day	39.9	39.9	39.9
Adjusted October and November obligations	56.1	52.1	50.1
Excess funds available over adjusted obligations	$ 29.5	$ 33.5	$ 35.5

Source: GAO developed this table based on information provided by the Panama Canal Commission.

[a]In addition to the Fund balance shown, toll revenues are deposited throughout the year and are available.



Board of Directors
Panama Canal Commission

April 8, 1985

Mr. Frederick D. Wolf, Director
Accounting and Financial Management Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Wolf:

I appreciate the opportunity to provide my observations and comments concerning the draft GAO letter to Senator Chiles regarding the repayment of interest on the U.S. investment in the Panama Canal. At the outset, I must admit that I am dismayed with the simplistic approach reflected in that letter on a matter that has such important consequences to the operation of this vital international waterway. The statements and analyses, while attempting to bolster support for "repayment of interest," provide a superficial view which fails to consider the long-term effect of that action on the financial viability of the Panama Canal Commission.

The Commission's long-standing position with respect to the retroactive transfer of interest (as well as the 1980 appropriation balance) from the special fund to the general fund of the Treasury is that it should only be made with a corresponding change in the source of Commission appropriations, i.e., from the Panama Canal Commission Fund to the general fund of the U.S. Treasury. In 1984, the Administration submitted proposed legislation which, if enacted, would have accomplished this change. Although the Congress gave serious consideration to this proposal, efforts to secure its passage were ultimately unsuccessful. Nevertheless, in retaining the requirement that the Commission operate out of the aforementioned special fund, it was clear that the Congress recognized the need for that agency to continue to have accumulated interest available as a source of funding authority. The GAO letter presents no new facts or findings which provide a basis for a change in that position. Moreover, the GAO letter does not address the specific concerns raised on several occasions by the Commission regarding this matter.

As you know, the Commission is a self-sustaining, businesslike entity providing an important service to world shipping. While the Commission is constituted as an appropriated-fund agency, the source of all funds appropriated is Canal revenues, not the U.S. taxpayer. An important feature of Canal operation that distinguishes it from other commercial operations is that, by law, the Panama Canal Commission is precluded from building up a working capital balance by means of operational profits.

Public Law 96-70 established the Panama Canal Commission Fund with the requirement that all Canal receipts be deposited thereto and that appropriations to the agency be limited to estimated deposits plus any unexpended balance in the Fund. This financial structure was not intended by

the Congress to impede Canal operations or to establish burdensome financial constraints, but rather to ensure that Canal revenues cover the financial requirements of the Canal. However, a fundamental deficiency in the new arrangement was overlooked in that, under the special-fund concept, the Commission is required to have a balance on deposit before funds appropriated by the Congress can be obligated. This special funding arrangement, possibly unique in the U.S. Government and certainly unique to a business enterprise, is workable only if there is an adequate funding authority balance available at the start of each fiscal year. Without this funding authority, the Canal organization would be unable to function financially or, at best, be relegated to essentially a "hand-to-mouth" existence. I do not believe this was intended by the framers of the Panama Canal Treaty or by Congress when it passed its implementing legislation.

The fact of the matter is that, had Congress not had the foresight to enact the first-year appropriations from the general fund of the Treasury, rather than from the special fund, the Commission would have been left without the financial resources from which to operate. That the Commission has been able to operate successfully under the special fund concept since 1980 is attributable to the availability of interest deposits and the remainder of the first-year appropriation as a beginning funding balance each year.

The question of whether interest should be deposited in the special fund vis-a-vis the general fund and whether past interest collections should be removed from the funding authority balance of the Commission was discussed at great length in hearings before the Merchant Marine and Fisheries Committee of the House of Representatives. Based on a projection of budget requirements for the Canal through 1999, the year U.S. management of the waterway ceases, the Committee recognized the need for the Commission to retain in the Panama Canal Fund not only the $85.6 million first-year appropriation, but also some $50 million in interest over the entire period. During these hearings, it was made clear that at the end of the Treaty period, any balance in the fund, including interest and the residual first-year appropriation, will remain with the U.S. Treasury.

In essence, therefore, the problem facing the Commission is one of having sufficient funding authority available at the beginning of each year. The Congress has given recognition to this need on various occasions. For example, both the Senate and the House agreed to a partial retention by the Commission of the 1980 general fund appropriation. After detailed review of the funding requirements of the Commission, including GAO recommendations, the House has proposed that only future collections of interest monies be deposited into the general fund of the Treasury, leaving prior collections of interest intact in the Commission Fund.

With this background, I would like to provide the following observations and comments with respect to the draft letter to Senator Chiles:

At issue here with the GAO draft letter is the level of funding authority that will enable the Commission to effectively meet its financial obligations during the initial months of each fiscal year. Since the Commission under the law has no opportunity to build up a working capital reserve through operating margins, the only source of initial funding authority for the Commission is retained interest collections and the residual balance of the 1980 appropriation. The draft letter to Senator Chiles confirms that the GAO agrees with that determination, except that it also includes the $10 million Emergency Fund as a source of financing.

The GAO draft letter concludes that, from the standpoint of both cash and appropriation (obligational) requirements, there are adequate resources in the Panama Canal Commission Fund to allow a transfer of accumulated interest collections to the general fund of the Treasury. This conclusion is predicated upon the use of the $85.6 million balance remaining from the 1980 appropriation and the $10.0 million Emergency Fund, for a total ongoing resource of $95.6 million. On the other hand, the Commission contends that (a) the Emergency Fund is not available for the use suggested by the GAO, (b) the $85.6 million residual 1980 appropriation is not only inadequate to cover current obligational requirements, but its value will diminish over time with inflation, and (c) the full amount of the past interest collections are required to be retained in the Panama Canal Commission Fund if the Canal is to remain financially viable through the end of the Treaty period. These points are discussed below.

A. Emergency Fund

The $10.0 million Emergency Fund, while an important component of the financial scheme of Canal operations, was appropriated to defray emergency expenses (such as those resulting from landslides or vessel accidents that block the channel or cause oil spills) and to finance operations when appropriations are inadequate to provide continuous safe and efficient operation of the Panama Canal. In our judgment, there is no basis to consider the use of these funds as a backstop for regular Commission obligations. First of all, the Congress has always enacted adequate appropriations for the operation of the waterway, so there is no shortage of appropriation in that respect. It is only the result of application of the special fund concept that imposes a funding problem, rather than the level of appropriations enacted. Secondly, the financing problem constitutes no true emergency as contemplated by the Panama Canal Act which authorized the establishment of an emergency fund.

B. Remaining 1980 Appropriation

The GAO draft letter reflects that, on the average, the Commission has incurred a cash requirement of $62.7 million and an operating obligational requirement of $93.0 million through the first two months over the last three fiscal years. We have not addressed the Commission's cash requirements

because it is irrelevant to the question at hand. This is so because it is obligations rather than cash disbursements which must be balanced against available funding authority. This is true for all government agencies, except that most agencies deal with appropriations instead of special fund balances.

It is clear from GAO's own figures that, disregarding the Emergency Fund, the residual balance from the 1980 appropriations of $85.6 million would be inadequate, on the average, by about $7.4 million to cover operational obligations in the first two months with no consideration for capital requirements. Aside from the fact that the Commission would be faced with a shortfall in funding authority at current obligational levels, it should be obvious that this deficiency will widen with time as inflation impacts on the Commission's obligational requirements. For example, assuming a modest inflation rate of 4% annually, and exclusive of costs not subject to inflation, the deficiencies can be expected to increase as demonstrated below:

Year	Operational Obligational Requirements (First two months)	1980 Appropriation Retained as funding Authority	Deficiency in Funding
1985	93.0	85.6	7.4
1990	*106.7	85.6	21.1
1995	*123.4	85.6	37.8
1999	*139.4	85.6	53.8

*While assuming an annual 4% increase in cost due to inflation, the projections do not take into consideration the higher cost requirement that will result from growth in Canal traffic.

C. Interest Collections Must be Retained in Commission Fund

It should be clear from the above schedule that, should the GAO recommendation be adopted, the Commission will be faced with serious funding problems within a period of less than five years, even without consideration of its capital requirements. The schedule also demonstrates the need to retain both the residual 1980 appropriation and accumulated interest in the Panama Canal Commission Fund balance throughout the period that the United States has responsibility for the operation of Canal. This is evidenced by the fact that the $53.8 million deficiency, projected above for 1999, closely approximates the accumulated interest collections of $52.1 million deposited into the Commission Fund over the first five years of operation. In view of the magnitude of these numbers, it is difficult to understand how the GAO could make a recommendation on such an important matter without giving consideration to the long-term impact of the proposed action upon the Canal operation.

With respect to the GAO's conclusions concerning capital appropriation requirements, we are unable to reconcile how the numbers provided support the conclusions reached. Regardless of what these figures purport to represent, however, I object strongly to the suggestion that the Commission could manage its capital program more effectively by working within the constraints of the capital funds carried over from prior years. Carry-over funds are earmarked and committed to complete projects approved by the Congress in prior years. Morever, the Commission's capital requirements are funded by separate appropriations, will vary in amount from year to year, and will continue to be closely scrutinized by the Congress. Therefore, it is not reasonable to argue that financial constraints on the use of Congressionally approved appropriations will promote more effective management of the capital program. On the contrary, availability of the funds appropriated at the beginning of the year allows the agency the flexibility to pursue the orderly conduct of its capital acquisition program and to take advantage of beneficial price arrangements.

Not addressed in the draft letter is the GAO's position relative to how the U.S. investment base in the Canal will be affected by the transfer of accumulated interest into the general fund of the Treasury and how this will impact on Canal tolls. In testimony last year before the House Subcommittee on Panama Canal/Outer Continental Shelf, the GAO in support of transferring accumulated interest into the general fund recommended the restoration of the interest-bearing investment by the amounts so transferred. This restoration would result in increasing the cost to be recovered from the shipping industry, the users of the Canal, by about $6.0 million annually starting in 1985. Additionally, the GAO proposed the retroactive calculation and collection of interest which, if adopted, would impose an additional $14.0 million of costs upon the Canal to be recovered in tolls. These added cost burdens would impact on the shipping industry at a time when it is just starting to recover from the severe economic downturn experienced by that segment in recent years. A further cost burden to Canal users in terms of higher tolls could serve to disrupt that recovery and adversely affect the volume of Canal traffic. *[GAO note]

The existing interest provisions of the Panama Canal Act have been used in setting Canal toll rates since the inception of the Commission some five and one-half years ago. To change these provisions retroactively would be patently unfair to our customers and would place an undue burden upon the Commission. Also, I can assure you that such a change would not escape severe criticism from the Government of Panama.

In summary, it is the Commission's position that:

> Both the residual balance of the 1980 appropriation and accumulated interest through 1984 are required to be retained as funding authority for the Commission over the remaining life of U.S. management of the Panama Canal. Accordingly, if the GAO's recommendation to transfer accumulated interest to the general fund is carried out, the Commission will be faced, in a very short while, with an untenable financial arrangement.

*This issue was addressed in our report on the Examination of the Panama Canal Commission's Financial Statements for the Years Ended September 30, 1983 and 1982 (GAO/NSIAD-85-26, April 17, 1985). The issue questions the method of accounting for interest which has resulted in an additional cumulative amount of interest due to the U.S. of $9.2 million for the period October 1, 1979, to September 30, 1983. (The interest as of September 30, 1984 is about $14 million.) However, the recommendations in this report regarding the transfer to the General Fund of the $52 million in interest should not necessitate any toll increases.

- The transfer of these amounts to the general fund would not result in any additional cash for the Treasury and, therefore, would not assist in the funding of appropriations for other government programs. This is so because Commission receipts are treated in the same manner as all other funds paid into the Treasury, i.e., they are used to meet the financing requirements of the U.S. Government on a current basis. Since these specific balances will remain unused over the remaining life of the Treaty, the Government has benefited as if the funds had been deposited into the Treasury as miscellaneous receipts in the first place.

- The requirement for retention of these balances by the Commission results solely from having to finance appropriations (obligations) from the special fund. For that reason, the Commission has gone on record as not opposing the so-called turn-in of these two balances, provided the source of its appropriations is changed from the special fund to the general fund.

- It would be unfair to Canal users for the U.S. Government to retroactively change the law with respect to the treatment of interest and thereby impose an unexpected cost burden on the shipping industry.

With regard to the interest issue, it was our belief that this matter was finally resolved in 1984 during hearings conducted by the Merchant Marine and Fisheries Committee and, ultimately, by House passage of H.R. 5655. Further, it was our belief that the Canal was authorized to retain the interest in order to operate efficiently until the year 2000 when the waterway will be turned over to the Republic of Panama, and when all Commission funds would be transferred to the general fund. Under that bill, as with H.R. 664, all future interest collections would be deposited into the general fund of the Treasury as miscellaneous receipts. The Commission strongly supports this provision. I solicit your support for this change as being consistent with providing fair treatment to both Canal customers and the U.S. Government.

Again, I appreciate the opportunity to review and comment on the draft letter and would be please to provide further clarification if needed. It is requested that the full text of this letter accompany the GAO's final letter to Senator Chiles.

Sincerely,

William R. Gianelli

William R. Gianelli
Chairman