United States General Accounting Office

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Report to the Congress

March 1996

FINANCIAL AUDIT

Panama Canal Commission's 1995 and 1994 Financial Statements

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-262043

March 29, 1996

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

This report presents the results of our audits of the Panama Canal Commission's financial statements for the fiscal years ended September 30, 1995 and 1994, its assertion on internal controls, and its compliance with laws and regulations.

On October 1, 1979, the Commission was established as an executive agency to carry out the responsibilities of the United States with respect to the Panama Canal Treaty of 1977.[1] The Commission will operate the Canal until the Treaty terminates on December 31, 1999, when the Republic of Panama will assume full responsibility for the Canal.

During the period covered by these audits, we were required by the Panama Canal Act of 1979 to conduct an annual audit of the Commission's financial statements.[2] Our opinion states that the Panama Canal Commission's financial statements present fairly, in all material respects, its financial position as of September 30, 1995 and 1994, and the results of its operations, changes in capital, and cash flows for the years then ended, in conformity with generally accepted accounting principles.

Also, our opinion states that management's assertion is fairly stated that, although improvements are needed in internal controls related to the review of the classification of obligations for consultant services under congressional spending limitation, internal controls in effect on September 30, 1995, provided reasonable assurance that losses, noncompliance, or misstatements material to the financial statements would be prevented or detected.

In conjunction with our 1995 tests for compliance with selected provisions of certain laws and regulations, management disclosed an Antideficiency Act [31 U.S.C. Section 1341 (a)(1)] violation related to noncompliance with

[1]Subsequent to the period covered by these audits, section 3522 of the Panama Canal Amendments Act of 1995 (1995 Act), Public Law No. 104-106, February 10, 1996, amended section 1101 of the Panama Canal Act of 1979 reconstituting the Commission as a wholly owned government corporation. As such, it will now be subject to chapter 91 of title 31, United States Code.

[2]Section 3526 of the 1995 Act amended section 1313 of the Panama Canal Act of 1979 to authorize the Board of Directors to direct the Commission to hire independent auditors to conduct the audit in lieu of the Comptroller General. In addition to conducting the audit of the Commission's financial statements, the auditor is to examine the Commission's forecast that it will be in a position to meet its financial liabilities on December 31, 1999.

a congressional spending limitation. The noncompliance was not material to the financial statements. Management has implemented internal controls which, if properly implemented and adhered to, should prevent future noncompliances. No other reportable instances of noncompliance with laws and regulations were disclosed for the provisions tested. Our audit was conducted in accordance with generally accepted government auditing standards.

During the course of the 1995 audit, we also noted that the Commission significantly improved general controls over the computerized information systems. We had identified matters for improvement and communicated them to the Commission in a previous management letter.[3] The Commission has corrected, or is in the process of correcting, all general control weaknesses identified and reported in that letter. We noted no internal control weaknesses during our audit of their fiscal year 1995 financial statements that needed to be communicated to the Commission in a separate management letter.

Scheduled Termination of the Commission

As provided by the Panama Canal Treaty of 1977, the Panama Canal Commission will terminate on December 31, 1999, when the Republic of Panama will assume full responsibility for the management, operation, and maintenance of the Panama Canal. The Treaty provides that the Canal be turned over in operating condition and free of liens and debts, except as the two parties may otherwise agree. As discussed in note 9 to the financial statements, as of September 30, 1995, the Commission forecasts that the present $90.7 million in unfunded liabilities should be covered by tolls over the remaining life of the Treaty. We did not examine the Commission's forecast and express no opinion on it. The ability to cover these future costs, including administrative costs, is dependent upon (1) obtaining the budgeted levels of Canal operations and (2) future economic events.

The Commission operates as a rate-regulated utility. In fiscal year 1995 approximately 74 percent of its operating revenues were obtained from tolls and the remaining 26 percent, from nontoll revenues, such as navigation services and electric power sales. Early retirement, compensation benefits for work injuries, and post-retirement medical care costs are being funded from Canal revenues on an accelerated basis in order to be fully funded by 1999. During the period of our audit, the

[3]Letter to the Chairman, Board of Directors, Panama Canal Commission (GAO/AIMD-95-104ML, March 31, 1995).

President of the United States served as the rate regulator for tolls, which are established at a level to recover the costs of operating and maintaining the Canal.[4]

Analysis of the Commission's Financial Statements

The following is taken from management's analysis of the Commission's financial statements. The analysis generally explains the changes in major financial statement line items from fiscal years 1994 to 1995. Our opinions on these financial statements do not extend to the analysis presented below, and, accordingly, we express no opinion on this analysis. While we do not express an opinion on the analysis, we found no material inconsistencies with the financial statements taken as a whole.

Results of Operations

The Commission's operations ended fiscal year 1995 at breakeven, compared to the net operating revenue of $1.7 million for fiscal year 1994. The net operating revenue for 1994 was applied to the $0.6 million outstanding balance of unrecovered costs from fiscal year 1992 operations and the $1.1 million balance left was paid to the Republic of Panama on March 9, 1995.

From fiscal years 1991 through 1995, toll and nontoll revenues increased an average of approximately 3.8 percent annually. Fiscal year 1995 total operating revenues increased to $586 million, up 6.9 percent from fiscal year 1994 due mainly to an increase in Canal traffic, principally larger vessels. Nontoll revenues, which consist primarily of navigation services and electric power sales, increased to $164 million during fiscal year 1995, up 12.6 percent from fiscal year 1994.

The deduction from tolls revenue for working capital was increased from $5 million in fiscal year 1994 to $10 million in fiscal year 1995 in order to substantially complete the financing of the Commission's storehouse and fuel inventories.

The deduction from tolls revenue for contributions for capital expenditures increased from $11.5 million in fiscal year 1994 to $30.3 million in fiscal year 1995. The increase was attributable to the funding required for the increase in the Commission's capital program in 1995 for the acquisition of the crane TITAN and to provide funding for anticipated additional capital expenditures for replacements and additions

[4]Sections 3527 and 3528 of the 1995 Act amended sections 1601 and 1604 of the Panama Canal Act of 1979, respectively, to authorize the Commission to prescribe the rules for measuring vessels and levying tolls for the Panama Canal.

to the tug fleet, acceleration of the Gaillard Cut widening project and the purchase of additional towing locomotives.

From fiscal years 1991 through 1995, total operating expenses increased an average of approximately 4.0 percent annually. Fiscal year 1995 total operating expenses increased to $586 million, up 7.3 percent over fiscal year 1994. The following were some of the highlights:

- Tonnage payments to the Republic of Panama increased $9.8 million or 13.9 percent in fiscal year 1995. The additional net tonnage transiting the Canal produced $7.6 million of the increase and a rate change from 36 cents to 37 cents per ton accounted for $2.2 million of the change.
- Navigation service and control costs increased $13.6 million or 14.8 percent due mainly to the cost of additional resources required to service the record traffic levels experienced in fiscal year 1995.
- The increase in locks operation costs of $10.4 million or 18.2 percent reflected the cost of additional crews required for the increased level of traffic, additional locks maintenance and repair projects, and increased costs for locks overhaul projects.
- Depreciation expense increased $5.7 million or 22.1 percent in fiscal year 1995 principally as the result of (1) an adjustment to the service life for certain assets, (2) the change in the capitalization limit from $1,500 to $5,000 for minor items acquired in fiscal year 1995, and (3) the depreciation for new additions to plant during the fiscal year. Partially offsetting these increases was a credit adjustment resulting from the amortization of capital contributions of assets acquired prior to fiscal year 1992.
- Interest expense on the interest-bearing investment of the United States decreased $3.2 million or 42.2 percent in fiscal year 1995 because of the larger average cash balances maintained by the Commission in its U.S. Treasury revolving fund account and lower interest rates.
- Other operating expenses increased $5.8 million or 18.8 percent primarily because of an increase in the provision for marine accident claims during the year related to accidents that occurred during fiscal year 1995.

Assets, Liabilities, and Capital

By the end of fiscal year 1995, total assets of the Commission increased by 3.3 percent to $851 million, and total liabilities and reserves decreased by 1.6 percent to $263 million. Capital increased by 5.6 percent to $588 million. The most significant changes in individual account balances by the end of fiscal year 1995 were the following:

- Property, plant, and equipment (excluding depreciation and valuation allowances) increased by a net $38 million to $1,141 million. This increase was due primarily to net capital expenditures of $38.7 million and the acquisition of several plant items from other U.S. government agencies. Major capital additions to plant from capital expenditures included $9.4 million for the Canal widening/straightening program; $8.0 million for the replacement and improvement of facilities and buildings; $6.6 million for the replacement and addition of floating equipment; $5.2 million for the replacement and addition of miscellaneous equipment; $4.0 million for improvements to electric power, communication, and water systems; $2.6 million for the replacement of motor vehicles; and $1.6 million for the replacement of launches and launch engines.
- Current assets increased by a net $54 million to $262 million due principally to an increase in cash. Cash increased by $46.8 million as a result of the net cash provided by operating activities exceeding the net cash used in investing activities.
- Deferred charges decreased by a net $26 million to $87 million. This was due principally to the amortization of deferred charges for early retirement, compensation benefits for work injuries, and post-retirement medical care costs.
- Liabilities and reserves decreased by a net $4.2 million to $263 million. The major reason for the net decrease included a decrease of $26.9 million for certain employee benefits, offset in part by increases in the liabilities for severance pay, accounts payable, employees' leave, marine accident claims, and in the reserve for lock overhauls.
- Capital increased by a net $31 million to $588 million, principally because of a $21.4 million net increase in capital contributions for capital expenditures and a $10.0 million increase in contributions for working capital.

Treaty Related Costs

The Panama Canal Act of 1979 requires us to include in our annual audit report to the Congress a statement listing (1) all direct and indirect costs incurred by the United States in implementing the 1977 Treaty, net of any savings, and (2) the cost of any property transferred to the Republic of Panama. The act also provides that direct appropriated costs of U.S. government agencies should not exceed $666 million, adjusted for inflation over the life of the Treaty. As of September 30, 1995, the inflation-adjusted target was $1,367 million.

U.S. Government agencies that provided services to the former Panama Canal Company and Canal Zone Government provided the direct and indirect cost information including the cost of property transferred to the Republic of Panama as required under the 1977 Treaty. This information is presented in unaudited supplementary schedules to the Commission's financial statements, and, accordingly, we express no opinion on these schedules. From fiscal years 1980 to 1995, the net reported costs to the U.S. Government under the Treaty amounted to $791 million, which is less than the act's inflation-adjusted target.

As required by the Panama Canal Act of 1979, we are sending copies of this report to the President of the United States and the Secretary of the Treasury. We are also sending copies to the Director of the Office of Management and Budget; the Secretaries of State, Defense, and the Army; the Chairman of the Board of Directors of the Panama Canal Commission; and the Administrator of the Panama Canal Commission.

Robert W. Gramling for

Comptroller General
of the United States

Contents

Abbreviations

FECA	Federal Employees' Compensation Act
FMFIA	Federal Managers' Financial Integrity Act of 1982
OMB	Office of Management and Budget

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Comptroller General
of the United States

B-262043

To the Board of Directors
Panama Canal Commission

Our audits of the Panama Canal Commission found

- the fiscal years 1995 and 1994 financial statements to be reliable in all material respects;
- although certain internal controls to help assure compliance with a statutory spending limitation should be improved, management fairly stated that internal controls in place on September 30, 1995, were effective in safeguarding assets from material loss, assuring material compliance with laws governing the use of budget authority and with other relevant laws and regulations, and assuring that there were no material misstatements in the financial statements; and
- reportable noncompliance with laws and regulations we tested for the fiscal year ended September 30, 1995.

We discussed a draft of this report with the Commission's Chief Financial Officer who agreed with our findings and conclusions.

Described below are significant matters considered in performing our audit and forming our conclusions.

Significant Matters

Antideficiency Act Violation

The Commission's management identified and reported an instance of reportable noncompliance with laws and regulations and certain related controls. The amount of the violation was not material to the financial statements.

In January 1996, the Commission reported to us a violation of the Antideficiency Act [31 U.S.C. Section 1341 (a)(1)] for the fiscal year 1995 Panama Canal Revolving Fund. The Commission exceeded its $50,030,000 congressional spending limitation for administrative expenses, as set forth in the fiscal year 1995 appropriation (Public Law 103-331) by $160,225. Management determined that the violation resulted from a weakness in the Commission's system of internal controls related to the review of the classification of obligations for consultant services. Management has taken steps to improve the specific control weaknesses related to this incident. As required in 31 U.S.C. Section 1351, the Commission has reported all relevant facts of this Antideficiency Act violation and a statement of actions taken to the President, the Office of Management and Budget (OMB), the Speaker of the House of Representatives, and the President of the Senate.

Liquidation of Liabilities

As discussed in note 9 to the financial statements, the Panama Canal Treaty requires that the Commission transfer the Canal to the Republic of Panama on December 31, 1999, free of liens and debts, except as the two parties may otherwise agree. To comply with this provision, the Commission is required to identify and fully fund its liabilities by that date. Note 9 indicates that, as of September 30, 1995, the Commission had total liabilities and reserves of $262.7 million and total resources of $172.0 million. The Commission forecasted that the net unfunded $90.7 million in liabilities should be collected from future toll revenues over the remaining life of the Treaty. We did not examine the Commission's forecast and, accordingly, express no opinion on the forecast.

The following sections provide our opinions on the Commission's financial statements and assertion on internal controls, and our report on the Commission's compliance with laws and regulations we tested. This section also discusses the information presented in the unaudited supplemental schedules and the scope of our audit.

Opinion on Financial Statements

The financial statements including the accompanying notes present fairly, in all material respects, in conformity with generally accepted accounting principles, the Commission's

- assets, liabilities, and capital;
- operating revenue and expenses;
- changes in capital; and
- cash flows.

Opinion on Management's Assertion About the Effectiveness of Internal Controls

We evaluated management's assertion about the effectiveness of its internal controls designed to

- safeguard assets against loss from unauthorized acquisition, use, or disposition;

- assure the execution of transactions in accordance with laws governing the use of budget authority and with other laws and regulations that have a direct and material effect on the financial statements or that are listed in OMB audit guidance and could have a material effect on the financial statements; and
- properly record, process, and summarize transactions to permit the preparation of reliable financial statements and to maintain accountability for assets.

Management of the Commission fairly stated that those controls in effect on September 30, 1995, provided reasonable assurance that losses, noncompliance, or misstatements material to the financial statements would be prevented or detected on a timely basis. Management of the Commission also fairly stated the need to improve certain internal controls for review of the classification of obligations for consultant services, as described above. These weaknesses in internal controls, although not considered to be material to the financial statements, represent deficiencies in the design or operations of internal controls which could adversely affect the entity's ability to meet the internal control objectives to assure the execution of transactions in accordance with laws and regulations or meet OMB criteria for reporting matters under the Federal Managers' Financial Integrity Act (FMFIA) of 1982.

Management made this assertion based upon criteria established under FMFIA and OMB Circular A-123, Internal Control Systems.

Compliance With Laws and Regulations

Except as noted above, our tests for compliance with selected provisions of certain laws and regulations disclosed no other instances of noncompliance that would be reportable under generally accepted government auditing standards. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Unaudited Supplementary Information

The Treaty related cost schedules are presented as required by the Panama Canal Act of 1979, and the schedule of property, plant, and equipment is presented for purposes of additional analysis. This information has not been subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly, we express no opinion on these schedules. While we do not express an opinion on the detailed schedule of property, plant, and equipment, we found no material inconsistencies with the financial statements taken as a whole.

Objectives, Scope, and Methodology

Management is responsible for

- preparing the annual financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing the internal control structure to provide reasonable assurance that the broad control objectives of FMFIA are met; and
- complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the financial statements are reliable (free of material misstatement and presented fairly, in all material respects, in conformity with generally accepted accounting principles) and (2) management's assertion about the effectiveness of internal controls is fairly stated, in all material respects, based upon criteria established under FMFIA and OMB Circular A-123, Internal Control Systems. We are also responsible for testing compliance with selected provisions of certain laws and regulations and for performing limited procedures with respect to unaudited supplementary information appearing in this report.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of the internal control structure related to safeguarding of assets, compliance with laws and regulations, and financial reporting;
- tested relevant internal controls over safeguarding, compliance, and financial reporting and evaluated management's assertion about the effectiveness of internal controls;
- tested compliance with selected provisions of the following laws and regulations:
  - Panama Canal Act of 1979,
  - Antideficiency Act,
  - Prompt Payment Act,

  - Civil Service Reform Act of 1978, as amended,
  - Fair Labor Standards Act, and
  - Accounting and Auditing Act of 1950;
- considered compliance with the process required by FMFIA for evaluating and reporting on internal control and accounting systems;
- prepared Treaty related costs schedules using unaudited information obtained from other federal agencies; and
- compared the unaudited detailed schedule of property, plant, and equipment for consistency with the information presented in the financial statements.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to those controls necessary to achieve the objectives outlined in our opinion on management's assertion about the effectiveness of internal controls. Because of inherent limitations in any internal control structure, losses, noncompliance, or misstatements may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.

We did our work in accordance with generally accepted government auditing standards.

Robert W. Gramling for

Comptroller General
of the United States

January 19, 1996, except for
note 12, as to which the date
is February 10, 1996

Financial Statements

Statements of Financial Position

September 30, 1995 and 1994
(Dollars in thousands)

ASSETS	1995	1994
PROPERTY, PLANT, AND EQUIPMENT:		
At cost	$1,141,403	$1,103,072
Less accumulated depreciation and valuation allowances	639,349	599,681
	502,054	503,391
CURRENT ASSETS:		
Cash	217,479	170,673
Accounts receivable	13,726	9,094
Inventories:		
Storehouse, less allowances for obsolete and excess inventories of $5,200 and $5,600, respectively	28,765	25,812
Fuel	1,778	2,054
	261,748	207,633
DEFERRED CHARGES:		
Early retirement benefits	60,576	75,720
Compensation benefits for work injuries	18,087	26,500
Post-retirement medical care costs	8,600	10,880
	87,263	113,100
	349,011	320,733
TOTAL ASSETS	$ 851,065	$ 824,124

The accompanying notes are an integral part of these statements.

September 30, 1995 and 1994
(Dollars in thousands)

CAPITAL AND LIABILITIES	1995	1994
CAPITAL:		
Investment of the United States Government:		
Paid-in capital	$244,204	$244,480
Other capital	226,771	226,771
	470,975	471,251
Capital Contributions:		
Working capital	19,000	9,000
Capital expenditures, being amortized	98,412	76,981
	117,412	85,981
	588,387	557,232
LIABILITIES AND RESERVES:		
Accounts Payable:		
Commercial vendors and other	19,408	14,491
U.S. Government agencies	2,843	1,676
Republic of Panama	13,634	10,045
	35,885	26,212
Accrued Liabilities:		
Employees' leave	65,905	62,618
Salaries and wages	6,252	9,177
Employees' repatriation	7,111	7,624
Marine accident claims	17,304	15,432
Net operating revenue payable to Republic of Panama	-	1,099
Other	3,062	2,735
	99,634	98,685
Estimated Liabilities:		
Early retirement benefits	60,576	75,720
Compensation benefits for work injuries	18,087	26,500
Post-retirement medical care costs	21,000	23,280
Retirement benefits to certain former employees	3,897	4,426
Severance pay	10,000	-
	113,560	129,926
Reserves:		
Lock overhauls	4,127	2,264
Marine accidents and casualty losses	8,000	8,000
Floating equipment overhauls	1,472	1,805
	13,599	12,069
	262,678	266,892
TOTAL CAPITAL AND LIABILITIES	$851,065	$824,124

The accompanying notes are an integral part of these statements.

Statements of Operations

Fiscal Years Ended September 30, 1995 and 1994
(Dollars in thousands)

	1995	1994
OPERATING REVENUES:		
Tolls revenue	$462,754	$419,219
Less contributions for:		
- Working capital	(10,000)	(5,000)
- Capital expenditures	(30,280)	(11,500)
Net tolls revenue	422,474	402,719
Other revenues	163,681	145,402
Total operating revenues	586,155	548,121
OPERATING EXPENSES:		
Payments to Republic of Panama:		
Public services	10,000	10,000
Fixed annuity	10,000	10,000
Tonnage	80,189	70,396
	100,189	90,396
Maintenance of channels, dams, and spillways	41,915	41,697
Navigation service and control	105,388	91,766
Locks operation	67,667	57,248
General repair, engineering, and maintenance services	29,483	27,242
Supply and transportation services	19,393	19,290
Utilities	37,117	39,968
Administrative and general	96,868	99,337
Depreciation	31,455	25,756
Fire and facility protection	15,555	15,283
Interest on interest-bearing investment, net	4,347	7,520
Other	36,778	30,966
Total operating expenses	586,155	546,469
Net Operating Revenue	-	1,652
Prior year loss recovered	-	(553)
NET OPERATING REVENUE PAID TO REPUBLIC OF PANAMA	$ -	$ 1,099

The accompanying notes are an integral part of these statements.

Statements of Changes in Capital

Fiscal Years Ended September 30, 1994 and 1995
(Dollars in thousands)

1994	Investment of U.S. Government: Interest-Bearing/ Paid-in Capital	Investment of U.S. Government: Non-Interest Bearing/ Other Capital	Capital Contributions	Total
CAPITAL AT OCTOBER 1, 1993	$ 98,237	$373,135	$74,670	$546,042
CHANGES IN CAPITAL:				
Expenditures from Panama Canal Revolving Fund	541,608	(541,608)	-	-
Tolls and other receipts deposited into Panama Canal Revolving Fund	(564,924)	564,924	-	-
Property transferred to other U.S. Government agencies	(121)	-	-	(121)
Working capital contributions	-	-	5,000	5,000
Capital expenditure contributions, being amortized	-	-	6,311	6,311
	(23,437)	23,316	11,311	11,190
Capital at September 30, 1994	74,800	396,451	85,981	557,232
Reclassification for cash in Panama Canal Revolving Fund	169,680	(169,680)	-	-
RESTATED CAPITAL AT SEPTEMBER 30, 1994	$244,480	$226,771	$85,981	$557,232

1995	Investment of U.S. Government: Paid-in Capital	Investment of U.S. Government: Other Capital	Capital Contributions	Total
CAPITAL AT OCTOBER 1, 1994	$244,480	$226,771	$ 85,981	$557,232
CHANGES IN CAPITAL:				
Property transferred to Republic of Panama	(273)	-	-	(273)
Property transferred to other U.S. Government agencies	(112)	-	-	(112)
Property transferred from other U.S. Government agencies	109	-	-	109
Working capital contributions	-	-	10,000	10,000
Capital expenditure contributions, being amortized	-	-	21,431	21,431
	(276)	-	31,431	31,155
CAPITAL AT SEPTEMBER 30, 1995	$244,204	$226,771	$117,412	$588,387

The accompanying notes are an integral part of these statements.

Statements of Cash Flows

Fiscal Years Ended September 30, 1995 and 1994
(Dollars in thousands)

	1995	1994
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net operating revenue	$ -	$ 1,652
Working capital contributions	10,000	5,000
Adjustments to reconcile net revenue to net cash provided by operating activities:		
Depreciation	31,455	25,756
Net change in reserves and other	715	(1,561)
Changes in operating assets:		
(Increase)/Decrease in accounts receivable	(4,632)	404
(Increase)/Decrease in inventories	(2,677)	2,684
Decrease in deferred charges	25,837	43,036
	18,528	46,124
Changes in operating liabilities:		
Increase in employees' leave	3,287	3,036
Decrease in estimated liabilities	(16,366)	(32,129)
Increase in all other liabilities	7,582	4,027
	(5,497)	(25,066)
Net change in operating assets and liabilities	13,031	21,058
Net cash provided by operating activities	55,201	51,905
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital contributions	30,280	11,500
Capital expenditures	(38,675)	(40,073)
Net cash used in investing activities	(8,395)	(28,573)
Net increase in cash	46,806	23,332
Cash, beginning of year	170,673	147,341
CASH, END OF YEAR	$217,479	$170,673
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash paid during year for interest	$ 4,372	$ 7,538

The accompanying notes are an integral part of these statements.

Notes to Financial Statements

The Panama Canal Commission ("Commission") is an agency of the Executive Branch of the United States Government, provided for by the Panama Canal Treaty of 1977 ("Treaty") and established by the Panama Canal Act of 1979 ("Act") enacted on September 27, 1979. The Commission was established to carry out the responsibilities of the United States with respect to the Panama Canal under the Treaty. In fulfilling these obligations, the Commission manages, operates, and maintains the Canal, its complementary works, installations, and equipment, and provides for the orderly transit of vessels through the Canal. The Commission will perform these functions until the Treaty terminates on December 31, 1999, at which time the Republic of Panama will assume full responsibility for the Canal, which shall be turned over in operating condition and free of liens and debts, except as the two Parties may otherwise agree.

The operation of the waterway is conducted on a self-financing basis. The Commission is expected to recover through tolls and other revenues all costs of operating and maintaining the Canal, including interest, depreciation, working capital, capital for plant replacement, expansion, improvements, and payments to the Republic of Panama for public services and annuities. Revenues from tolls and all other sources are deposited in the United States Treasury in an account known as the Panama Canal Revolving Fund. The resources in this fund are available for continuous use and serve to finance Canal operating and capital programs which are reviewed annually by the Congress. Information on obligations and outlays of the Commission's Revolving Fund are included in the Budget of the United States Government.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES.

A summary of significant accounting policies follows:

a. ACCOUNTING AND REPORTING. The accounts of the Commission are maintained pursuant to the Accounting and Auditing Act of 1950. Under this Act, the Comptroller General of the United States prescribes the principles, standards, and related requirements to be met. The Commission maintains its accounts in accordance with generally accepted accounting principles and follows STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 71, "Accounting for the Effects of Certain Types of Regulation".

b. RECLASSIFICATIONS. Certain prior year amounts have been reclassified to conform with the current financial statement presentation.

c. COST RECOVERY. The basis for tolls rates ("statutory tolls formula") is prescribed in section 1602(b) of the Act and provides:

> "Tolls shall be prescribed at rates calculated to produce revenues to cover as nearly as practicable all costs of maintaining and operating the Panama Canal (including costs authorized to be paid from the Panama Canal Dissolution Fund under section 1305(c)), together with the facilities and appurtenances related thereto, including unrecovered costs incurred on or after the effective date of this Act [October 1, 1979], interest, depreciation, working capital, payments to the Republic of Panama pursuant to paragraph 5 of Article III and paragraph 4(a) and (b) of Article XIII of the Panama Canal Treaty of 1977, and capital for plant replacement, expansion, and improvements. Tolls shall not be prescribed at rates calculated to produce revenues sufficient to cover payments to the Republic of Panama pursuant to paragraph 4(c) of Article XIII of the Panama Canal Treaty of 1977."

Unrecovered costs for any year are to be recovered from revenues in subsequent years.

d. PROPERTY, PLANT, AND EQUIPMENT. Property, plant, and equipment are recorded at cost. The cost of minor items of property, plant, and equipment is charged to expense as incurred. Administrative and other related general expenses are recovered currently and not capitalized.

The Commission increased in fiscal year 1995 its capitalization limit from $1,500 to $5,000. This change in the capitalization limit increased the charge to expense for minor items acquired in fiscal year 1995 by approximately $1.7 million. The change in the capitalization limit is consistent with accounting principles, standards, and related requirements established by the Comptroller General.

Depreciation of Commission property, plant, and equipment is provided using the straight-line method over the estimated service lives of the depreciable assets. Composite depreciation is provided for premature plant retirements and adjustments to service lives of certain assets. In fiscal year 1995, the Commission revised the estimate of useful service lives for certain assets based on studies performed during the year. These adjustments to estimated service lives increased depreciation expense in fiscal year 1995 by $6.0 million.

Recurring costs of dredging the waterway are charged to expense. Non-recurring dredging costs for substantial improvements and betterments to the waterway are capitalized and depreciated over their estimated service lives.

e. CONTRIBUTIONS FOR CAPITAL EXPENDITURES. The Board of Directors may program a portion of tolls revenue to provide financing for plant replacement, expansion, or improvements. Such funds from Canal users are accounted for as contributions for capital expenditures. Upon utilization, these contributions are amortized by an offset to depreciation expense in an amount calculated to approximate the depreciation on assets acquired with such contributions.

In fiscal year 1992, the Commission revised prospectively the estimated service lives used for the amortization of capital contributions to 20 years. In fiscal year 1995, the Commission adjusted the amortization period of capital contributions used for the acquisition of assets prior to fiscal year 1992 to the 20-year life adopted in 1992. This adjustment reduced depreciation expense in fiscal year 1995 by $2.8 million.

Contributions for capital expenditures were $30.3 million in fiscal year 1995 and $11.5 million in fiscal year 1994.

f. CONTRIBUTIONS FOR WORKING CAPITAL. The Board of Directors may program a portion of tolls revenue as contributions for working capital. Such funds are used primarily to finance materials and supplies and fuel inventories. Contributions for working capital were $10.0 million in fiscal year 1995 and $5.0 million in fiscal year 1994.

g. ACCOUNTS RECEIVABLE. Uncollectible accounts are recognized as a reduction in revenue when written off.

h. INVENTORIES. Operating materials and supplies are stated at average cost, plus cost of transportation. Allowances are provided for the estimated cost of obsolete and excess stock.

i. RETIREMENT BENEFITS. Employer contributions to the United States Civil Service Retirement System, the Federal Employee Retirement System, and the Republic of Panama Social Security System are charged to expense when paid. The Commission has no liability for future payments to employees under these systems.

As required by the Act, the Commission is liable for the increase in the unfunded liability of the United States Civil Service Retirement Fund for benefits payable to employees and their survivors under the early retirement provisions of the Act. The deferred charge and liability recorded in these statements reflect the payments due to the Office of Personnel Management over the life of the Treaty. The annual installment of $15.1 million to liquidate the increased liability is determined by the Office of Personnel Management. The gross amount to be recovered from tolls over the remaining life of the Treaty was $60.6 million as of fiscal year 1995 and $75.7 million as of fiscal year 1994.

Non-United States citizen employees, who retired from predecessor agencies prior to October 5, 1958, receive benefits under a separate annuity plan. The liability for future annuity payments is reflected in the Statement of Financial Position as "Retirement benefits to certain former employees". The funding of this liability was completed in fiscal year 1994 with a $2.2 million charge to operating expense.

j. POST-RETIREMENT MEDICAL CARE COSTS. Effective in fiscal year 1993, the Commission adopted STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 106, "Employers' Accounting for Post-retirement Benefits Other Than Pensions". The benefits cover Commission-sponsored medical care costs for certain former employees.

The liability for future post-retirement medical care costs is reflected in the Statement of Financial Position as "Post-retirement medical care costs" and the amount to be recovered over the remaining life of the Treaty is reported as a deferred charge. The costs of benefits for the post-1999 period were recognized in fiscal years 1993 and 1994. The costs for benefits prior to the year 2000 are recognized as payments are made. The charge to operating expenses for these benefits in fiscal years 1995 and 1994 were $2.3 million and $11.8 million, respectively. The amount for fiscal year 1994 included $9.2 million to complete the funding for post-1999 costs.

k. RESERVES. Reserves required to normalize expenses for incorporation in the tolls process are provided for through annual charges to operations. These reserves cover such irregular costs as lock overhauls; floating equipment overhauls; and probable losses from marine accidents, fire, damages other than fire, public liability, and other casualties.

l. HOUSING USE RIGHTS. No monetary value is assigned to the rights granted to the United States Government by the Republic of Panama to use Canal Area housing transferred to the Republic of Panama under the terms of the Treaty. The cost to manage, maintain, and provide livability improvements to these quarters is charged to expense. Rental income is included in other revenues.

2. BUDGETARY RESOURCES.

a. Cash, accounts receivable, and the borrowing authority are the resources used by the Commission to determine its solvency position. Incurring obligations in excess of the solvency position would be a violation of the Antideficiency Act.

b. The Commission has authority to borrow funds from the United States Treasury up to $100.0 million. No funds were borrowed during fiscal years 1995 and 1994.

3. CASH.

The components of the cash balance at September 30, 1995 and 1994 were: (dollars in thousands)

	1995	1994
Cash in Panama Canal Revolving Fund	$216,596	$169,680
Cash in trust account	883	993
Total cash balance	$217,479	$170,673

4. NET OPERATING REVENUE PAYABLE TO THE REPUBLIC OF PANAMA.

Unrecovered costs from prior year operations must be recovered before determining any net operating revenues payable to the Republic of Panama. The unrecovered costs remaining from fiscal year 1992 operations in fiscal year 1994 were $0.6 million. The net operating revenue for fiscal year 1994 was $1.7 million and, when netted against the $0.6 million of outstanding unrecovered costs from fiscal year 1992, resulted in $1.1 million which was paid to the Republic of Panama in March 1995.

5. ALLOWANCES FOR OBSOLETE AND EXCESS STOCK.

The allowances for obsolete and excess stock provide for: (1) the specific disposal of individual inventory items likely to occur; and (2) the systematic cost recognition for spare parts retained for possible use, but whose actual use most often does not occur. These allowances are evaluated on an annual basis. Based on the evaluations for fiscal years 1995 and 1994, the allowance for excess stock was adjusted to $4.2 million and $4.6 million, respectively; and the allowance for obsolete stock remained at $1.0 million each fiscal year.

6. COMPENSATION BENEFITS FOR WORK INJURIES.

The Commission funds a program administered by the Department of Labor to compensate certain employees for death and disability resulting from performance of duty injuries or illnesses as provided for in the Federal Employees' Compensation Act (FECA). All United States citizen employees are eligible for coverage, as are non-United States citizen employees hired prior to October 1, 1979. As provided by FECA, employees and certain dependents are beneficiaries for various periods that can extend to life.

The liability and deferred charge recorded in these statements reflect the payments due to a Department of Labor fund established pursuant to Public Law 100-705. The Department of Labor will be reimbursed from this fund for all expected future payments for accidents, adjusted for inflation and interest earned. The gross amount to be recovered from tolls over the remaining life of the Treaty to retire this liability was $18.1 million in fiscal year 1995 and $26.5 million in fiscal year 1994. The reduction in the amount from fiscal year 1994 to fiscal year 1995 was attributable to $8.4 million in payments made during 1995. An evaluation, as of September 30, 1995, by an independent actuarial firm was underway at the time the statements were prepared. No significant change to the liability is anticipated as a result of this study.

7. INTEREST EXPENSE, NET.

Pursuant to section 1603(d) of the Act, the Commission is required to pay interest on the investment of the United States in the Panama Canal. Interest is computed at a rate determined by the Secretary of the Treasury and is payable to the United States Treasury. The interest rates for fiscal years 1995 and 1994 were 9.266% and 9.390%, respectively.

The investment base for calculation of interest is defined in sections 1603(a), (b), and (c) of the Act. Gross interest expense for fiscal years 1995 and 1994, based on the average United States investment in the Canal for these periods, was $22.6 million and $22.9 million, respectively. The offsets against gross interest expense for fiscal years 1995 and 1994, based on the average cash balances maintained in the Commission's revolving fund for these periods, were $18.3 million and $15.4 million, respectively.

Net interest expense reported in the Statements of Operations was $4.3 million for fiscal year 1995 and $7.5 million for fiscal year 1994.

8. SEVERANCE PAY.

In fiscal year 1995, the Commission recognized a $10.0 million liability for severance pay based on proposed regulations issued by the Office of Personnel Management (OPM). The proposed regulations prescribe entitlement for severance pay for Federal employees of the Commission who will be affected by the transfer of control over the Panama Canal from the United States to the Republic of Panama under the terms of the Panama Canal Treaty of 1977. The estimated liability amount is subject to revision upon the issuance of final OPM regulations.

9. LIQUIDATION OF LIABILITIES.

As part of the Treaty, the Commission will transfer the Panama Canal property, plant, equipment, and inventory to the Republic of Panama on December 31, 1999. The Treaty requires that the Canal be in operating condition and free of liens and debts, except as the two Parties may otherwise agree. As a result, the Commission is required to identify and fully fund all liabilities by that date.

The following Statements of Financial Viability, as of September 30, 1995 and 1994, measure the Commission's ability to liquidate all estimated liabilities on December 31, 1999:

STATEMENTS OF FINANCIAL VIABILITY
SEPTEMBER 30, 1995 AND 1994
(Millions of Dollars)

	Sept 30, 1995	Sept 30, 1994
LIABILITIES AND RESERVES:		
Accounts payable	$ 35.9	$ 26.2
Accrued liabilities	99.6	98.7
Estimated liabilities	113.6	129.9
Reserves	13.6	12.1
TOTAL LIABILITIES AND RESERVES	262.7	266.9
RESOURCES:		
Cash	217.5	170.7
Accounts receivable	13.7	9.1
Less: Cash collected for capital commitments but not yet expended	(59.2)	(36.7)
TOTAL RESOURCES	172.0	143.1
LIABILITIES TO BE FUNDED FROM FUTURE RESOURCES	90.7	123.8
PROGRAMMED RESOURCES FROM FUTURE OPERATIONS:		
Cash to be collected for deferred charges	87.3	113.1
WORKING CAPITAL DEFICIENCY	3.4	10.7
Programmed resources from future operations for working capital deficiency	3.4	10.7
	$ 0.0	$ 0.0

In fiscal year 1995, the $87.3 million programmed resources from future operations and the $3.4 million working capital deficiency are forecasted to be recovered from tolls over the remaining life of the Treaty. The working capital deficiency relates to the financing of the storehouse and fuel inventories. The collection of these programmed resources has been included in the Commission's budget forecasts. Based upon the past operating results of the Commission and the assumptions underlying the budget forecasts, management believes that the collection of these programmed resources and working capital deficiency is reasonably attainable.

It should be noted that certain expenditures, such as administrative costs of liquidation, have not been estimated at this time and are not included in the Statement of Financial Viability. These expenditures will be programmed to be recovered from future operations when reliable estimates are available. In the opinion of management, the funding of these expenditures will not have a material adverse effect on the financial position of the Commission.

10. RESTATEMENT OF CAPITAL ACCOUNTS.

The capital accounts for the Investment of the United States Government in the waterway have been restated and retitled as of September 30, 1994. The restatement was required to more accurately reflect the true nature and extent of the capital accounts of the Commission. The interest-bearing account was restated and retitled as Paid-in Capital and sets forth the unrecovered investment of the United States Government in the waterway. The non-interest bearing account was restated and retitled as Other Capital and now represents the accumulated earnings and certain other retained capital that has been reinvested in the waterway.

The restatement as of September 30, 1994, is as follows:

(dollars in thousands)

	Interest-Bearing/ Paid-in Capital	Non-Interest Bearing/ Other Capital
As reported September 30, 1994	$ 74,800	$396,451
Reclassification for cash in Panama Canal Revolving Fund	169,680	(169,680)
As restated September 30, 1994	$244,480	$226,771

11. CONTINGENT LIABILITIES AND COMMITMENTS.

a. The Commission is a defendant in certain legal actions related to personal injury, employment disputes, and other matters related to the Commission's business. In the opinion of management, the settlement of these legal actions will not have a material adverse effect on the financial position of the Commission.

b. Commitments under uncompleted construction contracts and unfilled purchase orders amounted to $34.8 million at September 30, 1995 and $41.9 million at September 30, 1994.

c. Cash and negotiable securities held by United States depositories for the Commission to guarantee payment by third parties of their obligations were $18.0 million at September 30, 1995 and $17.0 million at September 30, 1994.

d. The Treaty provides that an annual amount of up to $10.0 million per year be paid to the Republic of Panama out of operating revenues to the extent that such revenues exceed expenditures. If the operating revenues in any year do not produce a surplus sufficient to cover this payment, the unpaid balance shall be paid from operating surpluses in future years. The balance contingently payable to the Republic of Panama amounted to $149.1 million at September 30, 1995 and $139.1 million at September 30, 1994. However, as set forth in the Treaty and in the Act, nothing shall be construed as obligating the United States Government to pay, after the date of termination of the Treaty, any unpaid balance accumulated before such date.

12. SUBSEQUENT EVENT

On February 10, 1996, the Panama Canal Act of 1979 (1979 Act) was amended by Public Law No. 104-106, sections 3521-3529, to make the Panama Canal Commission a wholly owned government corporation. The Commission continues to be under the direction of its Supervisory Board. The amendments confer additional general and specific corporate powers on the Board in addition to the powers it previously exercised under the 1979 Act. For example, the Commission has replaced the President as the party authorized to prescribe the rules for measuring vessels and levying tolls for the Panama Canal. The Commission is also authorized to hire independent auditors to conduct the audit in lieu of the Comptroller General. In addition to conducting the audit of the Commission's financial statements, the auditor is to examine the Commission's forecast that it will be in a position to meet its financial liabilities on December 31, 1999.

Supplementary Information (Unaudited)

Schedules of Treaty Related Costs

Department of Defense (DOD) Costs (Savings) Through Fiscal Year 1995

Agency	Cumulative Costs 9/30/94	FY 95 Activity	Cumulative Costs 9/30/95
U.S. Army			
Base Operations	$235,281,659	$13,884,742	$249,166,401
Communications	38,673,272	11,678,612	50,351,884
Commissary	9,970,502	96,860	10,067,362
Transportation	2,921,884	4,274	2,926,158
Technical Assistance	360,240	0	360,240
Health Services	217,270,487	21,232,089	238,502,576
Disposition of Remains	5,831,573	442,108	6,273,681
Criminal Investigations	1,382,194	177,517	1,559,711
Tropical Test Center	35,408	0	35,408
Procurement of Equipment	3,046,789	0	3,046,789
Military Construction	36,397,791	0	36,397,791
Military Pay	125,113,651	1,139,969	126,253,620
Ports	165,868	0	165,868
Family Housing Operations	18,340,718	666,963	19,007,681
Executive Agent Costs	27,029,152	0	27,029,152
Total U.S. Army	721,821,188	49,323,134	771,144,322
U.S. Air Force	49,489,240	2,293,263	51,782,503
U.S. Navy	3,345,537	764,600	4,110,137
DOD Dependent Schools*	37,028,000	1,095,000	38,123,000
Defense Mapping Agency	1,158,764	0	1,158,764
Total DOD	$812,842,729	$53,475,997	$866,318,726

*Obligations incurred rather than actual expenditures

Non-DOD Costs (Savings) Through Fiscal Year 1995

Agency	Cumulative Costs 9/30/94	FY 95 Activity	Cumulative Costs 9/30/95
State Department	($24,731,760)	($1,797,343)	$26,529,103)
Federal Aviation Administration	(57,721,583)	(4,251,300)	(61,972,883)
American Battle Monuments Commission	4,639,234	292,000	4,931,234
Panama Canal Commission	300,000	0	300,000
General Accounting Office	2,888,530	401,528	3,290,058
Smithsonian Tropical Research Institute	6,643,816	761,314	7,405,130
Gorgas Memorial Laboratory	(257,351)	0	(257,351)
Canal Area Court System			
U.S. Attorney	(1,669,246)	(161,485)	(1,830,731)
U.S. Marshall	(782,400)	(68,673)	(851,073)
Clerk of Court	(4,214,415)	0	(4,214,415)
Bureau of Prisons	2,797,477	48,837	2,846,314
Foreign Broadcast Information System	896,593	145,497	1,042,090
National Oceanic & Atmospheric Administration	78,679	0	78,679
Total Non-DOD	($71,132,426)	($4,629,625)	$75,762,051)
Total DOD	812,842,729	53,475,997	866,318,726
Total DOD and Non-DOD	$741,710,303	$48,846,372	$790,556,675

Property Transferred by Department of Defense and Federal Aviation Administration to the Republic of Panama Since October 1, 1979

Agency	Cumulative Transfers 9/30/94	FY 95 Transfers	Cumulative Transfers 9/30/95
Department of Defense			
U.S. Army	$52,299,088	$59,000,000	$111,299,088
U.S. Navy	12,530,769	0	12,530,769
U.S. Air Force	284,874	0	284,874
Total DOD	65,114,731	59,000,000	124,114,731
Federal Aviation Administration	4,638,360	0	4,638,360
Total	$69,753,091	$59,000,000	$128,753,091

Property Transferred by the Panama Canal Commission and Predecessor Organizations to the Republic of Panama Since October 1, 1979

Agency	Acquisition Costs: Cumulative Transfers 9/30/94	FY 95 Transfers	Cumulative Transfers 9/30/95
Canal Zone Government and Panama Canal Company	$168,317,629	0	$168,317,629
Panama Canal Commission	35,653,803	569,908	36,223,711
Total	$203,971,432	$569,908	$204,541,340

Agency	Net Book Value: Cumulative Transfers 9/30/94	FY 95 Transfers	Cumulative Transfers 9/30/95
Canal Zone Government and Panama Canal Company	$84,886,222	0	$84,886,222
Panama Canal Commission	11,100,846	272,787	11,373,633
Total	$95,987,068	$272,787	$96,259,855

Schedule of Property, Plant, and Equipment

September 30, 1995 and 1994
(Dollars in Thousands)

		1995		1994	
	Estimated Service Life	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances
Titles and treaty rights	26 yrs.[1]	$14,729	$9,140	$14,729	$7,825
Interest during construction	-	50,892	50,892	50,892	50,892
Canal excavation, fills and embankments	15-100 yrs.	364,401	192,669	355,900	182,935
Canal structures and equipment	4-100 yrs.	441,566	215,804	410,462	196,383
Supporting and general facilities	3-100 yrs.	205,012	128,969	197,838	120,008
Facilities held for future use	15-100 yrs.	2,043	1,729	1,657	1,492
Plant additions in progress	-	22,614	-	31,448	-
Suspended construction projects	-	40,146	40,146	40,146	40,146
TOTAL		$1,141,403	$639,349	$1,103,072	$599,681

[1] Effective in fiscal year 1995, estimated service life for titles and treaty rights was changed to 26 years from 40 years.

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