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REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

Examination Of Financial Statements Of The Panama Canal Company And The Canal Zone Government For Fiscal Years 1975 And 1974

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

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

CWO ΦΦΦΦ1

Pursuant to the Government Corporation Control Act (31 U.S.C. 841), we have examined the financial statements of the Panama Canal Company for the fiscal years ended June 30, 1975 and 1974. We also examined the Canal Zone Government's financial statements for the fiscal years ended June 30, 1975 and 1974 because the Company and the government are closely related in terms of purpose and organization and because the Company is required by law to absorb the net cost of the Canal Zone Government.

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

Elmer B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

GAO	General Accounting Office
OMB	Office of Management and Budget

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

EXAMINATION OF FINANCIAL STATEMENTS OF THE PANAMA CANAL COMPANY AND THE CANAL ZONE GOVERNMENT FOR FISCAL YEARS 1975 and 1974

D I G E S T

The Panama Canal Company and the Canal Zone Government are two interrelated U.S. Government agencies charged with administering the Panama Canal.

The Company (1) transits ships through the Canal, (2) provides services to shipping interests, (3) maintains and operates the locks (4) provides support services, and (5) carries out various administrative functions for the Canal Zone Government.

The Canal Zone Government provides services normally associated with civil government, including education, health, sanitation, protection, and postal services.

COMMENTS ON FINANCIAL STATEMENTS

The following matters are discussed in chapter 2:

--Uncertainties relating to the current treaty negotiations which could affect the financial statements. (See p. 6.)

--Implementation of a policy to recognize depreciation on formerly nondepreciated assets which has resulted in an additional annual depreciation of $8.3 million. (See p. 6.)

--A change in the Thatcher Ferry Bridge's service life, resulting in an annual depreciation expense increase of $115,600. (See p. 7.)

--Costs excluded from the Company's financial statements pursuant to law. (See p. 7.)

--Recent policy changes and world economic factors affecting toll revenue, including

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the July 1974 toll rate increase, reopening of the Suez Canal, proposed vessel measurement changes, and current worldwide economic recession and reduced petroleum demand. (See p. 9.)

--Reclassification of certain cost elements which have resulted in decreasing the reported net cost of the Canal Zone Government in the current year by $14.4 million. (See p. 10.)

--The Company's inability to earn interest on funds deposited in the U.S. Treasury because of legal restrictions. (See p. 12.)

--Capitalization of dredging costs in fiscal year 1975 amounting to $2 million. (See p. 15.)

--Accounting responsibilities for the Canal Zone Government. (See p. 16.)

PERSPECTIVES ON CANAL INVESTMENT

GAO's work during this biennial review and in earlier years convinces it that certain issues unique to the Panama Canal but affecting the national interest should be recognized and considered by the Congress and other policymakers in connection with future financial operations of the Canal. These issues concern (1) negotiations between the United States and the Republic of Panama on the Canal's status, (2) return of the U.S. Government's present investment in the Canal and related facilities, and (3) future outlays of capital. While this section does not recommend specific solutions, it does provide information which can be used to study issues currently being faced by the Panama Canal Company. (See pp. 17 to 23.)

OPINION ON THE COMPANY'S FINANCIAL STATEMENTS

In GAO's opinion, subject to the uncertainties relating to current treaty negotiations, the Company's financial statements (schs. 1 through 5) present fairly its financial position at June 30, 1975 and 1974; the results of its operations; changes in the investment of the United States, and source of funds used for capital expenditures for the fiscal years then ended, in conformity with generally accepted accounting principles which--except for the accounting policy change described in note 2 to the financial statements with which GAO concurs--have been applied on a consistent basis. (See pp. 24 and 25.)

OPINION ON THE CANAL ZONE GOVERNMENT'S FINANCIAL STATEMENTS

In GAO's opinion, subject to the uncertainties relating to current treaty negotiations, the Canal Zone Government's financial statements (schs. 6 through 9) present fairly its financial position at June 30, 1975 and 1974, and the results of its operations and changes in the investment of the United States for the fiscal years then ended, in conformity with the principles and standards of accounting prescribed by the Comptroller General. (See p. 25.)

CHAPTER 1

INTRODUCTION

The Panama Canal Company, known as the Panama Railroad Company until it was renamed by the act of September 26, 1950, and the Canal Zone Government, the two U.S. Government agencies charged with administering the Panama Canal, are closely interrelated in terms of purpose, organization, and operation.

The Company, a wholly owned U.S. Government corporation, is managed by a Board of Directors and the Canal Zone Government is administered by the Governor of the Canal Zone, who is also president of the Company. The Secretary of the Army, in an independent capacity, is the direct representative of the President of the United States as the sole stockholder of the Company and as supervisor of the administration of the Canal Zone Government. The Secretary of the Army, in his independent capacity as stockholder of the Company, also appoints the Company's Board of Directors.

Charged with maintaining and operating the Canal, the Company transits ships through the Canal, provides services to shipping interests, maintains and operates the locks, and provides support services. These support services include vessel repairs; harbor terminal operation; operation of a railroad, an electric power system, a communications system, and a water system; and other services--such as operation and maintenance of rental housing, retail stores, and service and recreational facilities--essential to employee welfare. In addition, under the terms of an interagency agreement, the Company administers the legal, personnel, and budget and accounting operations of the Canal Zone Government.

The Canal Zone Government, known as the Panama Canal (the agency) until it was renamed by the act of September 26, 1950, is an independent U.S. Government agency. It provides services associated with civil government, including education, health, sanitation, protection, and postal services for the Canal Zone.

A chart of the Canal organization (the Company and the government) appears on page 3. At the end of this chapter are two composite photographs, furnished by the Company, which illustrate some of the functions or activities carried out by the Canal organization.

FINANCING OF ACTIVITIES

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

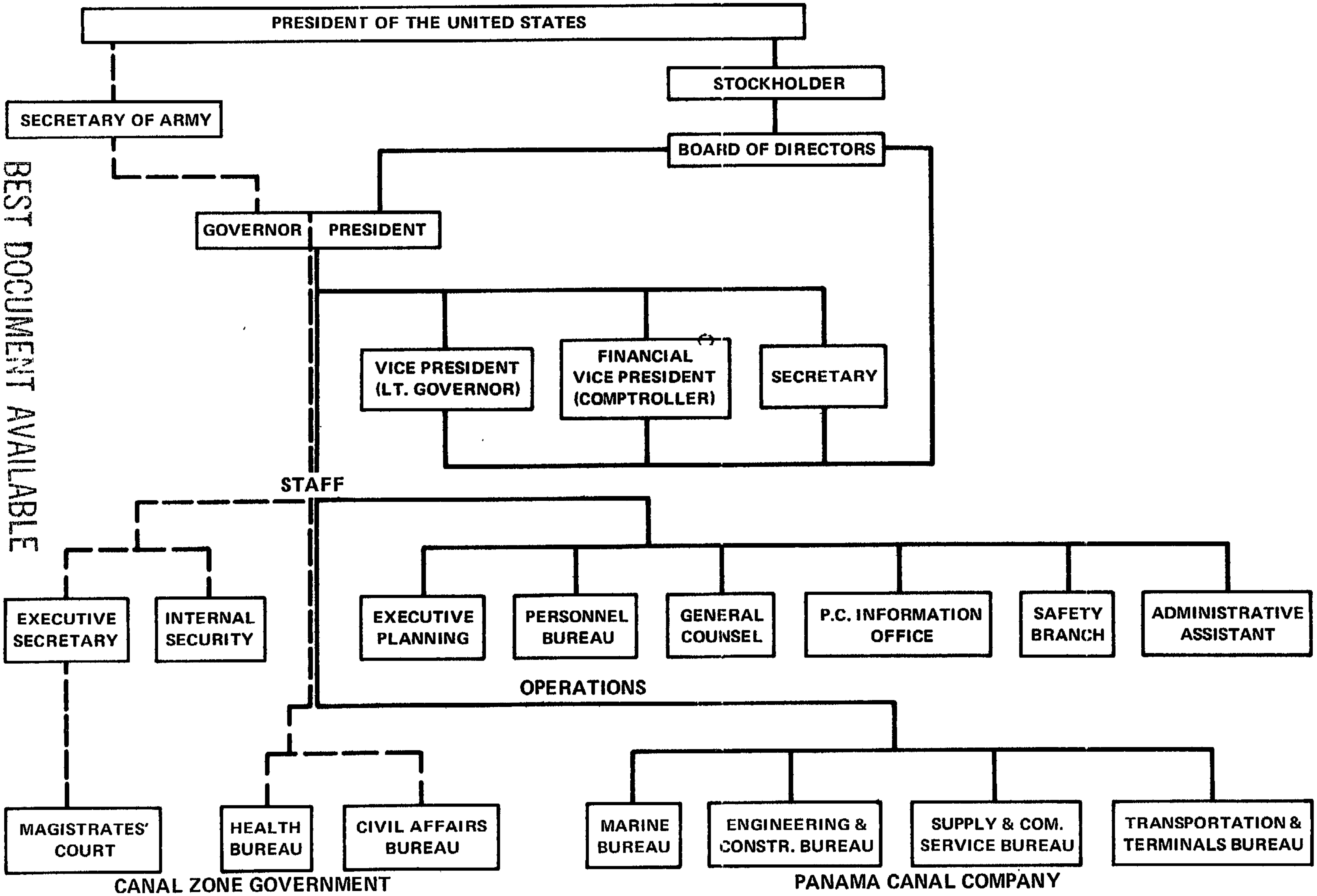
The Canal organization is designed to be self-sustaining. The Company finances its operating and capital expenditures with revenue from its transit tolls and support service operations. The government, on the other hand, receives annual appropriations to finance its operating and capital expenditures.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

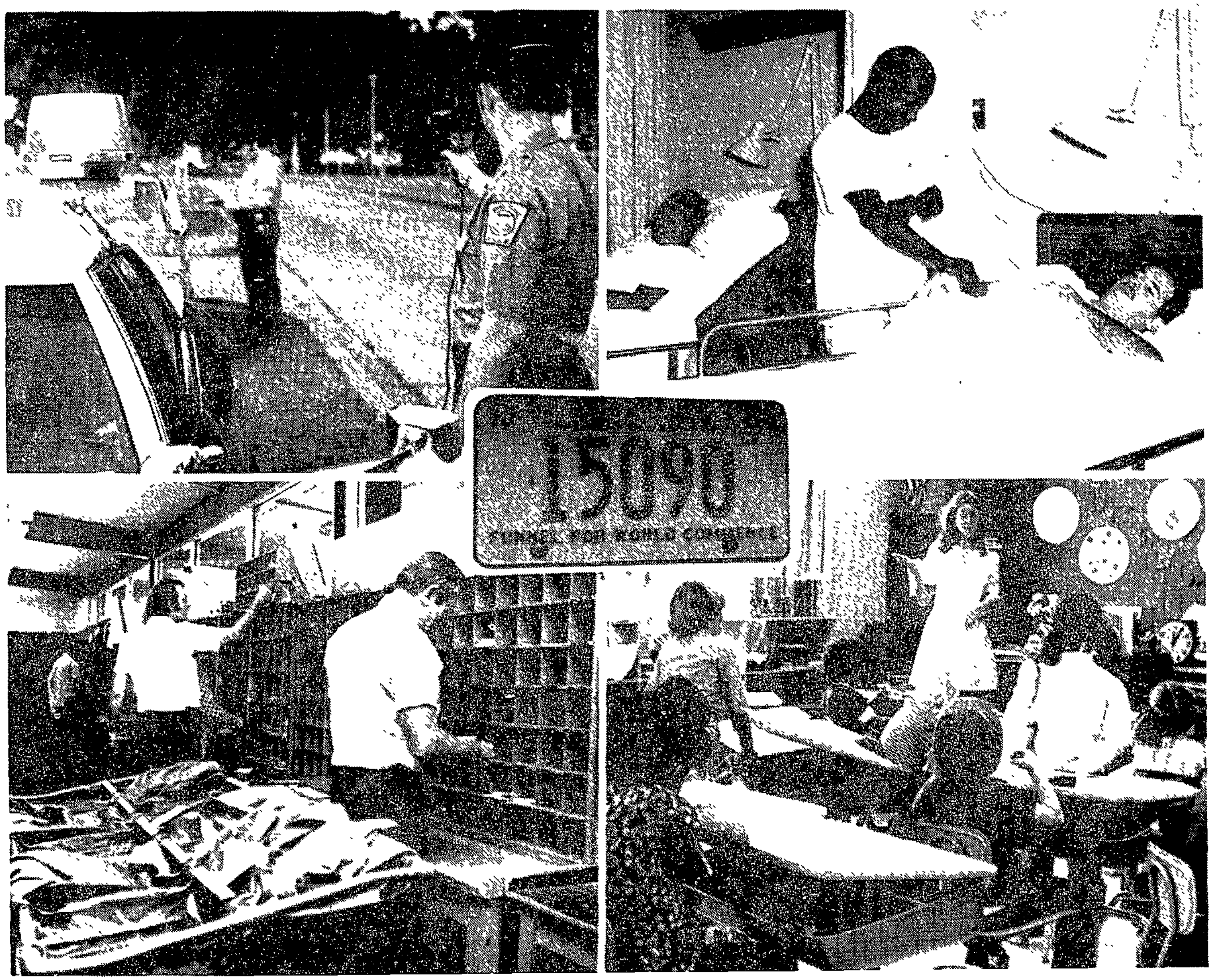
Tolls from canal transits are the Company's major source of revenue. The toll rates are established by the Company subject to the approval of the President of the United States (2 C.Z.C. section 412a). The basis of the toll rates is prescribed by section 412(b) of title 2 of the Canal Zone Code:

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

Canal toll rates, initially established in 1914, remained the same through fiscal year 1974, except for a slight adjustment in 1938. Revised toll rates went into effect at the beginning of fiscal year 1975. In addition, the Company published a notice in the Federal Register during July 1975 proposing several provisions in the rules for measuring vessels. The effects of these changes, if approved, on toll revenue, as well as the effects of other proposed toll changes and economic considerations, are discussed in chapter 2.

ORGANIZATION CHART
OF THE CANAL ORGANIZATION





SELECTED NONCOMMERCIAL AND CIVIL OPERATIONS OF THE CANAL ZONE GOVERNMENT

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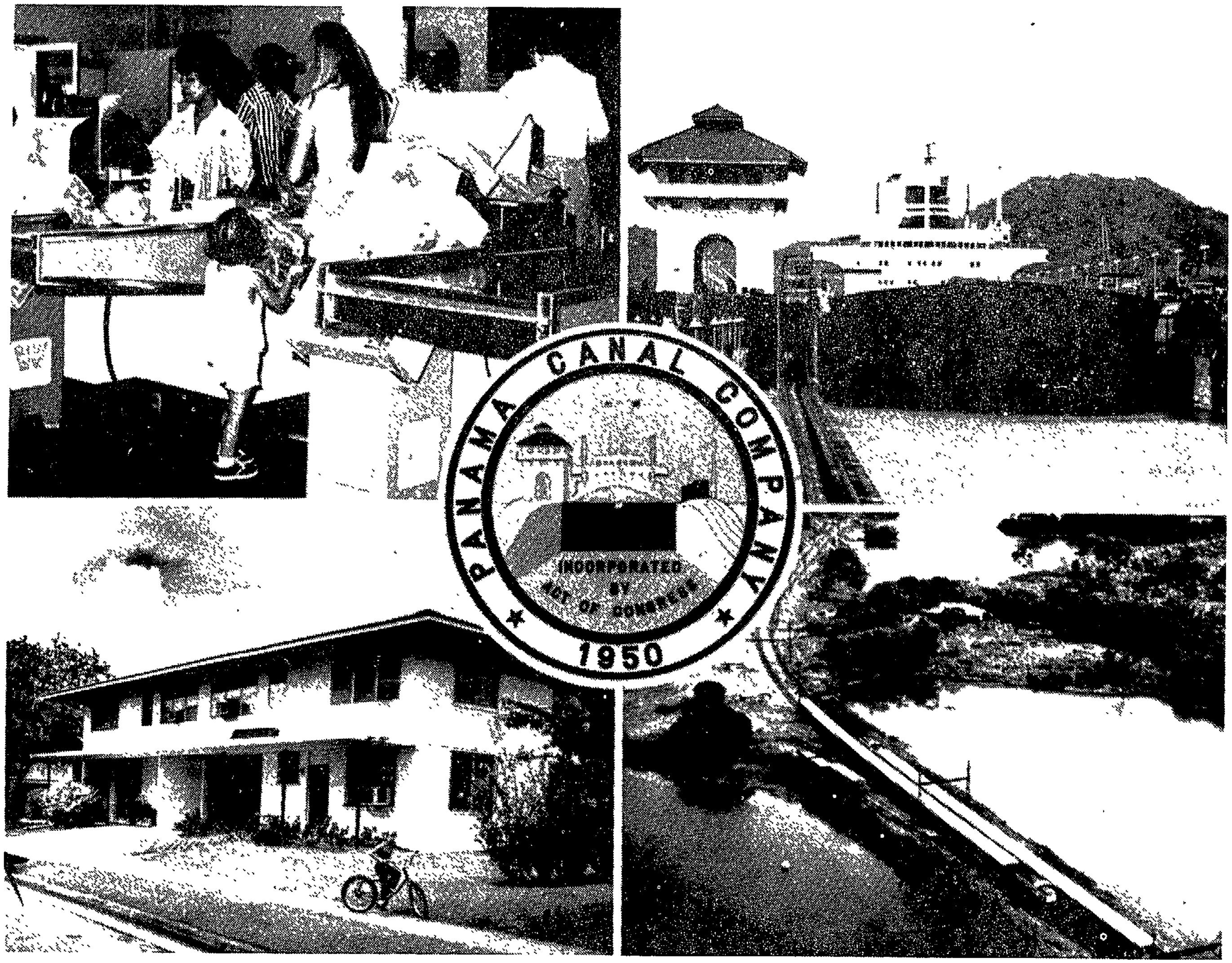

SELECTED COMMERCIAL ACTIVITIES OF THE COMPANY

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CHAPTER 2

COMMENTS ON FINANCIAL STATEMENTS

UNCERTAINTIES THAT COULD AFFECT THE FINANCIAL STATEMENTS

As stated in the Panama Canal Company's and the Canal Zone Government's financial statements (footnotes 10 and 9), the financial effects of the current treaty negotiations have not been determined. When the Governments of the United States of America and the Republic of Panama signed a Statement of Principles on February 7, 1974, it was recognized that the results of the ensuing negotiations and ultimate treaty could have an impact on the Canal organization. However, the financial statements have been prepared on the assumption that the Canal organization will continue to operate as in the past.

INITIATING DEPRECIATION OF CERTAIN ASSETS

As we stated in our report on the fiscal year 1973 financial statements (B-114839, Mar. 6, 1974), the Company reevaluated its position of not depreciating certain assets. These assets, valued at $332 million at June 30, 1973, included titles; treaty rights; and excavations of channels, harbors, and basins. As a result of the reevaluation, the Company's Board of Directors approved a policy, effective July 1, 1973, to begin depreciating these assets. We approve of this change in the depreciation policy and, in fact, have been generally advocating this accounting treatment since fiscal year 1952.

The Company's Board of Directors, after considering alternative depreciation periods, adopted a 40-year period as the most appropriate for recovering costs during the assets' remaining economic life. The period assumes that the Canal has an economic life of 100 years from the time it was constructed. We believe the period is reasonable and should be used until the assets are fully depreciated, unless later events indicate the period is no longer appropriate.

The Company decided to depreciate these assets prospectively to recover the cost from future revenues. In our opinion, this method is in accordance with generally accepted accounting principles as they relate to a rate-regulated business such as the Company.

On a straight-line basis of depreciation over a 40-year period, this change results in an added annual depreciation expense of $8.3 million.

CHANGE IN THATCHER FERRY BRIDGE'S SERVICE LIFE

In July 1973 Company officials advised the Board of Directors that, even though they had not specifically mentioned it in their Statement of Accounting Policies submitted for approval, the Company planned to accelerate the depreciation of the Thatcher Ferry Bridge. The accelerated rate, which became effective in fiscal year 1974, will cause the bridge to become fully depreciated at the same time those assets not previously depreciated become fully depreciated. In the Company's opinion, this change gives consistency to its depreciation policy in that the longest lived assets of the Canal proper, including the lock chambers, will be scheduled to become fully depreciated at the same time. The yearly depreciation expense increased by $115,600 because of the change.

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

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

--The cost of facilities acquired for national defense.

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

--Extraordinary expenditures on losses (1) incurred through directives based on national policy and (2) not related to the Company's operations.

In fact, however, the Company is not legally required to reimburse the U.S. Government for certain other costs incurred annually on behalf of the Canal organization. Comments on these costs, which amount to about $2.3 million a year, are presented below.

Annuity to the Republic of Panama

Article I of the 1955 treaty between the United States and the Republic of Panama increased the annual annuity to Panama for $430,000 to $1,930,000. It also required adjusting the annuity as the relationship between the U.S. dollar and gold changes. In accordance with

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this latter provision, the annuity was increased to $2,328,200 for fiscal years 1975 and 1974.

The U.S. Treasury pays the annuity from appropriations received by the Department of State. However, as required by the Canal Zone Code (title 2, section 62(g)), the Company reimburses the U.S. Treasury for the original amount of the annuity. The annual reimbursement also includes an adjustment to the original annuity for the effect of changes in the relationship between the U.S. dollar and gold. Thus, the Company paid $518,718 in both fiscal years 1975 and 1974. The remaining amount--$1,809,482 in both fiscal years 1975 and 1974--was borne by the U.S. Government. Annuity payments from U.S. Government funds amounted to about $30.7 million through fiscal year 1975.

Recurring annuities and injury and death compensation payments to certain former employees

Construction annuities and injury and death compensation are paid annually to certain employees of predecessor agencies of the Canal organization. For fiscal years 1975 and 1974, these payments averaged about $510,785 a year and were made from funds provided by other U.S. Government agencies.

Construction annuities are paid by the U.S. Civil Service Commission to U.S. citizens (and their widows) who worked on the Canal during the years 1904 to 1914. These annuities are paid pursuant to the act of May 29, 1944, as amended (48 U.S.C. 137a).

The Company pays injury and death compensation to employees (and their dependents) of the predecessor agencies of the Canal organization. The Company is reimbursed for these payments by the Office of Federal Employees Compensation, Department of Labor.

As shown below, construction annuities and injury and death compensation payments totaled $57,360,176 through fiscal year 1975.

Period	Construction annuity	Injury and death compensation	Total
Through fiscal year 1973	$50,788,424	$5,550,182	$56,338,606
Fiscal year 1974	410,087	116,685	526,772
Fiscal year 1975	367,480	127,318	494,798
Total	$51,565,991	$5,794,185	$57,360,176

TOLL RATE CHANGES AND OTHER ECONOMIC CONDITIONS AFFECTING TOLLS REVENUE

Revenue from transit operations is generated principally in the form of tolls and transit-related charges collected from vessels going through the Canal. The following table shows the results of transit operations for the past several years.

Fiscal year ended June 30	Number of transits paying tolls	Canal net tonnage	Transit revenue (note a)
		(millions)	
1972	15,104	116.3	$114.6
1973	15,054	129.1	128
1974	15,217	138.1	139
1975	14,693	136.6	164.1

a/Transit revenue equals tolls and toll credits, plus Navigation Service and Control revenues which are reported as other revenue in the Company's statement of operations. (See sch. 2.)

Several factors have had or will have a direct impact on the Canal's transit operations. These factors include the current worldwide economic recession and reduced petroleum demands, the July 1974 toll rate increase, the reopening of the Suez Canal, and the proposed vessel measurement rule changes.

The decline in paying transits and the decrease in net tonnage in fiscal year 1975 can best be attributed, according to Canal organization officials, to the economic recession and reduced petroleum demand. Even though the toll rate increase went into effect in July 1974, Company officials did not consider it a factor in the above decline. The net direct effect of the toll rate changes was to increase toll revenue for fiscal year 1975 by approximately $23.1 million.

The reopening of the Suez Canal on June 5, 1975, had no measurable effect on the Panama Canal's fiscal year 1975 operations. However, once the Suez Canal reaches its anticipated traffic flow, Canal organization officials project an estimated revenue loss amounting to about $12 million annually.

The Company has proposed changes in the vessel measurement procedures used for establishing tolls. The

Company estimates that if these changes had been in effect during fiscal year 1975, they would have increased toll revenue for that year by about $12 million.

RECLASSIFICATION OF CERTAIN COST ELEMENTS IN NET COST OF THE CANAL ZONE GOVERNMENT

As stated in the introductory chapter, the Canal Zone Government is an independent agency of the U.S. Government. The agency receives appropriations from the U.S. Government to meet its operating expenses and capital needs. In reality, however, these funds represent advances, since the amounts are returned to the U.S. Treasury (1) from charges made to individuals and agencies for the services rendered, and (2) from the Company by way of reimbursement of the net cost of the Canal Zone Government.

During the past several years, Canal organization officials have made two classification changes which have reduced the reported net cost of the Canal Zone Government. Although the changes did not affect the total cost which the Company actually reimbursed to the U.S. Treasury, the changes did reduce the reported net cost of the government. The table shows their effect.

	Fiscal year 1975		Fiscal year 1974	
	Amount of change	Balance	Amount of change	Balance
Net cost of Canal Zone Government before reclassification		$37,957,263		$35,425,823
Recoveries from the Company:				
Company sponsorship	$10,331,230		$10,165,489	
General Canal sponsorship	4,110,085		3,727,236	
Total		14,441,315		13,892,725
Net cost of Canal Zone Government after reclassification		$23,515,948		$21,533,098

The first classification change, made in fiscal year 1973, recognized the Company's costs for sponsoring health, education, and fire protection expenses for its employees. The reclassification resulted in the cost of the Company's sponsorship being reported in its statement of operations for fiscal years 1975 and 1974 under general and administrative expenses and reduced the reported net cost of the government by the amounts listed below.

	Amounts	
	Fiscal year 1975	Fiscal year 1974
Company sponsorship--education	$ 5,267,479	$ 5,829,647
Company sponsorship--health	3,539,056	2,993,743
Company sponsorship--fire	1,524,695	1,342,099
Total	$10,331,230	$10,165,489

The second classification change affecting the government's net cost was initiated in fiscal year 1975 and made retroactive to fiscal year 1974. The unrecovered health and education costs for certain nonsponsored individuals, previously absorbed in the net cost of the government, were identified as national policy costs and reimbursed by the Company. On the Company's statement of operations, the following amounts were reclassified from net cost of Canal zone Government to other expenses.

	Amounts	
	Fiscal year 1975	Fiscal year 1974
General Canal sponsorship--education	$ 489,895	$ 423,570
General Canal sponsorship--health	3,620,190	3,303,666
Total	$4,110,085	$3,727,236

A third reclassification procedure was instituted in fiscal year 1975 to recognize the government's sponsorship of education and health services provided to its employees. This new procedure, however, had no effect on the government's overall net cost; it merely increased the amounts reported as education and hospital recoveries on the government's statement of operations and effected an offsetting decrease to recoveries from miscellaneous charges and credits. The amounts involved in the change are listed below.

	Amounts
	Fiscal year 1975
Increase in education recoveries	$2,593,697
Increase in health recoveries	524,729
Decrease in recoveries from miscellaneous charges and credits	$3,118,426

All three of these reclassification changes had a direct impact on the government's statement of operations by increasing the recovery amounts reported for education and hospitals. Their net effect is summarized below.

	Amounts	
	Fiscal year 1975	Fiscal year 1974
Education recoveries	$ 8,351,071	$ 6,253,216
Health recoveries	7,683,975	6,297,410
Fire protection recoveries	1,524,695	1,342,099
Recovery increases	17,559,741	13,892,725
Less: Decrease in miscellaneous charges and credits recoveries resulting from reclassification	3,118,426	-
Net increase in total Canal Zone Government recoveries resulting from all reclassifications	$14,441,315	$13,892,725

COMPANY RESTRICTED FROM EARNING INTEREST ON CASH DEPOSITED WITH THE U.S. TREASURY

As a wholly owned U.S. Government corporation, the Company is subject to the Government Corporation Control Act (31 U.S.C. 841 *et seq.*) keeps all cash exceeding current operating requirements on deposit with the U.S. Treasury.

As shown in its statement of financial condition (sch. 1), the Company had a cash balance of approximately $42.1 million at the end of fiscal year 1975. About $2.9 million of this amount was on deposit in commercial banks or held on hand for anticipated cash needs during the following month. The remainder, about $39.2 million, was on deposit with the U.S. Treasury, as required by the Government Corporation Control Act.

Company officials are trying to find a way to earn interest on the funds deposited with the U.S. Treasury. The Company is designed to operate in a businesslike manner and to be financially self-sustaining, except for certain costs excluded by law. (See pp. 7 and 8.) Company officials believe, therefore, that they should be given the authority to manage cash in a prudent businesslike manner and thereby reduce the Company's annually increasing operating expenses.

However, the Government Corporation Control Act makes no provision for paying interest on U.S. Treasury accounts maintained by U.S. Government corporations. Furthermore, we are aware of no other general statutory authority which allows U.S. Government corporations to receive--or the U.S. Treasury to pay--interest on U.S. Government corporation funds deposited in the U.S. Treasury.

The Company, on the other hand, is required by title 2, section 62(e) of the Canal Zone Code to pay interest to the U.S. Treasury:

> "In order to reimburse the Treasury, as nearly as possible, for the interest cost of the funds and other assets directly invested in it, the Panama Canal Company shall pay interest to the Treasury on the net direct investment * * * (of the U.S. Government in the Panama Canal Company) * * * at a rate or rates determined by the Secretary of the Treasury as required to reimburse the Treasury for its cost. Payments of the interest charges shall be made annually to the extent earned, and if not earned shall be made from subsequent earnings."

Section 62 of the Canal Zone Code also provides the specific statutory formula for determining the base upon which interest is to be computed. The Canal Zone Code lists certain offsets which may be considered; however, the statutory framework, as well as the history of legislation concerning the Company, imply that the enumerated offsets are exclusive and that no offsets other than those enumerated are allowed. Since Company funds deposited with the U.S. Treasury are not an enumerated offset, these funds cannot legally be considered a repayment of the U.S. Government's investment or a reduction in the interest computation base.

Some possible alternatives which would allow the Company to reduce its interest cost are discussed below.

1. Reduce the size of the U.S. Government's net direct investment by paying a portion of the Company's cash balance into the U.S. Treasury as a dividend.

This alternative is now available to Company officials and would provide for both a return of the U.S. Government's investment and a reduction in the Company's annual interest expenses. It would not, however, provide a change in management's authority and, unless the entire amount on deposit was declared as a dividend, the amount of benefits being sought by management would not be realized. Furthermore, paying the entire amount on deposit would probably require the Company to borrow funds from the U.S. Treasury to meet its operating and capital requirements.

2. Seek a legislative change in section 62, title 2, of the Canal Zone Code to permit the cash on deposit with the U.S. Treasury to be deducted from interest computation base.

Although this change would reduce the Company's interest payments to the U.S. Treasury, it would also reduce any incentive to return the U.S. Government's investment. Consideration should be given, therefore, to coupling such a change with a requirement for a systematic return of the investment. This alternative has other advantages also: (1) the change involves only a minor revision in the terminology of existing Company legislation and (2) the change refers to specific Company legislation and would not, therefore, indicate a change in congressional financial policies toward other U.S. Government corporations. Had this type of provision been in effect during fiscal year 1975, the Company's operating expenses and net loss for the year would have been reduced by about $1.8 million.

3. Seek legislation similar to the act of August 25, 1959, (Public Law 86-200, 73 Stat. 428) which would authorize an increase in the Company's borrowing authority to an amount equivalent to the effect a dividend declaration would have on any fund ratios the Company is required to meet.

This alternative would provide for a return of the U.S. Government's investment and a reduction in the Company's annual interest expense. Furthermore, the Company's fund ratio requirements would not be affected. However, similar to alternative 1, the benefits being sought by the Company would not be realized unless the entire deposit was declared as a dividend.

4. Request the Secretary of the Treasury to waive, pursuant to his authority, the requirement of the Government Corporation Control Act and thereby permit the Company to earn interest by investing its funds in appropriate U.S. Government bonds.

This alternative would provide benefits similar to those cited in alternative 2. We would not object to this alternative, provided the financial interest of the United States is fully protected and an appropriate procedure for systematically returning the U.S. Government's investment in the Company is included.

Among the alternatives identified, only alternative 1 can presently be implemented by the Company and, as such, would not provide for the change being sought by Company management. Other alternatives probably could be developed; however, any alternative selected should, in our opinion, include provisions for (1) an incentive for the Company to return the U.S. Government's investment, preferably on a systematic basis requiring a minimum annual return, (2) a requirement that the Company's Board of Directors continue to identify the amount of funds available for dividend declaration, and (3) the continued protection of the U.S. Government's financial interests.

CAPITALIZATION OF CERTAIN DREDGING COSTS

It is Company policy that nonrecurring costs for substantial Canal improvements be capitalized and depreciated. Before substantial improvements can be undertaken, a capital program budget should be reviewed and approved by the Company's Board of Directors, the Office of Management and Budget, and the Congress.

Two major Canal improvement programs were undertaken in fiscal year 1975.

1. A program to widen certain sections of the Canal (estimated to cost $9.4 million through fiscal year 1978; $0.7 million of this amount was expended in fiscal year 1975).

2. A program to deepen certain sections of the Canal below its original design depth (estimated to cost $15.5 million through fiscal year 1979; $1.3 million of this amount was expended in fiscal year 1975).

Although the $2 million spent in fiscal year 1975 was appropriately capitalized, the programs were approved as routine maintenance programs rather than as capital improvements. Later, in its fiscal year 1977 capital program submission to the Congress, the Company identified these two programs as continuing capital improvements.

Even though both capital and operational expenditures are approved in the budget process, capital programs are described in greater detail. The importance of evaluating capital expenditures with respect to returning the U.S. investment is discussed in chapter 3.

ACCOUNTING RESPONSIBILITIES FOR THE CANAL ZONE GOVERNMENT

The Accounting and Auditing Act of 1950, 31 U.S.C. §66(a) (1970) places responsibility for establishing and maintaining adequate systems of accounting and internal control with the head of each executive agency. These systems are required to meet the accounting principles, standards, and related requirements prescribed by the Comptroller General.

The 1950 act requires that the Comptroller General approve accounting systems when they are deemed adequate and conform to his prescribed principles, standards, and related requirements. The Comptroller General approves the accounting system in two stages--the agency's statement of principles and standards and the design of the accounting system.

Regarding the Canal organization, the 1950 act applies to the government only. The Comptroller General approved the government's accounting principles and standards and system design in June 1964.

CHAPTER 3

PERSPECTIVES ON CANAL INVESTMENT

Our work during this biennial review and in earlier years convinces us that certain issues unique to the Panama Canal but affecting the national interest should be recognized and considered by the Congress and other policymakers in connection with future financial operations of the Canal. These issues concern (1) negotiations between the United States and the Republic of Panama on the Canal's status, (2) return of the U.S. Government's present investment in the Canal and related facilities, and (3) future outlays of capital. We are not making specific recommendations; rather, we are providing information that can be used in studying these issues and in defining the best interests of the U.S. Government.

NEGOTIATIONS ON THE CANAL'S STATUS

Negotiations between the United States and the Republic of Panama on the Canal's status have been and probably will continue to be a subject of congressional deliberation and concern. Our discussion of this issue presents the history of treaty rights acquired before construction of the Canal began and ends with the 1974 principles which serve as the basis for current treaty negotiations.

The first concession to build an interoceanic canal across the Isthmus of Panama was granted to a private French interest in 1878. Twenty years later, and after two unsuccessful attempts by the French to construct a canal, the almost bankrupt Compagnie Nouvelle du Canal de Panama offered to sell its canal-building rights to the United States. To obtain the French company's rights, the United States negotiated with Colombia. The resulting Hay-Herran Treaty authorized the sale of the French company's rights and granted the United States administrative control for a 100-year period over the land needed for a canal. Colombia was to receive an initial payment of $10 million and annual payments of $250,000. Although Colombia was to retain sovereignty over the land, the 100-year lease was to be indefinitely renewable.

The Hay-Herran Treaty was signed by both countries' negotiators on January 22, 1903, and was ratified by the U.S. Senate without alterations on March 17, 1903. Colombia, however, delayed ratification and finally rejected the treaty on August 12, 1903. Anticipating Colombia's action, a group of prominent Panamanians formed a revolutionary junta. A near-bloodless revolution was staged and, on November 4, 1903, Panama declared its independence from Colombia. The United States granted recognition of the newly declared republic almost immediately and Panama appointed a representative to negotiate a canal treaty with the United States.

In the treaty for the construction of an interoceanic canal, Panama granted to the United States all the rights over the Canal Zone it "would possess and exercise if it were the sovereign in perpetuity." The treaty, known as the Hay-Bunau Varilla Treaty, was ratified by the Republic of Panama on December 2, 1903, and by the United States on February 25, 1904. It became effective February 26, 1904.

With the exception of the jurisdictional powers granted in perpetuity, the Hay-Bunau Varilla Treaty was very similar to the Hay-Herran Treaty earlier rejected by Colombia. For instance, both treaties required the United States to make an initial $10 million payment, pay $250,000 annually, and guarantee the independence of the host country. In exchange, the United States was to be granted use and control of (1) a land zone--5 kilometers in the first treaty, 5 miles in the latter--extending to either side of the center of the canal route and (2) any additional land and waters outside this area necessary for the construction, maintenance, operation, and sanitation of the canal. Both treaties also granted the United States the right to maintain public law and sanitation standards in Panama City, at the Pacific end of the Canal Zone, and in Colon, at the Atlantic end. To maintain sanitation standards, the United States could acquire lands and properties (via eminent domain in the latter treaty) within these cities and their adjacent harbors. In addition, both treaties generally recognized the United States' interoceanic canal waterway and railroad rights as monopoly concessions.

The Hay-Bunau Varilla Treaty was modified by treaties in 1936 and 1955. The 1936 treaty was one of mainly concessions by the United States. For instance, the United States agreed to (1) increase the annuity payment from $250,000 to $430,000, (2) permit Panama to impose taxes and charges on certain vessels at Panamanian ports and on certain merchandise destined for Panama, and (3) relinquish the right to exercise eminent domain, to acquire additional lands and waters, and to maintain public order in Panama City and Colon. The treaty participants also agreed that the United States' guarantee to maintain the Republic of Panama's independence was to be superseded by a commitment to maintain peace and friendship between the two countries.

In revisions to the 1955 treaty, the United States agreed to (1) increase the annuity payment from $430,000 to $1.93 million and adjust the annuity as the relationship between the U.S. dollar and gold changes, (2) permit the Republic of Panama to impose income taxes on Panamanian nationals employed in the Canal Zone, (3) transfer, free of cost to the Republic of Panama, certain lands and land improvements no longer needed for canal activities, and (4) give up the right to enforce sanitation standards in Colon and Panama City. Additionally, the United States gave up its right to a railroad monopoly within territory under the Republic of Panama's jurisdiction.

The United States and the Republic of Panama are negotiating a new treaty. The United States' Secretary of State, Henry Kissinger, and Panama's Foreign Minister, Juan A. Tack, have signed a joint statement of eight fundamental principles to use as guidelines for negotiations.

--The 1903 treaty will be entirely abrogated.

--The concept of perpetuity will be eliminated.

--U.S. jurisdiction over Panamanian territory will be promptly terminated in accordance with terms specified in the treaty.

--The territory in which the Canal is situated will be returned to the jurisdiction of the Republic of Panama.

--The Republic of Panama will receive a just and equitable share of the benefits derived from the Canal's operation.

--The Republic of Panama will participate in administration of the Canal and, upon termination of the treaty, will assume total responsibility for its operation. The Republic of Panama shall grant to the United States, in accordance with and for the duration of the treaty, the rights necessary to regulate the transit of ships and to operate, maintain, protect, and defend the Canal.

--Panama will participate with the United States in the protection and defense of the Canal as agreed upon in the new treaty.

--Provisions for new projects to increase Canal capacity will be agreed on bilaterally.

Negotiations are continuing. A resulting treaty could affect the Canal organization's current structure and the scope of its activities. At this time, no final agreements have been reached.

RETURNING THE U.S. GOVERNMENT'S INVESTMENT

Through the Panama Canal enterprise, the United States has operated the Canal as an international public utility, providing over 60 years of virtually uninterrupted service to world commerce. To provide this service, the United States has made a large investment in the Panama Canal enterprise (i.e., the Panama Canal Company, the Canal Zone Government, and their predecessor agencies). Another issue for congressional consideration is whether the Company should be required to systematically repay this investment.

The gross investment in the enterprise--including appropriation, net property transfers, and interest on invested capital--since inception of the enterprise has been about $1.861 billion. 1/ Recoveries over those years--including dividend payments, interest payments, and toll credits for transits of U.S. Government vessels--have amounted to about $1.125 billion, leaving an unrecovered investment of about $736 million. 2/ Although the Canal organization's financial structure was designed to be self-sustaining, approximately $134 million of the $736 million has been incurred since the organization was established in 1951. As indicated in footnote 2 below, decisions have already been made which affect the amount which can be recovered.

1/This amount does not include appropriations made for Canal Zone Government operations, since, as stated in chapter 1, these appropriations are merely advances that are returned to the U.S. Treasury.

2/Of the $736 million unrecovered investment, approximately $579 million is regarded as the U.S. investment in the equity of the Panama Canal enterprise. (See schs. 1 and 6.) A large part of the remaining $157 million is unrecovered because of specific congressional actions. For example, specific laws exempt interest charges on capital invested in the Canal Zone Government and on the Thatcher Ferry Bridge, built pursuant to provisions of the 1955 treaty. Thus, an estimated $47 million in interest cost relating to these exempt items has not been recovered. Also, under the 1955 treaty and other treaty commitments, the United States has, without reimbursement, transferred property valued at about $22 million to the Republic of Panama.

There are presently two methods of repaying the U.S. investment: one for the Canal Zone Government and one for the Panama Canal Company. Since the government's operating costs, including depreciation, are repaid to the U.S. Treasury annually, the U.S. Government is being systematically repaid for its investment in the Canal Zone Government. The Company, on the other hand, is not required to systematically repay the U.S. investment in the Company. The Company repays invested capital only when its Board of Directors determines that funds exceeding working capital needs and plant replacement and expansion requirements are available. These repayments are referred to as dividends. At present, the Company's Board of Directors is required to assess, at least annually, the Company's needs and requirements to determine whether a dividend should be declared. In the 24 years the Company has been incorporated, dividends totaling $40 million have been declared. The Board of Directors has not declared a dividend within the past 6 years.

Why should a change in the Company's method for repaying the U.S. investment be considered? One reason is that some U.S. Government corporations, such as the Tennessee Valley Authority and the St. Lawrence Seaway Development Corporation, have specific systematic payback requirements. Another reason is that the Company recently concluded that the Canal no longer has an indefinite economic life and began depreciating the related costs. Until then, the Canal's economic life was considered to be virtually limitless, and such assets as titles, treaty rights, and excavations of channels, harbors, and basins, as well as other works, were not depreciated. Now these previously nondepreciable assets--which are part of the United States' equity--are being systematically depreciated. Similarly, consideration should be given to recovering the U.S. investment in the Panama Canal enterprise over the Canal's economic life. If it is not feasible to recover the entire investment this way, recovering a minimum amount equal to the annual depreciation might be considered.

It is the Company's position that, under existing statutory authority, a systematic repayment plan would be self-defeating. The Company advised us that:

> "Inasmuch as the toll rate formula prescribed by law does not provide for a profit factor, there is no way of generating funds for a systematic repayment of the U.S. Government's investment other than through the use of funds realized from the depreciation expense included in rates set to recover operating costs. In

recent years and in the foreseeable future, all such funds have been and will be needed to finance capital improvements and replacements. Accordingly, under a systematic repayment plan, appropriations equivalent to repayments would be required to finance the Company's capital program. Additionally, even without systematic repayments, there is the probability of a need for appropriations to finance a portion of near-future capital improvement and replacement requirements."

It is our belief that a profit factor is not needed to generate funds for at least a minimum annual repayment of the U.S. Government's investment. As previously stated, the Company recently started depreciating certain assets which represent a part of the U.S. investment in the Company. When the Company achieves its planned increases in toll rates to reach the required break-even point, the depreciation of these assets will generate about $8 million a year in additional funds for the Company. Since the Company has no foreseeable need to replace these particular assets, the additional funds will be available for repaying the U.S. investments or obtaining other assets. And, as stated below, the acquisition of other assets should be closely evaluated not only from the standpoint of need but also from the standpoint that such acquisitions represent an additional fixed U.S. investment in the Company.

FUTURE OUTLAYS OF CAPITAL

Closely related to the issue of returning the U.S. investment in the Panama Canal enterprise is the third issue: future capital outlays. Moneys generated by the Company in excess of its working capital needs are available for either capital expenditures or dividend declarations. Since the United States is the sole investor in the Panama Canal enterprise, Company expenditures for capital projects, in lieu of dividend declarations, represent an additional fixed U.S. investment in the Company. Thus, capital programs should be closely evaluated, not only from the standpoint of need but also from the standpoint that the program will represent an additional U.S. investment in the Company. In approving the Company's proposed annual capital budget, the Congress may wish to evaluate whether the Company should reinvest its moneys in capital projects or declare a dividend.

OBSERVATION

Because of the forces affecting the Canal organization, including the potential but unquantifiable impacts of current treaty negotiations, coordination between the legislative and executive branches is needed to provide direction to the Company's Board of Directors regarding investments in capital projects and return of U.S. investment in the Canal. If capital outlays are made without perceptive and adequate policy guidance from the highest Government levels, return of the U.S. investment could be more tenuous than it is now.

CHAPTER 4

SCOPE OF EXAMINATION AND

OPINION ON FINANCIAL STATEMENTS

We have examined the Company's statement of financial condition as of June 30, 1975 and 1974, and its related statements of operations, changes in investment of the United States and source of funds used for capital expenditures for the fiscal years then ended.

Because the Company is required to assume the net cost of the Canal Zone Government as an operating expense and because it acts as an agent for the Canal Zone Government in (1) advancing funds for its monthly operations, construction, and other activities and (2) collecting its revenue, we also examined the Canal Zone Government's statement of financial condition as of June 30, 1975 and 1974, and its related statements of operations and changes in the investment of the United States for the fiscal years then ended.

We made our examination in accordance with generally accepted auditing standards and included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances and in view of the financial audit work done by the Company's internal auditors.

PANAMA CANAL COMPANY

In our opinion, subject to the uncertainties described in note 10 to the financial statements, the accompanying financial statements (schs. 1 through 5) present fairly the financial position of the Panama Canal Company at June 30, 1975 and 1974, and the results of its operations, changes in investment of the United States, and source of funds used for capital expenditures for the fiscal years then ended, in conformity with generally accepted accounting principles which--except for the accounting policy change described in note 2 to the financial statements with which we concur--have been applied on a consistent basis.

CANAL ZONE GOVERNMENT

In our opinion, subject to the uncertainties described in note 9 to the financial statements, the accompanying financial statements (schs. 6 through 9) present fairly the financial position of the Canal Zone Government at June 30, 1975 and 1974, and the results of its operations and changes in the investment of the United States for the fiscal years then ended, in conformity with the principles and standards of accounting prescribed by the Comptroller General.

SCHEDULE 1

SCHEDULE 1

PANAMA CANAL COMPANY
Statement of Financial Condition
June 30, 1975 and 1974

ASSETS	1975	1974
PROPERTY, PLANT AND EQUIPMENT: (schedule 5)		
At cost (note 1a)	$847,164,641	$837,736,301
Less accumulated depreciation and valuation allowances (notes 1b, 2 and 3)	346,642,822	332,426,681
	$500,521,819	$505,309,620
CURRENT ASSETS:		
Cash	$ 42,136,938	$ 39,113,449
Accounts receivable, less allowance for doubtful accounts of $6,226,416 for 1975 and $5,839,721 for 1974 (notes 1c and 4)	$ 9,215,907	$ 10,180,726
Inventories: (note 1d)		
Merchandise held for resale	$ 7,834,942	$ 7,025,212
Materials and supplies, less allowance for obsolete and excess inventory of $636,241 for 1975 and $652,222 for 1974	16,385,775	13,283,714
	$ 24,220,717	$ 20,308,926
Other current assets	$ 993,261	$ 1,066,924
Total current assets	$ 76,566,823	$ 70,670,025
DEFERRED CHARGES:		
Retirement benefits to certain former employees (notes 1e and 5)	$ 11,528,000	$ 11,741,000
Other (notes 1f and 4)	4,173,303	4,773,557
	$ 15,701,303	$ 16,514,557
	$592,789,945	$592,494,202

The "Notes to Financial Statements" on pages 33 through 37 are an integral part of this statement.

SCHEDULE 1

L I A B I L I T I E S	1975	1974
INVESTMENT OF THE UNITED STATES: (schedule 3a and 3b)		
Contributed capital:		
Interest-bearing (4.649% and 4.349%)	$318,866,812	$318,676,541
Non-interest-bearing	18,051,630	18,051,630
Earned capital reinvested	175,376,040	183,595,016
	$512,294,482	$520,323,187
CURRENT LIABILITIES:		
Accounts payable:		
U.S. Government agencies	$ 6,297,066	$ 3,001,585
Other	4,968,015	3,909,474
	$ 11,265,081	$ 6,911,059
Accrued liabilities:		
Employees' leave	$ 20,986,575	$ 19,049,680
Salaries and wages	2,685,065	5,081,332
Retirement benefits to certain former employees (notes 1e and 5)	1,523,000	1,463,000
Claims for damages to vessels	5,719,350	5,272,050
U.S. Treasury	6,798,162	5,574,050
Other	4,503,701	3,156,597
	$ 42,215,853	$ 39,596,709
Total current liabilities	$ 53,480,934	$ 46,507,768
OTHER LIABILITIES AND RESERVES:		
Retirement benefits to certain former employees (notes 1e and 5)	$ 10,005,000	$ 10,278,000
Employees' repatriation	6,312,000	5,683,000
Lock overhauls (note 1g)	6,338,966	5,691,745
Casualty losses (notes 1h and 6)	457,567	472,557
Other (note 4)	3,900,996	3,537,945
	$ 27,014,529	$ 25,663,247
	$592,789,945	$592,494,202

SCHEDULE 2

PANAMA CANAL COMPANY
Statement of Operations
Fiscal Years Ended June 30, 1975 and 1974

	1975	1974
OPERATING REVENUES:		
Tolls	$143,332,428	$121,319,792
Other	108,541,286	94,734,576
Total operating revenues	$251,873,714	$216,054,368
OPERATING EXPENSES:		
Maintenance of channels and harbors (note 2)	$ 23,527,706	$ 19,538,841
Navigation service and control	31,280,694	27,646,514
Locks operations	20,934,821	17,940,427
General repair, storehouse, engineering, and maintenance services	7,267,915	6,686,047
Marine terminal operations	17,967,284	15,867,979
Transportation and utilities	22,405,889	15,534,477
Retail and housing operations, including cost of goods sold of $24,987,343 for 1975 and $22,697,927 for 1974	43,826,531	39,708,019
General and administrative (note 7)	41,066,447	37,293,251
Interest	14,820,124	13,859,153
Net cost of Canal Zone Government	23,515,948	21,533,099
Other (note 7)	13,479,331	12,244,838
Total operating expenses	$260,092,690	$227,852,645
NET LOSS (schedules 3a and 3b)	$ 8,218,976	$ 11,798,277

The "Notes to Financial Statements" on pages 33 through 37 are an integral part of this statement.

SCHEDULE 3a

PANAMA CANAL COMPANY
Statement of Changes in the Investment of the United States
Fiscal Year Ended June 30, 1975

	Contributed capital		
	Interest-bearing	Non-interest bearing	Earned capital reinvested
Balance June 30, 1974	$318,676,541	$18,051,630	$183,595,016
Net loss (schedule 2)	-	-	(8,218,976)
Reactivations (note 3)	191,812	-	-
Transfer of plant (note 3)	(1,541)	-	-
Balance June 30, 1975	$318,866,812	$18,051,630	$175,376,040

The "Notes to Financial Statements" on pages 33 through 37 are an integral part of this statement.

SCHEDULE 3b

PANAMA CANAL COMPANY
Statement of Changes in the Investment of the United States
Fiscal Year Ended June 30, 1974

	Contributed capital		
	Interest-bearing	Non-interest bearing	Earned capital reinvested
Balance June 30, 1973	$318,060,149	$18,051,630	$195,393,293
Net Loss (schedule 2)	-	-	(11,798,277)
Transfer of plant (note 3)	616,392	-	-
Balance June 30, 1974	$318,676,541	$18,051,630	$183,595,016

The "Notes to Financial Statements" on pages 33 through 37 are an integral part of this statement.

SCHEDULE 4

PANAMA CANAL COMPANY
Statement of Sources of Funds
Used for Capital Expenditures
Fiscal Years Ended June 30, 1975 and 1974

	1975	1974
FUNDS PROVIDED:		
Net loss (schedule 2)	$(8,218,976)	$(11,798,277)
Add-expenses not requiring current outlay of funds:		
Depreciation (note 1b)	18,278,290	18,343,589
Amortization (note 4)	1,108,536	1,107,928
Locks overhaul accrual (note 1g)	2,526,000	2,270,000
Accruals for self-insurance (note 1h)	2,200,000	2,200,002
Other	1,449,607	1,526,546
	$17,343,457	$ 13,649,788
Assumption of liability to Canal Zone Government for doubtful accounts receivable, net of amount deferred (note 4)	363,051	177,831
Net decrease in working capital	1,076,369	
Other	16,704	-
	$18,799,581	$ 13,827,619
FUNDS APPLIED:		
Casualty losses (notes 1h and 6)	$ 2,214,990	$ 2,077,435
Charges deferred to future periods, excluding provisions for doubtful accounts receivable	325,198	48,053
Net increase in working capital	-	783,837
Locks overhaul expenditures	1,878,779	2,088,507
Other	-	91,813
	$ 4,418,967	$ 5,089,645
FUNDS USED FOR CAPITAL EXPENDITURES	$14,380,614	$ 8,737,974

The "Notes to Financial Statements" on pages 33 through 37 are an integral part of this statement.

PANAMA CANAL COMPANY
Statement of Property, Plant and Equipment
Fiscal Years Ended June 30, 1975 and 1974

	1975		1974	
	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances
Titles and treaty rights	$ 14,728,889	$ 736,445	$ 14,728,889	$ 368,222
Interest during original construction	50,892,311	50,892,311	50,892,311	50,892,311
Canal excavation, fills and embankments	319,013,447	16,497,834	316,979,958	8,590,410
Canal structures and equipment	196,543,052	114,860,306	195,096,812	111,939,415
Other maritime facilities	28,450,368	20,612,549	26,901,059	20,046,490
Supporting and general facilities	165,834,521	89,312,893	162,912,271	87,603,836
Plant additions in progress	15,876,688	-	14,146,579	-
Facilities held for future use	5,411,402	5,298,581	5,664,459	5,545,124
Suspended, construction projects	40,145,798	40,145,798	40,145,798	40,145,798
Minor items of plant and equipment	10,268,165	8,286,105	10,268,165	7,295,075
Total	$847,164,641	$346,642,822	$837,736,301	$332,426,681

SCHEDULE 5

The "Notes to Financial Statements" on pages 33 through 37 are an integral part of this statement.

PANAMA CANAL COMPANY

Notes to Financial Statements

1. Summary of Significant Accounting Policies.

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

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

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

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

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

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

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

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

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

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

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

2. Accounting Change During Fiscal Year 1974.

The provision for depreciation in fiscal year 1973 excluded amounts historically not depreciated for titles, treaty rights, and excavation of channels, harbors, and basins and other works costing $332 million at June 30, 1973. However, the Company no longer considers it appropriate to assume that these assets have indefinite economic lives. Accordingly, the Company initiated depreciation of these assets over a period of 40 years beginning with fiscal year 1974. This change in policy resulted in an additional annual charge to expense of $8.3 million. Also, effective in fiscal year 1974, the Company changed the service life of the Thatcher Ferry Bridge to coincide with the remaining life of the above described assets. This change increased annual depreciation by approximately $116 thousand.

3. Plant Valuation Allowances.

Valuation allowances have been established as follows: (a) $15.2 million at June 30, 1975 and 1974, to reduce to usable value the cost of property, plant, and equipment transferred to the Company from the Panama Canal (agency) at July 1, 1951, and from other Government agencies subsequent to that date; (b) $50.9 million at June 30, 1975 and 1974, to offset interest costs during the original construction period; and (c) $65.7 million at June 30, 1975 and $66.2 million at June 30, 1974, to offset the cost of defense facilities and suspended construction projects, the latter being principally the partial construction of a third set of locks abandoned in the early part of World War II.

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

The provisions for depreciation, expressed as percentages of average cost of depreciable plant exclusive of valuation allowances, were 2.57% for fiscal year 1975 and 2.61% for fiscal year 1974.

4. Accounts Receivable.

The accounts receivable include doubtful Canal Zone Government receivables amounting to $3.9 million at June 30, 1975, and $3.5 million at June 30, 1974, with corresponding amounts reflected in the allowance for doubtful accounts for those years. Other liabilities at June 30, 1975 and 1974, include liabilities to the Canal Zone Government equal to these receivables. That portion of the total allowance applicable to years prior to fiscal year 1973 was recorded at June 30, 1973, as a deferred charge to be amortized over five years, at an annual rate of about $1.0 million. Approximately $2.0 million of this deferral remained in Other Deferred Charges at June 30, 1975.

5. Retirement Benefits.

Contributions to the Civil Service Retirement Fund amounted to $6.5 million and $5.8 million for fiscal years 1975 and 1974, respectively. Payments of annuities to employees not covered in the Civil Service Retirement System were $1.5 million for both fiscal years.

6. Reserve for Casualty Losses.

The reserve for marine accidents, included in the total casualty loss reserve, experienced net charges in excess of $2.0 million in 1975, an amount that exceeded the annual accrual, leaving a balance of $38 thousand. The Company, therefore, was unable to realize an addition in the reserve towards its estimated requirement. In view of 1974 and 1975 experience, the amount of the reserve and its annual provision will be reevaluated in fiscal year 1976.

7. Reclassification of Certain Expense Items.

Education and hospital services amounting to $4.1 million and $3.7 million for fiscal years 1975 and 1974, respectively, previously classified as net cost of Canal Zone Government, are now included in other expenses. These amounts represent the cost to the Company for services rendered by the Canal Zone Government to non-sponsored individuals.

A previous change, in fiscal year 1973, resulted in a reclassification of the Company's share of education, hospital, and fire protection costs from net cost of Canal Zone Government to general and administrative expense. For fiscal years 1975 and 1974, the effects of this reclassification were $10.3 million and $10.2 million, respectively.

8. Contingent Liabilities and Commitments.

The estimated maximum liability, in addition to liabilities taken into the accounts, which could result from pending claims and lawsuits was $5.4 million at June 30, 1975. In the opinion of management and Company counsel, these pending claims and lawsuits will be resolved with no material adverse effect on the financial condition of the corporation.

Commitments under uncompleted construction contracts and unfilled purchase orders amounted to $21.3 million at June 30, 1975. Of this amount, $0.9 million in unfilled purchase orders were prepaid. In addition, the Panama Canal Company is liable for an indeterminable amount with respect to death and disability payments under the Federal Employees' Compensation Act.

The Company held as custodian negotiable Government securities in the face amount of $5.4 million at June 30, 1975, to guarantee payment by third parties of their obligations.

Effective May 9, 1969, the Company entered into a 25-year contract with the Instituto de Recursos Hidraulicosy Electrification, an autonomous agency of the Republic of Panama, for the purchase of electric power to be produced by the agency. Effective September 1, 1972, by mutual agreement, the contract was suspended for a period of three years. On September 1, 1975, the suspension of the contract was extended to December 31, 1976. As of June 30, 1975, the Company's minimum liability over the remaining period of the contract amounted to approximately $66.1 million.

9. Borrowing Authority.

The Company has authority to borrow funds from the U.S. Treasury not to exceed $40 million outstanding at any time at interest rates to be determined by the Secretary of the Treasury. At June 30, 1975, none of this amount had been borrowed.

10. Uncertainties Which Impact on Financial Statements.

On February 7, 1974, the Governments of the United States of America and the Republic of Panama signed a Statement of Principles regarding the basis upon which a new relationship would be established on the status of the Panama Canal and the Canal Zone. Based on these principles, treaty negotiations have been continuing which may affect the organization of the Company and the scope of its activities. At this time, no final agreements have been announced.

The Company's financial statements have been prepared on the assumption of continuing operation and do not purport to reflect possible provisions and/or consequences of treaty positions or agreements.

 SCHEDULE 6

CANAL ZONE GOVERNMENT
Statement of Financial Condition
June 30, 1975 and 1974

A S S E T S	1975	1974
PROPERTY, PLANT AND EQUIPMENT: (schedule 9)		
At cost (note 1a)	$103,488,827	$100,121,192
Less accumulated depreciation and valuation allowances (notes 1b and 2)	45,941,214	43,047,082
	$ 57,547,613	$ 57,074,110
CURRENT ASSETS:		
Cash	$ 10,034,937	$ 9,966,750
U.S. Treasury securities (at par)	$ 1,000,000	$ 605,000
Accounts receivable:		
Panama Canal Company (note 3)	$ 3,900,996	$ 3,537,945
Other	3,551,660	2,599,233
	$ 7,452,656	$ 6,137,178
Inventories at average cost	$ 572,095	$ 647,645
Other current assets	$ 8,580	$ 8,056
Total current assets	$ 19,068,268	$ 17,364,629
INVESTMENT IN U.S. TREASURY SECURITIES (at par)	$ -	$ 400,000
SUMS DUE FROM FUTURE APPROPRIATIONS	$ 11,065,338	$ 9,863,226
	$ 87,681,219	$ 84,701,965

The "Notes to Financial Statements" on pages 46 through 48 are an integral part of this statement.

SCHEDULE 6

L I A B I L I T I E S	1975	1974
INVESTMENT OF THE UNITED STATES: (schedules 8a and 8b)		
Invested capital (note 2)	$58,119,708	$57,721,755
Unobligated capital fund	3,230,657	3,170,158
Obligated funds	5,235,159	3,481,480
	$66,585,524	$64,373,393
CURRENT LIABILITIES:		
Accounts payable:		
U.S. Government Agencies	$ 7,714,698	$ 6,508,404
Postal money orders payable	$ 1,075,818	$ 2,732,110
Less deposits with U.S. Postal Service	153,617	980,017
	$ 922,201	$ 1,752,093
Other	$ 258,446	$ 305,334
	$ 8,895,345	$ 8,565,831
Accrued liabilities:		
Employees' leave	$ 6,388,338	$ 5,664,225
Salaries and wages	1,068,252	1,820,320
Other	663,760	708,196
	$ 8,120,350	$ 8,192,741
Total current liabilities	$17,015,695	$16,758,572
OTHER LIABILITIES:		
Employees' repatriation	$ 3,374,000	$ 2,836,000
Retirement benefits to certain former employees (notes 1c and 5)	706,000	734,000
	$ 4,080,000	$ 3,570,000
	$87,681,219	$84,701,965

SCHEDULE 7a

CANAL ZONE GOVERNMENT

Statement of Operations
Fiscal Year Ended June 30, 1975

	Operating expenses: Funded costs	Operating expenses: Accrued depreciation	Operating expenses: Other non-fund charges and credits	Operating expenses: Total	Recoveries (Notes 6, 7 & 8)	Net cost of operations borne by Panama Canal Company
CIVIL FUNCTIONS:						
Office of director	$ 438,799	$ 764	$ 11,524	$ 451,087	$ -	$ 451,087
Customs and immigration	1,256,958	2,246	43,425	1,302,629	26,436	1,276,193
Postal service	2,169,842	13,360	25,865	2,209,067	1,736,861	472,206
Police protection	6,966,673	85,422	122,886	7,174,981	39,116	7,135,865
Fire protection	2,727,418	50,853	25,558	2,803,829	3,139,477	(335,648)
Judicial system	230,757	-	4,470	235,227	168,919	66,308
Education	19,767,646	642,917	331,204	20,741,767	20,387,563	354,204
Public areas and facilities	2,260,112	773,567	3,018	3,036,697	-	3,036,697
Internal security	313,306	18	11 995	325,319	-	325,319
Civil defense	55,674	6,418	1,474	63,566	-	63,566
Licenses and other fees	220,257	2,715	3,268	226,240	713,060	(486,820)
Total Civil Functions	$36,407,442	$ 1,578,280	$ 584,687	$38,570,409	$26,211,432	$12,358,977
HEALTH AND SANITATION:						
Office of director	$ 328,113	$ 196	$ 7,519	$ 335,828	$ 3,367	$ 332,461
Hospitals and medical services:						
Gorgas hospital and clinics	13,380,521	328,733	264,831	13,974,085	14,305,436	(331,351)
Coco Solo hospital and clinics	3,863,620	91,429	54,756	4,009,805	3,602,404	407,401
Canal Zone mental health center	2,369,752	22,490	44,805	2,437,047	2,341,036	96,011
Palo Seco hospital	398,027	4,868	1,084	403,979	388,729	15,250
Other public health services:						
Sanitation	870,458	2,112	8,067	880,637	6,289	874,348
Garbage collection	294,000	-	-	294,000	-	294,000
Preventive medicine and quarantine	695,473	1,947	31,545	728,965	17,724	711,241
School Health Unit	178,685	-	-	178,685	-	178,685
Veterinarian services	488,949	3,825	8,738	501,512	207,476	294,036
Cemeteries, operation and maintenance	184,371	776	-	185,147	64,991	120,156
Dental clinics	383,330	2,019	5,505	390,854	270,697	120,157
Care of dead	88,847	7,304	2,949	99,100	48,040	51,060
Total Health and Sanitation	$23,524,146	$ 465,699	$ 429,799	$24,419,644	$21,256,189	$ 3,163,455
GENERAL EXPENSES:						
Office of the Governor	$ 308,345	$ -	$ (8,229)	$ 300,116	$ -	$ 300,116
Recruitment and repatriation	591,030	-	-	591,030	-	591,030
Employees' home leave travel	520,788	-	-	520,788	-	520,788
Transportation of employees' vehicles	87,126	-	-	87,126	-	87,126
Government buildings and sites	445,615	61,829	4,370	511,814	26,753	485,061
Relief payment to former employees or their widows	116,288	-	-	116,288	-	116,288
Net increase in accrued liability for employees' repatriation	-	-	500,000	500,000	-	500,000
Miscellaneous charges and credits	1,316,977	949,255	15,270	2,281,502	(3,111,605)	5,393,107
Total General Expenses	3,386,169	1,011,084	511,411	4,908,664	(3,084,852)	7,993,516
Total	$63,317,757	$ 3,055,063	$1,525,897	$67,898,717	$44,382,769	$23,515,948

The "Notes to Financial Statements" on pages 46 through 48 are an integral part of this statement.

SCHEDULE 7a

CANAL ZONE GOVERNMENT

Statement of Operations
Fiscal Year Ended June 30, 1974

	Operating Expenses: Funded costs	Operating Expenses: Accrued depreciation	Operating Expenses: Other non-fund charges and credits	Operating Expenses: Total	Recoveries	Net cost of operations borne by Panama Canal Company
CIVIL FUNCTIONS:						
Office of director	$ 422,392	$ 1,671	$ 2,992	$ 427,055	$ -	$ 427,055
Customs and immigration	1,211,620	2,246	(2,669)	1,211,197	27,165	1,184,032
Postal service	2,035,172	13,182	23,092	2,071,446	1,670,437	401,009
Police protection	6,028,213	44,182	133,999	6,206,394	35,701	6,170,693
Fire protection	2,287,431	52,627	26,564	2,366,622	2,714,291	(347,669)
Judicial system	199,906	-	2,373	202,279	164,376	37,903
Education	18,448,413	642,088	229,321	19,319,822	18,194,968	1,124,854
Public areas and facilities	3,144,043	703,919	19,259	3,867,221	-	3,867,221
Internal security	299,720	-	(1,209)	298,511	-	298,511
Civil defense	54,625	5,934	-	60,559		60,559
Licenses and other fees	204,136	2,745	(417)	206,464	622,468	(416,004)
Total Civil Functions	$34,335,671	$1,468,594	$ 433,305	$36,237,570	$23,429,406	$12,808,164
HEALTH AND SANITATION:						
Office of director	$ 292,593	$ 257	$ 9,831	$ 302,681	$ 2,144	$ 300,537
Hospitals and medical services:						
Gorgas hospital and clinics	12,212,924	328,159	212,181	12,753,264	12,395,773	357,491
Coco Solo hospital and clinics	3,539,793	83,742	19,997	3,643,532	3,133,786	509,746
Canal Zone mental health center	2,323,769	22,002	26,385	2,372,156	1,785,039	587,117
Palo Seco hospital	370,732	4,747	6,391	381,870	367,556	14,314
Other public health services:						
Sanitation	836,881	2,112	13,276	852,269	7,213	845,056
Garbage collection	294,000	-	-	294,000	-	294,000
Preventive medicine and quarantine	579,630	1,947	8,656	590,233	22,852	567,381
School Health Unit	160,106	-	-	160,106	-	160,106
Veterinarian services	455,351	3,672	16,051	475,074	157,661	317,413
Cemeteries, operation and maintenance	149,352	1,043	-	150,395	43,512	106,883
Dental clinics	343,862	2,019	2,922	348,803	218,960	129,843
Care of dead	89,445	7,359	631	97,435	38,774	58,661
Total Health and Sanitation	$21,648,438	$ 457,059	$ 316,321	$22,421,818	$18,173,270	$ 4,248,548
GENERAL EXPENSES:						
Office of the Governor	$ 240,219	$ -	$ (1,608)	$ 238,611	$ -	$ 238,611
Recruitment and repatriation	360,240	-	-	360,240	-	360,240
Employees' home leave travel	328,040	-	-	328,040	-	328,040
Transportation of employees' vehicles	79,256	-	-	79,256	-	79,256
Government buildings and sites	546,092	59,735	7,018	612,845	27,980	584,865
Relief payment to former employees or their widows	114,524	-	-	114,524	-	114,524
Net increase in accrued liability for employees' repatriation	-	-	568,000	568,000	-	568,000
Miscellaneous charges and credits	1,157,236	1,039,568	12,723	2,209,527	6,676	2,202,851
Total General Expenses	$ 2,825,607	$1,099,303	$ 586,133	$ 4,511,043	$ 34,656	$ 4,476,387
Total	$58,809,716	$3,024,956	$1,335,759	$63,170,431	$41,637,332	$21,533,000

The "Notes to Financial Statements" on pages [illegible] through 48 are an integral part of this statement.

SCHEDULE 7b

SCHEDULE 7b

SCHEDULE 8a

CANAL ZONE GOVERNMENT
Statement of Changes in the Investment
of the United States
Fiscal Year Ended June 30, 1975

	Invested capital	Operating funds	Capital funds	Total investment
Investment at June 30, 1974 (schedule 6)	$57,721,755	$ 708,875	$ 5,942,763	$ 64,373,393
Appropriations by the Congress for fiscal year 1975	-	63,641,500	5,790,000	69,431,500
Investment at July 1, 1974	$57,721,755	$64,350,375	$11,732,763	$133,804,893
Increases of Investment:				
Transfer from other agencies	$ 13,891	$ -	$ -	$ 13,891
Decreases of Investment:				
Funded costs (schedule 7a)	$ -	$63,317,757	$ -	$ 63,317,757
Depreciation (note 1b) (schedule 7a)	3,055,063	-	-	3,055,063
Unobligated operating funds withdrawn by U.S. Treasury, net of restoration of $25,883	-	553,349	-	553,349
Miscellaneous plant adjustments	307,091	-	-	307,091
	$ 3,362,154	$63,871,106	$ -	$ 67,233,260
Transfer between funds:				
Capital expenditures	$ 3,821,766	$ -	$(3,821,766)	$ -
Decrease in inventories	(75,550)	75,550	-	-
	$ 3,746,216	$ 75,550	$(3,821,766)	$ -
Investment at June 30, 1975 (schedule 6)	$58,119,708	$ 554,819	$ 7,910,997	$ 66,585,524

INVESTMENT BY COMMITMENT OF FUNDS

	Invested capital	Operating funds	Capital funds	Total investment
Unobligated capital fund (schedule 6)	$ -	$ -	$ 3,230,657	$ 3,230,657
Obligated funds (schedule 6)	-	554,819	4,680,340	5,235,159
Invested capital:				
Property, plant and equipment (notes 1a and 2)	57,547,613	-	-	57,547,613
Inventories	572,095	-	-	572,095
	$58,119,708	$ 554,819	$ 7,910,997	$ 66,585,524

The "Notes to Financial Statements" on pages 46 through 48 are an integral part of this statement.

BEST DOCUMENT AVAILABLE

CANAL ZONE GOVERNMENT
Statement of Changes in the Investment of the United States
Fiscal Year Ended June 30, 1974

	Invested capital	Operating funds	Capital funds	Total investment
Investment at June 30, 1973 (schedule 6)	$57,420,102	$ 522,566	$ 5,906,562	$ 63,849,230
Appropriations by the Congress for fiscal year 1974	-	60,000,000	3,500,000	63,500,000
Investment at July 1, 1973	$57,420,102	$60,522,566	$ 9,406,562	$127,349,230
Increases of Investment:				
Transfer from other agencies	$ 382	$ -	$ -	$ 382
Decreases of Investment:				
Funded costs (schedule 7b)	$ -	$58,809,716	$ -	$ 58,809,716
Depreciation (note 1b) (schedule 7b)	3,024,956	-	-	3,024,956
Unobligated operating funds withdrawn by U.S. Treasury, net of restoration of $277,719	-	921,240	-	921,240
Miscellaneous plant adjustments	202,358	17,949	-	220,307
	$ 3,227,314	$59,748,905	$ -	$ 62,976,219
Transfer between funds:				
Capital expenditures	$ 3,463,799	$ -	$(3,463,799)	$ -
Increases in inventories	64,786	(64,786)	-	-
	$ 3,528,585	$ (64,786)	$(3,463,799)	$ -
Investment at June 30, 1974 (schedule 6)	$57,721,755	$ 708,875	$ 5,942,763	$ 64,373,393

INVESTMENT BY COMMITMENT OF FUNDS

	Invested capital	Operating funds	Capital funds	Total investment
Unobligated capital fund (schedule 6)	$ -	$ -	$ 3,170,158	$ 3,170,158
Obligated funds (schedule 6)	-	708,875	2,772,605	3,481,480
Invested capital:				
Property, plant and equipment (notes 1a and 2)	57,074,110	-	-	57,074,110
Inventories	647,645	-	-	647,645
	$57,721,755	$ 708,875	$ 5,942,763	$ 64,373,393

The "Notes to Financial Statements" on pages 46 through 48 are an integral part of this statement.

BEST DOCUMENT AVAILABLE

CANAL ZONE GOVERNMENT

STATEMENT OF PROPERTY, PLANT AND EQUIPMENT
JUNE 30, 1975 AND 1974

	1975		1974	
	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances
CIVIL FUNCTION FACILITIES:				
Customs and Immigration	$ 201,760	$ 186,388	$ 201,760	$ 184,142
Postal Division	461,974	148,274	458,231	134,915
Police Division	1,074,373	455,276	832,563	397,583
Fire Division	985,432	527,154	985,432	482,198
Fire Hydrant System	240,062	172,873	240,062	166,976
Division of Schools	27,876,199	8,249,011	27,916,069	7,705,573
Roads, Streets, Sidewalks	19,478,651	11,262,049	18,500,974	10,848,308
Sewer System	7,192,354	3,620,073	7,030,075	3,466,961
Permanent Townsites	7,721,770	4,641,946	7,703,857	4,492,857
Experimental Gardens	52,769	14,572	30,833	13,722
Street Lighting System	2,053,587	951,066	1,693,323	881,219
Public Areas - Facilities	768,193	180,011	768,193	159,875
Libraries - Museum	6,652	1,693	6,652	1,249
Internal Security	360	18	-	-
License Section	24,065	8,981	24,064	6,265
Civil Affairs Director's Office	1,195	530	1,195	423
Total Civil Function Facilities	$68,139,396	$30,419,915	$66,393,283	$28,942,266

The "Notes to Financial Statements" on pages 46 through 58 are an integral part of this statement.

SCHEDULE 9

BEST DOCUMENT AVAILABLE

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

STATEMENT OF PROPERTY, PLANT AND EQUIPMENT
JUNE 30, 1975 AND 1974

SCHEDULE 9

	1975		1974	
	Cost	Depreciation and valuation allowances	Cost	Depreciation and valuation allowances
HEALTH AND SANITATION FACILITIES:				
Gorgas Hospital - Clinics	$ 11,451,426	$ 3,589,922	$ 11,441,771	$ 3,291,281
Coco Solo Hospital - Clinics	3,431,178	1,321,926	3,240,239	1,248,300
Canal Zone Mental Health	1,044,967	426,587	1,025,510	404,096
Palo Seco Hospital	165,237	137,947	213,050	174,050
Division of Public Health	27,799	12,661	29,203	11,948
Sanitation Division	96,183	50,992	96,183	48,880
Division of Veterinary Medicine	134,977	92,178	134,977	88,353
Dental and Care of Dead	304,015	131,894	304,015	122,570
Office of Health Director	49,047	26,582	49,047	25,611
Total Health and Sanitation Facilities	$ 16,704,829	$ 5,790,689	$ 16,533,995	$ 5,415,089
GENERAL FACILITIES:				
Civil Defense - Youth Activities	$ 251,773	$ 73,089	$ 225,816	$ 60,108
Government Buildings	3,690,642	2,208,593	3,502,471	2,046,500
Total General Facilities	$ 3,942,415	$ 2,281,682	$ 3,728,287	$ 2,106,608
MINOR ITEMS OF PLANT AND EQUIPMENT	$ 6,359,822	$ 4,714,702	$ 6,359,822	$ 3,892,142
TOTAL PROPERTY, PLANT AND EQUIPMENT IN SERVICE	$ 95,146,462	$43,206,988	$ 93,015,387	$40,356,105
FACILITIES HELD FOR FUTURE USE	$ 2,796,591	$ 2,734,226	$ 2,767,726	$ 2,690,977
PLANT ADDITIONS IN PROGRESS	$ 5,545,774	$ -	$ 4,338,079	$ -
TOTAL	$103,488,827	$45,941,214	$100,121,192	$43,047,082

The "Notes to Financial Statements" on pages [illegible] through [illegible] are an integral part of this statement.

SCHEDULE 9

CANAL ZONE GOVERNMENT

Notes to Financial Statements

1. Summary of Significant Accounting Policies.

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

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

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

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

2. Plant Valuation Allowances.

Valuation allowances have been established at $1.8 million at June 30, 1975 and June 30, 1974, to reduce to usable value the cost of property, plant and equipment transferred to the Canal Zone Government from the Panama Canal (agency) at July 1, 1951, and from other U.S. Government agencies subsequent to that date.

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

The provisions expressed as percentages of average cost of depreciable plant exclusive of valuation allowances were 3.06% and 3.15% for fiscal years 1975 and 1974, respectively.

3. Accounts Receivable.

The doubtful Canal Zone Government accounts receivable were assumed by the Panama Canal Company in its accounts at June 30, 1973, as guarantor of those receivables. The stated value of these accounts is shown on the Canal Zone Government Statement of Financial Condition as receivable from the Company.

4. Contingent Liabilities and Commitments.

Commitments under uncompleted construction contracts and unfilled purchase orders amounted to $5.2 million at June 30, 1975. In addition, the Canal Zone Government is liable for an indeterminable amount with respect to death and disability payments under the Federal Employees' Compensation Act. The maximum liability which could result from outstanding claims and lawsuits is estimated at $0.7 million.

5. Retirement Benefits.

Contributions to the Civil Service Retirement Fund amounted to $2.7 million and $2.4 million for fiscal years 1975 and 1974, respectively. Payments of annuities to employees not covered in the Civil Service Retirement System were $0.1 million for both fiscal years.

6. Services Rendered to Panama Canal Company.

During fiscal years 1973 and 1974 the Panama Canal Company began paying the Canal Zone Government for its share of the cost of certain services instead of absorbing such cost as part of the net cost of Canal Zone Government. The effect of this change on the statement of operations was to increase recoveries about $14.4 million and $13.9 million for fiscal years 1975 and 1974, respectively, and decrease the net cost of operations by the same amounts.

7. Recognition of Sponsorship Costs.

Beginning with fiscal year 1975, the Canal Zone Government sponsorship of education and health costs for its employees was recognized in its statement of operations. This change provided consistency of treatment with that for sponsorship of employees of other U.S. Government agencies.

The recognition increased recoveries for civil functions by $2.6 million and health and sanitation by $0.5 million with offset in general expense. This change had no effect on net cost of Canal Zone Government.

8. Administrative Services.

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

9. Uncertainties Which Impact on Financial Statements.

On February 7, 1974, the Governments of the United States of America and the Republic of Panama signed a Statement of Principles regarding the basis upon which a new relationship would be established on the status of the Canal Zone and the Canal Zone Government. Based on these principles, treaty negotiations have been continuing which may affect the organization of the Canal Zone Government and the scope of its activities. At this time, no final agreements have been announced.

The Canal Zone Government's financial statements have been prepared on the assumption of continuing operation and do not purport to reflect possible provisions and/or consequences of treaty positions or agreements.

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