United States General Accounting Office

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Report to the Congress

July 1991

FINANCIAL AUDIT

Panama Canal Commission's 1990 Financial Statements

144508

GAO

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

Comptroller General
of the United States

B-114839

July 31, 1991

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

This report presents the results of the audit of the Panama Canal Commission's financial statements for the year ended September 30, 1990. Reports on the Commission's internal accounting controls and on its compliance with laws and regulations are also provided.

The Commission is a federal agency that was established on October 1, 1979, to carry out the responsibilities of the United States with respect to the Panama Canal Treaty of 1977. 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.

We are required by 22 U.S.C. 3723(a) to conduct an annual audit of the Commission. To help fulfill our responsibility, we contracted with an independent certified public accounting firm to conduct a financial audit of the Commission for the year ended September 30, 1990. We determined the scope of the audit work, monitored its progress at all key points, reviewed the working papers of the certified public accountants, Deloitte & Touche, and performed other procedures as we deemed necessary. The audit was conducted in accordance with generally accepted government auditing standards.

In our opinion, consistent with the opinion of Deloitte & Touche, the Panama Canal Commission's financial statements present fairly, in all material respects, its financial position as of September 30, 1990, and the results of its operations, changes in the investment of the U.S. government, and cash flows for the year then ended, in conformity with generally accepted accounting principles. The 1989 financial statements, which are presented for comparative purposes, have not been audited and, thus, an opinion is not expressed on them.

Due to security concerns, we were unable to travel to the Republic of Panama to conduct the 1989 and 1988 financial audits of the Commission. Instead, for each of those years we conducted a limited review. In conducting our limited reviews, we primarily analyzed the financial statements for unusual fluctuations and other changes from the prior years and obtained explanations from Commission personnel by telephone. Our reviews did not disclose any material modifications that should be made in the format of the 1989 and 1988 financial statements in order for them to be presented in conformity with generally accepted accounting principles. However, since we were unable to conduct financial audits, we cannot be assured that the financial statements are free of material misstatements. We also were unable to report on the Commission's internal control structure and on its compliance with laws and regulations. Our 1989 financial review was presented in our report, GAO/AFMD-90-105, September 21, 1990.

For the 1990 audit, the report by Deloitte & Touche on internal accounting controls disclosed no condition believed to be a material weakness. Its report on compliance with laws and regulations disclosed nothing to indicate that the Commission had not complied with such applicable laws and regulations which could have a material effect on the financial statements. We concur with these reports.

During the course of the audit, Deloitte & Touche also identified several matters for improvement in data processing operations which were not material to the financial statements. After coordinating with us, the firm communicated these matters for the Commission's consideration 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 is to be turned over in operating condition and free of liens and debts.

To do this, the Commission needs to recover all of its costs from its revenues. The Commission operates as a rate-regulated utility, with approximately 75 percent of revenue obtained from tolls and the remaining 25 percent from nontoll revenue, such as navigation fees and electric power sales. The President of the United States serves as the rate regulator for tolls, which are established at a level to recover the costs of operating and maintaining the canal. Retirement and worker injury compensation benefit costs are being funded from canal revenues on an accelerated basis so as to be fully funded by 1999.

Results of Operations

The Commission ended fiscal year 1990 with net revenues of $7 million, compared to a net loss of $7.3 million for fiscal year 1989. This net revenue reduced carry forward losses from prior years to $2.7 million. The

Panama Canal Act of 1979 requires that tolls be prescribed at rates calculated to cover such prior year losses.

From 1986 through 1990, toll and nontoll revenues increased an average of 3 percent annually. Fiscal year 1990 total operating revenues increased to $475 million, up 8.9 percent over fiscal year 1989. This was due to a 9.8 percent increase in toll rates, effective October 1, 1989, offset slightly by fewer ships transiting the canal with 2.3 percent less net tonnage. Nontoll revenue, which consists primarily of navigation fees and electric power sales, increased to $119 million during fiscal year 1990, up 12 percent from 1989. This increase was primarily due to a 20-percent surcharge imposed from April 1, 1990, to February 28, 1991, to cover additional costs incurred by the Commission during the Noriega regime and the December 1989 U.S. intervention in Panama (Operation Just Cause). The surcharge generated $6.5 million through September 30, 1990.

From 1986 through 1990, total operating expenses increased an average of 3 percent annually. Fiscal year 1990 total operating expenses increased to $468 million, up 5.5 percent over fiscal year 1989. However, a one-time reduction in the liability for marine traffic accidents to reflect actual experience lowered other operating expenses in 1989 by $8.5 million. Without this adjustment, fiscal year 1990 total operating costs would have increased by 3.5 percent over fiscal year 1989.

Most operating costs remained fairly constant between 1989 and 1990. Some of the highlights were:

- Tonnage payments to the Government of Panama decreased 2.3 percent in 1990 due to less canal traffic.
- Housing operating costs decreased 10 percent in 1990 due principally to lower maintenance costs.
- General and administrative costs in 1990 were down by 2 percent due to a decrease in the amount of employee benefits paid and lower depreciation costs.
- Utility costs increased by 12 percent in 1990 due primarily to higher fuel costs.
- Cost of maintenance for the channels and harbors increased 10 percent over 1989, due to dredging of canal waterways.

Assets, Liabilities, and Capital

Between September 30, 1989, and September 30, 1990, total assets of the Commission declined by less than 1 percent to $876 million, total liabilities declined by less than 2 percent to $403 million, and U.S. Government capital remained at approximately $473 million. The most significant changes in individual account balances for this period were:

- Property, plant, and equipment (excluding depreciation) increased by $28 million in 1990 to $997 million. This increase was due primarily to capital expenditures, such as $5.5 million for a fire protection system at Miraflores Locks; $4.1 million for tugboats, launches, and other floating equipment; $3.7 million for motor vehicle replacement; and $3.5 million for improvements to electric power and communication systems.
- Current assets increased in 1990 by $17 million to $168 million, due primarily to higher operating revenues and a large inventory purchase of fuel oil in September 1990.
- Other assets declined by $23 million in 1990 to $216 million almost solely due to amortizing deferred charges for retirement and workers' compensation benefits.
- Current liabilities increased in 1990 by $9 million to $140 million due primarily to higher marine accident claims of $4 million and higher operating costs.
- Long-term liabilities decreased $23 million in 1990 to $262 million primarily due to the amortization of employee benefits.

Treaty Related Costs

We are required by 22 U.S.C. 3723(b) 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 (22 U.S.C. 3712(f)) provides that direct appropriated costs of implementation should not exceed $666 million, adjusted for inflation.

As part of the annual required financial audit, U.S. government agencies which provided services to the former Panama Canal Company and Canal Zone Government provide the net cost information required under the 1977 treaty. This information is presented in unaudited supplementary schedules to the Commission's financial statements. From fiscal years 1980 to 1990, the Commission's net reported costs under the treaty amounted to $516 million, which is less than the act's inflation-adjusted target of $1,186 million as of September 30, 1990.

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. Also, we are 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.

for Milton J. Socolar

Comptroller General
of the United States

Contents

Auditors' Opinion

Deloitte & Touche

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To the Comptroller General of the United States
and the Board of Directors of the Panama Canal Commission:

We have audited the accompanying statement of financial position of the Panama Canal Commission as of September 30, 1990, and the related statements of operations, changes in the investment of the United States government and cash flows for the year then ended. These financial statements, and the schedules described below, are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Panama Canal Commission for the year ended September 30, 1989, were not audited by us and, accordingly, we do not express an opinion on them.

We conducted our audit in accordance with generally accepted auditing standards and the standards for financial audits contained in the U.S. General Accounting Office Government Auditing Standards (1988 Revision). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Panama Canal Commission as of September 30, 1990, and the results of its operations, its changes in the investment of the United States government, and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The treaty-related cost schedules are presented as required by the Panama Canal Act, and the schedule of property, plant, and equipment is presented for purposes of additional analysis. Neither schedule is a required part of the basic financial statements. The treaty-related cost schedules have not been subjected to the procedures applied in auditing the basic financial statements, and, accordingly, we express no opinion on them. While we do not express an opinion on the detailed schedule of property, plant, and equipment, the aggregate amount has been tested within the scope of our audit of the basic financial statements taken as a whole.

April 12, 1991

Deloitte & Touche

Member
DRT International

Auditors' Report on Internal Accounting Controls

Deloitte & Touche

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To the Comptroller General of the United States
and the Board of Directors of the Panama Canal Commission:

We have audited the financial statements of the Panama Canal Commission (the "Commission") for the year ended September 30, 1990, and have issued our report thereon dated April 12, 1991. Our audit was made in accordance with generally accepted auditing standards and the standards for financial audits contained in the U.S. General Accounting Office Government Auditing Standards (1988 Revision). As part of our audit, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary solely to determine the nature, timing and extent of our auditing procedures. For the purpose of our report, we have classified the significant internal accounting controls into the following categories:

- General Ledger
- Revenues/Accounts Receivable
- Payroll
- Expenditures/Accounts Payable
- Inventory
- Property Plant and Equipment
- Budgetary Controls

Our study included all of the control categories listed above.

The Commission's management is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Member
DRT International

Our study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system taken as a whole or on any of the categories described above. However, during our audit we did not become aware of any conditions that we believe to be a material weakness.

During the course of our audit, we identified a number of other weaknesses in internal accounting controls which will be reported in a separate Management Letter dated April 12, 1991. Although we did not consider these weaknesses to be material to the financial statements, they nonetheless merit management's attention.

This report is intended solely for the use of the U.S. General Accounting Office and the Panama Canal Commission. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the addressees, is a matter of public record.

Deloitte & Touche

April 12, 1991

Auditors' Report on Compliance With Laws and Regulations

Deloitte & Touche

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To the Comptroller General of the United States
and the Board of Directors of the Panama Canal Commission:

We have audited the financial statements of the Panama Canal Commission ("the Commission") for the year ended September 30, 1990, and have issued our report thereon dated April 12, 1991. Our audit was made in accordance with generally accepted auditing standards and the standards for financial audits contained in the U.S. General Accounting Office Government Auditing Standards (1988 Revision), and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered in the circumstances.

The Commission's management is responsible for compliance with laws and regulations. In connection with our audit referred to above, we selected and tested transactions and records to determine the Commission's compliance with laws and regulations, noncompliance with which could have a material effect on the financial statements of the Commission.

The results of our tests indicate that, for the items tested, the Commission complied with those provisions of laws and regulations, noncompliance with which could have a material effect on the financial statements. Nothing came to our attention that caused us to believe that, for the items not tested, the Commission was not in compliance with laws or regulations, noncompliance with which could have a material effect on the Commission's financial statements.

This report is intended solely for the use of the U.S. General Accounting Office and the Panama Canal Commission. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the addressees, is a matter of public record.

Deloitte & Touche

April 12, 1991

Member
DRT International

Financial Statements

Statement of Operations

Fiscal Years Ended September 30, 1990 and 1989

	1990	1989 (unaudited)
OPERATING REVENUES:		
Tolls revenue	$355,557,957	$329,765,627
Other revenues	119,115,510	106,034,363
Total operating revenues	474,673,467	435,799,990
OPERATING EXPENSES:		
Payments to the Government of Panama:		
Public services	10,000,000	10,000,000
Fixed annuity	10,000,000	10,000,000
Tonnage	58,457,476	59,819,225
	78,457,476	79,819,225
Maintenance of channels and harbors	40,236,327	36,506,857
Navigation service and control	82,746,857	79,796,645
Locks operation	51,318,435	48,988,652
General repair, engineering and maintenance services	24,485,404	22,004,849
Supply and logistics	22,161,520	20,488,618
Utilities	33,615,047	30,016,519
Housing operations	4,894,692	5,418,893
General and administrative	75,051,376	76,587,612
Interest on interest-bearing investment (Note 6)	15,113,342	13,878,234
Other	39,577,490	29,613,382
Total operating expenses	467,657,966	443,119,486
NET OPERATING REVENUE (LOSS) (Notes 1b and 4)	$ 7,015,501	$ (7,319,496)

The accompanying notes are an integral part of this statement.

Statement of Financial Position

September 30, 1990 and 1989

A S S E T S	1990	1989 (unaudited)
PROPERTY, PLANT AND EQUIPMENT:		
At cost (Note 1c)	$997,154,860	$969,630,333
Less accumulated depreciation and valuation allowances (Notes 1e and 2)	505,028,558	484,884,187
	492,126,302	484,746,146
CURRENT ASSETS:		
Cash:		
U.S. Treasury account	103,870,166	93,226,977
Cash in commercial banks and on hand	10,027,246	6,077,070
Postal, other trust funds and cash in transit	583,187	2,537,751
	114,480,599	101,841,798
Accounts receivable	13,330,765	11,371,717
Inventories, less allowance for obsolete and excess inventory of $800,000 and $400,000 respectively (Note 1g)	39,999,627	37,723,209
Other current assets	173,138	379,561
	167,984,129	151,316,285
OTHER ASSETS:		
Deferred charges:		
Cost of early retirement benefits (Note 1h)	136,296,000	151,440,000
Cost of work injuries compensation benefits (Notes 1m and 5)	71,685,341	78,871,578
Retirement benefits to certain former employees of predecessor agencies (Note 1h)	5,587,000	6,186,000
Other	-	492,149
	213,568,341	236,989,727
Unrecovered costs due from subsequent revenues (Notes 1b and 4)	2,712,659	9,728,161
	216,281,000	246,717,888
TOTAL ASSETS	$876,391,431	$882,780,319

The accompanying notes are an integral part of this statement.

September 30, 1990 and 1989

CAPITAL AND LIABILITIES	1990	1989 (unaudited)
CAPITAL:		
Investment of the United States Government:		
Interest-bearing (10.135% and 10.219%, respectively) (Note 6)	$133,175,778	$147,893,234
Non-interest-bearing	340,663,355	325,398,450
	473,839,133	473,291,684
CURRENT LIABILITIES:		
Accounts payable:		
U.S. Government agencies	3,926,959	4,146,044
Government of Panama	8,388,425	8,062,973
Other	12,931,505	12,420,588
	25,246,889	24,629,605
Accrued liabilities:		
Employees' leave	47,713,360	46,058,824
Salaries and wages	9,544,145	8,086,607
Cost of early retirement benefits (Note 1h)	15,144,000	15,144,000
Cost of work injuries compensation benefits (Notes 1m and 5)	8,018,170	6,536,705
Retirement benefits to certain former employees of predecessor agencies (Note 1h)	684,000	790,000
Employees' repatriation	833,000	857,000
Marine accident claims	19,531,203	15,387,115
Other	2,535,655	1,766,127
	104,003,533	94,626,378
Other current liabilities:		
Advances for capital - unexpended (Note 1d)	10,472,913	10,336,538
Other	463,042	1,697,007
	10,935,955	12,033,545
	140,186,377	131,289,528
DEFERRED CREDIT:		
Advances for capital being amortized (Note 1d)	54,248,871	46,898,321
LONG-TERM LIABILITIES AND RESERVES:		
Cost of early retirement benefits (Note 1h)	121,152,000	136,296,000
Cost of work injuries compensation benefits (Notes 1m and 5)	63,667,171	72,334,873
Retirement benefits to certain former employees of predecessor agencies (Note 1h)	4,903,000	5,396,000
Employees' repatriation	7,340,000	6,875,000
Lock overhauls (Note 1i)	1,891,632	371,865
Marine accidents (Note 1j)	6,000,000	7,000,000
Casualty losses (Note 1j)	993,865	993,865
Floating equipment overhauls (Note 1k)	2,169,382	2,033,183
	208,117,050	231,300,786
TOTAL CAPITAL AND LIABILITIES	$876,391,431	$882,780,319

The accompanying notes are an integral part of this statement.

Statement of Changes in the Investment of the United States Government

Fiscal Year Ended September 30, 1990

	Invested Capital		
	Interest-Bearing	Non-Interest Bearing	Total
INVESTMENT AT OCTOBER 1, 1989	$147,893,234	$ 325,398,450	$473,291,684
INCREASES IN INVESTMENT:			
Prior year receipts deposited into U.S. Treasury	-	676,875	676,875
Expenditures from Panama Canal Revolving Fund	469,595,421	(469,595,421)	-
Net revenue (Notes 1b and 4)	-	7,015,501	7,015,501
	469,595,421	(461,903,045)	7,692,376
DECREASES IN INVESTMENT:			
Tolls and other receipts deposited into Panama Canal Revolving Fund	484,188,786	(484,188,786)	-
Due U.S. Treasury for undeposited receipts	-	5,335	5,335
Property transferred to other U.S. Government agencies	124,091	-	124,091
Recovery of prior years unrecovered costs (Notes 1b and 4)	-	7,015,501	7,015,501
	484,312,877	(477,167,950)	7,144,927
INVESTMENT AT SEPTEMBER 30, 1990	$133,175,778 (Note 6)	$ 340,663,355	$473,839,133

The accompanying notes are an integral part of this statement.

Fiscal Year Ended September 30, 1989 (unaudited)

	Invested Capital		
	Interest-Bearing	Non-Interest Bearing	Total
INVESTMENT AT OCTOBER 1, 1988..............	$102,773,553	$ 371,024,286	$ 473,797,839
INCREASES IN INVESTMENT:			
Prior year receipts deposited into U.S. Treasury............................	-	420,341	420,341
Expenditures from Panama Canal Revolving Fund....................................	486,757,576	(486,757,576)	-
Unrecovered costs due from subsequent revenues (Notes 1b and 4)...............	-	7,319,496	7,319,496
	486,757,576	(479,017,739)	7,739,837
DECREASES IN INVESTMENT:			
Tolls and other receipts deposited into Panama Canal Revolving Fund	441,388,274	(441,388,274)	-
Due U.S. Treasury for undeposited receipts	-	676,875	676,875
Property transferred to other U.S. Government agencies.....................	249,621	-	249,621
Net loss (Notes 1b and 4)................	-	7,319,496	7,319,496
	441,637,895	(433,391,903)	8,245,992
INVESTMENT AT SEPTEMBER 30, 1989...........	$147,893,234 (Note 6)	$ 325,398,450	$473,291,684

The accompanying notes are an integral part of this statement.

Statement of Cash Flows

Fiscal Years Ended September 30, 1990 and 1989

INCREASE (DECREASE) IN CASH

Cash Flows from Operating Activities:	1990	1989 (unaudited)
Cash received:		
Tolls	$ 355,557,957	$ 329,765,627
Other collections	130,522,711	109,934,767
(Increase)/decrease in receivables	(1,891,882)	1,687,880
Total cash received	484,188,786	441,388,274
Cash disbursed:		
Operating expenditures	(427,033,108)	(415,892,640)
Interest paid	(15,123,945)	(13,846,542)
(Increase)/decrease in inventories	(2,276,418)	(794,260)
Increase/(decrease) in liabilities	10,695,798	(20,964,032)
Total cash disbursed	(433,737,673)	(451,497,474)
Net cash provided by/(used in) operating activities	50,451,113	(10,109,200)
Cash Flows from Capital Activities:		
Capital expenditures	(34,670,600)	(39,584,851)
Increase/(decrease) in liabilities	(1,187,148)	4,324,748
Net cash provided by/(used in) capital activities	(35,857,748)	(35,260,103)
Cash Flows from Postal and Trust Funds:		
Postal funds	(8,019)	(5,279)
Trust funds	(1,946,545)	100,242
Net cash provided by/(used in) postal and trust fund activities	(1,954,564)	94,963
Net increase/(decrease) in cash	12,638,801	(45,274,340)
Cash, beginning of year	101,841,798	147,116,138
Cash, end of year	$ 114,480,599	$ 101,841,798

The accompanying notes are an integral part of this statement.

Fiscal Years Ended September 30, 1990 and 1989

RECONCILIATION OF NET REVENUE (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	1990	1989 (unaudited)
Net revenue (loss)	$ 7,015,501	$ (7,319,496)
Adjustments to reconcile net income to net cash provided by operating activities:		
Adjustments not requiring outlay of cash:		
Depreciation	23,392,682	22,963,018
Provision for lock overhauls	11,402,000	6,353,000
Provision for marine and casualty losses	5,826,136	(5,642,936)
Provision for floating equipment overhauls	4,420,000	4,934,000
Advances for capital	10,472,913	4,451,618
Other	1,844,195	720,370
Total adjustments not requiring outlay of cash	57,357,926	33,779,070
Adjustments requiring outlay of cash:		
Lock overhauls expenditures	(9,882,233)	(6,192,767)
Marine and Casualty losses expenditures	(6,826,136)	(4,988,460)
Floating equipment overhauls expenditures	(4,283,801)	(4,889,526)
Total adjustments requiring outlay of cash	(20,992,170)	(16,070,753)
Changes in operating assets and liabilities:		
(Increase)/decrease in receivables	(1,891,882)	1,687,880
(Increase)/decrease in inventories	(2,276,418)	(794,260)
(Increase)/decrease in other assets	542,358	(427,609)
Increase/(decrease) in liabilities	10,695,798	(20,964,032)
Total changes in operating assets and liabilities	7,069,856	(20,498,021)
Total adjustments	43,435,612	(2,789,704)
Net cash provided by/(used in) operating activities	$ 50,451,113	$ (10,109,200)

The accompanying notes are an integral part of this statement.

Notes to Financial Statements

PANAMA CANAL COMMISSION

Notes to Financial Statements

1. Summary of Significant Accounting Policies.

A summary of significant accounting policies follows:

a. Accounting and Reporting. As required by section 1311(a) of the Panama Canal Act of 1979, Public Law 96-70 (hereafter referred to as the "Act"), the accounts of the Commission are maintained pursuant to the Accounting and Auditing Act of 1950. The Accounting and Auditing Act of 1950 requires that the principles, standards and related requirements be met, as prescribed by the Comptroller General of the United States, after consulting with the Secretary of the Treasury and the Director of the Office of Management and Budget concerning their accounting, financial reporting and budgetary needs. The Accounting and Auditing Act of 1950 also requires that the accounts be maintained on an accrual basis.

b. Cost Recovery. As required by section 1341(e)(1) of the Act, the application of generally accepted accounting principles to the Panama Canal Commission, a United States Government agency comparable to a rate-regulated public utility, determines the manner in which costs are recognized. The basis for tolls rates is prescribed in section 1602(b) of the Act. This section of the Act, known as the "statutory tolls formula," provides that:

> "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, together with the facilities and appurtenances related thereto, including unrecovered costs incurred on or after the effective date of this Act, 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."

Under this statutory tolls formula, any unrecovered costs are to be recovered from subsequent revenues. The amount for recovery from subsequent revenues is transferred from Invested Capital to an account within the Other Assets classification. Unrecovered costs are charged back to Invested Capital to the extent subsequent annual revenues exceed annual costs.

c. Property, Plant and Equipment. Property, plant and equipment are recorded at cost, or if acquired from another United States Government agency, at the value determined by the Director of the Office of Management and Budget. Administrative and other related general expenses are recovered currently and therefore not capitalized. The cost of minor items of property, plant and equipment is charged to expense as incurred.

d. Advances for Capital. A portion of tolls in excess of depreciation recoveries may be programmed annually by the Board of Directors for plant replacement, expansion, or improvements. Such funds are considered capital or on behalf of, employees and their survivors under the early retirement provisions of the Act. The annual installment to liquidate the increased liability is determined by the Office of Personnel Management.

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

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

k. Reserve for Floating Equipment Overhauls. A reserve is provided through an annual charge to expense to cover the estimated cost of overhauls to the Commission tugboat fleet.

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 Government of Panama under the terms of the Panama Canal Treaty of 1977. The cost to manage, maintain and provide livability improvements to these quarters is charged to expense. Rental income is included in other revenues.

m. Work Injuries Compensation Benefits. The Panama Canal Commission is liable for the cost of all benefits due under the Federal Employees' Compensation Act (FECA) which provides compensation for performance of duty injuries for eligible employees. The costs of the FECA program are recognized over the life of the Treaty.

2. Plant Valuation Allowances.

At July 1, 1951, certain valuation allowances for property, plant and equipment transferred from the Panama Canal (agency) to the Panama Canal Company and the Canal Zone Government were established, to reduce to usable value the costs of the assets transferred. At October 1, 1979, such valuation allowances as were applicable to the assets transferred from the Panama Canal Company and the Canal Zone Government to the Panama Canal Commission were carried forward and are comprised of: (a) $4.1 million at September 30, 1990 and 1989, to reduce to usable value the cost of property, plant and equipment transferred; (b) $50.9 million at September 30, 1990 and 1989, to offset interest costs imputed for the original Canal construction period; and (c) $42.3 million at September 30, 1990 and 1989, 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.

3. Budgetary Resources.

a. Cash, accounts receivable, and the borrowing authority are the resources used to determine the Commission's solvency position as prescribed in Section 86.6 Office of Management and Budget Circular A-34, Instructions on Budget Execution, under which the incurring of obligations in excess of budgetary resources is a violation of the Antideficiency Act. All cash exceeding current operating requirements is kept on deposit with the U.S. Treasury.

b. The Panama Canal Commission has authority to borrow funds from the U.S. Treasury not to exceed $100 million outstanding at any time for any of the purposes of the Commission. No funds were borrowed during fiscal years 1990 and 1989.

4. Unrecovered Costs due from Subsequent Revenues.

Pursuant to the provisions of sections 1341(b)(2) and 1602(b) of the Act, all unrecovered costs from previous years operations must be recovered before determining any net operating revenues due to the Government of Panama, as provided for under Article XIII paragraph 4(c) of the Panama Canal Treaty of 1977. The cumulative unrecovered costs from fiscal years 1989, 1988 and 1987 totaled $9.7 million. The net operating revenue for fiscal year 1990 was $7.0 million, which when netted against the outstanding unrecovered costs, leaves a balance of $2.7 million to be recovered from subsequent revenues.

5. Cost of Work Injuries Compensation.

The Commission administers a program to compensate certain employees for death and disability resulting from performance of duty injuries or illnesses as set forth in the Federal Employees' Compensation Act. 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. An evaluation as of September 30, 1989, was prepared by an independent actuarial firm. The values in that report were used to adjust the assets and liabilities at year-end 1989. The report also served as the basis for determining the adequacy of the assets and liabilities at year-end 1990.

6. Interest-Bearing Investment of the United States Government.

The interest-bearing investment of the United States Government in the Panama Canal is determined based on section 1603(a) of the Act. The interest-bearing investment of the United States Government was $133.2 million at September 30, 1990 and $147.9 million at September 30, 1989.

7. Extraordinary Activities.

Since April 1988, the Commission has incurred a series of unusual and extraordinary costs due to the political situation that existed in Panama because of the Noriega regime. These costs were incurred in order to insure the proper and safe operation of the Canal in the face of growing harassment of Commission employees by that regime. Costs incurred totaled $6.8 million in fiscal year 1990 and $4.6 million in fiscal year 1989.

The Board of Directors has approved the recovery of these costs through the use of a temporary 20 percent surcharge on linehandling and tug service charges. The surcharge will be terminated on February 28, 1991.

advances from Canal users. Upon utilization, these advances are amortized through an offset to depreciation expense in an amount calculated to approximate the depreciation on assets acquired with such advances. In fiscal years 1990 and 1989, no amounts from tolls were programmed for such purpose.

At the direction of the Board of Directors, a system was implemented in fiscal year 1983 whereby shippers, for a fee, can make an advance reservation for a vessel transit. Such funds are considered capital advances from Canal users and upon utilization, the advances are amortized through an offset to depreciation expense in an amount calculated to approximate the depreciation on assets acquired with such advances. This system generated funds of $10.5 million in fiscal year 1990 and $4.5 million in fiscal year 1989.

e. Depreciation. Property, plant and equipment are depreciated over their estimated service lives at rates computed using a straight-line method with additional annual depreciation, identified as composite, to provide for premature plant retirements.

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

f. Accounts Receivable. Uncollectible accounts receivable of the Panama Canal Commission are recognized as a reduction in revenue when written off. Any subsequent collections of Commission accounts receivable previously written off are recorded as revenue.

g. Inventories. Operating materials and supplies are stated at average cost, plus cost of transportation to the ultimate destination on the Isthmus of Panama. An allowance has been established to reflect the estimated cost of obsolete and excess stock.

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

Non-United States citizen employees, who retired from predecessor agencies prior to October 5, 1958, are not covered by the United States Civil Service Retirement System but do receive benefits under a separate annuity plan. Payments made under this annuity plan are recorded as a current year expense. Annual amounts expended were $1.1 million in fiscal year 1990 and $1.3 million in fiscal year 1989. The Commission's liability for future annuity payments to these former employees or their eligible widows is reflected in the statement of financial position as retirement benefits to certain former employees of predecessor agencies and an equal amount is recorded as a deferred charge.

As required by the Act, the Panama Canal Commission is liable for the increase in the unfunded liability of the United States Civil Service Retirement Fund which is attributable to benefits payable from that fund to,

8. Contingent Liabilities and Commitments.

In addition to recorded liabilities, the estimated maximum contingent liability which could result from pending claims and lawsuits was $11.9 million at September 30, 1990 and $10.1 million at September 30, 1989. In the opinion of management and the Commission's General Counsel, these pending claims and lawsuits will be resolved with no material adverse effect on the financial condition of the agency.

Commitments under uncompleted construction contracts and unfilled purchase orders amounted to $34.3 million at September 30, 1990 and $38.0 million at September 30, 1989. Of these amounts, unfilled prepaid purchase orders totaled less than $0.1 million as of September 30, 1990 and $0.1 million as of September 30, 1989.

Cash and negotiable securities of a kind acceptable by the United States Government in the amount of $13.2 million were held by the United States depositories designated by the Panama Canal Commission at September 30, 1990 and $12.4 million at September 30, 1989, to guarantee payment by third parties of their obligations.

The Panama Canal Treaty of 1977, Article XIII, paragraph 4(c), provides that an annual amount of up to $10 million per year be paid to the Government of Panama out of operating revenues to the extent that such revenues exceed expenditures. Payment to the Government of Panama is subject to the limitations set forth in section 1341(e) of the Act. In the event 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 up to the amount available from these surpluses. As of September 30, 1990, the balance contingently payable to the Government of Panama amounts to $101.1 million. As of September 30, 1989, the balance contingently payable to the Government of Panama amounted to $91.1 million. However, as set forth in the Exchange of Instruments of Ratification of Panama Canal Treaties paragraph (a)(4) and in section 1341(d) of the Act, nothing may be construed as obligating the United States to pay after the date of the termination of the Treaty any unpaid balance accumulated before such date.

9. Treaty Impact.

On September 7, 1977, the United States of America and the Republic of Panama signed the Panama Canal Treaty of 1977. The Treaty provided for the establishment of the Panama Canal Commission on October 1, 1979, to assume certain operational responsibilities for the Canal until December 31, 1999. When the Treaty terminates on December 31, 1999, the Republic of Panama shall assume total responsibility for the management, operation, and maintenance of the Panama Canal, which shall be turned over in operating condition and free of liens and debts, except as the two parties may otherwise agree. The effects of these long-range requirements are not considered in the financial statements.

Schedules of Treaty-Related Costs

Non-DOD Costs (Savings) Through Fiscal Year 1990

Agency	Prior FY Costs	FY 90 Costs	Total Costs
State Department	$(15,759,187)	$(1,795,075)	$(17,554,262)
Federal Aviation Administration	(36,465,083)	0	(36,465,083)
American Battle Monuments Commission	3,316,950	244,000	3,560,950
Panama Canal Commission	300,000	0	300,000
General Accounting Office	1,628,567	20,418	1,648,985
Smithsonian Tropical Research Institute	3,448,107	582,667	4,030,774
Gorgas Memorial Laboratory	(257,351)	0	(257,351)
Canal Area Court System			
U.S. Attorney	(946,425)	(135,665)	(1,082,090)
U.S. Marshal	(472,315)	(56,960)	(529,275)
Clerk of Court	(4,214,415)	0	(4,214,415)
Bureau of Prisons	2,464,917	18,799	2,483,716
Foreign Broadcast Information System	360,628	118,288	478,916
National Oceanic and Atmospheric Administration	78,679	0	78,679
Total non-DOD	$(46,516,928)	$(1,003,528)	$(47,520,456)

Department of Defense (DOD) Costs (Savings) Through FY 1990

	Prior FY Costs	FY 90 Costs	Total Costs
U.S. Army			
Base Operations	$158,228,949	$16,567,520	$174,796,469
Communications	26,956,290	2,696,209	29,652,499
Commissary	9,027,496	689,704	9,717,200
Transportation	2,902,539	2,274	2,904,813
Technical Assistance	360,240	0	360,240
Health Services	118,037,207	19,598,580	137,635,787
Disposition of Remains	3,073,961	395,421	3,469,382
Criminal Investigations	741,336	86,084	827,420
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	83,339,950	4,382,010	87,721,960
Ports	165,868	0	165,868
Family Housing Operations	13,473,270	483,040	13,956,310
Executive Agent Costs	1,712,152	1,983,000	3,695,152
TOTAL ARMY	457,499,246	46,883,842	504,383,088
U.S. Air Force	36,881,331	2,217,172	39,098,503
U.S. Navy	737,044	428,128	1,165,172
DOD Dependents Schools (Note A)	8,955,000	8,757,000	17,712,000
Defense Mapping Agency	1,158,764	0	1,158,764
TOTAL DOD	$505,231,385	$58,286,142	$563,517,527

A Obligations incurred rather than actual expenditures

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

Agency	Prior Transfers	FY 90 Transfers	Total Transfers
Department of Defense			
U.S. Army	$40,338,046	$ 0	$40,338,046
U.S. Navy	4,930,769	0	4,930,769
U.S. Air Force	275,874	0	275,874
Total DOD	45,544,689	0	45,544,689
Federal Aviation Administration	4,638,360	0	4,638,360
Total	$50,183,049	$ 0	$50,183,049

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

Agency	Acquisition Cost: Prior Transfers	Acquisition Cost: FY 1990 Transfers	Acquisition Cost: Total Transfers
Canal Zone Government and Panama Canal Company	$168,317,629	$ 0	$168,317,629
Panama Canal Commission	29,225,827	0	29,225,827
Total	$197,543,456	$ 0	$197,543,456

Agency	Net Book Value: Prior Transfers	Net Book Value: FY 1990 Transfers	Net Book Value: Total Transfers
Canal Zone Government and Panama Canal Company	$84,886,222	$ 0	$84,886,222
Panama Canal Commission	9,614,749	0	9,614,749
Total	$94,500,971	$ 0	$94,500,971

Schedule of Property, Plant, and Equipment

SEPTEMBER 30, 1990 AND 1989

	Estimated Service Life	1990 Cost	1990 Depreciation and Valuation Allowances	1989 Cost	1989 Depreciation and Valuation Allowances
Titles and treaty rights	40 yrs.	$ 14,728,889	$ 6,351,834	$ 14,728,889	$ 5,983,612
Interest during construction	-	50,892,311	50,892,311	50,892,311	50,892,311
Canal excavation, fills, and embankments	15-100 yrs.	347,758,177	148,683,080	347,753,732	140,138,508
Canal structures and equipment	4-100 yrs.	350,010,308	164,872,569	326,975,387	157,356,034
Supporting and general facilities	5-100 yrs.	154,327,319	91,505,889	146,352,516	87,790,847
Facilities held for future use	10-100 yrs.	3,330,878	2,577,077	3,330,878	2,577,077
Plant additions in progress	-	35,961,180	-	39,450,822	-
Suspended construction projects	-	40,145,798	40,145,798	40,145,798	40,145,798
TOTAL		$997,154,860	$505,028,558	$969,630,333	$484,884,187

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