Translation of financial statements originally issued in Spanish

Panama Canal Authority

Independent Auditors' Report

Financial statements
September 30, 2007

Deloitte – Panamá

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Independent Auditors' Report and Financial Statements
September 30, 2007

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Translation of a report originally issued in Spanish
(See explanation in the notes to the financial statements)

Independent Auditors' Report

To the Board of Directors of the Panama Canal Authority

Report on the financial statements

We have audited the accompanying financial statements of the Panama Canal Authority, which comprise the balance sheet as of September 30, 2007 and the statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes. The financial statements as of September 30, 2006, were audited by other auditors whose report dated December 6, 2006 expressed an unqualified opinion.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Deloitte.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Panama Canal Authority as of September 30, 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte (signed)

November 21, 2007
Panama, Rep. of Panama

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Balance sheet
September 30, 2007
(In thousands of balboas)

	Notes	2007	2006
Assets			
Non-current assets:			
Properties, plant and equipment, net	4, 17	B/. 2,239,693	B/. 2,181,293
Account receivable	5	-	20,140
Current assets:			
Cash and bank deposits	6	1,406,383	821,170
Investments in securities	7	335,162	490,399
Accounts receivable	8	37,112	31,946
Inventories, net	9	35,368	29,115
Accumulated interest receivable and other assets		26,151	25,135
Total current assets		1,840,176	1,397,765
Total assets		B/. 4,079,869	B/. 3,599,198
Equity and liabilities			
Equity:			
Contributed capital	17	B/. 1,904,968	B/. 1,904,540
Retained earnings:			
Appropriated	10	1,475,151	1,154,918
Unappropriated	11	486,414	315,332
Total equity		3,866,533	3,374,790
Severance payable	12	10,000	10,000
Current liabilities:			
Accounts payable	13	75,802	98,943
Provision for marine accident claims	14	29,883	27,715
Salaries and leave payable		81,447	83,540
Other liabilities		16,204	4,210
Total current liabilities		203,336	214,408
Contingent liabilities and commitments	20		
Total equity and liabilities		B/. 4,079,869	B/. 3,599,198

The accompanying notes are an integral part of these financial statements.

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Income statement
For the year ended September 30, 2007
(In thousands of balboas)

	Notes	2007	2006
Revenues:			
Toll revenues		B/. 1,183,927	B/. 1,026,427
Vessel-transit-related services		354,315	318,476
		1,538,242	1,344,903
Other revenues:			
Electric power sales		95,588	74,008
Potable water sales		19,573	19,018
Interest income		77,072	50,085
Miscellaneous	18	29,910	6,811
Total other revenues		222,143	149,922
Total revenues		1,760,385	1,494,825
Expenses:			
Salaries and wages		348,171	332,190
Employee benefits		43,958	41,795
Materials and supplies		40,713	36,124
Fuel		64,834	63,175
Transportation and allowances		1,743	1,480
Contracted services and fees		34,503	37,049
Insurance		9,753	9,892
Provision for marine accidents	14	3,285	3,004
Provision for obsolete inventory	9	849	2,958
Other expenses		11,544	8,608
		559,353	536,275
Capitalized labor and materials	15	(34,915)	(47,835)
Total expenses		524,438	488,440
Income before fees and depreciation		1,235,947	1,006,385
Fee per net ton	13	(358,765)	(252,796)
Panamanian Treasury (Tesoro Nacional) – public service fees		(1,826)	(1,577)
Depreciation	4	(68,709)	(76,087)
Net income	16	B/. 806,647	B/. 675,925

The accompanying notes are an integral part of these financial statements.

Panama Canal Authority

Statement of changes in equity
For the year ended September 30, 2007
(In thousands of balboas)

	Notes	Contributed Capital	Retained Earnings Appropriated	Retained Earnings Unappropriated	Total equity
Balance as of September 30, 2005		B/. 1,904,547	B/. 794,325	B/. 268,850	B/. 2,967,722
Transfer to Panamanian Treasury	11	-	-	(268,850)	(268,850)
Net income		-	-	675,925	675,925
Contributions to the investment program	10	-	76,974	(76,974)	-
Increase in equity reserves	10	-	325,469	(325,469)	-
Decrease in equity reserves	10	-	(41,850)	41,850	-
Properties transferred to the Government of Panama		(7)	-	-	(7)
Balance as of September 30, 2006		1,904,540	1,154,918	315,332	3,374,790
Transfer to Panamanian Treasury	11	-	-	(315,332)	(315,332)
Net income		-	-	806,647	806,647
Contributions to the investment program	10	-	348,574	(228,803)	119,771
Increase in equity reserves	10	-	107,409	(107,409)	-
Decrease in equity reserves	10	-	(135,750)	15,979	(119,771)
Properties transferred to PCA		428	-	-	428
Balance as of September 30, 2007		B/. 1,904,968	B/. 1,475,151	B/. 486,414	B/. 3,866,533

The accompanying notes are an integral part of these financial statements.

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Cash flows statement
For the year ended September 30, 2007
(In thousands of balboas)

	Notes	2007	2006
Cash flows from operating activities:			
Net income		B/. 806,647	B/. 675,925
Adjustments for:			
Depreciation		66,804	74,402
Loss on disposal of fixed asset		1,213	316
Provision for obsolete inventory		849	2,958
Provision for marine accident claims		3,285	3,004
Changes in operating assets and liabilities:			
Accounts receivable		(5,166)	(5,916)
Inventories		(7,102)	(1,001)
Accumulated interest receivable and other assets		(1,016)	(12,738)
Current liabilities		(14,357)	34,001
Net cash provided by operating activities		851,157	770,951
Cash flows from investing activities:			
Net increase of fixed asset		(125,989)	(160,614)
Net decrease (increase) in investments		155,237	(184,745)
Collection of non-current account receivable	5	20,140	-
Net increase in time deposits, over 90 days		(446,473)	(282,196)
Net cash used in investing activities		(397,085)	(627,555)
Cash flows from financing activities:			
Transfer to Panamanian Treasury		(315,332)	(268,850)
Net increase (decrease) in cash and bank deposits		138,740	(125,454)
Cash and bank deposits at beginning of the year		103,739	229,193
Cash and bank deposits at end of the year	6	B/. 242,479	B/. 103,739
Investing activities that did not represent cash outflows			
Properties transferred to PCA		B/. (428)	B/. -
Properties transferred to the Government of Panama		-	7
Fixed assets – capitalized depreciation		(1,905)	(1,685)
		B/. (2,333)	B/. (1,678)

The accompanying notes are an integral part of these financial statements.

Explanation Added for Translation into English

The accompanying financial statements have been translated from Spanish into English for international use. These financial statements are presented in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board. Certain accounting practices applied by the Panama Canal Authority that conform with International Financial Reporting Standards may not conform with accounting principles generally accepted in the country of use.

1. General Information

The Panama Canal Authority (PCA) is an autonomous agency of the Government of Panama, established in conformity with Article 310 of the Political Constitution of the Republic of Panama. The PCA is responsible for the administration, operation, conservation, maintenance, modernization, and other related activities of the Panama Canal (the Canal), that are necessary to ensure the safe, uninterrupted, efficient and profitable operation of the Canal in accordance with the constitutional and legal regulations in effect. The PCA has its own patrimony and the right to manage it. The PCA was organized on June 11, 1997 under Law No.19 (Organic Law).

The PCA, in coordination with government entities designated by law, is also responsible for the management, maintenance, use and conservation of the water resources of the Canal watershed, including lakes and their tributary streams.

With the expiration of the 1977 Torrijos-Carter Treaty at noon on December 31, 1999, the Panama Canal reverted to the Republic of Panama free of debts and liens, becoming an inalienable patrimony of the Republic of Panama, open to the peaceful and uninterrupted passage of vessels of all nations and whose use will be subject to the requirements and conditions established by the Political Constitution of Panama, the Organic Law of PCA, and its management.

As of September 30, 2007, the PCA had a total of 9,270 (2006: 9,210) employees, of which 7,835 (2006: 7,875) were permanent and 1,435 (2006: 1,335) were temporary.

The Panama Canal Authority's Board of Directors authorized and approved the issuance of the financial statements, for the period ended September 30, 2007, on November 21, 2007.

(In thousands of balboas)

2. Adoption of New and Revised International Financial Reporting Standards

At the date of these financial statements, the following standards and interpretations were issued but not yet in effect:

IFRS 7 – Financial Instruments: Disclosures	Effective for annual periods beginning on or after January 1, 2007
IFRS 8 – Operating Segments, replaces IAS 14, Segment Reporting	Effective for annual periods beginning on or after January 1, 2009
IFRIC 10 - Interim Financial Reporting and Impairment	Effective for annual periods beginning on or after November 1, 2006
IFRIC 11, IFRS 2 – Group and Treasury Share Transactions	Effective for annual periods beginning on or after March 1, 2007
IFRIC 12 – Service Concession Arrangements	Effective for annual periods beginning on or after January 1, 2008

The Board of Directors considers that the adoption of those standards and interpretations, applicable to future periods, would not have an important effect in PCA's financial statements.

3. Significant accounting policies

The financial statements for the year ended September 30, 2007, have been formulated from systematized Accounting Records maintained by the organization.

a. Statement of compliance - PCA's financial statements have been prepared in conformity with the International Financial Reporting Standards.

b. Basis of presentation - The financial statements have been prepared under the historical cost convention, in conformity with International Financial Reporting Standards. PCA applied accounting policies consistently with those applied last year.

c. *Use of estimates* - The preparation of the financial statements, in conformity with the International Financial Reporting Standards, requires management to make estimates and assumptions that affect reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Future actual results could differ from those estimates. The most significant estimates for these financial statements are the provision for marine accident claims, provision for obsolete inventory of supplies and materials, and the determination of the useful life of fixed assets.

d. *Properties, plant, and equipment* - Items of properties, plant, and equipment with a value of five thousand balboas or more are recorded at cost. The cost of items that are not capitalized or under five thousand balboas is expensed as incurred.

Depreciation is calculated using the straight-line method over the following estimated useful lives of the depreciable assets:

Buildings	25 - 75 years
Structures	5 - 100 years
Equipment	3 - 75 years

The useful life of assets is reviewed periodically to ensure that the depreciation period is consistent with the economic benefit expectations of the components of properties, plant, and equipment.

The gain or loss resulting from the retirement or disposal of an asset is the difference between the net proceeds and the net book value of the asset. The gain or loss is reflected in the statement of income when incurred, except for buildings and properties that were received from the Government of Panama, which are charged against equity when they are demolished or returned to the Government of Panama.

Maintenance and repairs are expensed as incurred, while major improvements are capitalized. Dredging costs incurred for recurrent maintenance of the waterway, as a result of landslides and erosion, are expensed. Dredging costs for substantial improvements to the waterway are capitalized and depreciated over their estimated useful lives.

Construction in progress represents plant and properties under construction and includes construction and other direct costs. Such items are not subject to depreciation until the assets are completed and placed in operation.

e. Impairment of assets - Assets that are subject to amortization are reviewed annually to identify any impairment losses, whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. An impairment loss is recognized when the asset's carrying amount exceeds its recoverable amount, which is the higher of an asset's net selling price and its value in use.

f. Financial instruments **-** The financial assets and liabilities are recognized in the balance sheet of the PCA when they become a contractual obligation of the instrument.

- ***Cash and bank deposits*** **-** Consist of cash on hand, deposits in current and saving accounts, and time deposits, free of liens and with original maturity dates of less than 90 days or over 90 days not exceeding one year.

- ***Commercial accounts receivable*** **-** The commercial accounts receivable are recorded at their face value.

- ***Classification of financial assets into current or non-*****current -** In the balance sheet, financial assets are classified according to their maturities, that is, current assets, are those with maturities of less than or equal to twelve months; and non-current, above such period.

- ***Commercial accounts payable*** - The commercial accounts payable do not earn interests explicitly and are recorded at their face value.

- ***Classification of financial liabilities into current or non-*****current -** In the balance sheet, financial liabilities are classified according to their maturities, that is, current liabilities, are those with maturities of less than or equal to twelve months; and non-current, above such period.

g. Investments **in securities -** Purchases of investments are recognized on the settlement date, the date on which PCA pays and receives the asset.

Investments in securities are acquired with the intention to be held to maturity and are recorded at amortized cost. Amortized cost is the initial cost of the investment, adjusted by the cumulative amortization of any discount or premium on acquisition. The amortization of the discount or premium is recognized as an increase or decrease of interest income in the statement of income.

h. Inventories - The inventories of materials, operating supplies, and fuel are valued at average cost, which does not exceed net realizable value, after the allowance for obsolete supplies and materials inventory.

i. ***Allowance for obsolete supplies and materials*** **-** The supplies and materials inventory is annually evaluated to determine if stock levels are adequate or are in excess and should be reduced due to obsolescence, impairment, diminishment of quality, slow turnover or are not useful for the operation and functioning of the Canal.

   If any inventory item of supplies and materials complies with the previously mentioned characteristics, the allowance is adjusted to its reasonable value to recognize the probable loss.

j. ***Revenue recognition*** **-** Revenues are recognized as a result of the economic benefits which flow to the PCA and those revenues could be easily measured. The following specific criteria have to be complied before revenues are recognized:

   Toll revenue
   The toll revenue is recognized once vessels complete their transits through the Canal.

   Services rendered
   Revenues from other services are recognized when services are rendered.

   Interest
   Interest income on bank deposits and investments are recognized as accrued.

k. ***Severance payable*** **-** Severance labor payments are charged to expense as incurred, except for the portion corresponding to the years of employment with the Panama Canal Commission, as explained in Note 12.

l. ***Monetary unit*** **-** The PCA maintains its accounting records in balboas (B/.), and its financial statements are expressed in that currency. The balboa, monetary unit of the Republic of Panama, is at par and has free exchange with the U.S. dollar. The Republic of Panama does not issue paper money and in its place utilizes the U.S. dollar as legal currency.

m. ***Comparison of information*** **-** The information contained in these financial statements referring to the year 2006 is presented for comparison purposes with similar information related to the year 2007.

n. ***Reclassifications*** **-** Some figures of the year 2006 have been reclassified from their original presentation for comparative purposes with 2007.

o. Critical judgment in the application of accounting policies

Fixed assets:

To determine the useful life of fixed assets, a catalog of property, plant, and equipment units is used. The catalog is an internal guide that identifies the basis to determine the elements of a plant unit, based upon the criteria established in the International Financial Reporting Standards.

This catalog details all the assets according to function and useful life, whose main objective is to unify the criteria used in the classification of capital assets and the estimation of depreciation expense based on the execution of the investment programs.

Marine accident claims:

The PCA is responsible for recording a provision for marine accidents as soon as it is known of a probable economic obligation derived from this incident. Such provision includes an estimate of costs for repairs, dry dock, damages to cargo and inspection, among others. These elements constitute the basis to record the initial liability which is updated based on inspections or presentation of claims duly supported.

The PCA will make payments for claims that are properly supported and accepted by the PCA during the administrative or judicial stage or in conformity with the Organic Law, Article 69, or in compliance with a final ruling from the Maritime Tribunal, in those cases where the PCA may be liable.

(In thousands of balboas)

4. Properties, plant and equipment, net

Properties, plant, and equipment are as follows:

	September 30, 2007			
	Beginning Balance	Additions	Decreases	Ending Balance
Assets				
Land	B/. 1,022,222	B/. 359	B/. -	B/. 1,022,581
Buildings	86,330	1,534	(159)	87,705
Structures	546,779	56,514	(509)	602,784
Equipment	748,050	45,216	(6,942)	786,324
Constructions in progress	169,576	24,699	-	194,275
	2,572,957	128,322	(7,610)	2,693,669
Accumulated depreciation				
Buildings	23,376	2,882	(72)	26,186
Structures	110,224	20,828	(438)	130,614
Equipment	258,064	44,999	(5,887)	297,176
	391,664	68,709	(6,397)	453,976
Net value	B/. 2,181,293	B/. 59,613	B/. (1,213)	B/. 2,239,693

	September 30, 2006			
	Beginning Balance	Additions	Decreases	Ending Balance
Assets				
Land	B/. 1,022,222	B/. -	B/. -	B/. 1,022,222
Buildings	82,924	3,340	66	86,330
Structures	496,767	32,326	17,686	546,779
Equipment	663,350	103,764	(19,064)	748,050
Constructions in progress	146,707	22,869	-	169,576
	2,411,970	162,299	(1,312)	2,572,957
Accumulated depreciation				
Buildings	20,129	3,180	67	23,376
Structures	86,933	19,305	3,986	110,224
Equipment	209,504	53,602	(5,042)	258,064
	316,566	76,087	(989)	391,664
Net value	B/. 2,095,404	B/. 86,212	B/. (323)	B/. 2,181,293

(In thousands of balboas)

The PCA recorded losses in retirements or disposals of assets for B/.1,213 (2006: B/.316). During 2007, the main assets that were retired included workshop equipment; telecommunication and electronic equipment; surveillance and access control system; office, laboratory and clinic, vehicular, and floating equipment; installations and other structures. During 2006, the main assets retired included a lighting system, winch, computer system, various projectors, forklifts, uninterruptible power system, and a gasoline tank.

A portion of the depreciation for an amount of B/.1,905 (2006: B/.1,685) corresponding to equipment utilized in investment projects was capitalized as properties, plant and equipment during the period. (See note 15)

5. Account receivable

During fiscal year 2007, the account receivable from the Office of Transition Administration (OTA) was paid in full. This account was originated at the time of the transfer of the Canal and corresponds to the portion of the Investment Program as of December 31, 1999 that was not transferred by the Panama Canal Commission.

6. Cash and bank deposits

Cash and bank deposits are composed as follows:

		2007		2006
Cash on hand	B/.	41	B/.	34
Deposits in current accounts		8,126		7,957
Deposits in saving accounts		93		59,842
Time deposits with original maturities under 90 days		234,219		35,906
		242,479		103,739
Time deposits with original maturities over 90 days not exceeding one year		1,163,904		717,431
	B/.	1,406,383	B/.	821,170

(In thousands of balboas)

Article 44 of the Organic Law states that PCA's funds may be placed in short-term investment grade instruments and may not be used to buy other types of financial investment instruments issued by Panamanian or foreign public or private entities, or to grant loans to such entities or to the Panamanian Government. All investments in time deposits are placed in investment grade banks.

7. Investments in securities

Investments in securities were acquired with the intention to be held to maturity, and are mainly composed of bonds. All the investments are short-term and have been placed in investment grade instruments.

Changes in investments in securities held to maturity are stated as follows:

	2007	2006
Balance at the beginning of the year	B/. 490,399	B/. 305,654
Additions	611,094	638,506
Redemptions	(766,331)	(453,761)
Balance at the end of the year	B/. 335,162	B/. 490,399

	2007	2006
Fair value	B/. 335,130	B/. 490,295
Unrealized loss	32	104
Amortized cost	B/. 335,162	B/. 490,399

(In thousands of balboas)

8. Accounts receivable

The accounts receivable are detailed as follows:

		2007		2006
Transit-related services	B/.	16,221	B/.	8,229
Electric power sales		15,343		15,985
National Institute of Pipelines and Sewerage (Instituto de Acueductos y Alcantarillados Nacionales)		3,326		4,781
Other government entities		1,296		1,221
Other services		926		1,730
	B/.	37,112	B/.	31,946

9. Inventories, net

The inventories are detailed as follows:

		2007		2006
Supplies and materials	B/.	36,777	B/.	32,188
Fuel		4,991		3,437
Provision for obsolete inventory		(6,400)		(6,510)
	B/.	35,368	B/.	29,115

Change in the provision for obsolete inventory of supplies and materials is as follows:

		2007		2006
Balance at the beginning of the year	B/.	6,510	B/.	5,236
Increase		849		2,958
Charges		(959)		(1,684)
Balance at the end of the year	B/.	6,400	B/.	6,510

(In thousands of balboas)

10. Appropriated retained earnings

Article 41 of the Organic Law allows PCA to set aside funds from net income of the year to cover the costs of the investment program and the modernization and expansion of the Canal, as well as for other equity reserves that may be needed to cover possible catastrophic risks, working capital and other contingencies.

Changes in appropriated retained earnings are detailed as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
2007				
Reserves for:				
Canal expansion	B/. 120,000	B/. 35,300	B/. (120,000)	B/. 35,300
Catastrophic risks	36,000	-	-	36,000
Social and environmental program of the Canal watershed	10,000	-	-	10,000
Contingencies and working capital	122,866	20,112	-	142,978
Enterprise capitalization	182,003	51,997	-	234,000
Other	15,750	-	(15,750)	-
	486,619	107,409	(135,750)	458,278
Contributions for:				
Investment programs	668,299	348,574	-	1,016,873
	B/. 1,154,918	B/. 455,983	B/. (135,750)	B/. 1,475,151

	Beginning Balance	Increase	Decrease	Ending Balance
2006				
Reserves for:				
Canal expansion	B/. -	B/. 120,000	B/. -	B/. 120,000
Catastrophic risks	36,000	-	-	36,000
Social and environmental program of the Canal watershed	10,000	-	-	10,000
Contingencies and working capital	99,400	23,466	-	122,866
Enterprise capitalization	-	182,003	-	182,003
Other	57,600	-	(41,850)	15,750
	203,000	325,469	(41,850)	486,619
Contributions for:				
Investment programs	591,325	76,974	-	668,299
	B/. 794,325	B/. 402,443	B/. (41,850)	B/. 1,154,918

The equity reserves established up to date are as follows:

Reserve for Canal expansion
The Board of Directors approved an equity reserve for the construction program of the Panama Canal third set of locks. The funds for this reserve are segregated based on the levels of earnings obtained, in attention to the financing needs of the PCA for determined projects during the implementation of the program. The Board of Directors approved a contribution of B/.35,300 (2006: B/.120,000). Additionally, the Board of Directors approved the transfer of B/.119,771 of the reserve established in fiscal year 2006 to increase the funds for the Investment Program – Canal Expansion.

Reserve for catastrophic risks
The Board of Directors approved an equity reserve with the purpose of covering the amounts deductible of the catastrophic risks insurance policies for a total amount of B/.36,000, thus the PCA did not increase this reserve for fiscal years 2007 and 2006.

Reserve for the social and environmental program of the Canal watershed
The Board of Directors approved the establishment of a reserve to finance the social and environmental program of the Canal watershed. The purpose of this program is to preserve the natural resources and to promote the development and integral management of the watershed. In fiscal years 2007 and 2006, PCA did not make appropriations to this reserve.

Reserve for contingencies and working capital
The Board of Directors approved an equity reserve for contingencies and working capital based on the PCA's level of revenues. The amount of this reserve will be defined based on the average of 30 days of Canal revenues or billing, and will be funded in stages, periodically, as agreed by the Board of Directors. The Board of Directors approved the increase of this reserve by B/.20,112 (2006: B/.23,466) for a total of B/.142,978 (2006: B/.122,866).

Enterprise capitalization
The Board of Directors approved a reserve for the Enterprise capitalization. The purpose of this reserve is to ensure and facilitate the long-term financial projection of the Enterprise. This reserve will be funded in stages, according to the periodicity agreed by the Board of Directors. The Board of Directors approved to reserve B/.51,997 (2006: B/.182,003) for a total of B/.234,000 (2006: B/.182,003).

Other equity reserves

The Board of Directors approved the establishment of other equity reserves, which contemplate programs to support Canal operation and administration. During fiscal year 2007, the Board of Directors approved the use of B/.10,000 (2006: B/.28,838) and to return B/.5,750 (2006: B/.13,012) to the unappropriated retained earnings.

Contributions to the investment programs

The Board of Directors approved to increase funds to the investment programs for B/.348,574 (2006: B/.76,974).

11. Unappropriated retained earnings

Article 41 of the Organic Law establishes that after covering the costs for the investment program and the reserves detailed in Note 10, any surplus shall be remitted to the Panamanian Treasury in the following fiscal period. Therefore, PCA should transfer the total amount of B/.486,414 to the Panamanian Treasury which corresponds to the year ended September 30, 2007 (2006: B/.315,332).

In compliance with Law 28 of 2006, during the construction period of the third set of locks, the Canal tonnage payments and contributions for operational surplus to the National Treasury will be maintained and increased. Any payments for the surplus from the operation shall not be less to those effected to the National Treasury in 2005 for the amount of B/.268,850. The combined payments for fee per net ton and the surplus from the operation shall not be less than the payments effected in fiscal year 2006 for the amount of B/.568,128.

12. Severance payable

In May 1999, the Panama Canal Commission's Board of Directors approved the transfer of B/.10,000 to PCA for severance payments to involuntarily terminated employees. This amount takes into account the employees' years of service with the Commission. At the date of this report, no employees transferred from the Panama Canal Commission have been separated unjustifiably from their jobs.

(In thousands of balboas)

13. Accounts payable

The accounts payable are as follows:

	2007	2006
Panamanian Treasury	B/. 28,466	B/. 20,713
Supplies and others	47,336	78,230
	B/. 75,802	B/. 98,943

Article 39 of the Organic Law establishes that PCA shall pay annually to the Panamanian Treasury a fee per net ton, or its equivalent, collected from vessels paying tolls for the use of the Canal. This fee shall be set by PCA. The total of such fees amounted to B/.358,765 (2006: B/.252,796).

The balance payable to the Panamanian Treasury represents the fee per net ton payment that is outstanding at September 30, 2007.

14. Provision for marine accident claims

The provision for marine accident claims for B/.29,883 (2006: B/.27,715), represents the estimated value of filed or anticipated claims for accidents occurred in Canal waters for which PCA expects to be liable.

PCA carries out investigations to determine the cause of each marine accident. When the cause of the accident is determined, PCA records, if applicable, a provision based on an estimate of the vessel's permanent and temporary repair costs. The amount of the provision is reviewed at the date of the balance sheet, and if necessary, it is adjusted to reflect the best estimate at that moment.

(In thousands of balboas)

Changes in the provision for marine accident claims are detailed, as follows:

		2007		2006
Balance at beginning of the year	B/.	27,715	B/.	27,524
Provision for the year		3,285		3,004
Payments made		(1,117)		(2,813)
Balance at end of the year	B/.	29,883	B/.	27,715

The increase in the provision is included as an expense of the current period under "Provision for Marine Accidents."

15. Capitalized labor and materials

During the execution of the Investment Program - Others and Investment Program – Canal Expansion, the PCA utilizes the services of contractors as well as its own resources and equipment.

The direct costs of labor, materials and supplies, equipment (fuel, maintenance and depreciation), and other expenses attributed to the investments made with the PCA's own resources and equipment are recorded originally as operating expenses as incurred. These costs are later credited in the statement of income and charged to properties, plant and equipment.

(In thousands of balboas)

The most significant projects of the investment program that have been executed with PCA's own resources and equipment are detailed as follows:

	2007	2006
Investment Program – Others:		
Widening and straightening of the Gaillard (Culebra) Cut	B/. 9,405	B/. 2,940
Deepening of Gatun Lake and Gaillard (Culebra) Cut	8,081	25,462
New Tie-Up Station for Vessels in Cartagena Hill	4,787	-
New Tie-Up Station for Vessels in Gaillard (Culebra) Cut	-	599
Tow Track Rehabilitation	3,659	6,596
Improvements to the Lighting Systems in all Locks	1,299	910
Procurement and Installation of Hydraulic Operators for the Rising Stem Valves	829	1,767
Replacement of Turntables in Gatun Locks	724	-
Deepening of the Entrances to the Canal	-	4,204
Assembly of Towing Locomotives	-	600
Investment Program – Canal Expansion:		
Dredging of Gatun Lake	1,332	-
Studies and Specifications in all Locks	613	-
Other projects	4,186	4,757
Total capitalized	B/. 34,915	B/. 47,835

16. Income taxes

The PCA is not subject to income taxes, as stated in Article 43 of the Organic Law which exempts it from the payment of all national or municipal taxes, except for the employer's contribution of social security, educational insurance, workmen's compensation, fees for public services, and the fee per net ton.

17. Contributed capital

Article 310 of the Political Constitution of the Republic of Panama states that PCA has its own patrimony and the right to manage it.

Upon the transfer of the Canal to the Republic of Panama at noon on December 31, 1999, PCA became the administrator of all personal and real estate property identified in the Organic Law of PCA as the patrimony necessary to operate and maintain the Canal.

This patrimony is divided into two groups: the inalienable patrimony, comprised of land, lakes, rivers, dams, locks and anchorages, as established in Article 2 of the Organic Law; and the economic patrimony, comprised of installations, buildings, structures and equipment that support the operation of the Canal, as established in Article 33 of the same Law.

In compliance with these requirements, the Government of Panama transferred the related land and buildings to PCA. In order to record the assets transferred by the Government of Panama as part of PCA's patrimony, a conservative method was used to reflect an estimated market value for each asset subsequently registered in the Public Registry.

18. Other miscellaneous revenues

With the termination of the Torrijos-Carter Treaty of 1977, at noon on December 31, 1999, the Panama Canal reverted to the Republic of Panama free of debt and taxes. To this end, the existing liabilities in Panama Canal Commission books (maritime accidents and other contractual liabilities) were cleared in full; thus, the PCA received from the U.S. Treasury, during fiscal year 2007, the sum of B/.20,817 corresponding to the remainder of funds from the settlement of those liabilities. Those extraordinary funds were recorded as "other revenues" in fiscal year 2007.

19. Remunerations and benefits to key managers

The PCA paid remunerations and benefits to key managers for a total of B/.1,979 (2006: B/.1,748).

20. Contingent liabilities, commitments and contracts

Contingent liabilities
PCA has received claims and is a defendant in various legal proceedings mainly related to marine accidents. The PCA's contingent liabilities amounted approximately to B/.2,374 (2006: B/.2,797) corresponding to marine accident claims. It is management and its legal advisors' opinion that the outcome of these matters is not likely to have a material adverse effect on the PCA's financial position.

Commitments
Commitments under uncompleted construction contracts and undelivered purchase orders amounted approximately to B/.167,000 (2006: B/.146,000).

According to the sales contract of potable water, between the PCA and the National Institute of Pipelines and Sewerage (Instituto de Acueductos y Alcantarillados Nacionales [IDAAN]), and the Implementation Agreement of that contract, the PCA is committed to build and operate a water purification plant. The IDAAN is committed to purchase the volume of water that will insure the return of PCA's investment in the infrastructure to supply the demand requested by IDAAN.

Contracts of the Canal Expansion
The third set of locks program is a plan to expand the Canal's capacity composed of three integrated components: 1) the construction of two lock facilities – one on the Atlantic side and another on the Pacific side, each with water reutilization basins; 2) the excavation of new access channels to the new locks and the widening of existing navigational channels; and, 3) the deepening of existing navigation channels and the elevation of Gatun Lake's maximum operating level.

The objectives of the Canal expansion are to: 1) achieve long-term sustainability and growth through the payments it makes to the National Treasury; 2) maintain the Canal's competitiveness as well as the value added by Panama's maritime route to the national economy; 3) increase the Canal's capacity to capture the growing tonnage demand with the appropriate levels of services for each market segment; and, 4) make the Canal more productive, safe, and efficient.

The program will have an approximate estimated cost of B/.5,250 million, which includes provisions for contingencies and inflation during the construction period. This estimate assumes 2% average annual inflation.

The execution of the program of the third set of locks will begin in 2007 and will take up to 8 years, between 2007 and 2014. The third set of locks could begin operations in 2015.

Program investments for the construction of the third set of locks will be recovered through tolls collected by the Canal.

The third set of locks program will be financed through a mix of PCA capital contributions and interim external financing. The amount to come from external financing will depend on (1) investment amounts required by the project; (2) the need to build as fast as it is technically and economically viable; (3) Canal revenues resulting from Canal traffic volumes and the price policy implemented by PCA.

The source for the repayment of this interim financing will be the Canal tolls and no State guarantees will be utilized to back up the third set of locks program. The external financing contracts undersigned by PCA will be solely guaranteed by the cash flows that the program will generate.

The implementation schedule is divided into five specific areas: 1) the program administration that includes international consultancy and environmental impact studies; 2) the contracts for the excavation of the access channel; 3) the dredging contracts; 4) the contract for the design and construction of the new locks; and 5) the projects to raise Gatun Lake's maximum level.

The expansion program began during fiscal year 2007. By the end of the fiscal year, the total sum of contracts awarded is B/.59,243 and the total expenses incurred are B/.13,698.

In compliance with Law 28 of 2006 and as part of the transparency commitment embraced by the PCA since it was granted the task of administrating the most strategic resource of the Panamanian people, the PCA has presented quarterly reports with the advancements of the Expansion Program to the National Assembly of Panama, the Office of the Comptroller General and the Ad-hoc Commission created to follow up the work. Additionally, on November 8, 2007, the Board of Directors and the PCA Administration presented the biannual report to the plenary meeting of the Legislative Branch as set forth by Law 28. These reports are public and are available in the PCA web site at www.pancanal.com.

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