

Translation of a report originally issued in Spanish

Panama Canal Authority

**Special Purpose Audit Report
on the Costs of Investments in Progress and Operating Expenses
in the Panama Canal Expansion Program**

September 30, 2007

Deloitte - Panama

Panama Canal Authority

Special Purpose Audit Report September 30, 2007

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SPECIAL PURPOSE AUDIT REPORT

To the Board of Directors of the Panama Canal Authority

We have audited the accompanying statements of costs of investments in progress and operating expenses in the Panama Canal Expansion Program for the year ended September 30, 2007. These statements are the responsibility of the management of the Panama Canal Authority. Our responsibility is to express an opinion on the statements based on our audit.

We conducted our audit in accordance with International Standard on Auditing (ISA) 800 "The Independent Auditor's Report on Special Purpose Audit Engagements". This standard requires that we plan and perform the audit to obtain reasonable assurance about whether the statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the statements of costs of investments in progress and operating expenses. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

In our opinion, the statements present fairly, in all material respects, the costs of investments in progress and operating expenses in the Panama Canal Expansion Program for the year ended September 30, 2007 in accordance with International Financial Reporting Standards.

(Signed by Deloitte)

June 23, 2009
Panama, Republic of Panama

Panama Canal Authority

Statement of Costs of Investments in Progress

Canal Expansion Program

At September 30, 2007

(In thousands of balboas)

Program Management	B/.	5,420
Costruction of the New Locks		3,638
Pacific Access Channel		1,708
Navigational Channel Improvements		2,110
Water Supply Improvements		<u>-</u>
	B/.	<u><u>12,876</u></u>

The accompanying notes are an integral part of this special purpose audit report.

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**Statement of Operating Expenses
Canal Expansion Program
Year ended September 30, 2007
(In thousands of balboas)**

Contracted services and fees	B/.	109
Materials and supplies		119
Transportation and allowances		9
Internal support		507
Other expenses		<u>77</u>
	B/.	<u>821</u>

The accompanying notes are an integral part of this special purpose audit report.

Panama Canal Authority

Notes to the Special Purpose Audit Report

Year ended September 30, 2007
(In thousands of balboas)

1. General Information

The Panama Canal Authority (PCA) is an autonomous agency of the Government of Panama, established in conformity with Article 316 of the Political Constitution of the Republic of Panama. 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).

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 is subject to the requirements and conditions established by the Political Constitution of Panama, the Organic Law of PCA, and its management.

The main office of the Administration is located at Building 101, Balboa - Ancón.

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Year ended September 30, 2007
(In thousands of balboas)

2. General information of the project

2.1 Approval and estimated cost

The people of Panama approved the Canal Expansion program through the referendum held on October 22, 2006. The Program has an estimated cost of B/.5,250,000, detailed as follows:

Description	Estimated amount
Constuction of two new locks; Atlantic and Pacific	B/. 2,730,000
Water saving basins	620,000
Construction of channels	820,000
Improvements to existing navigational channels	290,000
Water supply improvements	260,000
Inflation during the construction period	530,000
Total	<u><u>B/. 5,250,000</u></u>

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

The schedule of the Program is divided in two main phases: the preconstruction phase and the construction phase.

The preconstruction phase includes the development of designs, models, specifications and contracts, pre-classification of possible contractors, and finally, contractor selection. For the locks component, this phase could last between two and three years.

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Year ended September 30, 2007
(In thousands of balboas)

The construction phase includes the simultaneous construction of both lock facilities with their water reutilization basins, dry excavation of the new access channel, and dredging of both new lock access channels and Gatun Lake navigational channels, as well as of the sea entrances.

2.2 Estimated construction period

The execution of the Panama Canal Expansion Program began in fiscal year 2007 and will take up to a maximum of 8 years. Operations are estimated to begin in 2014.

On June 23, 2009, the Panama Canal Authority's Board of Directors approved and authorized the issuance of this special purpose audit report, for the period ended September 30, 2007.

3. Significant accounting policies

3.1 Statement of compliance

This report, related to the accounts of costs of investments in progress and operating expenses in the Panama Canal Expansion Program, has been prepared in conformity with International Financial Reporting Standards.

3.2 Costs of investments in progress

Accumulated costs of investments in progress include all direct charges for materials, labor, studies, equipment, professional fees and indirect costs associated with the expansion works. After finishing these works, the construction value will become part of property, plant and equipments and its depreciation will begin.

3.3 Operating expenses

Expenditures that are not capitalized primarily include service contracts and purchase of materials that do not meet the capitalization criteria. They also include the purchase of equipment whose unit cost is equal to or less than B/.5. All these items are recorded as expenses in the period they are incurred.

3.4 Internal support

Internal support in the Canal Expansion Program includes: salaries and employment benefits, materials, supplies and use of equipment. That internal support directly related to investment projects in the Canal Expansion Program is capitalized. Internal support

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Year ended September 30, 2007
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charged to operating expenses represents indirect costs that are not directly attributable to the construction of the facility. These expenses include internal resources dedicated mainly to cleaning, moving and maintenance tasks of buildings and equipment.

4. Costs of Investments in Progress

At September 30, 2007, the accumulated costs of investments in progress of the Panama Canal Expansion Program amounted to B/.12,876. These costs are included in the audited financial statements of the PCA at September 30, 2007 in Property, Plant and Equipment - Constructions in progress for B/.194, 275.

The annual activity of costs of investments in progress, is detailed as follows:

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Ending Balance</u>
Costs of investments in progress			
Program Management	B/. -	B/. 5,420	B/. 5,420
Construction of the New Locks	-	3,638	3,638
Pacific Access Channel	-	1,708	1,708
Navigational Channel Improvements	-	2,110	2,110
Water Supply Improvements	-	-	-
	<u>B/. -</u>	<u>B/. 12,876</u>	<u>B/. 12,876</u>

5. Operating Expenses

The operating expenses of the Panama Canal Expansion Program for B/.821, detailed in the statement of operating expenses of this report, are included in the income statement of the PCA's audited financial statements.

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6. Total Cost of the Panama Canal Expansion Program

The total cost of the Panama Canal Expansion Program at September 30, 2007 is summarized as follows:

Capitalized costs	B/. 12,876
Expenses	<u>821</u>
	<u>B/. 13,697</u>

7. Subsequent Events

Canal Expansion Finance Contracts

Article 319 of the Political Constitution of the Republic of Panama and the Organic Law, whereby the Panama Canal Authority is organized, establishes that the Board of Directors is entitled to authorize, upon duly reasoned and supported proposal by the Administrator, the acquisition of loans and other credit obligations to make investments upon prior approval of the President's Cabinet and within the terms provided by this Law and the Political Constitution of Panama.

On October 10, 2008, the Board of Directors agreed to request the President's Cabinet to approve the contract of loans and other credit obligations to cover the financing needs of the Canal Expansion Program for an amount of B/.2,300,000. Consequently, the President's Cabinet, by means of Cabinet Decree No. 178 of October 13, 2008, approved the request and, in turn, on October 14, 2008, the Board of Directors authorized the Administration to proceed with the loan contracts in accordance with the terms and with the following multilateral and bilateral agencies:

Terms:

- Financing will be provided without guarantees or recourse to the Panamanian Government.
- Financing will not be subject to binding commitments of obtaining goods or services from any particular source.
- Lenders shall not intervene in the operation or management of the Canal.

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- Financing will not have an effect on payments to the National Treasury, pursuant to Law No. 28 of 2006.
- Loans will have a twenty year maturity, with a ten year grace period.
- Interest rate and commitments and underwriting fees will be agreed based on market conditions and at the moment of their disbursements.

The following multilateral and bilateral agencies approved the loans to the PCA:

- The European Investment Bank (EIB), for B/.500,000.
- The Japan Bank for International Cooperation (JBIC), for \$800,000.
- The Inter-American Development Bank (IDB), for B/.400,000.
- The International Finance Corporation (IFC), for B/.300,000.
- The Andean Development Corporation (ADC), for B/.300,000.
