

Translation of financial statements originally issued in Spanish

Panama Canal Authority

Independent Auditors' Report

**Financial statements
September 30, 2008**

Deloitte – Panamá

Panama Canal Authority

Independent Auditors' Report and Financial Statements September 30, 2008

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Translation of a report originally issued in Spanish

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of the Panama Canal Authority

We have audited the accompanying financial statements of the Panama Canal Authority, which comprise the balance sheet as of September 30, 2008, and the income statement, statement of changes in equity and cash flows statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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.



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 Panama Canal Authority as of September 30, 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte (signed)

December 16, 2008
Panama, Republic of Panama

Panama Canal Authority

Balance sheet September 30, 2008 (In thousands of balboas)

	Notes	2008	2007
Assets			
Non-current assets:			
Properties, plant and equipment, net	4, 15	B/. 2,438,710	B/. 2,239,693
Current assets:			
Cash and bank deposits	5	1,653,148	1,406,383
Investments in securities	6	470,426	335,162
Accounts receivable	7	35,192	37,112
Inventories, net	8	39,861	35,368
Accrued interest receivable and other assets		<u>22,379</u>	<u>26,151</u>
Total current assets		<u>2,221,006</u>	<u>1,840,176</u>
Total assets		<u>B/. 4,659,716</u>	<u>B/. 4,079,869</u>
Equity and liabilities			
Equity:			
Contributed capital	15	B/. 1,904,968	B/. 1,904,968
Retained earnings:			
Appropriated	9	2,159,761	1,475,151
Unappropriated	10	<u>343,852</u>	<u>486,414</u>
Total equity		<u>4,408,581</u>	<u>3,866,533</u>
Severance	16	-	10,000
Current liabilities:			
Accounts payable	11	119,358	75,802
Provision for marine accident claims	12	27,474	29,883
Accrued salaries and vacation pay		90,535	81,447
Other liabilities		<u>13,768</u>	<u>16,204</u>
Total current liabilities		<u>251,135</u>	<u>203,336</u>
Total equity and liabilities		<u>B/. 4,659,716</u>	<u>B/. 4,079,869</u>

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

Panama Canal Authority

Income statement

For the year ended September 30, 2008

(In thousands of balboas)

	Notes	2008	2007
Revenues:			
Toll revenues		B/. 1,317,475	B/. 1,183,927
Vessel-transit-related services		<u>428,103</u>	<u>354,315</u>
		1,745,578	1,538,242
Other revenues:			
Electric power sales		142,895	95,588
Potable water sales		19,709	19,573
Interest income		70,875	77,072
Miscellaneous	16	<u>27,988</u>	<u>29,910</u>
Total other revenues		<u>261,467</u>	<u>222,143</u>
Total revenues		<u>2,007,045</u>	<u>1,760,385</u>
Expenses:			
Salaries and wages		354,959	348,171
Employee benefits		49,402	43,958
Materials and supplies		41,407	40,713
Fuel		100,287	64,834
Transportation and allowances		1,366	1,743
Contracted services and fees		41,030	34,503
Insurance		10,020	9,753
Provision for marine accidents	12	642	3,285
Provision for obsolete inventory	8	772	849
Other expenses		<u>8,998</u>	<u>11,544</u>
		608,883	559,353
Capitalized labor and materials	13	<u>(55,711)</u>	<u>(34,915)</u>
Total expenses		<u>553,172</u>	<u>524,438</u>
Income before fees and depreciation		1,453,873	1,235,947
Fees per net ton	11	(355,034)	(358,765)
Panamanian Treasury (Tesoro Nacional) – public service fees		(1,874)	(1,826)
Depreciation	4	<u>(68,503)</u>	<u>(68,709)</u>
Net income	14	<u>B/. 1,028,462</u>	<u>B/. 806,647</u>

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, 2008 (In thousands of balboas)

	Notes	Contributed <u>Capital</u>	<u>Retained Earnings</u>		<u>Total equity</u>
			<u>Appropriated</u>	<u>Unappropriated</u>	
Balance as of September 30, 2006		B/. 1,904,540	B/. 1,154,918	B/. 315,332	B/. 3,374,790
Transfer to Panamanian Treasury	10	-	-	(315,332)	(315,332)
Net income		-	-	806,647	806,647
Contributions to the investment program	9	-	348,574	(228,803)	119,771
Increase in equity reserves	9	-	107,409	(107,409)	-
Decrease in equity reserves	9	-	(135,750)	15,979	(119,771)
Properties transferred to PCA		<u>428</u>	<u>-</u>	<u>-</u>	<u>428</u>
Balance as of September 30, 2007		1,904,968	1,475,151	486,414	3,866,533
Transfer to Panamanian Treasury	10	-	-	(486,414)	(486,414)
Net income		-	-	1,028,462	1,028,462
Contributions to the investment program	9	-	579,032	(579,032)	-
Increase in equity reserves	9	-	105,578	(105,578)	-
Balance as of September 30, 2008		<u>B/. 1,904,968</u>	<u>B/. 2,159,761</u>	<u>B/. 343,852</u>	<u>B/. 4,408,581</u>

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

Panama Canal Authority

Cash flows statement

For the year ended September 30, 2008

(In thousands of balboas)

	Notes	2008	2007
Cash flows from operating activities:			
Net income		B/. 1,028,462	B/. 806,647
Adjustments for:			
Depreciation		66,180	66,804
Loss on disposal of fixed asset		1,114	1,213
Provision for obsolete inventory		772	849
Provision for marine accidents		642	3,285
Severance	16	(10,000)	-
Changes in operating assets and liabilities:			
Accounts receivable		1,920	(5,166)
Inventories		(5,265)	(7,102)
Accrued interest receivable and other assets		3,772	(1,016)
Current liabilities		<u>47,157</u>	<u>(14,357)</u>
Net cash provided by operating activities		<u>1,134,754</u>	<u>851,157</u>
Cash flows from investing activities:			
Net increase of fixed asset		(266,311)	(125,989)
Net (increase) decrease in investments		(135,264)	155,237
Decrease in non-current account receivable		-	20,140
Net increase in time deposits, over 90 days		<u>(238,586)</u>	<u>(446,473)</u>
Net cash used in investing activities		<u>(640,161)</u>	<u>(397,085)</u>
Cash flows from financing activities:			
Transfer to Panamanian Treasury		<u>(486,414)</u>	<u>(315,332)</u>
Net increase in cash and bank deposits		8,179	138,740
Cash and bank deposits at beginning of the year		<u>242,479</u>	<u>103,739</u>
Cash and bank deposits at end of the year	5	<u>B/. 250,658</u>	<u>B/. 242,479</u>
Investing activities that did not represent cash outflows			
Properties transferred to PCA		B/. -	B/. (428)
Fixed assets – capitalized depreciation		<u>(2,323)</u>	<u>(1,905)</u>
		<u>B/. (2,323)</u>	<u>B/. (2,333)</u>

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

Panama Canal Authority

Notes to financial statements

September 30, 2008

(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. 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, 2008, the PCA had a total of 9,447 (2007: 9,270) employees, of which 7,797 (2007: 7,835) were permanent and 1,650 (2007: 1,435) 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, 2008, on December 16, 2008.

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Notes to financial statements

September 30, 2008

(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:

IAS 1 (Revised) - Presentation of Financial Statements	Effective for accounting periods beginning on or after January 1, 2009.
IFRS 8 - Operating segments, replaces IAS 14, Segment reporting	Effective for annual periods beginning on or after January 1, 2009.
IAS 23 (Revised) - Borrowing costs	Effective for annual periods beginning on or after January 1, 2009.
IFRIC 12 - Service Concession Arrangements	Effective for annual periods beginning on or after January 1, 2008.
IFRIC 14 - The limit on a defined benefit asset, minimum funding requirements and their interaction	Effective for annual periods beginning on or after January 1, 2009.
IFRIC 16 - Hedges of Net Investment in a Foreign Operation	Effective for accounting periods beginning on or after January 1, 2008.

The Administration 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

3.1 Statement of compliance - PCA's financial statements have been prepared in conformity with the International Financial Reporting Standards, issued by the International Accounting Standard Board ("IASB") and the interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB.

3.2 Basis of presentation - The financial statements have been prepared under the historical cost. PCA applied accounting policies consistently with those applied last year.

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(In thousands of balboas)

3.3 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 materials and supplies, and the determination of the useful life of fixed assets.

3.4 Properties, plant, and equipment - Items of properties, plant, and equipment with a value of B/.5 or more are recorded at cost. The cost of items that are not capitalized or under B/.5 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 once it is determined they have no operating use for the PCA.

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.

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(In thousands of balboas)

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.

3.5 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.

3.6 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.

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

- **Classification of financial assets and liabilities into current or non-current** - In the balance sheet, financial assets and liabilities are classified according to their maturity date. Current assets and liabilities are those with a maturity date that is less than or equal to twelve months; and non-current, greater than twelve months.

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

- **Write-off of financial liabilities** - The Company removes financial liabilities when, and only when, the Company's obligations are discharged, cancelled or they expire.

3.7 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.

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(In thousands of balboas)

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

3.9 Allowance for obsolete materials and supplies - 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.

3.10 Revenue recognition - Revenues are recognized when it is probable that future economic benefits will flow to the PCA and those benefits can be measured reliably. 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.

3.11 Severance - Severance labor payments are charged to expense as incurred.

3.12 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.

3.13 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.

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Notes to financial statements September 30, 2008 (In thousands of balboas)

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 records 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 properly supported claims.

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.

4. Properties, plant and equipment, net

Properties, plant, and equipment are as follows:

	September 30, 2008			
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Decreases</u>	<u>Ending Balance</u>
Assets				
Land	B/. 1,022,581	B/. 186	B/. -	B/. 1,022,767
Buildings	87,705	4,813	(24)	92,494
Structures	602,784	98,945	(1)	701,728
Equipment	786,324	85,330	(3,072)	868,582
Constructions in progress	<u>194,275</u>	<u>79,360</u>	<u>-</u>	<u>273,635</u>
	<u>2,693,669</u>	<u>268,634</u>	<u>(3,097)</u>	<u>2,959,206</u>
Accumulated depreciation				
Buildings	26,186	2,750	(24)	28,912
Structures	130,614	22,997	(1)	153,610
Equipment	<u>297,176</u>	<u>42,756</u>	<u>(1,958)</u>	<u>337,974</u>
	<u>453,976</u>	<u>68,503</u>	<u>(1,983)</u>	<u>520,496</u>
Net value	<u>B/. 2,239,693</u>	<u>B/. 200,131</u>	<u>B/. (1,114)</u>	<u>B/. 2,438,710</u>

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Notes to financial statements September 30, 2008 (In thousands of balboas)

	September 30, 2007			
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Decreases</u>	<u>Ending Balance</u>
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	<u>169,576</u>	<u>24,699</u>	<u>-</u>	<u>194,275</u>
	<u>2,572,957</u>	<u>128,322</u>	<u>(7,610)</u>	<u>2,693,669</u>
Accumulated depreciation				
Buildings	23,376	2,882	(72)	26,186
Structures	110,224	20,828	(438)	130,614
Equipment	<u>258,064</u>	<u>44,999</u>	<u>(5,887)</u>	<u>297,176</u>
	<u>391,664</u>	<u>68,709</u>	<u>(6,397)</u>	<u>453,976</u>
Net value	<u>B/. 2,181,293</u>	<u>B/. 59,613</u>	<u>B/. (1,213)</u>	<u>B/. 2,239,693</u>

The PCA recorded losses in retirements or disposals of assets for B/. 1,114 (2007: B/.1,213). During 2008, the main assets that were retired included diesel motors, communication equipment, elevators, vehicular equipment, pumps, containers, film processors, surveillance and intrusion detection systems. 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.

A portion of the depreciation for an amount of B/.2,323 (2007: B/.1,905) corresponding to equipment utilized in investment projects was capitalized as properties, plant and equipment during the period (See note 13).

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Notes to financial statements September 30, 2008 (In thousands of balboas)

5. Cash and bank deposits

Cash and bank deposits are composed as follows:

	2008	2007
Cash on hand	B/. 33	B/. 41
Deposits in current accounts	22,455	8,126
Deposits in saving accounts	64	93
Time deposits with original maturities under 90 days	<u>228,106</u>	<u>234,219</u>
	250,658	242,479
Time deposits with original maturities over 90 days not exceeding one year	<u>1,402,490</u>	<u>1,163,904</u>
	<u>B/. 1,653,148</u>	<u>B/. 1,406,383</u>

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 PCA investments in time deposits are placed in investment grade banks.

6. Investments in securities

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

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Notes to financial statements

September 30, 2008

(In thousands of balboas)

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

	2008	2007
Balance at the beginning of the year	B/. 335,162	B/. 490,399
Additions	649,170	611,094
Redemptions	<u>(513,906)</u>	<u>(766,331)</u>
Balance at the end of the year	<u>B/. 470,426</u>	<u>B/. 335,162</u>

At September 30, 2008, the fair value of investments in securities held to maturity was B/.463,726 (2007: B/.335,130) and the book value was B/.470,426 (2007: B/.335,162). The fair value of investments in securities held to maturity at December 8, 2008 was B/.323,977 and the book value was B/.328,254.

7. Accounts receivable

Accounts receivable are detailed as follows:

	2008	2007
Transit-related services	B/. 6,427	B/. 16,221
Electric power sales	23,934	15,343
National Institute of Pipelines and Sewerage (Instituto de Acueductos y Alcantarillados Nacionales)	2,190	3,326
Other government entities	1,140	1,296
Other services	<u>1,501</u>	<u>926</u>
	<u>B/. 35,192</u>	<u>B/. 37,112</u>

8. Inventories, net

The inventories are detailed as follows:

	2008	2007
Supplies and materials	B/. 37,428	B/. 36,777
Fuel	8,938	4,991
Provision for obsolete inventory	<u>(6,505)</u>	<u>(6,400)</u>
	<u>B/. 39,861</u>	<u>B/. 35,368</u>

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Notes to financial statements September 30, 2008 (In thousands of balboas)

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

	2008	2007
Balance at the beginning of the year	B/. 6,400	B/. 6,510
Increase	772	849
Charges	<u>(667)</u>	<u>(959)</u>
Balance at the end of the year	<u>B/. 6,505</u>	<u>B/. 6,400</u>

9. 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:

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
2008				
Reserves for:				
Canal expansion	B/. 35,300	B/. 56,006	B/. -	B/. 91,306
Investment projects - others	-	25,000	-	25,000
Catastrophic risks	36,000	-	-	36,000
Social and environmental program of the Canal watershed	10,000	-	-	10,000
Contingencies and working capital	142,978	14,701	-	157,679
Enterprise capitalization	<u>234,000</u>	<u>9,871</u>	-	<u>243,871</u>
	458,278	105,578	-	563,856
Contributions for:				
Investment programs	<u>1,016,873</u>	<u>579,032</u>	-	<u>1,595,905</u>
	<u>B/. 1,475,151</u>	<u>B/. 684,610</u>	<u>B/. -</u>	<u>B/. 2,159,761</u>

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September 30, 2008

(In thousands of balboas)

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
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	<u>15,750</u>	<u>-</u>	<u>(15,750)</u>	<u>-</u>
	486,619	107,409	(135,750)	458,278
Contributions for:				
Investment programs	<u>668,299</u>	<u>348,574</u>	<u>-</u>	<u>1,016,873</u>
	<u>B/. 1,154,918</u>	<u>B/. 455,983</u>	<u>B/. (135,750)</u>	<u>B/. 1,475,151</u>

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 an increase of B/.56,006 (2007: B/.35,300).

Reserve for investment projects - others

The Board of Directors approved an equity reserve for the investment programs in the Panama Canal. The funds of this reserve are segregated based on the earning levels, according to PCA's financing needs for particular projects during programs execution. At the end of fiscal year 2008, the Board of Directors approved a reserve of B/.25,000.

Reserve for catastrophic risks

The Board of Directors approved an equity reserve to cover the amounts deductible of the catastrophic risks insurance policies for a maximum amount of B/.36,000, thus the PCA did not increase this reserve for fiscal years 2008 and 2007.

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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 2008 and 2007, 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. During fiscal year 2008, the Board of Directors approved the increase of this reserve by B/.14,701 (2007: B/.20,112) for a total of B/.157,679 (2007: B/.142,978).

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. During fiscal year 2008, the Board of Directors approved the increase of this reserve by B/.9,871 (2007: B/.51,997) for a total of B/.243,871 (2007: B/.234,000).

Other equity reserves

The Board of Directors approved the establishment of other equity reserves, which consider programs to support Canal operation and administration. During fiscal year 2007, the Board of Directors approved the use of B/.10,000 and to return B/.5,750 to the unappropriated retained earnings. During fiscal year 2008, the PCA did not make increases to this reserve.

Contributions to the investment programs

The Board of Directors approved to increase funds to the investment programs for B/.579,032 (2007: B/.348,574).

10. 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 9, any surplus shall be remitted to the Panamanian Treasury in the following fiscal period. Therefore, PCA should transfer the total amount of B/.343,852 to the Panamanian Treasury which corresponds to the year ended September 30, 2008 (2007: B/.486,414).

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In compliance with Law 28 of 2006, during the construction period of the third set of locks, the PCA will continue to make increasing payments to the National Treasury based on Canal tonnage fees and any operational surplus. Any payments based on an operational surplus shall not be less than those made to the National Treasury in 2005 for the amount of B/.268,850. The combined payments based on Canal tonnage fees and operational surpluses shall not be less than the payments effected in fiscal year 2006 for the amount of B/.568,128.

11. Accounts payable

The accounts payable are as follows:

	2008	2007
Panamanian Treasury	B/. 27,460	B/. 28,466
Suppliers and others	<u>91,898</u>	<u>47,336</u>
	<u>B/. 119,358</u>	<u>B/. 75,802</u>

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/.355,034 (2007: B/.358,765).

The balance payable to the Panamanian Treasury represents mainly the fee per net ton payment that is outstanding at September 30, 2008.

12. Provision for marine accident claims

The provision for marine accident claims for B/.27,474 (2007: B/.29,883), represents the estimated value of filed or anticipated claims for accidents occurred in Canal waters for which PCA expects to be liable.

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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 that in the opinion of management, is PCA's responsibility. 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.

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

	2008	2007
Balance at beginning of the year	B/. 29,883	B/. 27,715
Provision for the year	642	3,285
Payments made	<u>(3,051)</u>	<u>(1,117)</u>
Balance at end of the year	<u>B/. 27,474</u>	<u>B/. 29,883</u>

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

13. 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.

In both Investment Programs, the internal cost transfers of labor, materials and supplies, use of equipment (fuel, maintenance and depreciation), and other expenses attributable 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 of the period in which they were incurred and charged to the construction in progress account in properties, plant and equipment.

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The direct costs incurred for personal services in the Investment Program – Canal expansion, and the contracted services in the investment projects of both programs, are charged directly to the construction in progress account in property, plant and equipment.

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

	2008	2007
Investment Program - Others:		
Widening and straightening of the Gaillard (Culebra) Cut	B/. 9,147	B/. 9,405
Deepening of Gatun Lake and Gaillard (Culebra) Cut	6,768	8,081
Rehabilitation of barges 403 and 407	1,500	-
New Tie-Up Station for Vessels in Cartagena Hill	672	4,787
Tow Track Rehabilitation	2,025	3,659
Improvements to the Lighting Systems in all Locks	-	1,299
Procurement and Installation of Hydraulic Operators for the Rising Stem Valves	645	829
Replacement of Turntables in Gatun Locks	798	724
Other various projects	<u>2,576</u>	<u>2,803</u>
	<u>24,131</u>	<u>31,587</u>
Investment Program - Canal Expansion:		
Dredging of Gatun Lake	24,370	1,332
Deepening of Gaillard (Culebra) Cut	4,500	-
Studies and Specifications in all Locks	299	613
Dry excavation No. 4 of the North Pacific channel access and construction of Borinquen's dam	803	-
Other various projects	<u>1,608</u>	<u>1,383</u>
	<u>31,580</u>	<u>3,328</u>
Total capitalized	<u>B/. 55,711</u>	<u>B/. 34,915</u>

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14. 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.

15. Contributed capital

Article 316 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 all those 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 fair value for each asset subsequently registered in the Public Registry.

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16. Other miscellaneous revenues

In May 1999, the Panama Canal Commission, prior to its dissolution and liquidation, transferred B/.10,000 to PCA for the creation of a severance fund for compensation payments that would cover the time of service of former Panama Canal Commission (PCC) employees hired by the PCA who could be involuntarily terminated from their positions after being contracted. During fiscal year 2008, the Board of Directors authorized the Administration to reverse this provision as there had been no involuntary separations which have required the disbursement in such cases. This provision of B/.10,000 was reversed and recorded as “other revenues” in fiscal year 2008.

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. To this end, the existing PCC liabilities (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.

17. Remunerations and benefits to key managers

The PCA paid remunerations and benefits to key managers for a total of B/.1,487 (2007: B/.1,979).

18. Risk Management of Financial Instruments

Investments in securities

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

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Risk management of investments in securities

The Board of Directors, through Agreement No. 75 of March 23, 2004, established the criteria and directives applicable to PCA's liquidity investment.

The PCA's Finance Committee of the Board of Directors is responsible for presenting a conservative investment policy to the Board of Directors for its consideration with the purpose of preserving the capital and generating a reasonable return at low risk levels.

The PCA's Liquidity Investment Committee will be responsible for executing the investment policy as approved by the Board of Directors.

The main risks that have been identified by PCA include credit risks, counterparty risks, market risks, and liquidity risks.

18.1 Credit Risk

The risk that the debtor or issuer of a financial asset may fail to make any payments, completely and on time, pursuant to the terms and conditions agreed at the time of acquisition. To mitigate the credit risk, the liquidity investment policy establishes limits per industry and limits per issuer depending on risk rating.

18.2 Counterparty Risk

The risk that a counterparty may fail to liquidate the transactions involved in the purchase of securities. The PCA has no counterparty risks since all of its securities are purchased by means of the delivery versus payment method through a compensation system in a custody account.

18.3 Market Risk

The risk that the value of a financial asset will drop due to changes in interest rates, in foreign currency exchange rates, or due to the impact of other financial variables which are beyond the control of the PCA.

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The PCA's liquidity investment policy establishes that all PCA's investments and deposits shall be made in the United States of America legal tender. Securities are purchased only with the intention to be held to maturity, which is the most conservative, non-speculative process, and limits are established per industry and per issuer, depending on risk rating.

Periodically, the securities portfolio market value is monitored to determine the strength and possible deterioration of securities in custody.

Investments in securities held-to-maturity:

	2008		2007	
	Book Value	Fair Value	Book Value	Fair Value
Financial instruments related to to U.S.	B/. -	B/. -	B/. 1,852	B/. 1,841
Investments in multilaterals	27,969	28,232	-	-
Investments in commercial paper and financial bonds	235,450	229,547	189,285	189,196
Investments in commercial paper and non-financial bonds	<u>207,007</u>	<u>205,947</u>	<u>144,025</u>	<u>144,093</u>
	<u>B/. 470,426</u>	<u>B/. 463,726</u>	<u>B/. 335,162</u>	<u>B/. 335,130</u>

18.4 Liquidity Risk

The risk that an entity will have difficulties in meeting commitments associated with financial liabilities.

The PCA's Treasury monitors on a daily basis the available liquidity levels after fulfilling the PCA's funding needs and to avoid overdrafts.

19. Contingent liabilities and commitments

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 to approximately B/.1,903 (2007: B/.2,374) corresponding to marine accident claims.

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The PCA conferred with tax authorities of the Central Government regarding the application of the law pertaining to taxes withheld from remittances to foreign countries. To date, these consultations continue, and a final determination regarding the potential liability resulting from the application of this tax law has not been made. If the final determination is different from PCA's current position, the approximate liability will be no greater than B/.11,000 based on remittances through September 30, 2008.

The opinion of management and its legal advisors' is 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 to approximately B/.554,000 (2007: B/.167,000).

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 expansion program began during fiscal year 2007. By the end of the fiscal year, the total sum of contracts awarded is B/.229,280 (2007:B/.59,243) and the total costs incurred are B/.102,435 (2007:B/.13,698).

20. Fair value of financial instruments

The following assumptions were used by Management to estimate the fair value of each financial instrument category in the balance sheet:

- a. *Cash and bank deposits* - The book value approximates its fair value due to its liquidity and short-term maturity.
- b. *Accounts receivable* - Accounts receivable are recorded at their face value, which approximates its fair value due to its short-term maturity.

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- c. *Supplies and materials inventory* - These are recorded at acquisition cost, adjusted by an allowance for slow-moving or obsolete materials and supplies, and do not include profit margin.
- d. *Accounts payable* - The book value of accounts payable corresponds to the cost of the transaction performed, which approximates its fair value due to its short-term maturity.

These estimates are subjective in nature, involve uncertainty and critical judgment elements, and therefore, cannot be precisely established. Any change in assumptions or criteria can significantly affect the estimates.

21. 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 approval by the President's Cabinet and within the terms provided by this Law and the Political Constitution of the Republic.

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 financial needs of the Expansion Program through a Third Set of Locks 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 the binding commitment of obtaining goods or services from any particular source.
- Lenders shall not intervene in the operation or management of the Canal.
- Financing will not have an effect on payments to the National Treasury, pursuant to Law No. 28 of 2006.

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- Loans will have a twenty year maturity, with a ten year grace period.
- Interest rate and commitments and underwriting fees will be accorded based on market conditions and at the moment of their disbursements.

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

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

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