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Statement for the record

by the

International Division

U.S. General Accounting Office

Submitted to the

Committee on Merchant Marine and Fisheries

United States House of Representatives

Mr. Chairman and Members of the Committee:

We are pleased to present our views on the Panama Canal Commission's accounting procedures for setting aside reserves for marine accidents.

MARINE ACCIDENT RESERVE

From time to time, ships transiting the Canal are involved in accidents. Ship accidents are viewed as a normal and expected part of doing business in the Panama Canal.

The Commission's marine accident reserve to pay for vessel damage claims is, in effect, a way of insuring against this normal business risk and spreading the cost evenly over time. The reserve is charged to current operations and is not unlike other business practices of charging insurance premiums against current operations.

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However in this case, rather than paying premiums to an outsider, an amount is collected from each Canal user to pay for ship accident claims which occur (part of the tolls rate). Specifically, each month the Commission records, as an expense, one twelfth (1/12) the annual estimate needed to pay for marine accidents. Currently, the Commission is estimating an annual need of $12 million, so the monthly expense is $1 million. When an accident does occur, the Commission estimates the cost it will be responsible for paying and sets up an account payable for that amount. The amount of the reserve is reduced by the amount of the payable.

In our opinion, the practice of setting up such a reserve accomplishes a matching of cost and revenues by charging users each year with their share of the cost of accidents that will occur. Additionally, the reserve process described above normalizes or levels out cost fluctuations.

The Commission is required by its implementing legislation to recover all costs of operating and maintaining the Canal. Tolls are to be increased or decreased as these costs fluctuate. If reserves were not employed, the tolls rate would need to rise each time there was a major accident and lowered as soon as the costs of the accident were recovered. The tolls adjustment mechanism would not be that responsive--a increase in the tolls rate takes 6 months. Additionally, although unrecovered costs can be made up from future tolls revenues, excess recovery becomes a profit and, under the Treaty and Act, the first $10 million in profits is payable to the Republic of Panama.

PESERVE COVERAGE

The reserve described above provides for all marine accidents within the Canal. That is, it includes the estimated cost of claims for damages arising from marine accidents which may occur

--within the Canal locks,

--outside the Canal locks with an estimated liability of $120,000 or less, and

--outside the Canal locks with an estimated liability of more than $120,000.

The Commission has the authority to adjust and pay the first two categories of claims. Sections 1411 and 1412 of the Panama Canal Act directs the Commission to promptly adjust and pay all claims arising from accidents within the locks and all those outside the locks where the claim or estimated liability is $120,000 or less. These are to be paid from appropriations for operating and maintaining the Canal.

The Commission, however, has no authority to adjust or pay claims in the third category--that is, claims arising from accidents which occur outside the locks and where the claim or estimated liability exceeds $120,000. Rather, section 1415 of the Act requires the Commission to submit this category of claims to the Congress with a special report on the accident containing the material facts and the Commission's recommendation. The Act is silent as to what the Congress will do upon receipt of these reports.

Some question whether the Commission should consider this last category of claims in its reserve for marine accidents when it has no authority to pay such claims. We believe reserves should continue for this category of claims; collected as a part of tolls and deposited in the Panama Canal Commission Fund. However, authorization and appropriation from the Fund to pay such claims now must await the action of the Congress on the reports rendered by the Congress.

The Act is clear that the Panama Canal is to be self-supporting and none of the cost of operation and maintenance should be borne by the U.S. taxpayer. The Commission's decision to include all claims in its reserve is in recognition of this requirement to be self-supporting. It also assumes that the Congress will not deny a valid claim arising from an accident caused by the negligence or fault of an officer or employee of the United States acting within the scope of his employment and in the line of duty. We agree with the self-support concept.

CONCLUSION

In short, we believe the Commission's marine accident reserve reflects prudent financial management under the rules for operating and maintaining the Canal. It allows for a reasonable accommodation in that it allows for matching revenues with expenses, assuring self-support through cost recovery, and providing for a reasonably stable toll rate.

We recently approved the Commission's statement of accounting principles and standards which include the marine accident reserve. Additionally, we have completed our examination of the Commission's financial statements for fiscal years 1980 and 1981. We discussed the Commission's marine accident reserve in our 1980 report, but we did not challenge either its concept or coverage.