

93 años y cada día hacemos historia...

93 years making history every day...

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September 3, 2007
Commencement of the Expansion Program works in the Panama Canal.





Message

FROM THE CHAIRMAN
OF THE BOARD OF
DIRECTORS



The blasts were symbolically felt around the world as the momentous explosions rocked Paraiso Hill

marking the commencement of the works for the Canal expansion, a milestone for Panama and global trade. On September 3, 2007, the Panama Canal Authority (ACP) broke ground for expansion with an estimated 30,000 Panamanians and world leaders on hand to witness history.

The project will build a new lane of traffic along the Panama Canal through the construction of a third set of locks, which will double capacity and allow the transit of longer and wider ships, and bigger cargo volumes.

Panama is going through an unprecedented time of change and growth since the people voted to expand the waterway, and the Canal's impact in the global landscape continues to grow considerably.

Panama's strategic geographic location and the many essential services and products it provides to the maritime industry, in addition to its thriving economy fueled by the private sector, place the country in an outstanding position in Latin America. Moreover, the opportunities to accelerate and sustain the growth in the decades to come are numerous.

This promising future is marked in many ways by the role that the Canal plays in the country's productivity. As such, the Board of Directors and the Canal's Administration understand that mutual cooperation will yield the greatest ongoing benefits for Panamanians.



The ACP's financial contribution to the National Treasury, which the government allocates to various social programs, increase again this year. We do this in compliance with Law 28 of 2006, whereby "the construction of a third set of locks in the Panama Canal is approved", which enforces strict transparency standards, and openly discloses every matter related to the Canal expansion.

I would like to take a moment to acknowledge the members of the Board of Directors for their contributions to the development of the country, ACP's management team, employees, and other friends of the Canal for their dedication, heart and tenacity.

As we move forward with the expansion, we are taking action and establishing critical goals for our future. We will continue to set the bar high and remain true to our commitment of a safe, reliable, and efficient service to the industry for years to come.

May God Almighty bless and guide us as we embark upon this exciting endeavor.

Dani Kuzniecky
Chairman of the Board of Directors



Board | OF DIRECTORS



Dani Kuzniecky
President



Abel Rodríguez Cañizales
Director



Adolfo Ahumada
Director



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Director



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Director



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Director



Eduardo A. Quirós B.
Director



Norberto R. Delgado D.
Director



Ricardo De la Espriella
Director



Guillermo Chapman
Director

VISION

WORLD LEADER in services to the maritime industry and in sustainable development for the conservation of the Panama Canal watershed.

CORNERSTONE of the global transportation system and driving force for the progress, development and growth of Panama.

MODEL of excellence, integrity and transparency in our conduct; committed to the integral development of our human resource team.

MISSION

To produce the maximum sustainable benefit from our geographical position.

Message | FROM THE ADMINISTRATOR



It is a pleasure to present to our country, teammates, clients and friends

this summary of the Panama Canal Authority's (ACP) performance during fiscal year 2007.

Looking back into fiscal year 2007, we are indeed pleased that we have reached our goals. There were many challenges, but the Canal staff's determination was stronger. With professionalism and national pride, they handled the required tasks by responding to the expectations of an ambitious vision – one that will enable us to become world leaders in service to the industry and accelerate Panama's progress, development, and growth.

We started with Panama's historic mandate to expand the Canal through the construction of a third set of locks. Less than one year later, the September 3rd blasts in Paraiso Hill marked the beginning of the waterway's expansion and placed once again the Canal and Panama on the world stage.

Embracing the expansion challenge, considered this century's most important Latin-American project for, required transitions, the adoption of more modern and efficient operational and administrative procedures; the appointment of a new Minister for Canal Affairs and head of the Board of Directors; and the realignment of the Authority in light of its importance in the maritime industry and the successful implementation of the project. All this as well as a differently structured organization that promotes the group's performance and preserves the Canal's working team.





Despite the new challenges and the changes, the Panama Canal reached new traffic and tonnage records at the end of fiscal year 2007, another evidence of the steady growth and demand for the waterway's efficient service.

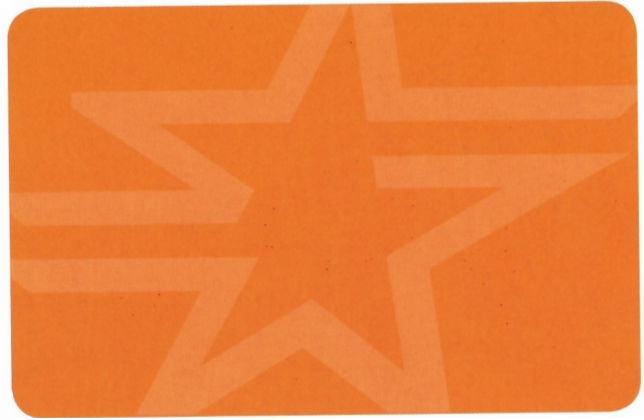
For the first time ever, the Canal surpassed its transit record of 300 million Panama Canal/Universal Measurement System (PC/UMS) tons – the volumetric measure used for cargo going through the waterway – in a single fiscal year.

By the end of fiscal year 2007, 14,721 vessels transited the waterway, a 3.7 percent increase compared to the 14,194 transits reported in fiscal year 2006. Canal Waters Time (CWT) decreased 7.4 percent from fiscal year 2006 (from 30.5 to 27.84 hours), and booking system usage was 95.2 percent, an increase of 1.7 percent when compared to the 93.5 percent on fiscal year 2006.

During September, the year's productive labor was rewarded when traffic records were set. On September 19, 2007, 25 Panamax vessels (the largest that can transit the waterway) crossed the Canal, breaking the original record of 24 vessels set in July 2003. On that same day, a total of 43 ships transported 1.114 million PC/UMS tons to shatter the mark set last May 6th with 1.072 million tons per day.

Reaffirming our commitment to the environment, ACP, in coordination with other Panamanian organizations, students, officials, and environmental groups, planted together the 550,000th tree in the Canal watershed.

Moreover, the Canal continues to be Panama's development engine, and for the next 19 years, its significant contributions to the economy will be key to





the funding of agreements created during the National Concerted Effort, which focuses on the improvement of Panamanian living conditions.

Assuredly, more important challenges lie ahead, and we are amply prepared to meet them with innate perseverance and optimism. We have firm conviction on that we will achieve the goals set before us. We have great confidence in the skilled and committed labor force that is energized by a profound love for Panama and its most strategic resource.

The ACP's vision for international commerce and our commitment to serve the maritime industry proudly define who we are and steer our operations on behalf of our customers.

I invite you to learn more about the Panama Canal through of our Annual Report for fiscal year 2007,

Alberto Alemán Zubieta

Administrator
Panama Canal Authority (ACP)





Alberto Alemán Zubieta
Administrator



Administration



José Barrios Ng.
Deputy Administrator
Executive Vice-President
Administration and Finance

Executive Vice-Presidents



Manuel Benítez
Operations



Francisco Loaiza
Human Resources



Jorge L. Quijano
Engineering and Programs
Management



Esteban Sáenz
Environment, Water and
Energy

Vice-Presidents



Luis Alfaro
Engineering



Álvaro Cabal
Legal Advise



Ana María Chiquilani
Corporate Affairs



Fernán Molinos
Corporate Communications



Rodolfo Sabonge
Market Research and
Analysis

A continuous | HISTORY

The waterway is the epicenter of the history of the interoceanic route through Panama.

It is living history and it is our turn to provide it continuity. On October 1, 2006, at the start of the fiscal year summarized in this document, Panama was getting ready to make a decision that would define its direction through history; Panamanians were about to accept the responsibility of a commitment to present and future generations.

At the beginning of October 2006, employees of the Panama Canal Authority (Autoridad del Canal de Panamá, ACP, for its acronym in Spanish) visited the remotest areas of the country to inform their fellow citizens of the details of the proposal to expand the Canal by means of the construction of a third set of locks. From Kuna Yala, Darien, Cocle, and Veraguas, to Bocas del Toro and the border of Chiriqui, Canal spokespersons talked to, worked, discussed, and shared with other Panamanians from all social strata, all ethnic and cultural groups; all with diverse political beliefs. All of these steps were taken in order to guarantee that all Panamanians would be informed and have the necessary criteria to make the best decision for the country. And it happened. On October 22, 2006, Panamanians approved the Panama Canal Expansion in the course of a national referendum, and granted ACP the responsibility of executing the program. In the future, this decision will be acknowledged as one of the most important milestones in the historical development of the transit route on behalf of our nation's benefit and progress.

Accepting the challenge

In order to align the organization, improve services, and accept the challenge of executing the expansion program, ACP carried out a restructuring process.

Thereorganization, completed this fiscal year, consolidated ACP into five departments: Operations; Administration and Finance; Environment, Water and Energy; Human Resources; and Engineering and Programs Administration. Also within the new organizational structure are the Offices of Corporate Communication; Market Research and Analysis, and General Counsel.

The Engineering and Programs Management Department has been staffed with Canal employees from a number of technical and professional disciplines, who immediately undertook their duties to advance, administrate, and develop all of the phases required for executing the Expansion Program, with the participation and support of the rest of the organization.

Program planning and design

As part of the expansion program planning and designing process, ACP developed a thorough risk analysis to ensure the project's timely completion, budget compliance, and quality control. In this sense, the established key elements, among many others, are the selected program configuration, conceptual design, project composition, and organizational structure selected to execute the program.

The conceptual design is based on proven technology to minimize potential operational and construction risks. The program site and physical alignment were conceived to minimize environmental impact and hindrances to Canal transits during the expansion work. The type of contract chosen was a design-build contract so as to transfer in a comprehensive manner the risk of the final design to the



contractor. Both sets of locks will be built under the same contract in order to guarantee their compatibility and component exchange, resulting in operational and maintenance costs and risks reduction.

Based on its broad experience in the matter, ACP has decided to utilize its resources to perform all navigational channel dredging and deepening works. Gatun Lake's channel dredging will be directly performed by ACP to maximize flexibility and prevent interference of the works with channel transit operations. The construction of the access channel to the Pacific locks has been divided into a maximum of five separate contracts so that the program is executed in the proper sequence while minimizing the risk of contractors interfering with each other's work.

All relevant environmental impact studies were prepared prior to program commissioning for environmental management planning and fauna rescue programs implementation. All this was conceived in order to reduce potential delays and cost overruns.

Tolls were increased before proceeding to contract works, reducing demand risks significantly and guaranteeing a substantial part of the program's financing in advance. Additionally, ACP, as part of the corporate reorganization process, formed a project team with the appropriate resources to successfully execute the program. This team is advised by international consultants in matters of program administration, project financing, risk transference, as well as contractual and financial law.

September 3, 2007 - a day in history

In a public ceremony, before thousands of Panamanians from different parts of the country, as well as diplomatic representatives from many nations, Martin Torrijos Espino, President of Panama, activated the first blast that officially set off the fieldwork of the Expansion Program. Among the international representatives who served as witnesses were: Colombian President Alvaro Uribe, Salvadorian President Antonio Saca, Nicaraguan President Daniel Ortega, Honduran President Manuel Zelaya, and former U.S. President James Carter, who was one of the key players and signatory of the 1977 Torrijos-Carter Treaty for the transfer of the waterway to the Republic of Panama on December 31, 1999.



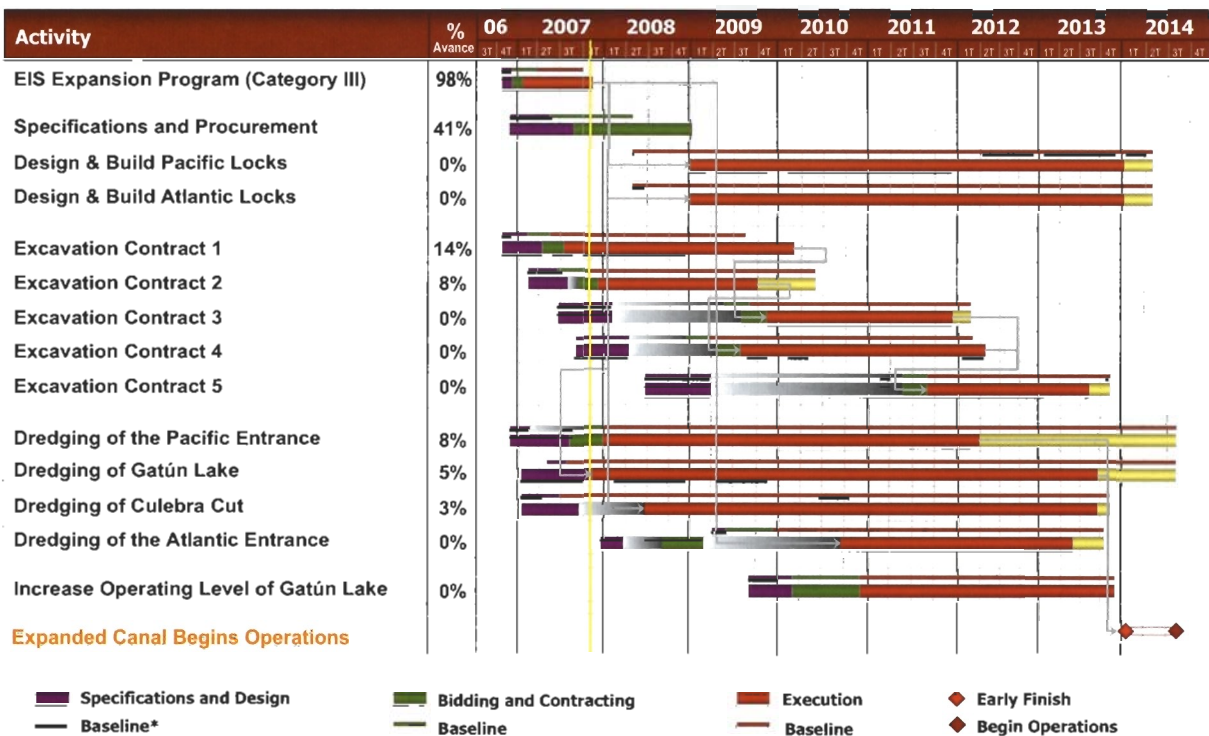


The Canal Expansion Program

Consists of the construction of two sets of locks, one on the Pacific side and the other on the Atlantic side. Each lock will have three steps, each step three water reutilization basins. The Expansion Program also includes; widening and deepening the existing navigational channels in Gatun Lake and the Pacific and Atlantic entrances, as well as deepening the Culebra Cut. A dry excavation of a new 6.1 kilometers access channel will be carried out in order to connect the Pacific locks with the Culebra Cut.

The execution of these works has been programmed in up to eight (8) projects scheduled to be completed in the year 2014, and are described below:

Schedule of Main Projects



*Updated as of October 31, 2007. Baseline from December 31, 2006.



Contracts for the Environmental Impact Study (EIS)

The environmental viability of the Expansion Program is of the up most importance. In order to guarantee this aspect in all of its components, Category I, II, and III Environmental Impact Studies (EIS) were prepared to determine the potential effects of the works as well as their required mitigation measures, and have been duly approved by the competent authorities.

During this year, ACP submitted and received approval from the National Environmental Authority (ANAM) for the environmental impact studies for the following projects: Development of Site T6; Gatun Road; and Cocoli and Gatun's Field Offices. ANAM also approved the Category II studies related to the land movement and Cerro Paraiso's grading project, which also includes the relocation of pylons and 230KV lines. As well as Borinquen Road; and the study related to the widening and deepening of the Panama Canal Pacific entrance access channel. The Category III Pospanamax environmental impact study, which considers the entire Expansion Program, was still under ANAM's review for approval on September 30, 2007.

Pursuant to its responsibility towards the communities involved, and for the purpose of duly disclosing and obtaining approval of the abovementioned studies, ACP conducted several field trips with ANAM and the Environmental Sectoral Units (ESU) to the different project areas. Additionally, ACP conducted a series of public consultations, as well as meetings to present the Pacific dredging project and the first excavation project on the Pacific side to the residents of the following communities: Amador, Pedro Miguel, Paraiso, La Boca, and Diabolo; and coordination meetings with the Ancon Community Council.

For the Category III environmental impact study, ACP conducted a public forum on August 26, 2007 in the Gatun Auditorium, in the province of Colon. The purpose of this forum was to listen to opinions and comments of the residents of the areas within the project's vicinity. Also, on Sunday, September 2, a similar forum was conducted in ACP Managerial Wing of the Ascanio Arosemena Training Center, in the province of Panama.

Additionally, and as part of its commitment to the country, ACP has





incorporated among the components of the Expansion Program a number of performance standards known as the Equator Principles, in order to ensure project development in compliance with responsible environmental and social practices.

Archaeological rescue: a responsibility with the past

According to ACP's commitment to rescue and preserve the Nation's memory and footprints still to be discovered in the transit route, ACP has undertaken the responsibility of rescuing and preserving all and any historic element that may remain in future working areas. The Expansion Program's Environmental Impact Study established mitigation measures to protect all archaeological resources, since any type of changes to pre-Columbian sites would be irreversible.

Based on the archaeological prospecting conducted during the Expansion Program feasibility studies, ACP contracted the archaeological rescue of the area where the new Pacific locks will be located, and is carrying out additional prospecting and rescue programs in the area of the Cocoli River detour. These studies and rescues are coordinated with the National Bureau of Historical Patrimony of the National Culture Institute (INAC). Mitigation measures contemplate monitoring land movements in order to detect other unreported sites.

In 2007, a specialized firm was contracted to evaluate by prospecting and performing the archaeological rescue of two firing ranges located on the Pacific side, to the south of the Cocoli branch of Miraflores Lake, and to the west of the former town of Cocoli. Its purpose was to determine their relevance and value, as proof of human presence in the area.

Wildlife rescue

A number of wildlife species living in different project working areas have been rescued and relocated prior to initiating the first land movements in Cerro Paraíso. Rescues and relocations have included anteaters, squirrel monkeys, and some reptiles.

The wildlife rescue program aims to preserve the animal species that may be found within the different areas of the Expansion Program and reaffirms the commitment to guarantee its environmental viability.





Ad-hoc Commission
of the Canal Expansion

Excavation contracts for the access channel Pacific Access Channel

An access channel will be built in order to connect the new Pacific locks with the Culebra Cut, which will be approximately 7 kilometers long and 218 meters wide at the bottom. This new navigational channel will start to the west of the existing Miraflores locks and continue parallel to Miraflores Lake and Pedro Miguel locks, to end in Culebra Cut, close to the Centenary Bridge and the community of Paraiso. Its construction will require the movement of 47 million cubic meters of material, particularly soil and rock.

For the purpose of generating greater competitiveness, it has been proposed that the dry-excavation contracts for the Pacific side (also known as PAC: Pacific Access Channel) be separated into 5 execution phases.

Once this new channel is built, vessels coming from the Pacific Ocean will enter the new locks and go directly to the Culebra Cut; this will save the time spent transiting an intermediate set of locks such as Pedro Miguel's.

First contract for the Pacific Access Channel (PAC-1)

The first construction works contract for the Canal Expansion Program, PAC-1, was awarded as a result of a lowest-price public bid process, on July 6. The bidding process took place in a transparent manner, before the members of ACP Board of Directors and Administration, as well as the members of the Ad hoc Commission of the Canal Expansion, and representatives from the bidding companies.

Ten proposals were received from companies from Brazil, Colombia, Mexico, the U.S., Italy, and Panama. On July 17, 2007, ACP awarded this first dry-excavation contract to the Panamanian company Constructora Urbana, S.A., complying with the prequalification requirements established in ACP's contracting regulations and offering the lowest price in the public bid.

The contract known as PAC-1 includes the excavation, removal, and disposal of 7.4 million cubic meters of material on the west bank of the





waterway, mainly from Cerro Paraiso, facing the Paraiso community; and clearing 146 hectares of land in the area of Cartagena, in order to remove potentially hazardous material. About 3.4 kilometers of Borinquen Road will be relocated west of Pedro Miguel Locks, within ACP's operational areas. Relocation sites for 12 pylons of the 230-kilowatt electrical transmission line will be prepared between Panama and La Chorrera.

Second contract for the Pacific Access Channel (PAC-2)

On September 18, ACP opened the bid process for the second dry-excavation contract to build the access channel to the Pacific locks. The new channel will be approximately seven kilometers long and 218 meters wide at the bottom. The works included in this second dry-excavation project comprise the removal of around 7.5 million cubic meters from a 2.4 kilometer stretch. The project will be developed at the opposite end to Paraiso Hill, where the first dry-excavation contract is under execution.

Over 20 companies from eight countries in Europe, North, South, and Central America - including Panama - participated in the preliminary bid process for the second dry-excavation contract for the Canal Expansion Program. Representatives from these companies went on a surveillance tour to the area where the contract works will be performed, and surveyed the geological cores to observe the type of material that will be found during the excavation works.

The PAC-2 contract also includes the construction of the second phase of the new Borinquen Road, which comprises the relocation of an approximately 1.3 kilometer long stretch; the construction of a new crossing over the new Cocoli River detour; the removal and/or relocation of electric utilities, telecommunication lines, and water lines; the construction of rock dikes and retention dikes; and other related jobs. These are scheduled to be awarded in November 2007.

Dredging contracts

The project to widen and deepen the Pacific entrance and the southern access to the third set of locks entails dredging approximately 9.1





million cubic meters of material from the seabed, and seeks to create the proper conditions for the safe and seamless transit of Postpanamax vessels from and to the third set of locks. The channels included in the project are 14.4 kilometers long and will be widened at least 218 meters and deepened to a maximum level of -15.5 meters. The project will mainly be executed under contract, and ACP will provide any necessary or required support, and will supervise and inspect the works.

Design-building contract for the new locks

144 representatives from Asian, European, North, Central, and South American companies attended the follow-up meeting for the process that began on August 27, 2007, when ACP opened the prequalification period for this contract through the publication of participation requirements.

On September 13, 2007, ACP presented a progress report on the waterway's expansion and the contracting process schedule during an informative meeting for the prequalification process for the design-build contract bid for the new Panama Canal locks. The meeting was attended by representatives of approximately 60 companies from 18 countries. Prior to the informative meeting, interested firms took a survey tour on the Atlantic and Pacific sides to the areas where the new locks will be built.

During the prequalification stage, proposals submitted by the competing consortia will be evaluated, based on their technical qualifications, experience, and financial capability. The four consortia that best meet the requirements established on ACP's terms of reference may participate in the bid phase and last stage of the process.

November 15, 2007 was established as the deadline for receiving all prequalification proposal documents. ACP will evaluate the qualifications of all interested companies, and select the four best qualified to participate in the final bid for designing and building the new locks. Bid documents will be homologated in February 2008, during informative meetings with the four prequalified consortia.





During the second stage of the bid process, ACP will issue a notification to receive proposals from prequalified firms, for designing and building the new locks. The new locks will be contracted under the design-build model that consists on having a sole contractor to design and build the project, reducing ACP's design risk.

Program management service

The program management service contract was awarded on August 15, 2007 to the U.S.-based firm CH2M Hill, a major world-class project management firm which submitted the best-value proposal. Among CH2M Hill's duties will be: providing support, coordination, and consulting services for the execution of the Expansion Program, by forming a joint team with ACP personnel, and helping to guarantee the program's effective and efficient execution.

CH2M Hill assisted ACP in developing the terms of reference for the design-build contract for the Pospanamax locks; by revising the organizational structure and personnel requirements for the execution of the program; checking and updating cost estimates; and developing a program management plan. The program management consulting firm also submitted a draft evaluation report and their recommendations regarding the tools and processes to be used to manage the Expansion Program.

Other international companies

Other international companies have advised ACP on the processes required to carry out the management tasks in the Expansion Program. Being such companies Mayer Brown Rowe & Maw LLP, an international law consultation services provider for work contracts including bidding of program management services to support management in the construction of the third set of locks; URS Holdings / Fundación UDP / Fundación UNACHI / ENTRIX, which conducted the Category III Environmental Impact Study; Shearman & Sterling, LLP, which provides general legal consultancy with emphasis on the Expansion Program financing, to support the financing consultancy contract in its legal aspects. Also Parsons Brinckerhoff, that identified





the dredging project environmental impact on the navigational channel in the Pacific entrance, and estimated the greenhouse effect gas emission reduction - mainly carbon dioxide (CO₂) emissions that may be obtained from traffic increase through the expanded Panama Canal, and analysed the migratory processes and changes in the demographic structure, as well as their potential impact and effect on the metropolitan and adjacent areas as possible result of the Canal Expansion Program. Another firm, Mizuho Corporate Bank, was contracted to provide consultancy for the program's financing. All required financing is scheduled to be structured by September 2008.

Modelling

In order to help determine the right design for the locks approach walls and the maneuvers and assistance vessels required to perform the approach exercise, ACP contracted the construction of a tank model of the new set of locks as well as Pospanamax vessels; in order to simulate the entry and exit of vessels from one chamber to the other, from locks to ocean and lake, and its effect on navigation.

By the end of this period the contractor completed the construction of tank navigation simulation and 12,000-TEU container ship models, and began conducting tests all through August 2007. During this month, a team of ACP engineers and pilots performed an on-site inspection at Flanders Hydraulic Laboratories in Ambers, Belgium, of the first tests on the vessel's entry from ocean to chamber without an approach structure. In September 2007, they performed an additional on-site inspection of the second test for the vessel's entry from the ocean to the chamber, this time with a permeable approach structure. The estimated completion date for these tests is April 2008.

A scaled physical model of the new locks was also developed, including their water reutilization basins. This model will help to validate the filling and emptying system mathematical models; to refine details and the geometry of the elements that compose the hydraulic system; and to minimize potential cavitations and turbulences so that the locks may operate safely and efficiently and have a longer life.



The construction of the 12000-TEU model vessel at a 1:30 scale was completed by the end of this period. An ACP team of engineers and pilots inspected the progress of the works and verified all design details and tests during a field trip to CNR Laboratories in Lyon, France, in August 2007.

A 3D model was developed of the density currents in the locks chambers, the ocean and water discharges to minimize their effect on Pospanamax ships navigation. The model will also enable the identification of design and operational modes changes that may be required for safe and expedite navigation. The model will be calibrated with data on current vectors and densities in the areas near the locks.

By the end of September 2007, the contractor sent a report with the data obtained and processed from the measurements performed in May 2007 at the Miraflores locks and the Pacific entrance. The existing locks area macro model as well as the new locks areas were still under construction. This model will be used to simulate tidal currents and hydro-meteorological effects. The contractor started the detailed model of the density currents and discharge in the new locks. On September 19, 2007 the contractor submitted an advance report on the tridimensional numerical models to the ACP engineers and pilots team.

Accountability

Pursuant to Law 28 of 2006, and as part of ACP's commitment to transparency ever since it was assigned the responsibility of administrating the most strategic Panamanian resource, ACP submitted quarterly advance reports on the Expansion Program to the National Legislators Assembly, the Office of the General Comptroller of Panama, and the Ad-hoc Commission created to follow-up on the program. On April 23, the Board of Directors and ACP's administration also defended their six-month report before the entire legislative body, according to Law 28 provisions. These reports are public and available at www.panacanal.com.

To complement these commitments, ACP has continued the last year's task of informing as many Panamanians as possible regarding



the scope and progress of the Canal expansion work. This task has included the participation of ACP in presentations and exhibitions throughout the country. It included national fairs, maritime congresses, and public activities, the most important being Expocomer 2007. A special conference was organized for this exhibition which included site visits to explain business opportunities that will be generated by the construction of the third set of locks. Over 800 representatives, from local companies and firms, from 30 countries, participated in this activity.

In addition to informing Panamanians about the program, ACP has also updated the international community and foreign representatives who have visited Panama. We have received visitors and authorities such as the Chilean President Michelle Bachelet, U.N. Secretary General Ban Ki-moon, Spain's Chief of State José Luis Rodríguez Zapatero, Brazil's President Luiz Inácio Lula da Silva, Interamerican Development Bank (IDB) President Luís Alberto Moreno, France's Ministry of Economy Christine Lagarde, former U. S. President James Carter, and U.S. Secretaries of State, Transportation, and Commerce, Condoleezza Rice, Mary E. Peters, and Carlos M. Gutierrez, respectively.

ACP's international informative campaign has also included meetings between ACP's Board of Directors and Advisory Board with officials in Shanghai, China and with representatives from the financial community in New York, U.S.A. In July 2007, for the purpose of the program's financing, ACP presented the Expansion Program in New York, followed by a series of meetings with financial institutions interested in financing the program. Over 150 representatives from the U.S., European, and Asian financial institutions interested in financing the program participated in this event. Also during the month of July, ACP met with the two top credit rating firms to discuss the possibility of having them rate ACP's credit.

In August, ACP ordered an update of the demand forecasting model, initiated efforts to contract risk evaluation services, and organized a second round of meetings with financial institutions in New York. On



September 18, ACP gave a presentation in Hong Kong to financial institutions from Asia who are interested in financing the Expansion Program.

Conferences at the Technological University of Panama

As part of the technological transfer effort conducted for the higher education centers of Panama, during the months of August and September, ACP initiated a cycle of visits to the main facilities and regional campuses of the Technological University of Panama (UTP, for its acronym in Spanish) to present an update on the progress of the Canal Expansion Program. ACP executives and engineers had the opportunity to offer a general overview of ACP's progress from a technical standpoint to over 1,800 UTP students and professors, on issues such as: hydraulic models for the new locks, conceptual design of the structures for the new locks, and geotechnical characterization for the Expansion Program. There was also opportunity to present updates on issues such as: legal aspects and contracting system with regard to the Canal expansion, as well as the project's environmental aspects.

All of these activities have allowed the preparation and beginning of the works to start satisfactorily, and to advance at full speed and without difficulties. At this pace and facing the challenges that may arise, ACP is on its way to fulfill the historical responsibility entrusted by the Panamanian people.





1st row: Stephan Schmidheiny, Salvador A. Jurado, William A. O'Neil (Chairman), Andrónico Luksic Craig

2nd row: Flemming R. Jacobs, Mikio Sasaki, Captain Wei Jiafu, C.C. Tung

3rd row: Dr. Ernst G. Frankel, Admiral William J. Flanagan, Tommy Thomsen

4th row: Dr. Aaron Gellman, Gerhard Kurz

5th row: Joe R. Reeder, Phillip A. Embiricos,

Absent: Albert H. Nahmad and Koji Miyahara

In December 1999, in accordance with Article 19 of the Organic Law

the Panama Canal Authority established the Advisory Board to serve as a consultative body for the Canal enterprise with the main responsibility to provide guidance and recommendations to the Board of Directors and the Canal administration.

In view of the international service provided by the Canal, the Advisory Board is composed of distinguished professionals who represent a solid cross section of world's transportation, trade, business, telecommunications, construction and development, academia, and the banking sector.



Mizuho Corporate Bank, Ltd.
Financial Advisor



CH2M HILL,
Project Manager



AON Risk Service Construction Group
Risk Advisor

Social

RESPONSIBILITY...
CORPORATE
COMMITMENT



Being the Panama Canal our nation's primary resource

and strategic for international commerce, we are compelled to provide a spotless administration that will attempt to improve actual conditions regarding poverty, inequality, and environmental imbalance in our country in order to achieve sustainable development.

During fiscal year 2007, we continued driving social responsibility in all our actions, harmoniously joining together our corporate objectives and strategic goals; become leaders and role model for the country's organizations and companies, not only in the creation of economic and financial value, but in the way of doing business, since we take into consideration social (people and communities) and environmental impact, incorporating respect toward ethical values. Within this work-frame we carry out various initiatives with the community in order to foster among them the responsibility we all share for environmental and water resource conservation. We continue to strengthen alliances with several Government and educational institutions, thus sharing our values of high social, environmental and economic profitability.

The Canal Watershed

A commitment towards caring for the environment

ACP maintains its commitment to care for water resource quality in the Canal Watershed by participating in activities related to natural resource conservation that will ensure the region's sustainable transformation.

For our organization, these activities become a fundamental responsibility by which we guarantee permanent water supply for human consumption as well as for ship transit operations through the Canal.

In achieving these goals we incorporate all users or involved groups into the environmental management processes, while reaching a balance between each

one's interests through participation, shared responsibility, and knowledge.

In such sense, ACP has structured a strategy for the Canal Watershed integrated management through the Inter-institutional Commission for the Canal Watershed, which drives an effort of public consultation and dialogue resulting in the "Plan for Sustainable Development and Water Resources Integrated Management of the Panama Canal Watershed". This plan is considered a mid-term and long-term strategy for the conservation and use of available resources, as well as a model for sustainable human development that can be imitated in other regions of the country and which considers water as the joint axis for land arranging.

The document combines agreements and establishes the basis for a common agenda which allows for the rational use of natural resources without compromising the future needs of this region's population. It is the result of an arrangement process with the main Watershed actors, including Government institutions having competency within it, local governments, business groups, universities and investigation centers existing in the country, non-governmental organizations working in the area, community groups, and others as well.

During fiscal year 2007, we continued gathering necessary data for measuring environmental performance of each and all Watershed actors through the Water Quality Index (IQA). This index enables us to know the quality of the water resource to identify necessary measures for maintaining good quality water availability for all Watershed inhabitants. Also, the Water Quality Yearbook for calendar year 2006 was prepared.

As part of the measures undertaken for ensuring water resource quality, in fiscal year 2007, ACP reforested 252.5



hectares with native species; and celebrated this accomplished goal with a sowing ceremony of sprout number 550,000. This event completed the sowing of 622 hectares since the beginning of the reforestation program in 1998. This program's future actions are directed toward expanding the reforestation program under the concept of environmental economic incentives and developing environmental restoration in Canal operation areas for erosion control.

In order to strengthen forest care, together with the National Environmental Authority (ANAM), our strategic partner in environmental matters, an aerial inspection of the forest cover in Chagres National Park was carried out. This area provides around 60.0 percent of water and maintains 53.0 percent of Watershed mature forests. This surveillance facilitated ANAM's monitoring work within the protected area, enabling them to identify some strategies for the conservation of this Watershed region.

Another significant achievement was educating a group of young people from Watershed communities as part of a training process called "Program for Environmental Conservation and Employment Education in the Panama Canal Watershed", which was conducted through Mitsubishi Corporation funds. This program resulted in 437 young people now having the opportunity of being incorporated into the labor market, besides receiving environmental education that emphasizes on environmentally friendly work practices and integrated Watershed management. Because of its success, we expect to extend this project's scope to include other Watershed localities. During fiscal years 2006 and 2007, the same program through ACP funds enabled some 800 young people from 89 Watershed communities to receive training in technical work areas and environmental and cleaner production issues. These programs were made possible through agreements between ACP, Ministry of Education (MEDUCA), and National Institute for Professional Education and Training for Human Development (INADEH).

Other progress obtained in cadastre and titling matters was the fulfillment of the measuring process of 1,828 agriculture and livestock farm parcels in El Cacao district. These results will serve as the basis for developing an economic incentives program that ACP will begin implementing on fiscal year 2008.

All environmental activities performed are oriented towards turning the Canal Watershed into a model for our nation's sustainable development and territorial patrimony.



Committed

EMPLOYEE...
KEY FOR CONTINUOUS
IMPROVEMENT



The training and development programs for the personnel at the Panama Canal Authority (ACP)

are based on the appropriate planning of human assets to guarantee the achievement of mid- and long-term organizational goals. The workforce is encouraged to seek continual personal improvement through a variety of training activities, designed within the vision, mission and values of corporative identity, which ultimately has a positive impact on the productivity levels of our organization.

During fiscal year 2007, following the approval of the Canal Expansion Program, a series of professional development initiatives related to areas within the different phases of the project have been started. The training program on project management is noteworthy, as it follows the standards of the Project Management Institute. Over 130 professionals in the areas of engineering, operations, and finance have received intensive training this year and 24 have obtained their international PMP (Project Management Professional®) certification. Experts from the University of Texas at Dallas and CH2M HILL conducted this training program.

Another training focus was the concept of "Design-Build" framework, which was facilitated by "The Design-Build Institute of America-DBIA". Over 60 professionals, including engineers, lawyers, environmentalists, contracting and budget specialist participated, and received training in areas such as risk management, procurement and contracting specifications and performance. Training and development programs, which respond to the different industrial, maritime and professional activities at ACP, were implemented. Throughout this fiscal year, 50

different programs were managed in technical/vocational occupations. On-site tutors were available to assist in specialization and in development of multidisciplinary skills within the operational areas. The program objectives guarantee the dexterity of the human labor required for the operation, as well as for the new projects scheduled by ACP. Training, within the Maritime Operation Department, included traffic management specialists, locks locomotive operators, small craft and boats operators and divers.

In the Dredging Division, a significant number of dredging officers were trained, and in response to the investment projects, personnel for operation and maintenance of the power plants and the new water plant for drinking water in Mendoza are being trained. In addition, training on the recent technology applied at the Locks (control room, locomotives, valves, monitoring and energy systems) was conducted. With the purchase of the new towboats, design and training on the hydraulics mechanics and electrical equipment technology was offered.

A significant component for the navigation personnel was the certification and recertification programs for the pilots and the craft operators. Similarly, training practice in maneuvers at the bridge was offered at the new mooring stations. In this fiscal year, navigational programs were implemented to insure high performance from work gangs for ships transits.

ACP will continue contact and coordination with colleges and higher education centers and professional and labor institutions to insure that the academic offering stand



in line with mid and long term professional demands. Throughout the year, in response to the cooperation agreement with the Instituto Nacional de Formación Profesional y Capacitación para el Desarrollo Humano (INADEH), a national program for technical training, support and assessment in the process of infrastructure and equipment rehabilitation was offered at workshops nationwide. In addition, the Panama Canal Authority and INADEH have been working jointly in training programs geared towards areas of interest for ACP, such as training for heavy equipment and drilling operators, blasting specialists, construction workers, electricians, sheet metal-mechanics, and in some cases, including hands-on practice in the field. During the coming years, programs updating college and technical career students will be supported so that a variety of work opportunities will be offered through interinstitutional agreements with colleges and labor training centers.

ACP is an organization that views their employees as major stakeholders and is committed to their development. The Administration's commitment to training development of their work force is best exemplified by the substantial financial investment in education and the 90.0 percent participation rate. Educational reimbursement programs to encourage continued personal growth are provided. In addition, there are ongoing courses and programs designed to update training and development. These programs, held at facilities and workshops, are continually improved and supported with appropriate equipment and materials. The success of employee training and development indicates that ACP is achieving its corporate goals as it relates to human resources and the creation of a desirable work environment.



Constant

MODERNIZATION...
LOOKING INTO
THE FUTURE

Fiscal year 2007 marked the conclusion of investments

of over more than B/. 700.0 million as part of ACP's accelerated modernization program, which began in fiscal year 1996, with the purpose of preparing the Canal to maintain the reliability and competitiveness of the water route. Following is the description of some of the most significant investment projects:

Acquisition of locomotives

Objective: to add 18 new units and to replace the existing 82 locomotive fleet with a 100 unit fleet. This will increase the capacity of the locks to handle the growing number and sizes of vessels that transit the Canal.

Investment: B/. 212.3 million

Beginning: FY 1996 **End:** FY 2007



Tow Track Rehabilitation:

Objective: to replace the locks track system, consisting of approximately 53,100 feet of tow tracks; 20,000 feet of return tracks and 17,000 feet of spur tracks for crane movement.

Investment: B/. 146.8 million

Beginning: FY 1998 **End:** FY 2007



Replacement of miter gates moving machinery with hydraulic system:

Objective: to increase safety and reliability of the miter gates operations and minimize maintenance costs by using standard components.

Investment: B/. 31.6 million

Beginning: FY 1998 **End:** FY 2007



Relocation of the Paraiso (Cucaracha) tie-up station for transiting vessels:

Objective: to replace Paraiso tie-up station that was demolished as a result of Culebra cut widening works. This station went into service on January 2006.

Investment: B/. 14.6 million

Beginning: AF 2000 **End:** AF 2007





In order to face market demand, ACP continues making investments in different areas of operation such as modernization of equipment and machinery, Canal channel maintenance and infrastructure, as well as technological improvements. Among the main investments which will continue to be performed can be mentioned:

Culebra cut straightening / widening:

Objective: to straighten the Culebra cut with the purpose of complying with the minimum visibility distance required by Regulation 22 of the International Convention for the Safety of Life at Sea (SOLAS), which establishes that ships of 45 meters or more in length shall view the sea surface at a distance of 500 meters.

Investment: B/. 229.5 million

Beginning: FY 2003 **End:** FY 2011



Acquisition and replacement of tugboats:

Objective: to procure thirteen tugboats and replace the eight oldest tugboats in order to provide effective assistance to an increasing number of Panamax vessels.

Investment: B/. 142.6 million

Beginning: FY 2004 **End:** FY 2010



Deepening of Gatun lake and Culebra cut:

Objective: to deepen the navigation channel 0.9 meters to increase the lake's active water storage (and therefore the effective water availability) by 362.9 million cubic meters, which will maintain the relatively high existing water supply reliability of 99.6 percent.

Investment: B/. 110.8 million

Beginning: FY 2002 **End:** FY 2008



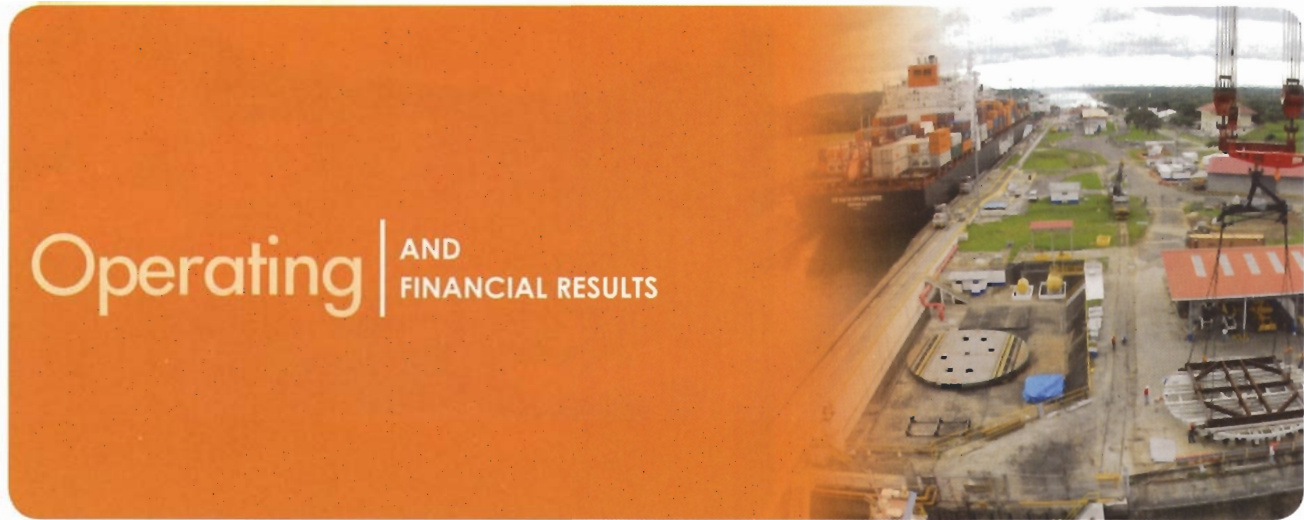
Acquisition of suction dredge:

Objective: procurement of suction dredge to perform dredging operations together with the existing dredges in the Expansion Program. Once the program concludes, the new dredge will replace the Minda Dredge.

Investment: B/. 120.0 million

Beginning: FY 2007 **End:** FY 2011





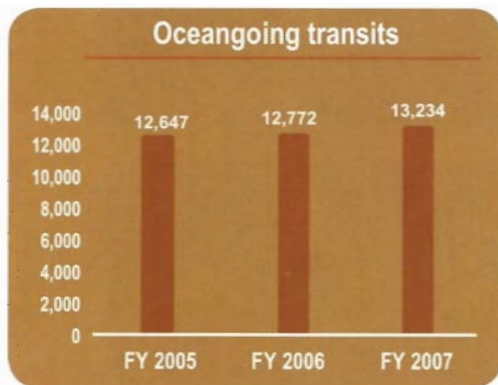
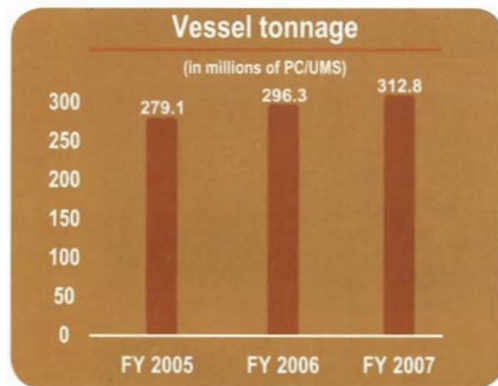
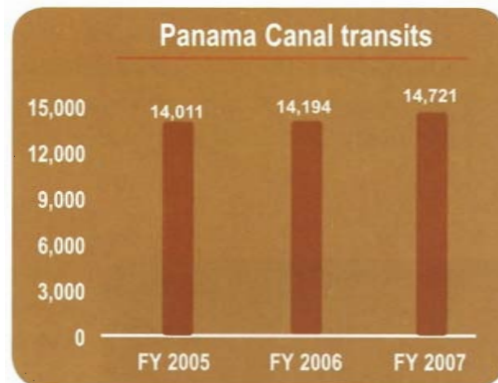
Operating results
Traffic

The growth in the global economy was beneficial to the Panama Canal during fiscal year 2007. The United States, the main customer of the waterway, experienced a 1.9 percent deceleration in the growth of its Gross National Product (GNP) relative to previous years. Nevertheless, commercial trade showed growth in the transportation of goods through the Panama Canal.

China, the second most important customer of the Canal, remains one of the world's most dynamic economies. It is anticipated that Chinese product exports and imports will continue to be the drivers of this growth; for fiscal year 2008 and 2009, it is estimated that growth will surpass the 10.0 percent mark. Japan's growth has been moderate, driven mainly by internal consumption; in addition, Japanese exports benefited from a weak yen and an increase in corporate investments.

In fiscal year 2007, the Panama Canal registered 14,721 transits, a 3.7 percent increase over the 14,194 transits of the previous fiscal year. PC/UMS tonnage was 312.8 million tons for oceangoing vessels, a 5.4 percent increase relative to fiscal year 2006. Tolls revenues increased 15.3 percent, as a result of the rise in the average size of vessels that transited the Canal, the implementation of the third phase of the programmed adjustment in the toll structure of full container vessels, in May 2007, and the general toll increase effective in July 2007. Transits of oceangoing vessels recorded a total of 13,223 in fiscal year 2007 for a daily average of 36 transits.

Tolls revenues totaled B/. 1,183.8 million, a 15.3 percent increase, B/. 157.0 million above the previous year's toll revenues.





Liner services segment

The full container vessels segment continues to be the main contributor to all traffic indicators for the Panama Canal. This segment reported 3,622 transits, 128.5 millions PC/UMS tons and B/. 645.9 million in tolls revenues. These figures represented increases of 10.1 percent in transits, 12.0 percent in PC/UMS tons and 28.5 percent in toll revenues as compared to fiscal year 2006. During fiscal year 2007, the full container vessel segment reported 12.6 million TEU, a 13.4 percent increase over fiscal year 2006 TEU figures.

The primary reasons for this increase are the introduction of new services via the Panama Canal, especially in the Asia-United States East Coast route, an increase in the average size of vessels deployed in the Canal route, and the implementation of the third phase in the programmed adjustment of the full container vessels tolls structure in May.

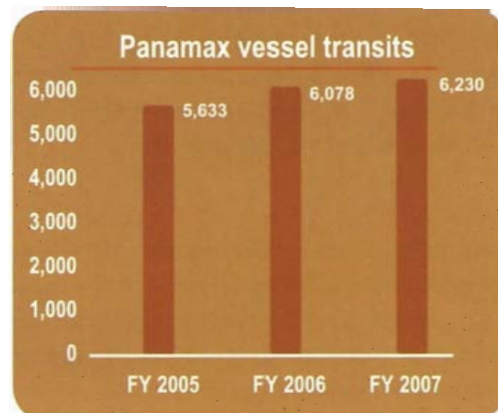
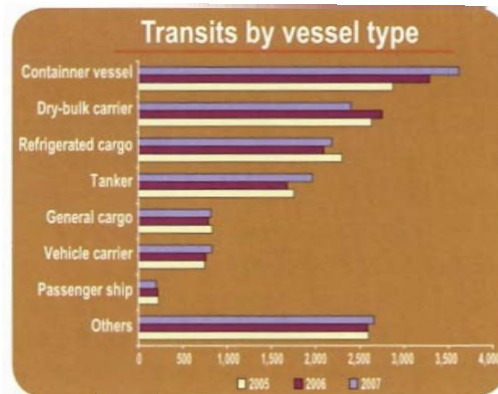
According to the programmed adjustment in the tolls structure of full container vessels, the application of the new toll tariff increase in May, from B/. 49.0 per TEU to B/. 54.0 per TEU based on capacity, contributed significantly to the increase in tolls revenues in this segment.

The upsurge of all maritime trade indicators for containerized cargo, mainly in the Asia-United States East Coast and the North-South routes between the South America West Coast and Europe, coupled with the aforementioned factors, have all contributed to the positive results of this segment during fiscal year 2007.

Liquid bulk segment

The Liquid Bulk segment posted 1,972 transits, 39.6 million PC/UMS tons and B/. 111.5 million in tolls revenues in fiscal year 2007, representing increments of 17.1, 20.0 and 22.6 percent, respectively, compared to fiscal year

2006. This increase in traffic of vessels carrying liquid cargo, especially vessels of 100 feet beam and higher, is the result of the growth in imports of distilled products such as gasoline and diesel from the United States, Chile, Ecuador, and Peru.





Dry bulk segment

The Dry Bulk segment's indicators were down this year, as the following figures attest: transits were 12.7 percent lower than the previous year and PC/UMS tonnage, at 49.9 million, was 15.4 percent below last year's figures. As a result, tolls revenues were B/. 146.9 million, 13.9 percent less than the previous year. Almost all dry bulk commodities fell this year, resulting in a 15.3 percent decrease in total cargo tonnage. Grain shipments, the largest percentage of cargo tonnage, were around 12.0 percent lower; for instance, corn fell almost 30.0 percent. The aforementioned declines are due to a growing trend by grain shippers to transport their commodities to Asia using the alternate route that begins in the Pacific Northwest. This trend is the result of a rise in freight rates and an increase in the gap between freight rates in the Pacific Northwest and the Gulf of Mexico.

Specialized service segment - vehicle carrier

Fiscal year 2007 was an outstanding period for this segment, with record-breaking results in traffic. The number of transits rose to 835, a 9.0 percent increase from fiscal year 2006. In turn, PC/UMS tonnage registered approximately 40.7 million, a 9.5 percent rise above the previous fiscal year total.

The implementation on July 1, 2007 of the proposal to modify the regulations for the admeasurement of vessels and the tolls system resulted in year-end revenues of B/. 111.6 million, an increase of 11.8 percent from fiscal year 2006.

According to the main vehicle carrier operators for the segment, Japanese manufacturers increased their exports to the United States to meet a strong customer demand for fuel-efficient automobiles.

Specialized service segment - passenger vessels

During the 2006-2007 cruise season, the passenger vessel segment experienced a surge in PC/UMS tonnage, despite a drop of 6.8 percent, to 205 transits, compared to the previous season. This rise was the result of a repositioning or redeployment of vessels with beams of 100 feet and less to other destinations, particularly Europe.

On the other hand, overall PC/UMS tonnage increased by 2.1 percent to 9.1 million tons from the 2005-2006 season, as a result of the initiative by major cruise lines such as Princess Cruises and Holland America Line to attract more tourists to longer travel itineraries aboard Panamax vessels to destinations that include Panama and South America. Tolls revenues registered B/. 26.2 million, a 2.2 percent increase over the 2005-2006 cruise season.





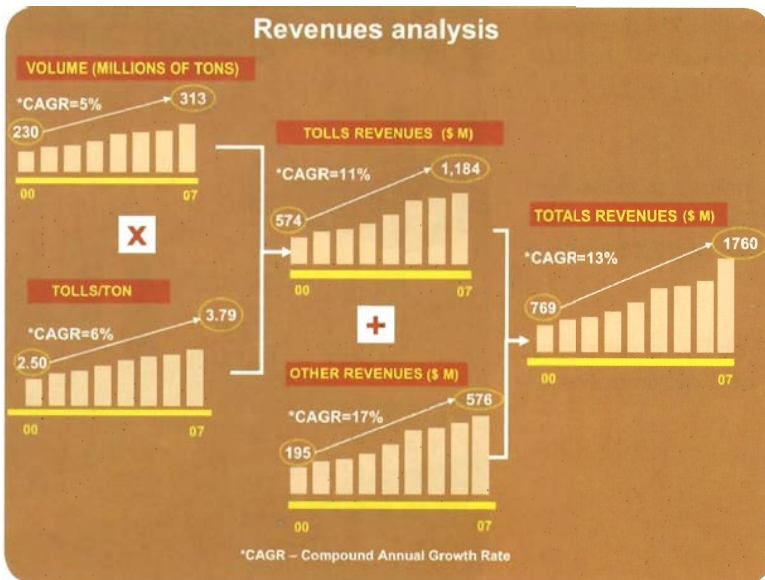
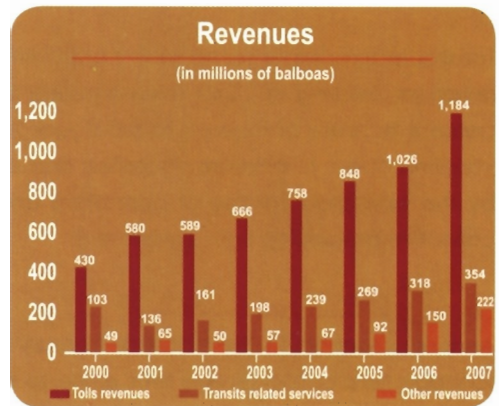
Financial results

Revenues

At the end of fiscal year 2007, total revenues amount to B/. 1,760.4 millions, representing an increase of B/. 265,6 millions, 17.8 percent compared to B/. 1,494.8 in fiscal year 2006. Toll revenues account for 67.3 percent, reaching a total of B/. 1,183,9 millions (2006; B/. 1,026.4 millions), 15.3 percent more than the previous fiscal year. During the last three years, toll revenues show an annual average growth of 18.2 percent.

The 11.2 percent increase in revenues from transit related services, this year, reflects the higher level of intensity being experimented by the core business. These services total this year B/. 354.3 millions (2006; B/. 318.5 millions), representing a 20.1 percent of the total revenues.

It is important to point out the rapid growth of other Canal revenues, reaching 12.6 percent of total revenues, with B/. 222.2 millions this fiscal year (48.2 percent more than the B/. 149,9 millions collected last year), as the result of the continued growth in energy sales and interest income.





Expenses

Total operating expenses represent approximately 29.8 percent of total revenues, totaling B/. 524.4 millions during fiscal year 2007, only a 7.4 percent increase compared to fiscal year 2006. A percentage of this variation obeys to additional salaries, and employee benefits caused by the increased volume of operations and the negotiations of the collective bargaining units agreements.

Payment to the National Treasury

Annual payments to the National Treasury in fiscal year 2007 for net tonnage and public service fees arose to B/. 360.6 millions (2006: B/. 254.4 millions), a 41.8 percent increase. This payment represents 20.5 percent of the total revenues or 29.1 percent of the net earnings before taxes and depreciation.

Net Income

Fiscal year 2007 resulted in a net income of B/. 806.6 millions, 19.3 percent more than fiscal year 2006. About B/. 320.2 millions were retained and the rest B/. 486.4 millions became dividend paid to the National Treasury.

Total contribution to the National Treasury amount B/. 847.0 millions (2006: B/. 569.7 millions), a 48.7 percent increase (B/. 277.3 millions). Between fiscal year 2000 and 2007, this total contribution show an annual growth rate of 26.1 percent.

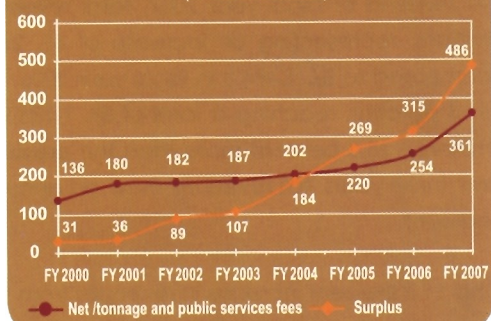
Financial Indicators

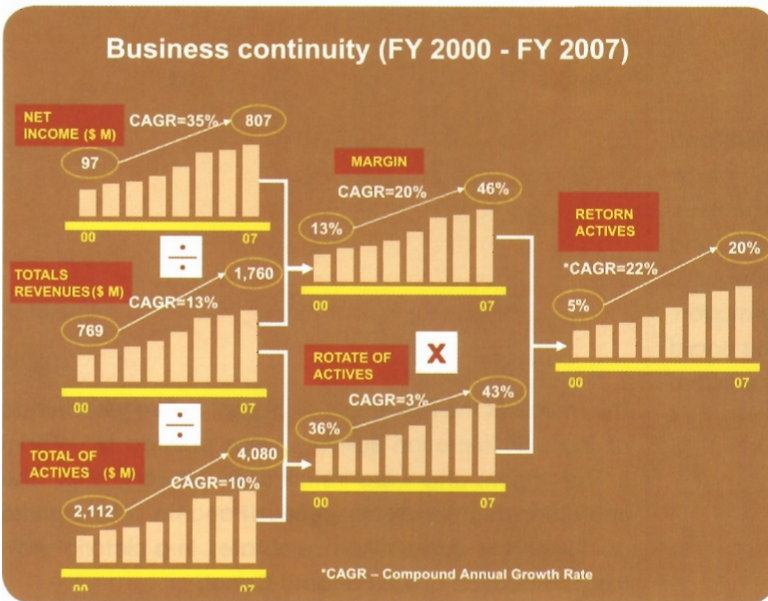
ACP continues to reflect healthy and profitable indices as a result of operations for fiscal year 2007: Return on Assets (ROA) increased to 20.0 from 15.0 percent; and return over capital increase to 22.3 from 21.3 percent.

This increase in profitability is attributed to ACP ability to set prices, efficient policy and control, higher productivity and maximization of the waterway installed capacity.

Payment to the National Treasury

(in millions of balboas)





These indices continue to reflect an upward trend, with annual growth rates of 14.2 percent for ROA and 14.4 percent for ROAE for the past three years of operation, which reiterates ACP ability to continuously generate sustainable surpluses.

| Financial indicators (in millions of balboas) | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|--|-------|-------|-------|-------|-------|-------|-------|-------|
| EBITDA | 140 | 172 | 222 | 313 | 441 | 545 | 752 | 875 |
| Profit margin | 12.6% | 15.1% | 20.9% | 28.0% | 35.7% | 40.0% | 45.2% | 45.8% |
| Utility / Sales (ROS) | 12.7% | 15.1% | 20.9% | 28.0% | 35.8% | 40.0% | 45.2% | 45.8% |
| Utility / Heritage (ROE) | 4.8% | 5.6% | 7.5% | 10.8% | 14.3% | 16.3% | 20.0% | 20.9% |
| Return / Heritage (ROAE) | 4.9% | 5.7% | 7.7% | 11.2% | 15.0% | 17.2% | 21.3% | 22.3% |

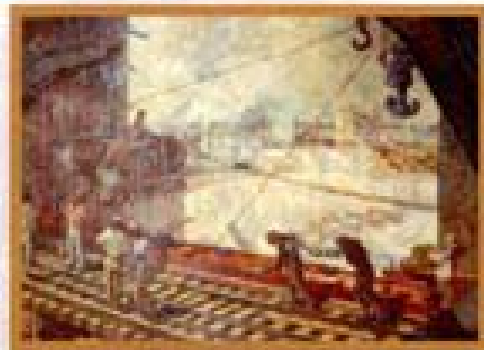


Victor Diamond
Executive Director

The Office of Inspector General is an independent and objective entity that evaluates the effectiveness of risk management, control, and governance processes. The Inspector General directs all internal audits and investigations, is an agent of positive change throughout the organization, and is a reliable source of information. In addition, it has an oversight responsibility to the Board of Directors and provides support to achieve an efficient administration.

The murals of the Panama Canal, that adorn the rotunda of the Administration Building, were painted by Willem B. Van Ingen, and were installed on January 1915. The impression of light and colors reflects Panama's atmosphere quality and its composition celebrates, in a pictorial way, the construction of the Panama Canal.

The mural represents the construction of the Gatun Dam Spillway. Gatun Lake was formed by damming up Chagres River, and the fourteen locks of the dam keep the lake at 85 feet above sea level. At the moment of its creation, Gatun Lake was the world biggest artificial lake.



(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

**Independent Auditor's 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 Auditor's 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 4, 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 | | <u>26,151</u> | <u>25,135</u> |
| Total current assets | | <u>1,840,176</u> | <u>1,397,765</u> |
| Total assets | | <u>B/. 4,079,869</u> | <u>B/. 3,599,198</u> |
| 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 | <u>486,414</u> | <u>315,332</u> |
| Total equity | | <u>3,866,533</u> | <u>3,374,790</u> |
| 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 | | <u>16,204</u> | <u>4,210</u> |
| Total current liabilities | | <u>203,336</u> | <u>214,408</u> |
| Contingent liabilities and commitments | 20 | | |
| Total equity and liabilities | | <u>B/. 4,079,869</u> | <u>B/. 3,599,198</u> |

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 | | <u>354,315</u> | <u>318,476</u> |
| | | 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 | <u>29,910</u> | <u>6,811</u> |
| Total other revenues | | <u>222,143</u> | <u>149,922</u> |
| Total revenues | | <u>1,760,385</u> | <u>1,494,825</u> |
| 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 | | <u>11,544</u> | <u>8,608</u> |
| | | 559,353 | 536,275 |
| Capitalized labor and materials | 15 | <u>(34,915)</u> | <u>(47,835)</u> |
| Total expenses | | <u>524,438</u> | <u>488,440</u> |
| 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 | <u>(68,709)</u> | <u>(76,087)</u> |
| Net income | 16 | <u>B/. 806,647</u> | <u>B/. 675,925</u> |

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

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

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

| | Note | 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 | | <u>851,157</u> | <u>770,951</u> |
| 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 | | <u>(397,085)</u> | <u>(627,555)</u> |
| 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 | | <u>103,739</u> | <u>229,193</u> |
| Cash and bank deposits at end of the year | 6 | <u>B/. 242,479</u> | <u>B/. 103,739</u> |
| 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) |
| | | <u>B/. (2,333)</u> | <u>B/. (1,678)</u> |

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

Notes to financial statements

September 30, 2007

(In thousands of balboas)

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.

Panama Canal Authority

Notes to financial statements

September 30, 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.

Panama Canal Authority

Notes to financial statements

September 30, 2007

(In thousands of balboas)

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.

Panama Canal Authority

Notes to financial statements

September 30, 2007

(In thousands of balboas)

- i. 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 year 2006 have been reclassified from their original presentation for comparative purposes with 2007.
- o. Critical judgement 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.

(Translation of financial statements originally issued in Spanish)

Panama Canal Authority

Notes to financial statements September 30, 2007 (In thousands of balboas)

4. Properties, plant, and equipment, net

Properties, plant, and equipment are as follows:

| | <u>September 30, 2007</u> | | | |
|---------------------------------|------------------------------|------------------|------------------|---------------------------|
| | <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 | 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 |
| | | | | |
| | <u>September 30, 2006</u> | | | |
| | <u>Beginning Balance</u> | <u>Additions</u> | <u>Decreases</u> | <u>Ending Balance</u> |
| 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 |

Panama Canal Authority

Notes to financial statements

September 30, 2007

(In thousands of balboas)

The PCA recorded losses in retirement or disposal of assets for B/.1,213 (2006: B/.316). During 2007, the main assets that were retired include 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 | <u>234,219</u> | <u>35,906</u> |
| | 242,479 | 103,739 |
| Time deposits with original maturities over 90 days not exceeding one year | <u>1,163,904</u> | <u>717,431</u> |
| | <u>B/. 1,406,383</u> | <u>B/. 821,170</u> |

(Translation of financial statements originally issued in Spanish)

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Notes to financial statements

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(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. Investment in securities

Investment 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 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 | <u>(766,331)</u> | <u>(453,761)</u> |
| Balance at the end of the year | <u>B/. 335,162</u> | <u>B/. 490,399</u> |
| | 2007 | 2006 |
| Fair value | B/. 335,130 | B/. 490,295 |
| Unrealized loss | <u>32</u> | <u>104</u> |
| Amortized cost | <u>B/. 335,162</u> | <u>B/. 490,399</u> |

Panama Canal Authority

Notes to financial statements

September 30, 2007

(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 |
| | <u>B/. 37,112</u> | B/. | <u>31,946</u> |

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 | <u>(6,400)</u> | | <u>(6,510)</u> |
| | <u>B/. 35,368</u> | B/. | <u>29,115</u> |

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 | <u>(959)</u> | | <u>(1,684)</u> |
| | <u>B/. 6,400</u> | B/. | <u>6,510</u> |

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.

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(In thousands of balboas)

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

| | 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 |
| | <u>203,000</u> | <u>325,469</u> | <u>(41,850)</u> | <u>486,619</u> |
| Contributions for: | | | | |
| Investment programs | 591,325 | 76,974 | - | 668,299 |
| | <u>B/. 794,325</u> | <u>B/. 402,443</u> | <u>B/. (41,850)</u> | <u>B/. 1,154,918</u> |

Panama Canal Authority

Notes to financial statements

September 30, 2007

(In thousands of balboas)

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.

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Notes to financial statements

September 30, 2007

(In thousands of balboas)

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

13. Accounts payable

The accounts payable are as follows:

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

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September 30, 2007

(In thousands of balboas)

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.

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

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

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

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(In thousands of balboas)

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.

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 | <u>4,186</u> | <u>4,757</u> |
| Total capitalized | <u>B/. 34,915</u> | <u>B/. 47,835</u> |

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(In thousands of balboas)

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.

Panama Canal Authority

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(In thousands of balboas)

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.

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(In thousands of balboas)

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.

(Translation of financial statements originally issued in Spanish)

Autoridad del Canal de Panamá

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(In thousands of balboas)

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.

Para mayor información sobre el Canal de Panamá, visite la Oficina de Información en el Edificio de la Administración, en Balboa, o llame al (507) 272-7602 ó (507) 272-7677. El Centro de Visitantes de las Esclusas de Miraflores está abierto de 9 a.m. a 5 p.m., todos los días. Usuarios de Internet pueden acceder la página de la ACP en www.pancanal.com o enviar un correo electrónico a info@pancanal.com

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