

RECOGNIZABLE EXPENSES—Continued

	District One	District Two	District Three
	<i>Reimbursed Expenses:</i> (\$13,000)	<i>Reimbursed Expenses:</i> (\$83,376) (\$174,414) (\$211,849)	<i>Reimbursed Expenses:</i> (\$163,207)
	<i>Not Recognized or Allowed:</i> (\$782) (\$43,100)	<i>Not Recognized or Allowed:</i> (\$74) (\$720) (\$28,124)	<i>Not Recognized or Allowed:</i> (\$995) (\$19,780)
	<i>Misclassified Expenses:</i> (\$4,500) (\$11,740) (\$120,377)	<i>Misclassified Expenses:</i> (\$8,600) (\$20,470)	<i>Misclassified Expenses:</i> (\$4,050) (\$23,100)
	<i>Undocumented Expenses:</i> None	<i>Undocumented Expenses:</i> (\$125,559)	<i>Undocumented Expenses:</i> None
Total expenses 2001 +	\$566,308	\$733,190	\$1,421,148
Inflation adjustment (2%)	\$11,326	\$14,664	\$28,423
Director's adjustments	\$21,872	\$20,500	\$25,000
		\$41,817	\$66,159
Total projected expenses for 2003 pilotage season	\$599,506	\$810,171	\$1,540,730

The following is a summary of the independent CPA's major findings and proposed adjustments, along with the Director's corresponding adjustments:

Summary of Major Findings and Proposed Adjustments

We divided the adjustments we made to the reported expenses into five categories: (1) equalization among districts, (2) reimbursed expenses, (3) expenses not reasonable or necessary for pilotage services (46 CFR 404.5(a)), (4) misclassified expenses, and (5) undocumented expenses.

(1) Equalization Among Districts

The Coast Guard must ensure that each association's expenses are analyzed fairly and consistently with the other associations because of how they are organized. The associations of Districts One and Three are organized as partnerships, while the association of District Two is organized as a corporation. Because of this difference, the District Two association pays the employer's share of Social Security and Medicare taxes, insurance, and travel expenses out of corporate funds. In the associations of Districts One and Two, the individual pilots pay these expenses because each pilot is self-employed. Because these taxes, insurance, and travel expenses are legitimate business expenses that should be recognized for ratemaking purposes, funds for these expenses have been added to District One and Three's expense bases on the independent CPA's recommendation. In District One, \$62,096 in Social Security

and Medicare taxes, and \$10,120 in travel expenses have been added to the expense base. In District Three, \$143,035 in Social Security and Medicare taxes, along with \$152,535 in travel expenses have been added to the expense base.

(2) Reimbursed Expenses

The independent CPA found that a number of expenses are reimbursed to the pilots' associations and recommended that these expenses should not be included in each district's expense base. Examples are reimbursement from one pilots' association to another for shared pilot boats and dispatch, reimbursement for dividends received on Workmen's Compensation premiums, and reimbursement from Canadian pilots for shared administrative expenses, dispatch, and pilot boat services.

The Director agrees with the independent CPA's recommendation to deduct these reimbursed expenses from the expense bases of the districts. Although these are legitimate business expenses, they are paid for by other districts or parties, not by the associations claiming them, and, as such, should not be included in the expense base of the district being reimbursed. In District Two, we deducted \$174,414 and \$83,376 in reimbursed expenses for pilotage and dispatch services and for the refund of Workmen's Compensation premiums of \$211,849, from the expense base. Likewise, in District Three, we deducted \$163,207 in reimbursed expenses for

pilotage and in dispatch services from the expense base.

Settlement of a lawsuit in 2002 reimbursed the District One Pilots' Association \$13,000 in legal fees. Accordingly, we have deducted this reimbursed amount from the expense base.

(3) Expenses Not Recognized or Not Allowed as Reasonable or Necessary for the Provision of Pilotage Services (46 CFR 404.5(a))

Excessive capital lease costs associated with the rental of two pilot boats, lobbying expenses, and certain miscellaneous expenses (advertising, business promotion, and donations) were identified as unnecessary for the provision of pilotage services.

During 2001, District Two paid Erie Leasing \$62,950 in lease cost for the rental of two pilot boats. The Director considers this cost unreasonable. In 46 CFR 404.5(a)(3), it states:

Lease costs for both operating and capital leases are recognized for ratemaking purposes to the extent that they conform to market rates. In the absence of a comparable market, lease costs are recognized for ratemaking purposes to the extent that they conform to depreciation plus an allowance for return on investment (computed as if the asset had been purchased with equity capital). The portion of lease costs that exceed these standards is not recognized for ratemaking purposes.

Using this methodology, with the cost of the pilot boats being \$315,000, a market return of 7.04 percent, and a depreciation amount of \$9,450, the