

result is an allowable lease expense of \$31,626 ( $\$315,000 \times 7.04\% = \$22,176 + \$9,450 = \$31,626$ ). To bring pilot-boat expenses of District Two into line with those of Districts One and Three, the Director is reducing District Two's expense base by \$28,124 ( $\$59,750$  rental fee —  $\$31,626$  allowable fee =  $\$28,124$  excessive lease fee).

The Director, in consultation with the District One Pilots' Association, identified \$43,100 in lobbying expenses and has deducted this amount from its expense base because they are not recognized for ratemaking purposes.

In addition, the independent CPA has recommended a deduction from District One's expenses of \$782 for advertising, two deductions from District Two's expenses in amounts of \$74 for business promotion and \$720 for donations, and \$995 from District Three's expense base for donations. None of these expenses is necessary for the provision of pilotage services. The independent CPA further recommended a deduction of \$19,780 from District Three's expenses for an uncollectable account or bad debt. While this treatment of bad debt is an acceptable practice for financial reporting, it is unnecessary for ratemaking in that it is a one-time, non-recurring expense. The Director agrees with the independent CPA and has deducted all these expenses from the expense bases.

#### (4) Misclassified Expenses

The independent CPA recommended deductions of \$4,500, \$11,740, and \$120,377 from District One, \$8,600 and \$20,470 from District Two, and \$4,050 and \$23,100 from District Three because these payments were made directly to pilots as compensation. District One paid \$4,500 to registered pilots to train temporarily registered pilots on Lake

Ontario and \$120,377 to an independent registered pilot for the provision of pilotage services. District Two made payments to pilots in the amount of \$8,600 to attend yearly meetings. This was paid in addition to payments to pilots for travel and *per diem* expenses. Additionally, District One made payments of \$11,740 in union dues, District Two made payments of \$20,470 in association dues, and District Three made payments of \$4,050 and \$23,100 for subscriptions and union dues. The Director agrees with the independent CPA because the payments benefit pilots and will be treated as pilot compensation in accordance with 46 CFR 404.5(a)(6), and he deducted these payments from the districts' expense bases.

#### (5) Undocumented Expenses

A detailed inspection of District Two's expense accounts and annual audited financial statements disclosed payments of \$38 daily per diem to each pilot based on days available. These payments in November 2001 and late December 2001 totaled \$125,559 and were not documented. The Internal Revenue Service procedures (Rev. Proc. 2001-47) require substantiation as to time, place, and purpose of expenses paid. These payments were in addition to properly documented travel and per diem payments made throughout the year. The total combined per diem (food and incidental) expense claimed actually exceeded the maximum amount possible if every pilot would have been on travel for every day during the season. The travel regulations do not contemplate a payment based on "days available" for travel. The independent CPA recommended that \$125,559 be deducted from District Two's expense base. The Director agrees and has

deducted the amount from the expense base and treated it as pilot compensation in accordance with 46 CFR 404.5(a)(6). Properly substantiated and documented travel and per diem costs incurred while a pilot is engaged in legitimate travel in connection with the provision of pilotage service will be recognized for ratemaking purposes.

#### Step 1.C: Adjustment for Inflation or Deflation

To adjust expenses for inflation (there being no deflation, yet), we increased the total recognized expenses for each association by two percent. This figure is based on the approximate average change in the Consumer Price Index (CPI) from July 2001 to November 2002.

#### Step 1.D: Projection of Operating Expenses

Once all adjustments are made to the recognized operating expenses, the Director projects these expenses for each pilotage area. The Director considers foreseeable circumstances that could affect the accuracy of the expenses as projected and, as well as possible, determines the "projection of operating expenses."

District-wide general and administrative expenses are apportioned to each area according to the number of pilots in that area. Expenses that are attributable to a pilotage area are applied directly to it. For instance, in District One, approximately \$31,000 in taxi expense is directly attributable to Area 1; but the remaining general and administrative expense in District One is then apportioned according to the number of pilots assigned to Areas 1 and 2. The results of Step 1.D for each district are displayed as follows:

#### DISTRICT ONE

	Area 1 St. Lawrence River	Area 2 Lake Ontario	Total District One
Projection of operating expenses .....	\$315,253	\$284,253	\$599,506

#### DISTRICT TWO

	Area 4 Lake Erie	Area 5 Southeast Shoal to Port Huron, MI	Total District Two
Projection of operating expenses .....	\$312,726	\$497,445	\$810,171