

by a Coast Guard-contracted independent accounting firm that compiles this information into financial reports for each District. The financial reports are reviewed by the Coast Guard in accordance with the requirements contained at Appendix C to Part 404, on an annual basis.

(2) Every five years, the Coast Guard is required by the regulations to complete a thorough audit of pilot association expenses and establish

pilotage rates in accordance with the procedures detailed in § 404.10. Because we are issuing an interim rule that adjusts the current rate, we are following the methodology appearing at appendix A to part 404.

(3) All data used in this interim rule are taken from these reports. The reports reflect the period ending December 31, 2001. These reports may be found in the docket.

Step 1.B. Determination of Recognizable Expenses

(1) The Coast Guard determines which Association expenses will be recognized for ratemaking purposes, using the guidelines for the recognition of expenses contained in § 404.05.

(2) The following is a summary of the independent CPA's major findings and adjustments to the pilot associations' audited expenses, along with the Coast Guard's corresponding adjustments:

RECOGNIZED EXPENSES

	District One	District Two	District Three
Reported expenses for 2001	\$687,591	\$1,386,376	\$1,336,710
Independent CPA Proposed Adjustments	<i>Equalization Between Districts</i>	<i>Equalization Between Districts</i>	<i>Equalization Between Districts</i>
	\$10,120	None	\$143,035
	\$62,096		\$152,535
Reimbursed Expenses	Reimbursed Expenses	Reimbursed Expenses	Reimbursed Expenses
(\$13,000)	(\$83,376)	(\$174,414)	(\$163,207)
	(\$211,849)		
Not Recognized or Allowed	Not Recognized or Allowed	Not Recognized or Allowed	Not Recognized or Allowed
(\$782)	(\$74)	(\$995)	
(\$43,100)	(\$720)	(\$19,780)	
	(\$28,124)		
Misclassified Expenses	Misclassified Expenses	Misclassified Expenses	Misclassified Expenses
(\$4,500)	(8,600)	(\$4,050)	
(\$11,740)	(\$20,470)	(\$23,100)	
(\$120,377)			
Undocumented Expenses	Undocumented Expenses	Undocumented Expenses	Undocumented Expenses
None	(125,559)	None	None
<i>Total expenses 2001 +</i>	\$566,308	\$733,190	\$1,421,148
Inflation adjustment (2%)	\$11,326	\$14,664	\$28,423
Coast Guard's Adjustments	\$21,872	\$20,500	\$25,00
		\$43,406	\$66,159
Total projected expenses for 2003 pilotage season	\$599,506	\$811,760	\$1,540,730

Step 1.C. Adjustment for Inflation or Deflation

(1) In making projections of future expenses, expenses that are subject to inflationary or deflationary pressures are adjusted. Costs not subject to inflation or deflation are not adjusted. Annual cost inflation or deflation will be projected to the succeeding navigation season, reflecting the gradual increase or decrease in costs throughout the year. The inflation adjustment is

based on the year 2000 change in the Consumer Price Index for the North Central Region of the United States.

(2) Based upon the foregoing, a 2 percent inflation adjustment was made to the expense base. That adjustment appears in the table above.

Step 1.D. Projection of Operating Expenses

Once all adjustments are made to the recognized operating expenses, the

Coast Guard projects these expenses for each pilotage area. In doing so, the Coast Guard takes into account foreseeable circumstances that could affect the accuracy of the projection. General and administrative expenses are apportioned to each area according to the number of pilots needed in that area. 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	\$359,704	\$239,802	\$599,506