

INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES
ST. LAWRENCE SEAWAY PILOTS' ASSOCIATION
CONTRACT # GS-23F-0124M

DECEMBER 31, 2009

St. Lawrence Seaway Pilots' Association

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INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES

United States Coast Guard
Great Lakes Pilotage Branch

We have performed the procedures enumerated in the accompanying Summary of Agreed-upon Procedures and Results, which was agreed to by the United States Coast Guard (USCG), solely to assist you in evaluating certain aspects of the expenses incurred by the St. Lawrence Seaway Pilots' Association ("District 1" or the "Association") for the year ended December 31, 2009. The United States Coast Guard is responsible for evaluating such expenses incurred. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are included in the accompanying Summary of Agreed-upon Procedures and Results and Summary of Findings and Recommendations, respectively.

We were not engaged to, and did not; conduct an audit, the objective of which would be the expression of an opinion on the accounting records. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the United States Coast Guard and the St. Lawrence Seaway Pilots' Association, and is not intended to be and should not be used by anyone other than those specified parties.

Reznick Group, P.C.

Bethesda, Maryland
January 21, 2011

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS

I. OVERVIEW

The Great Lakes Pilotage Branch is responsible for oversight of the St. Lawrence Seaway Pilots' Association, as well as two other pilot associations, which provide piloting services in the Great Lakes region. Included in this oversight function is the responsibility to set pilotage rates, which encompass pilot compensation, other piloting costs, and other measures. The procedures listed below are designed to assist the Great Lakes Pilotage Branch in determining those rates.

II. EVALUATION OF REPORTED EXPENSES

Procedure:

Obtain a listing of the expenses incurred by District 1 during the year ended December 31, 2009 and perform the following:

1. Segregate each expense class/account into groups of 1) specific or 2) general, and determine the method of testing to be utilized in order to achieve, at a minimum, a 95% confidence level.
2. Groups to be tested using sampling procedures:
 - A. Calculate planning materiality and tolerable misstatement (75% of planning materiality) based on each group balance using industry guidelines.
 - B. Select all individually significant items in each group for testing. Items above 1/3 tolerable misstatement are considered significant.
 - C. Using an industry standard sampling form, determine remaining sample size to be selected from each group.
3. Groups to be tested using procedures other than sampling procedures:
 - A. Rent expense (equipment): Determine that the expense is allowable per CFR Part 404.5 (3), which states that "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". Depreciation will be recalculated and an allowance for return on investment will be determined using the Moody's Corporate Bond AAA index as of December 31, 2009, or 5.33%.
4. For each transaction selected for testing, obtain invoices or other supporting documentation and determine if amounts are a) appropriately included in the rate

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

calculation; b) included in pilot compensation or; c) excluded from these categories, using the following information:

- A. Title 46: Shipping, Part 404-Great Lakes Pilotage Ratemaking, Section 5 Guidelines for the recognition of expenses;
 - B. Federal Register final and interim rulings, including:
 - i. NPRM - USCG-2002-11288-0001
 - ii. 1st IR - USCG-2002-11288-0156
 - iii. 2nd IR - USCG-2002-11288-0187
 - iv. Final Rule - USCG-2002-11288-0233;
 - C. Previously issued Independent Accountants' Reports on Applying Agreed-upon Procedures; and
 - D. Discussions with the Director of the United States Coast Guard, Great Lakes Pilotage Branch.
5. Evaluate the results of our test work performed and identify exceptions, if any. Exceptions will be extrapolated to groups, accounts, or by using other measures as deemed appropriate and will result in adjustments to pilot compensation, other piloting costs, or both. Adjustments will only be recorded for identified misstatements, within a given group, exceeding 3% of planning materiality.

Results:

The 'Total amount reported' column in the table below represents amounts provided by District 1 from their general ledger as of December 31, 2009. The breakdown of amounts by area was provided by District 1 for information purposes only and was not subject to the procedures above. Exceptions are shown in the "Adjustments" column below. Each adjustment references the finding number located in the Summary of Findings and Recommendations, which describes the reasoning for such adjustment.

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

The following are the results of performing such procedures:

	District 1				
	Area 1	Area 2	Total amount reported	Adjustments	Adjusted amount
Pilotage Costs					
Compensation:					
Salaries (01), (02), (05)	\$ 818,275	\$ 612,716	\$ 1,430,991	\$ (98,250)	\$ 1,332,741
Employee benefits	34,750	26,667	61,417	-	61,417
Dues and subscriptions (03)	-	-	-	24,395	24,395
Other Pilotage Costs:					
Pilot subsistence/Travel (04)	164,782	131,436	296,218	(8,265)	287,953
License insurance	28,428	18,952	47,380	-	47,380
Payroll taxes (01)	-	-	-	86,712	86,712
Other (05)	980	857	1,837	(1,052)	785
Total Pilotage Costs	<u>1,047,216</u>	<u>790,628</u>	<u>1,837,843</u>	<u>3,540</u>	<u>1,841,383</u>
Pilot Boat and Dispatch Costs					
Pilot boat expense	<u>101,612</u>	<u>82,506</u>	<u>184,118</u>	<u>-</u>	<u>184,118</u>
Total Pilot Boat and Dispatch Costs	<u>101,612</u>	<u>82,506</u>	<u>184,118</u>	<u>-</u>	<u>184,118</u>
Administrative Expenses					
Legal (06)	10,450	8,685	19,135	(482)	18,653
Depreciation/Auto leasing/Other	8,917	7,283	16,200	-	16,200
Dues and subscriptions (03)	13,717	10,678	24,395	(24,395)	-
Bad debt expense (07)	9,302	1,004	10,305	(10,305)	-
Utilities	478	346	823	-	823
Accounting/Professional fees	2,182	1,818	4,000	-	4,000
Bookkeeping and administration	77,730	66,121	143,852	-	143,852
Other (08)	762	582	1,344	(214)	1,130
Total Administrative Expenses	<u>123,538</u>	<u>96,516</u>	<u>220,054</u>	<u>(35,396)</u>	<u>184,658</u>
Total Costs and Expenses	<u>\$ 1,272,365</u>	<u>\$ 969,650</u>	<u>\$ 2,242,015</u>	<u>\$ (31,856)</u>	<u>\$ 2,210,159</u>

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SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

III. VARIANCE ANALYSIS

Procedure:

Obtain a listing of the expenses incurred by District 1 for the years ended December 31, 2002 through 2009 and perform the following:

1. Segregate accounts into groups based on account description.
2. Compute average of the accounts and groups from 2002 to 2009.
3. Compute difference between the actual balance for each year and the average for each account and group.
4. Compute percentage change between the actual balance for each year and the average for each account and group.
5. Identify accounts and groups with differences between actual and average in excess of 1/3 of tolerable misstatement (materiality calculation will be based on the total of all expense accounts) and accounts and groups with percentage changes between actual and average in excess of 10%. Review remaining account and group analytics and judgmentally determine if any should be selected for additional review.
6. Identify other ratios to perform based on review of account and group analysis. The following ratios will be performed:
 - A. Compute pilot compensation as a percentage of revenue;
 - B. Compute pilot boat expense as a percentage of revenue;
 - C. Compute license insurance per pilot;
 - D. Compute BC/MMP insurance per pilot; and
 - E. Compute travel expense per pilot.
7. Obtain explanation and supporting documentation from pilot association personnel, if deemed necessary, to support identified variances and determine if reasonable.
8. Conclude if any instances were identified that led us to believe 2009 expenses were overstated for ratemaking purposes.

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

No exceptions were noted as a result of performing such procedures.

IV. COMPARISON OF PILOT ASSOCIATION ACTIVITIES

Procedure:

Obtain a listing of the expenses incurred by District 1, Lakes Pilots Association, Inc. ("District 2") and Western Great Lakes Pilots Association, LLP ("District 3") for the year ended December 31, 2009 and perform the following:

1. Segregate accounts for each District into three categories: a) Pilotage Costs (Compensation, which includes pilot distributions and dividends, and Other Pilotage Costs), b) Pilot Boat and Dispatch Costs, and c) Administrative Costs.
2. For each district, compare 2009 expenses and the percentage of each expense, to total district revenue.
3. Perform an analysis of the significant cost categories incurred by the Districts and provide a summary of the composition of the following categories:
 - A. Pilot compensation and payroll taxes,
 - B. Travel expense/pilot subsistence,
 - C. Pilot boat and dispatch costs,
 - D. Cost associated with affiliated entities, and
 - E. Administrative expenses,
 - i. Legal, accounting and professional fees,
 - ii. Office rent, and
 - iii. Depreciation/auto leasing/other.

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

The following are the results of performing such procedures:

	District 1		District 2		District 3		Total	
	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue
Total Revenue	\$ 2,274,009		\$ 2,091,330		\$ 3,040,158		\$ 7,405,497	
Pilotage Costs								
Compensation:								
Salaries	\$ 1,332,741	58.61%	\$ 662,629	31.68%	\$ 854,147	28.10%	\$ 2,849,517	38.48%
Employee benefits	61,417	2.70%	339,349	16.23%	378,701	12.46%	779,467	10.53%
Dues and subscriptions	24,395	1.07%	11,015	0.53%	34,049	1.12%	69,459	0.94%
Other Pilotage Costs:								
Pilot subsistence/travel	287,953	12.66%	165,080	7.89%	312,180	10.27%	765,213	10.33%
License insurance	47,380	2.08%	15,634	0.75%	23,095	0.76%	86,109	1.16%
Payroll taxes	86,712	3.81%	63,223	3.02%	62,973	2.07%	212,908	2.87%
Other	785	0.03%	41,359	1.98%	1,809	0.06%	43,953	0.59%
Total Pilotage Costs	1,841,383	80.96%	1,298,289	62.07%	1,666,954	54.82%	4,806,626	64.90%
Pilot Boat and Dispatching Costs								
Pilot boat costs	184,118	8.10%	216,014	10.33%	340,679	11.21%	740,811	10.00%
Dispatching costs	-	0.00%	12,975	0.62%	93,881	3.09%	106,856	1.44%
Payroll taxes	-	0.00%	7,154	0.34%	12,765	0.42%	19,919	0.27%
Total Pilot Boat and Dispatch Costs	184,118	8.10%	236,143	11.28%	447,325	14.71%	867,586	11.72%

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

	District 1		District 2		District 3		Total	
	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue
Administrative Expenses								
Legal	18,653	0.82%	60,911	2.91%	32,783	1.08%	112,347	1.52%
Office rent	-	0.00%	75,688	3.62%	9,900	0.33%	85,588	1.16%
Insurance	-	0.00%	26,019	1.24%	14,694	0.48%	40,713	0.55%
Employee benefits	-	0.00%	69,613	3.33%	107,617	3.54%	177,230	2.39%
Payroll taxes	-	0.00%	9,552	0.46%	10,424	0.34%	19,976	0.27%
Other taxes	-	0.00%	23,850	1.14%	26,633	0.88%	50,483	0.68%
Depreciation/Auto leasing/Other	16,200	0.71%	75,396	3.61%	37,982	1.25%	129,578	1.75%
Interest	-	0.00%	10,757	0.51%	5,278	0.17%	16,035	0.22%
Dues and subscriptions	-	0.00%	110	0.01%	-	0.00%	110	0.00%
Bad debt expense	-	0.00%	-	0.00%	-	0.00%	-	0.00%
Utilities	823	0.04%	30,409	1.45%	33,149	1.09%	64,381	0.87%
Salaries	-	0.00%	108,884	5.21%	76,660	2.52%	185,544	2.51%
Accounting/Professional fees	4,000	0.18%	23,500	1.12%	18,751	0.62%	46,251	0.62%
Bookkeeping fees	143,852	6.33%	-	0.00%	-	0.00%	143,852	1.94%
Other	1,130	0.05%	21,157	1.01%	13,808	0.45%	36,096	0.49%
Total Administrative Expenses	184,658	8.13%	535,846	25.61%	387,679	12.75%	1,108,183	14.96%
Total Costs and Expenses	\$ 2,210,159	97.19%	\$ 2,070,278	98.98%	\$ 2,501,958	82.30%	\$ 6,782,395	91.59%

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Pilot Compensation and Payroll Taxes

- District 1: Pilots were compensated through capital drawings based on available funds. Therefore, pilot salary expenses are not recorded. All capital drawings were included in the sampling population and have been allocated to pilot compensation or other expenses as deemed appropriate. The pilots were responsible for paying payroll taxes within their personal tax filing. The district recorded a 'self-employment tax equivalent' in the Statement of Pilots' Capital, in its audited financial statements for the year ended December 31, 2009. This amount was computed by multiplying total capital drawings by the IRS standard self-employment tax rate of 15.3%, consisting of 12.4% for social security and 2.9% for Medicare, up to \$106,800. Compensation in excess of \$106,800 is subject to the 2.9% Medicare tax only. An adjustment was made to reclass the expected employer portion of the payroll taxes, using IRS standard tax rates of 6.2% for Social Security and 1.45% for Medicare.
- District 2: Pilots were compensated on a 'per available day' basis at either \$200 or \$150 per day. Pilots also received other special compensation payments as determined during the year. Payroll taxes were computed and recorded by the association based on IRS guidelines.
- District 3: Pilots were compensated on a 'per available day' basis at either \$250 or \$175 per day. Applicant pilots were paid at a rate of 80% or 90% of the standard pilot rate. The pilots also receive distributions. These distributions were not included in pilot compensation, for the purposes of this report except for the recalculation of payroll taxes. The pilots were responsible for paying payroll taxes within their personal tax filing. Therefore, payroll taxes on pilot compensation were not recorded by the Association. An adjustment was made to reclass the expected employer portion of the payroll taxes, using IRS standard tax rates of 6.2% for Social Security and 1.45% for Medicare.

Travel Expense/Pilot Subsistence

- District 1: All travel expenses incurred, such as fuel or taxi charges, are generally reimbursed at actual costs and require a receipt to be submitted. Mileage was computed using standard rates and per diem is calculated at \$52 per day based on submitted expense reports.

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- District 2: All travel expenses incurred, such as hotel or taxi charges, were generally reimbursed at actual costs and require a receipt to be submitted. Per diem reimbursements were calculated at a rate of \$52 per day based on approximately 200 days per year which is considered the length of time of the normal operating season of the pilots starting in April and ending in December.
- District 3: Pilots were provided a per diem of \$52 'per available working day', or non-rest days. In addition, pilots were provided a hotel allowance of either \$100 or \$70 for each night's stay as documented on their expense report. Also, pilots were provided an allowance for transportation costs, such as taxi charges, for travel days as documented on their expense reports. The allowance was based on typical transportation costs incurred in each respective port area. Mileage was computed using standard rates. All other travel expenses incurred, such as fuel or tolls, were generally reimbursed at actual costs and require a receipt to be submitted.

Pilot Boat and Dispatch Costs

- District 1: This District paid an affiliated entity to manage the overall operations of the pilot boats, including payment of pilot boat operators. District 1 did not incur dispatch charges, as dispatching was provided by the Canadian Great Lakes Pilotage Authority in exchange for pilot boat services.
- District 2: This District owns pilot boats and incurred costs to operate these boats, such as salaries, fuel and maintenance. This District provided pilot boat services to its own pilots, as well pilots from District 3 and Canada. Total expenses incurred were reduced by the revenue incurred from these services. This District also incurred dispatch expenses.
- District 3: This District received pilot boat services from several entities at its various ports, including District 2. This District employed dispatchers to handle its dispatch needs.

Costs Associated with Affiliated Entities

- District 1: This District entered into transactions with affiliated entities for services associated with pilot boat operations, bookkeeping and administration services, and equipment rental in the amounts of \$184,118, \$143,852 and \$16,200, respectively, during the year ended December 31, 2009 for a total of \$344,170. Per discussion with District 1 personnel, payments are not made

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

pursuant to contractual arrangements. Rather, charges are based on the operating expenses of the affiliated entities and can fluctuate from year to year. The affiliated entities incurred operating expenses of \$344,478 per their audited financial statements as of December 31, 2009.

District 2: This District leased property from an affiliated entity at a monthly rate of \$5,474, or \$65,688 annually. Per discussions with District 2 personnel, this amount was based on operating expenses of the affiliated entity. Specifically, lease payments were based on principal and interest incurred by the affiliated entity associated with the purchase of land used by the district. The affiliated entity incurred operating expenses of \$987 and principal and interest payments totaling \$59,717 per its audited financial statements as of December 31, 2009.

District 3: This District did not enter into transactions with or make payments to affiliated entities.

Administrative Expense

Legal, Accounting and Professional Fees:

District 1: This District incurred legal expenses in the normal course of business and in conjunction with the other districts, with a shared attorney used for common issues affecting the pilot associations and the ratemaking process. The District also incurred accounting fees for preparation of audited financial statements and tax returns.

District 2: This District incurred legal expenses in the normal course of business and in conjunction with the other districts, with a shared attorney used for common issues affecting the pilot associations and the ratemaking process. In addition, this District incurred legal costs associated with an unresolved matter being investigated by the U. S. Coast Guard. The District also incurred accounting fees for preparation of audited financial statements and tax returns.

District 3: This District incurred legal expenses in the normal course of business and in conjunction with the other districts, with a shared attorney used for common issues affecting the pilot associations and the ratemaking process. The District also incurred accounting fees for preparation of audited financial statements and tax returns.

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Office Rent:

- District 1: This District did not incur office rent expense. It operated in a building owned by an affiliated entity and such operating expenses were incorporated in other fees paid to the affiliated entity.
- District 2: This District leased office space from an unrelated party on a month-to-month basis until it commenced occupancy of a building owned by an affiliated entity on December 1, 2009. This District leased property from an affiliated entity at a monthly rate of \$5,474, or \$65,688 annually.
- District 3: This District leased office space from an unrelated party on a month-to-month basis at an amount equal to \$9,900 annually.

Depreciation/Auto Leasing/Other:

- District 1: This District does not incur depreciation expense. Such expenses were incorporated in other fees paid to the affiliated entity. The Association leases computer equipment from an affiliated entity.
- District 2: This District incurred depreciation on pilot boats, a housing location at one port, and various pieces of equipment. The district also entered into automobile lease agreements.
- District 3: This District incurred depreciation on equipment and vehicles. The expenses for navigation equipment purchased during 2009 is included in this administrative account.

V. RECOMMENDED GENERAL LEDGER ACCOUNTS

Procedure:

Recommend a list of general ledger accounts for use by each Association.

Results:

As a result of performing the aforementioned agreed-upon procedures, we recommend the Districts incorporate the account groupings listed in Procedures I and III into the financial data provided to the Great Lakes Pilotage Branch for analysis, understanding that more detailed subaccounts would be necessary to accurately classify expenses incurred.

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SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

VI. BANK STATEMENT AND RECONCILIATION COMPARISON

Procedure:

Obtain bank statements and bank reconciliations for all cash accounts as of December 31, 2009 and perform the following:

1. Verify the bank statement agrees to the bank reconciliation with differences below 3% of planning materiality based on unadjusted total expenses;
2. Verify the bank reconciliation agrees to the trial balance with differences below 3% of planning materiality based on adjusted total expenses; and
3. Conclude if any instances were identified that would suggest that cash is not properly reconciled and recorded.

Results:

No exceptions were noted as a result of performing such procedures.

St. Lawrence Seaway Pilots' Association

SUMMARY OF FINDINGS AND RECOMMENDATIONS

The following findings detail adjustments necessary for ratemaking purposes, as identified in section II of the previous report.

Finding Number: D1-09-01

Finding Title: Payroll Taxes - Pilots

Condition:

The Association did not incur payroll taxes for pilot compensation as the pilots are responsible for these on their individual tax returns. The Association incurred compensation costs related to an internally calculated self-employed equivalent tax amount, using IRS self-employment standard tax rate.

Criteria:

Federal Register, Vol. 70, No. 46, section 12091 dated March 10, 2005 allows for estimated Social Security and Medicare taxes to be recorded on behalf of the Association when these taxes are incurred by the pilots on their individual tax returns. Note: these estimates are based on taxes that would be incurred by the Association, not what the pilots incur on their own tax returns as a self-employed individual.

Effect:

Operating expenses are understated.

Cause:

The pilots of the Association are self-employed, therefore they incur these payroll costs on their individual tax returns.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards. Estimates should be based on taxes that would be incurred by the Association and not based on individual self-employment rates.

St. Lawrence Seaway Pilots' Association

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Finding Number: D1-09-02

Finding Title: Pilot Compensation and Benefits

Condition:

The Association incurred costs for pilot compensation and benefits that did not relate to 2009.

Criteria:

Procedures performed are for expenses incurred during the year ended December 31, 2009 only.

Effect:

Pilot compensation is overstated.

Cause:

Expenses incurred for 2008 or 2010 were received and paid during 2009.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D1-09-03

Finding Title: Dues and Subscriptions

Condition:

The Association incurred costs for dues and subscriptions that were classified as operating expenses.

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

St. Lawrence Seaway Pilots' Association

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Effect:

Pilot compensation is understated and expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D1-09-04

Finding Title: Travel Expenses

Condition:

The Association incurred costs for travel expenses that did not relate to 2009. The Association did not have appropriate documentation to support some travel expenses or travel expenses were miscalculated. Revenue was received for certain taxi expenses, therefore these specific charges are not considered necessary for ratemaking purposes.

Criteria:

Procedures performed are for expenses incurred during the year ended December 31, 2009 only. Regulation 46 CFR 404.5(a)(8)(i) states that undocumented expenses are not recognized as reasonable for ratemaking purposes. Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

Effect:

Operating expenses are overstated.

Cause:

Expenses incurred in 2008 were received and paid during 2009. Pilots did not properly attach receipts for with their expense reimbursement forms or expenses were calculated with an incorrect rate or number of days. Revenue was received for certain taxi expenses.

St. Lawrence Seaway Pilots' Association

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards. Receipts for travel expenses incurred should be provided with expense reimbursement forms and these forms should be reviewed for accuracy.

Finding Number: D1-09-05

Finding Title: Training Fund

Condition:

The Association incurred certain costs in connection with pilot training, including travel expenses and amounts considered pilot compensation. The Association did not have appropriate documentation to support some of these travel expenses.

Criteria:

Federal Register, Vol. 71, No. 63, section 16505 dated April 3, 2006 states the expenses are recognized on a reimbursable basis only. Includable expenses are those that have been incurred and are both reasonable and necessary for the provision of pilotage service. Regulation 46 CFR 404.5(a)(8)(i) states that undocumented expenses are not recognized as reasonable for ratemaking purposes.

Effect:

Operating expenses are overstated and pilot compensation is understated.

Cause:

A payment to a pilot for accompanying a trainee is considered pilot compensation. All travel expenses must be documented and demonstrated that they are necessary and reasonable in order to be reimbursable.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards. All travel expenses must be properly documented.

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SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Finding Number: D1-09-06

Finding Title: Legal Expenses

Condition:

The Association incurred legal costs that were associated with lobbying expenses.

Criteria:

Regulation 46 CFR 404.5(a)(8)(ii) states that lobbying expenses are not recognized as reasonable for ratemaking purposes.

Effect:

Operating expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D1-09-07

Finding Title: Bad Debt Expense

Condition:

The Association incurred costs associated with bad debt expense.

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

St. Lawrence Seaway Pilots' Association

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Effect:

Operating expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D1-09-09

Finding Title: Other Expenses

Condition:

The Association incurred costs for advertising.

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

Effect:

Operating expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES

LAKES PILOTS ASSOCIATION, INC.
CONTRACT # GS-23F-0124M

DECEMBER 31, 2009

Lakes Pilots Association, Inc.

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INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES

United States Coast Guard
Great Lakes Pilotage Branch

We have performed the procedures enumerated in the accompanying Summary of Agreed-upon Procedures and Results, which was agreed to by the United States Coast Guard (USCG), solely to assist you in evaluating certain aspects of the expenses incurred by the Lakes Pilots Association, Inc. ("District 2" or the "Association") for the year ended December 31, 2009. The United States Coast Guard is responsible for evaluating such expenses incurred. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are included in the accompanying Summary of Agreed-upon Procedures and Results and Summary of Findings and Recommendations, respectively.

We were not engaged to, and did not conduct an audit, the objective of which would be the expression of an opinion on the accounting records. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the United States Coast Guard and the Lakes Pilots Association, Inc., and is not intended to be and should not be used by anyone other than those specified parties.

Reznick Group, P.C.

Bethesda, Maryland
January 21, 2011

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS

I. OVERVIEW

The Great Lakes Pilotage Branch is responsible for oversight of the Lakes Pilots Association, Inc., as well as two other pilot associations, which provide piloting services in the Great Lakes region. Included in this oversight function is the responsibility to set pilotage rates, which encompass pilot compensation, other piloting costs, and other measures. The procedures listed below are designed to assist the Great Lakes Pilotage Branch in determining those rates.

II. EVALUATION OF REPORTED EXPENSES

Procedure:

Obtain a listing of the expenses incurred by District 2 during the year ended December 31, 2009 and perform the following:

1. Segregate each expense class/account into groups of 1) specific or 2) general, and determine the method of testing to be utilized in order to achieve, at a minimum, a 95% confidence level.
2. Groups to be tested using sampling procedures:
 - A. Calculate planning materiality and tolerable misstatement (75% of planning materiality) based on each group balance using industry guidelines.
 - B. Select all individually significant items in each group for testing. Items above 1/3 tolerable misstatement are considered significant.
 - C. Using an industry standard sampling form, determine remaining sample size to be selected from each group.
3. Groups to be tested using procedures other than sampling procedures:
 - A. Depreciation expenses/Auto leases: Depreciation will be recalculated based on schedules provided, including purchase amounts and useful lives. Auto leases will be reviewed to determine if they meet keep capital lease requirements. Any lease meeting these requirements will be capitalized and depreciation will be capitalized for the purposes of these procedures.
 - B. Rent expense: For lease agreements with unaffiliated entities, the lease will be tested by recalculating the expense based on the terms of the signed lease agreement. For lease agreements with affiliated entities, CFR Part 404.5 (3) will

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

be applied, stating that “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”. In lieu of depreciation, actual annual expenses incurred in conjunction with purchase and maintenance of the land will be determined. Return on investment will be determined using the Moody’s Corporate Bond AAA index as of December 31, 2009, or 5.33%.

4. For each transaction selected for testing, obtain invoices or other supporting documentation and determine if amounts are a) appropriately included in the rate calculation; b) included in pilot compensation or; c) excluded from these categories, using the following information:
 - A. Title 46: Shipping, Part 404-Great Lakes Pilotage Ratemaking, Section 5 Guidelines for the recognition of expenses;
 - B. Federal Register final and interim rulings, including:
 - i. NPRM - USCG-2002-11288-0001
 - ii. 1st IR - USCG-2002-11288-0156
 - iii. 2nd IR - USCG-2002-11288-0187
 - iv. Final Rule - USCG-2002-11288-0233;
 - C. Previously issued Independent Accountants’ Reports on Applying Agreed-upon Procedures; and
 - D. Discussions with the Director of the United States Coast Guard, Great Lakes Pilotage Branch.
5. Evaluate the results of our test work performed and identify exceptions, if any. Exceptions will be extrapolated to groups, accounts, or by using other measures as deemed appropriate and will result in adjustments to pilot compensation, other piloting costs, or both. Adjustments will only be recorded for identified misstatements, within a given group, exceeding 3% of planning materiality.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

The 'Total amount reported' column in the table below represents amounts provided by District 2 from their general ledger as of December 31, 2009. The breakdown of amounts by area was provided by District 2 for information purposes only and was not subject to the procedures above. Exceptions are shown in the "Adjustments" column below. Each adjustment references the finding number located in the Summary of Findings and Recommendations, which describes the reasoning for such adjustment.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

The following are the results of performing such procedures:

	District 2				Adjusted amount
	Area 4	Area 5	amount reported	Adjustments	
Pilotage Costs					
Compensation:					
Salaries (01), (02)	\$ 203,178	\$ 458,641	\$ 661,819	* \$ 810	\$ 662,629
Employee benefits	104,179	235,170	339,349	-	339,349
Dues and subscriptions (03)	-	-	-	11,015	11,015
Other Pilotage Costs:					
Pilot subsistence/Travel (02), (04)	67,580	101,371	168,951	(3,871)	165,080
License insurance	6,254	9,380	15,634	-	15,634
Payroll taxes	19,453	43,770	63,223	-	63,223
Other	12,697	28,662	41,359	-	41,359
Total Pilotage Costs	413,342	876,993	1,290,335	7,954	1,298,289
Pilot Boat and Dispatch Costs					
Pilot boat expense (12)	28,026	179,577	207,603	8,411	216,014
Dispatch expense	12,975	-	12,975	-	12,975
Payroll taxes	-	7,154	7,154	-	7,154
Total Pilot Boat and Dispatch Costs	41,001	186,731	227,732	8,411	236,143

* Includes \$25,000 of dividends that were not subject to the agreed-upon procedures in Section II

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

	District 2				Adjusted amount
	Area 4	Area 5	Total amount reported	Adjustments	
Administrative Expenses					
Legal (05)	30,052	45,079	75,131	(14,220)	60,911
Office rent	30,275	45,413	75,688	-	75,688
Insurance	10,408	15,611	26,019	-	26,019
Employee benefits (06)	26,483	39,725	66,208	3,405	69,613
Payroll taxes	3,821	5,731	9,552	-	9,552
Other taxes (07)	9,815	14,723	24,538	(688)	23,850
Depreciation/Auto leasing/Other (08)	27,383	41,075	68,458	6,938	75,396
Interest (09)	16,314	24,471	40,785	(30,028)	10,757
Dues and subscriptions (03)	4,450	6,675	11,125	(11,015)	110
Utilities	12,164	18,245	30,409	-	30,409
Salaries (01)	43,071	64,607	107,678	1,206	108,884
Accounting/Professional fees	9,400	14,100	23,500	-	23,500
Other (10), (11)	9,427	14,140	23,567	(2,410)	21,157
Total Administrative Expenses	233,064	349,594	582,658	(46,812)	535,846
Total Costs and Expenses	\$ 687,408	\$ 1,413,317	\$ 2,100,725	\$ (30,447)	\$ 2,070,278

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

III. VARIANCE ANALYSIS

Procedure:

Obtain a listing of the expenses incurred by District 2 for the years ended December 31, 2002 through 2009 and perform the following:

1. Segregate accounts into groups based on account description.
2. Compute average of the accounts and groups from 2002 to 2009.
3. Compute difference between the actual balance for each year and the average for each account and group.
4. Compute percentage change between the actual balance for each year and the average for each account and group.
5. Identify accounts and groups with differences between actual and average in excess of 1/3 of tolerable misstatement (materiality calculation will be based on the total of all expense accounts) and accounts and groups with percentage changes between actual and average in excess of 10%. Review remaining account and group analytics and judgmentally determine if any should be selected for additional review.
6. Identify other ratios to perform based on review of account and group analysis. The following ratios will be performed:
 - A. Compute pilot compensation as a percentage of revenue;
 - B. Compute pilot boat expense as a percentage of revenue;
 - C. Compute federal income tax as a percentage of income;
 - D. Compute medical insurance per pilot;
 - E. Compute travel expense per pilot.
7. Obtain explanation and supporting documentation from pilot association personnel, if deemed necessary, to support identified variances and determine if reasonable.
8. Conclude if any instances were identified that led us to believe 2009 expenses were overstated for ratemaking purposes.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

No exceptions were noted as a result of performing such procedures.

IV. COMPARISON OF PILOT ASSOCIATION ACTIVITIES

Procedure:

Obtain a listing of the expenses incurred by St. Lawrence Seaway Pilots' Association (District 1), District 2 and Western Great Lakes Pilots Association, LLP (District 3) for the year ended December 31, 2009 and perform the following:

1. Segregate accounts for each District into three categories: a) Pilotage Costs (Compensation, including pilot distributions and dividends, and Other Pilotage Costs), b) Pilot Boat and Dispatch Costs, and c) Administrative Costs.
2. For each district, compare 2009 expenses and the percentage of each expense, to total district revenue.
3. Perform an analysis of the significant cost categories incurred by the Districts and provide a summary of the composition of the following categories:
 - A. Pilot compensation and payroll taxes,
 - B. Travel expense/pilot subsistence,
 - C. Pilot boat and dispatch costs,
 - D. Cost associated with affiliated entities, and
 - E. Administrative expenses,
 - i. Legal, accounting and professional fees,
 - ii. Office rent, and
 - iii. Depreciation/auto leasing/other.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

The following are the results of performing such procedures:

	District 1		District 2		District 3		Total	
	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue
Total Revenue	\$ 2,274,009		\$ 2,091,330		\$ 3,040,158		\$ 7,405,497	
Pilotage Costs								
Compensation:								
Salaries	\$ 1,332,741	58.61%	\$ 662,629	31.68%	\$ 854,147	28.10%	\$ 2,849,517	38.48%
Employee benefits	61,417	2.70%	339,349	16.23%	378,701	12.46%	779,467	10.53%
Dues and subscriptions	24,395	1.07%	11,015	0.53%	34,049	1.12%	69,459	0.94%
Other Pilotage Costs:								
Pilot subsistence/travel	287,953	12.66%	165,080	7.89%	312,180	10.27%	765,213	10.33%
License insurance	47,380	2.08%	15,634	0.75%	23,095	0.76%	86,109	1.16%
Payroll taxes	86,712	3.81%	63,223	3.02%	62,973	2.07%	212,908	2.87%
Other	785	0.03%	41,359	1.98%	1,809	0.06%	43,953	0.59%
Total Pilotage Costs	1,841,383	80.96%	1,298,289	62.07%	1,666,954	54.82%	4,806,626	64.90%
Pilot Boat and Dispatching Costs								
Pilot boat costs	184,118	8.10%	216,014	10.33%	340,679	11.21%	740,811	10.00%
Dispatching costs	-	0.00%	12,975	0.62%	93,881	3.09%	106,856	1.44%
Payroll taxes	-	0.00%	7,154	0.34%	12,765	0.42%	19,919	0.27%
Total Pilot Boat and Dispatch Costs	184,118	8.10%	236,143	11.28%	447,325	14.71%	867,586	11.72%

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

	District 1		District 2		District 3		Total	
	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue
Administrative Expenses								
Legal	18,653	0.82%	60,911	2.91%	32,783	1.08%	112,347	1.52%
Office rent	-	0.00%	75,688	3.62%	9,900	0.33%	85,588	1.16%
Insurance	-	0.00%	26,019	1.24%	14,694	0.48%	40,713	0.55%
Employee benefits	-	0.00%	69,613	3.33%	107,617	3.54%	177,230	2.39%
Payroll taxes	-	0.00%	9,552	0.46%	10,424	0.34%	19,976	0.27%
Other taxes	-	0.00%	23,850	1.14%	26,633	0.88%	50,483	0.68%
Depreciation/Auto leasing/Other	16,200	0.71%	75,396	3.61%	37,982	1.25%	129,578	1.75%
Interest	-	0.00%	10,757	0.51%	5,278	0.17%	16,035	0.22%
Dues and subscriptions	-	0.00%	110	0.01%	-	0.00%	110	0.00%
Bad debt expense	-	0.00%	-	0.00%	-	0.00%	-	0.00%
Utilities	823	0.04%	30,409	1.45%	33,149	1.09%	64,381	0.87%
Salaries	-	0.00%	108,884	5.21%	76,660	2.52%	185,544	2.51%
Accounting/Professional fees	4,000	0.18%	23,500	1.12%	18,751	0.62%	46,251	0.62%
Bookkeeping fees	143,852	6.33%	-	0.00%	-	0.00%	143,852	1.94%
Other	1,130	0.05%	21,157	1.01%	13,808	0.45%	36,096	0.49%
Total Administrative Expenses	184,658	8.13%	535,846	25.61%	387,679	12.75%	1,108,183	14.96%
Total Costs and Expenses	\$ 2,210,159	97.19%	\$ 2,070,278	98.98%	\$ 2,501,958	82.30%	\$ 6,782,395	91.59%

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Pilot Compensation and Payroll Taxes

- District 1: Pilots were compensated through capital drawings based on available funds. Therefore, pilot salary expenses are not recorded. All capital drawings were included in the sampling population and have been allocated to pilot compensation or other expenses as deemed appropriate. The pilots were responsible for paying payroll taxes within their personal tax filing. The district recorded a 'self-employment tax equivalent' in the Statement of Pilots' Capital, in its audited financial statements for the year ended December 31, 2009. This amount was computed by multiplying total capital drawings by the IRS standard self-employment tax rate of 15.3%, consisting of 12.4% for social security and 2.9% for Medicare, up to \$106,800. Compensation in excess of \$106,800 is subject to the 2.9% Medicare tax only. An adjustment was made to reclass the expected employer portion of the payroll taxes, using IRS standard tax rates of 6.2% for Social Security and 1.45% for Medicare.
- District 2: Pilots were compensated on a 'per available day' basis at either \$200 or \$150 per day. Pilots also received other special compensation payments as determined during the year. Payroll taxes were computed and recorded by the association based on IRS guidelines.
- District 3: Pilots were compensated on a 'per available day' basis at either \$250 or \$175 per day. Applicant pilots were paid at a rate of 80% or 90% of the standard pilot rate. The pilots also receive distributions. These distributions were not included in pilot compensation, for the purposes of this report except for the recalculation of payroll taxes. The pilots were responsible for paying payroll taxes within their personal tax filing. Therefore, payroll taxes on pilot compensation were not recorded by the Association. An adjustment was made to reclass the expected employer portion of the payroll taxes, using IRS standard tax rates of 6.2% for Social Security and 1.45% for Medicare.

Travel Expense/Pilot Subsistence

- District 1: All travel expenses incurred, such as fuel or taxi charges, are generally reimbursed at actual costs and require a receipt to be submitted. Mileage was computed using standard rates and per diem is calculated at \$52 per day based on submitted expense reports.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- District 2: All travel expenses incurred, such as hotel or taxi charges, were generally reimbursed at actual costs and require a receipt to be submitted. Per diem reimbursements were calculated at a rate of \$52 per day based on approximately 200 days per year which is considered the length of time of the normal operating season of the pilots starting in April and ending in December.
- District 3: Pilots were provided a per diem of \$52 'per available working day', or non-rest days. In addition, pilots were provided a hotel allowance of either \$100 or \$70 for each night's stay as documented on their expense report. Also, pilots were provided an allowance for transportation costs, such as taxi charges, for travel days as documented on their expense reports. The allowance was based on typical transportation costs incurred in each respective port area. Mileage was computed using standard rates. All other travel expenses incurred, such as fuel or tolls, were generally reimbursed at actual costs and require a receipt to be submitted.

Pilot Boat and Dispatch Costs

- District 1: This District paid an affiliated entity to manage the overall operations of the pilot boats, including payment of pilot boat operators. District 1 did not incur dispatch charges, as dispatching was provided by the Canadian Great Lakes Pilotage Authority in exchange for pilot boat services.
- District 2: This District owns pilot boats and incurred costs to operate these boats, such as salaries, fuel and maintenance. This District provided pilot boat services to its own pilots, as well pilots from District 3 and Canada. Total expenses incurred were reduced by the revenue incurred from these services. This District also incurred dispatch expenses.
- District 3: This District received pilot boat services from several entities at its various ports, including District 2. This District employed dispatchers to handle its dispatch needs.

Costs Associated with Affiliated Entities

- District 1: This District entered into transactions with affiliated entities for services associated with pilot boat operations, bookkeeping and administration services, and equipment rental in the amounts of \$184,118, \$143,852 and \$16,200, respectively, during the year ended December 31, 2009 for a total of \$344,170. Per discussion with District 1 personnel, payments are not made

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

pursuant to contractual arrangements. Rather, charges are based on the operating expenses of the affiliated entities and can fluctuate from year-to-year. The affiliated entities incurred operating expenses of \$344,478 per their audited financial statements as of December 31, 2009.

District 2: This District leased property from an affiliated entity at a monthly rate of \$5,474, or \$65,688 annually. Per discussions with District 2 personnel, this amount was based on operating expenses of the affiliated entity. Specifically, lease payments were based on principal and interest incurred by the affiliated entity associated with the purchase of land used by the District. The affiliated entity incurred operating expenses of \$987 and principal and interest payments totaling \$59,717 per its audited financial statements as of December 31, 2009.

District 3: This District did not enter into transactions with or make payments to affiliated entities.

Administrative Expense

Legal, Accounting and Professional Fees:

District 1: This District incurred legal expenses in the normal course of business and in conjunction with the other districts, with a shared attorney used for common issues affecting the pilot associations and the ratemaking process. The District also incurred accounting fees for preparation of audited financial statements and tax returns.

District 2: This District incurred legal expenses in the normal course of business and in conjunction with the other districts, with a shared attorney used for common issues affecting the pilot associations and the ratemaking process. In addition, this District incurred legal costs associated with an unresolved matter being investigated by the U. S. Coast Guard. The District also incurred accounting fees for preparation of audited financial statements and tax returns.

District 3: This District incurred legal expenses in the normal course of business and in conjunction with the other districts, with a shared attorney used for common issues affecting the pilot associations and the ratemaking process. The District also incurred accounting fees for preparation of audited financial statements and tax returns.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Office Rent:

- District 1: This District did not incur office rent expense. It operated in a building owned by an affiliated entity and such operating expenses were incorporated in other fees paid to the affiliated entity.
- District 2: This District leased office space from an unrelated party on a month-to-month basis until it commenced occupancy of a building owned by an affiliated entity on December 1, 2009. This district leased property from an affiliated entity at a monthly rate of \$5,474, or \$65,688 annually.
- District 3: This District leased office space from an unrelated party on a month-to-month basis at an amount equal to \$9,900 annually.

Depreciation/Auto Leasing/Other:

- District 1: This District does not incur depreciation expense. Such expenses were incorporated in other fees paid to the affiliated entity. The association leases computer equipment from an affiliated entity.
- District 2: This District incurred depreciation on pilot boats, a housing location at one port, and various pieces of equipment. The district also entered into automobile lease agreements.
- District 3: This District incurred depreciation on equipment and vehicles. The expense for navigation equipment purchased during 2009 is included in this administrative account.

V. RECOMMENDED GENERAL LEDGER ACCOUNTS

Procedure:

Recommend a list of general ledger accounts for use by each Association.

Results:

As a result of performing the aforementioned agreed-upon procedures, we have recommended the account groupings listed in Procedures I and III, for each pilot association, understanding that more detailed subaccounts would be necessary to accurately classify expenses incurred.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

VI. BANK STATEMENT AND RECONCILIATION COMPARISON

Procedure:

Obtain bank statements and bank reconciliations for all cash accounts as of December 31, 2009 and perform the following:

1. Verify the bank statement agrees to the bank reconciliation with differences below 3% of planning materiality based on unadjusted total expenses;
2. Verify the bank reconciliation agrees to the trial balance with differences below 3% of planning materiality based on adjusted total expenses; and
3. Conclude if any instances were identified that would suggest that cash is not properly reconciled and recorded.

Results:

No exceptions were noted as a result of performing such procedures.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

The following findings detail adjustments necessary for ratemaking purposes, as identified in section II of the previous report.

Finding Number: D2-09-01

Finding Title: Pilot Compensation

Condition:

The Association misclassified non-pilot payroll expenses as pilot compensation.

Criteria:

N/A

Effect:

Operating expenses are understated and pilot compensation is overstated.

Cause:

This was caused by an error while recording payroll expense.

Recommendation:

Expenses recorded should be reviewed for proper classification.

Finding Number: D2-09-02

Finding Title: Pilot Compensation

Condition:

The Association incurred travel costs for an event held by the International Longshoreman's Association.

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Effect:

Pilot compensation is understated and expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D2-09-03

Finding Title: Dues and Subscriptions

Condition:

The Association incurred costs for dues and subscriptions that were classified as operating expenses.

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

Effect:

Pilot compensation is understated and expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Finding Number: D2-09-04

Finding Title: Travel Expenses

Condition:

The Association incurred costs for travel expenses that did not relate to 2009. The Association incurred excess per diem charges.

Criteria:

Procedures performed are for expenses incurred during the year ended December 31, 2009 only. Federal Register, Vol. 70, No. 46, section 12806 dated March 10, 2005 states that "Using Federal Travel Regulations' established allowances for Transportation workers daily meals and expenses in CFR part 301-11, the per diem allowance was recalculated allowing per diem for each pilot for 200 travel days, which included days engaged in pilotage, travel between assignments, and down time at remote locations awaiting dispatch."

Effect:

Operating expenses are overstated.

Cause:

Expenses incurred in 2008 were received and paid during 2009. Per diem charges were incurred in excess of 200 days per pilot.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D2-09-05

Finding Title: Legal Expenses

Condition:

The Association incurred legal costs that were associated with lobbying expenses and costs that did not relate to 2009.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Criteria:

Regulation 46 CFR 404.5(a)(8)(ii) states that lobbying expenses are not recognized as reasonable for ratemaking purposes. Procedures performed are for expenses incurred during the year ended December 31, 2009 only.

Effect:

Operating expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes. Expenses incurred in 2008 were received and paid during 2009.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D2-09-06

Finding Title: Employee benefits

Condition:

The Association did not properly record employee health insurance costs incurred during 2009.

Criteria:

Procedures performed are for expenses incurred during the year ended December 31, 2009 only.

Effect:

Operating expenses are understated.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Cause:

The Association recorded health insurance expenses for the period February 2009 through January 2010. January 2010 health insurance expenses were lower than January 2009 health insurance expenses.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U. S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D2-09-07

Finding Title: Other Taxes

Condition:

The Association incurred costs for other taxes that did not relate to 2009.

Criteria:

Procedures performed are for expenses incurred during the year ended December 31, 2009 only.

Effect:

Operating expenses are overstated.

Cause:

Expenses incurred in 2008 were received and paid during 2009.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Finding Number: D2-09-08

Finding Title: Depreciation/Auto Leasing

Condition:

The Association did not properly capitalize automobile leases.

Criteria:

Certain leases qualify as capital leased under generally accepted accounting principles (GAAP) and therefore should be capitalized and depreciated.

Effect:

Operating expenses are understated.

Cause:

Automobile leases were not properly capitalized. Expenses were recorded based on lease payments instead of depreciation.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D2-09-09

Finding Title: Interest Expense

Condition:

The Association incurred costs for interest expense for stock redemption notes payable to the pilots.

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Effect:

Operating expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D2-09-10

Finding Title: Other Expenses

Condition:

The Association incurred costs for advertising.

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

Effect:

Operating expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Finding Number: D2-09-11

Finding Title: Other Expenses

Condition:

The Association incurred costs for other expenses that did not relate to 2009.

Criteria:

Procedures performed are for expenses incurred during the year ended December 31, 2009 only.

Effect:

Operating expenses are overstated.

Cause:

Expenses incurred in 2008 and 2010 were received and paid during 2009.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D2-09-12

Finding Title: Pilot Boat Expense

Condition:

The Association received a refund for costs incurred that did not relate to 2009.

Criteria:

Procedures performed are for expenses incurred during the year ended December 31, 2009 only.

Effect:

Operating expenses are understated.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Cause:

A refund for expenses incurred during 2008 was received in 2009.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES

**WESTERN GREAT LAKES PILOTS
ASSOCIATION, LLP
CONTRACT # GS-23F-0124M**

DECEMBER 31, 2009

Western Great Lakes Pilots Association, LLP

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INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES

United States Coast Guard
Great Lakes Pilotage Branch

We have performed the procedures enumerated in the accompanying Summary of Agreed-upon Procedures and Results, which was agreed to by the United States Coast Guard (USCG), solely to assist you in evaluating certain aspects of the expenses incurred by the Western Great Lakes Pilots Association, LLP ("District 3" or the "Association") for the year ended December 31, 2009. The United States Coast Guard is responsible for evaluating such expenses incurred. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are included in the accompanying Summary of Agreed-upon Procedures and Results and Summary of Findings and Recommendations, respectively.

We were not engaged to, and did not; conduct an audit, the objective of which would be the expression of an opinion on the accounting records. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the United States Coast Guard and the Western Great Lakes Pilots Association, LLP, and is not intended to be and should not be used by anyone other than those specified parties.



Bethesda, Maryland
January 21, 2011

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS

I. OVERVIEW

The Great Lakes Pilotage Branch is responsible for oversight of the Western Great Lakes Pilots Association, LLP, as well as two other pilot associations, which provide piloting services in the Great Lakes region. Included in this oversight function is the responsibility to set pilotage rates, which encompass pilot compensation, other piloting costs, and other measures. The procedures listed below are designed to assist the Great Lakes Pilotage Branch in determining those rates.

II. EVALUATION OF REPORTED EXPENSES

Procedure:

Obtain a listing of the expenses incurred by District 3 during the year ended December 31, 2009 and perform the following:

1. Segregate each expense class/account into groups of 1) specific or 2) general, and determine the method of testing to be utilized in order to achieve, at a minimum, a 95% confidence level.
2. Groups to be tested using sampling procedures:
 - A. Calculate planning materiality and tolerable misstatement (75% of planning materiality) based on each group balance using industry guidelines.
 - B. Select all individually significant items in each group for testing. Items above 1/3 tolerable misstatement are considered significant.
 - C. Using an industry standard sampling form, determine remaining sample size to be selected from each group.
3. Groups to be tested using procedures other than sampling procedures:
 - A. Office rent - Superior expense: Recalculate the expenses based on the terms of the executed lease agreement.
4. For each transaction selected for testing, obtain invoices or other supporting documentation and determine if amounts are a) appropriately included in the rate calculation; b) included in pilot compensation or; c) excluded from these categories, using the following information:

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- A. Title 46: Shipping, Part 404-Great Lakes Pilotage Ratemaking, Section 5 Guidelines for the recognition of expenses;
 - B. Federal Register final and interim rulings, including:
 - i. NPRM - USCG-2002-11288-0001
 - ii. 1st IR- USCG-2002-11288-0156
 - iii. 2nd IR - USCG-2002-11288-0187
 - iv. Final Rule - USCG-2002-11288-0233;
 - C. Previously issued Independent Accountants' Reports on Applying Agreed-upon Procedures; and
 - D. Discussions with the Director of the United States Coast Guard, Great Lakes Pilotage Branch.
5. Evaluate the results of our test work performed and identify exceptions, if any. Exceptions will be extrapolated to groups, accounts, or by using other measures as deemed appropriate and will result in adjustments to pilot compensation, other piloting costs, or both. Adjustments will only be recorded for identified misstatements, within a given group, exceeding 3% of planning materiality.

Results:

The "Total amount reported" column in the table below represents amounts provided by District 3 from their general ledger as of December 31, 2009. The breakdown of amounts by area was provided by District 3 for information purposes only and was not subject to the procedures above. Exceptions are shown in the 'Adjustments' column below. Each adjustment references the finding number located in the Summary of Findings and Recommendations, which describes the reasoning for such adjustment.

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

The following are the results of performing such procedures:

	District 3					Adjusted amount
	Area 6	Area 7	Area 8	amount reported	Adjustments	
Pilotage Costs						
Compensation:						
Salaries (01), (05)	\$ 451,172	\$ 236,422	\$ 297,498	\$ 985,092	* \$ (130,945)	\$ 854,147
Employee benefits (02)	172,065	90,165	113,458	375,688	3,013	378,701
Dues and subscriptions (03)	-	-	-	-	34,049	34,049
Other Pilotage Costs:						
Pilot subsistence/Travel (04)	144,081	75,501	95,005	314,587	(2,407)	312,180
License insurance	10,577	5,543	6,975	23,095	-	23,095
Payroll taxes (05)	-	-	-	-	62,973	62,973
Other (06)	1,025	537	675	2,237	(428)	1,809
Total Pilotage Costs	778,920	408,168	513,611	1,700,699	(33,745)	1,666,954
Pilot Boat and Dispatch Costs						
Pilot boat costs	156,031	81,763	102,885	340,679	-	340,679
Dispatch costs (01)	46,365	24,296	30,572	101,233	(7,352)	93,881
Payroll taxes	5,846	3,064	3,855	12,765	-	12,765
Total Pilot Boat and Dispatch Costs	208,242	109,123	137,312	454,677	(7,352)	447,325

* Includes \$195,369 of 2009 distributions that were not subject to the agreed-upon procedures in Section II

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

	District 3					Adjusted amount
	Area 6	Area 7	Area 8	amount reported	Adjustments	
Administrative Expenses				Total		
Legal (07)	16,462	8,626	10,855	35,942	(3,159)	32,783
Office rent	4,534	2,376	2,990	9,900	-	9,900
Insurance	6,730	3,527	4,438	14,694	-	14,694
Employee benefits (02)	50,668	26,551	33,410	110,630	(3,013)	107,617
Payroll taxes	4,774	2,502	3,148	10,424	-	10,424
Other taxes (08)	11,599	6,078	7,648	25,326	1,307	26,633
Depreciation/Auto leasing	17,396	9,116	11,471	37,982	-	37,982
Interest	2,417	1,267	1,594	5,278	-	5,278
Dues and subscriptions (03)	15,594	8,172	10,283	34,049	(34,049)	-
Utilities	15,182	7,956	10,011	33,149	-	33,149
Salaries	35,110	18,398	23,151	76,660	-	76,660
Accounting/Professional fees	8,588	4,500	5,663	18,751	-	18,751
Other (09)	6,852	3,591	4,518	14,961	(1,153)	13,808
Total Administrative Expenses	195,906	102,660	129,180	427,746	(40,067)	387,679
Total Costs and Expenses	\$ 1,183,068	\$ 619,951	\$ 780,103	\$ 2,583,122	\$ (81,164)	\$ 2,501,958

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

III. VARIANCE ANALYSIS

Procedure:

Obtain a listing of the expenses incurred by District 3 for the years ended December 31, 2002 through 2009 and perform the following:

1. Segregate accounts into groups based on account description.
2. Compute average of the accounts and groups from 2002 to 2009.
3. Compute difference between the actual balance for each year and the average for each account and group.
4. Compute percentage change between the actual balance for each year and the average for each account and group.
5. Identify accounts and groups with differences between actual and average in excess of 1/3 of tolerable misstatement (materiality calculation will be based on the total of all expense accounts) and accounts and groups with percentage changes between actual and average in excess of 10%. Review remaining account and group analytics and judgmentally determine if any should be selected for additional review.
6. Identify other ratios to perform based on review of account and group analysis. The following ratios will be performed:
 - A. Compute pilot compensation as a percentage of revenue;
 - B. Compute pilot boat expense as a percentage of revenue;
 - C. Compute other payroll taxes as a percentage of other salaries;
 - D. Compute pilot payroll taxes as a percentage of pilot compensation;
 - E. Compute license insurance per pilot;
 - F. Compute medical insurance per pilot;
 - G. Compute travel expense per pilot;
 - H. Compute motel expense per pilot;

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- I. Compute motel expense per assignment;
 - J. Compute telephone expense per pilot;
 - K. Compute average pilot compensation per pilot; and
 - L. Compute average pilot compensation per pilot assignment.
7. Obtain explanation and supporting documentation from pilot association personnel, if deemed necessary, to support identified variances and determine if reasonable.
8. Conclude if any instances were identified that led us to believe 2009 expenses were overstated for ratemaking purposes.

Results:

No exceptions were noted as a result of performing such procedures.

IV. COMPARISON OF PILOT ASSOCIATION ACTIVITIES

Procedure:

Obtain a listing of the expenses incurred by St. Lawrence Seaway Pilots' Association (District 1), Lakes Pilots Association, Inc. (District 2) and District 3 for the year ended December 31, 2009 and perform the following:

- 1. Segregate accounts for each District into three categories: a) Pilotage Costs (Compensation, which includes pilot distributions and dividends, and Other Pilotage Costs), b) Pilot Boat and Dispatch Costs, and c) Administrative Costs.
- 2. For each District, compare 2009 expenses and the percentage of each expense, to total district revenue.
- 3. Perform an analysis of the significant cost categories incurred by the Districts and provide a summary of the composition of the following categories:
 - A. Pilot compensation and payroll taxes,
 - B. Travel expense/pilot subsistence,
 - C. Pilot boat and dispatch costs,

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- D. Cost associated with affiliated entities, and
- E. Administrative expenses,
 - i. Legal, accounting and professional fees,
 - ii. Office rent, and
 - iii. Depreciation/auto leasing/other.

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

The following are the results of performing such procedures:

	District 1		District 2		District 3		Total	
	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue
Total Revenue	\$ 2,274,009		\$ 2,091,330		\$ 3,040,158		\$ 7,405,497	
Pilotage Costs								
Compensation:								
Salaries	\$ 1,332,741	58.61%	\$ 662,629	31.68%	\$ 854,147	28.10%	\$ 2,849,517	38.48%
Employee benefits	61,417	2.70%	339,349	16.23%	378,701	12.46%	779,467	10.53%
Dues and subscriptions	24,395	1.07%	11,015	0.53%	34,049	1.12%	69,459	0.94%
Other Pilotage Costs:								
Pilot subsistence/travel	287,953	12.66%	165,080	7.89%	312,180	10.27%	765,213	10.33%
License insurance	47,380	2.08%	15,634	0.75%	23,095	0.76%	86,109	1.16%
Payroll taxes	86,712	3.81%	63,223	3.02%	62,973	2.07%	212,908	2.87%
Other	785	0.03%	41,359	1.98%	1,809	0.06%	43,953	0.59%
Total Pilotage Costs	1,841,383	80.96%	1,298,289	62.07%	1,666,954	54.82%	4,806,626	64.90%
Pilot Boat and Dispatching Costs								
Pilot boat costs	184,118	8.10%	216,014	10.33%	340,679	11.21%	740,811	10.00%
Dispatching costs	-	0.00%	12,975	0.62%	93,881	3.09%	106,856	1.44%
Payroll taxes	-	0.00%	7,154	0.34%	12,765	0.42%	19,919	0.27%
Total Pilot Boat and Dispatch Costs	184,118	8.10%	236,143	11.28%	447,325	14.71%	867,586	11.72%

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

	District 1		District 2		District 3		Total	
	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue	Adjusted amount	% of district revenue
Administrative Expenses								
Legal	18,653	0.82%	60,911	2.91%	32,783	1.08%	112,347	1.52%
Office rent	-	0.00%	75,688	3.62%	9,900	0.33%	85,588	1.16%
Insurance	-	0.00%	26,019	1.24%	14,694	0.48%	40,713	0.55%
Employee benefits	-	0.00%	69,613	3.33%	107,617	3.54%	177,230	2.39%
Payroll taxes	-	0.00%	9,552	0.46%	10,424	0.34%	19,976	0.27%
Other taxes	-	0.00%	23,850	1.14%	26,633	0.88%	50,483	0.68%
Depreciation/Auto leasing/Other	16,200	0.71%	75,396	3.61%	37,982	1.25%	129,578	1.75%
Interest	-	0.00%	10,757	0.51%	5,278	0.17%	16,035	0.22%
Dues and subscriptions	-	0.00%	110	0.01%	-	0.00%	110	0.00%
Bad debt expense	-	0.00%	-	0.00%	-	0.00%	-	0.00%
Utilities	823	0.04%	30,409	1.45%	33,149	1.09%	64,381	0.87%
Salaries	-	0.00%	108,884	5.21%	76,660	2.52%	185,544	2.51%
Accounting/Professional fees	4,000	0.18%	23,500	1.12%	18,751	0.62%	46,251	0.62%
Bookkeeping fees	143,852	6.33%	-	0.00%	-	0.00%	143,852	1.94%
Other	1,130	0.05%	21,157	1.01%	13,808	0.45%	36,096	0.49%
Total Administrative Expenses	184,658	8.13%	535,846	25.61%	387,679	12.75%	1,108,183	14.96%
Total Costs and Expenses	\$ 2,210,159	97.19%	\$ 2,070,278	98.98%	\$ 2,501,958	82.30%	\$ 6,782,395	91.59%

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Pilot Compensation and Payroll Taxes

- District 1: Pilots were compensated through capital drawings based on available funds. Therefore, pilot salary expenses are not recorded. All capital drawings were included in the sampling population and have been allocated to pilot compensation or other expenses as deemed appropriate. The pilots were responsible for paying payroll taxes within their personal tax filing. The district recorded a 'self-employment tax equivalent' in the Statement of Pilots' Capital, in its audited financial statements for the year ended December 31, 2009. This amount was computed by multiplying total capital drawings by the IRS standard self-employment tax rate of 15.3%, consisting of 12.4% for social security and 2.9% for Medicare, up to \$106,800. Compensation in excess of \$106,800 is subject to the 2.9% Medicare tax only. An adjustment was made to reclass the expected employer portion of the payroll taxes, using IRS standard tax rates of 6.2% for Social Security and 1.45% for Medicare.
- District 2: Pilots were compensated on a 'per available day' basis at either \$200 or \$150 per day. Pilots also received other special compensation payments as determined during the year. Payroll taxes were computed and recorded by the association based on IRS guidelines.
- District 3: Pilots were compensated on a 'per available day' basis at either \$250 or \$175 per day. Applicant pilots were paid at a rate of 80% or 90% of the standard pilot rate. The pilots also receive distributions. These distributions were not included in pilot compensation, for the purposes of this report except for the recalculation of payroll taxes. The pilots were responsible for paying payroll taxes within their personal tax filing. Therefore, payroll taxes on pilot compensation were not recorded by the Association. An adjustment was made to reclass the expected employer portion of the payroll taxes, using IRS standard tax rates of 6.2% for Social Security and 1.45% for Medicare.

Travel Expense/Pilot Subsistence

- District 1: All travel expenses incurred, such as fuel or taxi charges, are generally reimbursed at actual costs and require a receipt to be submitted. Mileage was computed using standard rates and per diem is calculated at \$52 per day based on submitted expense reports.
- District 2: All travel expenses incurred, such as hotel or taxi charges, were generally reimbursed at actual costs and require a receipt to be submitted. Per diem

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

reimbursements were calculated at a rate of \$52 per day based on approximately 200 days per year which is considered the length of time of the normal operating season of the pilots starting in April and ending in December.

- District 3: Pilots were provided a per diem of \$52 'per available working day', or non-rest days. In addition, pilots were provided a hotel allowance of either \$100 or \$70 for each night's stay as documented on their expense report. Also, pilots were provided an allowance for transportation costs, such as taxi charges, for travel days as documented on their expense reports. The allowance was based on typical transportation costs incurred in each respective port area. Mileage was computed using standard rates. All other travel expenses incurred, such as fuel or tolls, were generally reimbursed at actual costs and require a receipt to be submitted.

Pilot Boat and Dispatch Costs

- District 1: This District paid an affiliated entity to manage the overall operations of the pilot boats, including payment of pilot boat operators. District 1 did not incur dispatch charges, as dispatching was provided by the Canadian Great Lakes Pilotage Authority in exchange for pilot boat services.
- District 2: This District owns pilot boats and incurred costs to operate these boats, such as salaries, fuel and maintenance. This District provided pilot boat services to its own pilots, as well pilots from District 3 and Canada. Total expenses incurred were reduced by the revenue incurred from these services. This District also incurred dispatch expenses.
- District 3: This District received pilot boat services from several entities at its various ports, including District 2. This District employed dispatchers to handle its dispatch needs.

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Costs Associated with Affiliated Entities

- District 1: This District entered into transactions with affiliated entities for services associated with pilot boat operations, bookkeeping and administration services, and equipment rental in the amounts of \$184,118, \$143,852 and \$16,200, respectively, during the year ended December 31, 2009 for a total of \$344,170. Per discussion with District 1 personnel, payments are not made pursuant to contractual arrangements. Rather, charges are based on the operating expenses of the affiliated entities and can fluctuate from year to year. The affiliated entities incurred operating expenses of \$344,478 per their audited financial statements as of December 31, 2009.
- District 2: This District leased property from an affiliated entity at a monthly rate of \$5,474, or \$65,688 annually. Per discussions with District 2 personnel, this amount was based on operating expenses of the affiliated entity. Specifically, lease payments were based on principal and interest incurred by the affiliated entity associated with the purchase of land used by the District. The affiliated entity incurred operating expenses of \$987 and principal and interest payments totaling \$59,717 per its audited financial statements as of December 31, 2009.
- District 3: This District did not enter into transactions with or make payments to affiliated entities.

Administrative Expense

Legal, Accounting and Professional Fees:

- District 1: This District incurred legal expenses in the normal course of business and in conjunction with the other districts, with a shared attorney used for common issues affecting the pilot associations and the ratemaking process. The District also incurred accounting fees for preparation of audited financial statements and tax returns.
- District 2: This District incurred legal expenses in the normal course of business and in conjunction with the other districts, with a shared attorney used for common issues affecting the pilot associations and the ratemaking process. In addition, this District incurred legal costs associated with an unresolved matter being investigated by the U. S. Coast Guard. The District also incurred accounting fees for preparation of audited financial statements and tax returns.

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

District 3: This District incurred legal expenses in the normal course of business and in conjunction with the other districts, with a shared attorney used for common issues affecting the pilot associations and the ratemaking process. The District also incurred accounting fees for preparation of audited financial statements and tax returns.

Office Rent:

District 1: This District did not incur office rent expense. It operated in a building owned by an affiliated entity and such operating expenses were incorporated in other fees paid to the affiliated entity.

District 2: This District leased office space from an unrelated party on a month-to-month basis until it commenced occupancy of a building owned by an affiliated entity on December 1, 2009. This district leased property from an affiliated entity at a monthly rate of \$5,474, or \$65,688 annually.

District 3: This District leased office space from an unrelated party on a month-to-month basis at an amount equal to \$9,900 annually.

Depreciation/Auto Leasing/Other

District 1: This District does not incur depreciation expense. Such expenses were incorporated in other fees paid to the affiliated entity. The Association leases computer equipment from an affiliated entity.

District 2: This District incurred depreciation on pilot boats, a housing location at one port, and various pieces of equipment. The District also entered into automobile lease agreements.

District 3: This District incurred depreciation on equipment and vehicles. The expense for navigation equipment purchased during 2009 is included in this administrative account.

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

V. RECOMMENDED GENERAL LEDGER ACCOUNTS

Procedure:

Recommend a list of general ledger accounts for use by each Association.

Results:

As a result of performing the aforementioned agreed-upon procedures, we recommend the Districts incorporate the account groupings listed in Procedures I and III into the financial data provided to the Great Lakes Pilotage Branch for analysis, understanding that more detailed subaccounts would be necessary to accurately classify expenses incurred.

VI. BANK STATEMENT AND RECONCILIATION COMPARISON

Procedure:

Obtain bank statements and bank reconciliations for all cash accounts as of December 31, 2009 and perform the following:

1. Verify the bank statement agrees to the bank reconciliation with differences below 3% of planning materiality based on unadjusted total expenses;
2. Verify the bank reconciliation agrees to the trial balance with differences below 3% of planning materiality based on adjusted total expenses; and
3. Conclude if any instances were identified that would suggest that cash is not properly reconciled and recorded.

Results:

No exceptions were noted as a result of performing such procedures.

Western Great Lakes Pilots Association, LLP

SUMMARY OF FINDINGS AND RECOMMENDATIONS

The following findings detail adjustments necessary for ratemaking purposes, as identified in section II of the previous report.

Finding Number: D3-09-01

Finding Title: Winter Navigation Salaries

Condition:

The Association incurred revenue and expenses for winter navigation piloting and dispatching services performed on a contract basis and are not part of the normal pilot shipping season.

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

Effect:

Pilot compensation and dispatching expenses are overstated.

Cause:

The Association's audited financial statements and trial balance do not exclude revenue and expenses associated with winter navigation piloting and dispatching, as these are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D3-09-02

Finding Title: Medical Expense - Pilots

Condition:

The Association incurred medical expenses on behalf of applicant pilots.

Western Great Lakes Pilots Association, LLP

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Criteria:

Regulation 46 CFR 404.5(a)(6) states medical, pension, and other benefits paid to pilots, or for the benefit of pilots, by the Association are treated as pilot compensation.

Effect:

Pilot compensation is understated and expenses are overstated.

Cause:

The Association classifies the costs incurred as a medical expense instead of an employee benefit.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D3-09-03

Finding Title: Dues and Subscriptions

Condition:

The Association incurred costs for dues and subscriptions that were classified as operating expenses.

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

Effect:

Pilot compensation is understated and expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Western Great Lakes Pilots Association, LLP

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D3-09-04

Finding Title: Travel Expenses

Condition:

The Association incurred costs for travel expenses that did not relate to 2009. The Association did not have appropriate documentation to support some travel expenses or travel expenses were miscalculated using the wrong rate or number of days.

Criteria:

Procedures performed are for expenses incurred during the year ended December 31, 2009 only. Regulation 46 CFR 404.5(a)(8)(i) states that undocumented expenses are not recognized as reasonable for ratemaking purposes.

Effect:

Operating expenses are overstated.

Cause:

Expenses incurred in 2008 were received and paid during 2009. Pilots did not properly attach receipts for with their expense reimbursement forms or expenses were calculated with an incorrect rate or number of days.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards. Receipts for travel expenses incurred should be provided with expense reimbursement forms and these forms should be reviewed for accuracy.

Western Great Lakes Pilots Association, LLP

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Finding Number: D3-09-05

Finding Title: Payroll Taxes - Pilots

Condition:

The Association did not incur payroll taxes for pilot compensation as the pilots are responsible for these on their individual tax returns.

Criteria:

Federal Register, Vol. 70, No. 46, section 12091 dated March 10, 2005 allows for estimated Social Security and Medicare taxes to be recorded on behalf of the Association when these taxes are incurred by the pilots on their individual tax returns.

Effect:

Operating expenses are understated.

Cause:

The pilots of the Association are self-employed, therefore they incur these payroll costs on their individual tax returns.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D3-09-06

Finding Title: Drug Program Expense

Condition:

The Association incurred drug program expenses that did not relate to 2009.

Criteria:

Procedures performed are for expenses incurred during the year ended December 31, 2009 only.

Western Great Lakes Pilots Association, LLP

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Effect:

Operating expenses are overstated.

Cause:

Expenses incurred in 2008 were received and paid during 2009.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D3-09-07

Finding Title: Legal Expenses

Condition:

The Association incurred legal costs that were associated with lobbying expenses and costs that did not relate to 2009.

Criteria:

Regulation 46 CFR 404.5(a)(8)(ii) states that lobbying expenses are not recognized as reasonable for ratemaking purposes. Procedures performed are for expenses incurred during the year ended December 31, 2009 only.

Effect:

Operating expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes. Expenses incurred in 2008 were received and paid during 2009.

Western Great Lakes Pilots Association, LLP

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.

Finding Number: D3-09-08

Finding Title: Other Taxes

Condition:

The Association did not accrue all taxes incurred for its 2009 Michigan Business Tax annual return.

Criteria:

N/A.

Effect:

Operating expenses are understated.

Cause:

Actual taxes incurred are often not determined until after year end and therefore were not included in the financial data provided.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards, as well as incorporate expenses which had not been accrued.

Finding Number: D3-09-09

Finding Title: Other Expenses

Condition:

The Association incurred costs for logo clothing expenses and donations/memoriums.

Western Great Lakes Pilots Association, LLP

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Criteria:

Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes.

Effect:

Operating expenses are overstated.

Cause:

The classifications of expenses in the Association's audited financial statements and trial balance are not tailored for ratemaking submission purposes.

Recommendation:

Expenses submitted for ratemaking should be in a standard format approved by the U.S. Coast Guard, detailing adjustments necessary to comply with ratemaking standards.