

INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES

**ST. LAWRENCE SEAWAY PILOTS' ASSOCIATION
CONTRACT # GS-23F-0124M**

DECEMBER 31, 2011

St. Lawrence Seaway Pilots' Association

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INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES

United States Coast Guard
Great Lakes Pilotage Division

We have performed the procedures enumerated in the accompanying Summary of Agreed-upon Procedures and Results, which were 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 and Seaway Pilot Inc. (collectively known as "District 1" or the "Association") for the year ended December 31, 2011, as explained in Section I of the report. 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 in the accompanying 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
November 30, 2012

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS

I. OVERVIEW

The Great Lakes Pilotage Division 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 based on operating expenses. The procedures listed below are designed to assist the Great Lakes Pilotage Division in determining which expenses meet the eligibility requirements to be included in such rates. Procedures are performed on these expenses that were submitted by the pilot association and considered to be eligible for ratemaking purposes.

II. EVALUATION OF REPORTED EXPENSES

Procedure:

Obtain a listing of the expenses incurred by District 1 for the year ended December 31, 2011 and perform the following procedures:

1. For each transaction selected for testing, determine if amounts are a) necessary and reasonable for the provision of pilotage service; b) to be 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
 - 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 Division.
2. Segregate each account into groups of 1) specific or 2) general classes, and determine the methods of testing to be utilized.
3. Identify accounts to be selected for sampling.
 - A. These accounts will include:
 - i. Travel expense
 - ii. Member expenses
 - iii. Repair and maintenance expenses
 - iv. Insurance expense
 - v. Other operating expenses

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- B. For accounts to be sampled, calculate planning materiality and tolerable misstatement (TM 75% of planning materiality) based on total submitted expenses and pilot compensation using industry guidelines.
 - i. Select all individually significant items in each group for testing. Items that are greater than 1/3 of TM are considered individually significant.
 - ii. Using an accounting industry standard sampling form and assessing risk at high, determine remaining sample size to be selected from each group.
 - iii. Obtain supporting documentation for each transaction selected for testing.

- 4. For accounts not selected for sampling, perform the following procedures:
 - A. Pilot compensation
 - i. Review schedule provided by the District for appropriate classification
 - ii. Agree pilot compensation to the audited financial statements of the District as of December 31, 2011

 - B. Depreciation expense
 - iii. Review schedule provided by the District for items that may not be eligible
 - iv. Select material fixed asset additions that are greater than 1/3 of TM
 - v. Recalculate depreciation expense for each fixed asset addition selected for testing

 - C. Payroll (other than pilot compensation) and related expenses
 - i. Review payroll schedule provided by the District for the items that may not be eligible
 - ii. Agree to annual payroll summary register or haphazardly select 3 employees and agree to employee W-2 or other supporting documentation
 - iii. Recalculate estimated tax calculation and verify appropriate rates are being used

 - D. Legal expense
 - i. Review all invoices from the attorney shared by the three Districts
 - ii. Review one invoice from every other attorney identified in the general ledger

 - E. Real estate taxes
 - i. Review tax bill for amount, location and tax period
 - ii. Recalculate tax expense based on taxable year

 - F. Utility expense
 - i. Review general ledger and verify there are no more than 12 monthly transactions during the year
 - ii. Review any transactions in excess of the 12 monthly expected transactions and determine if the expense is appropriate

 - G. Interest expense
 - i. Obtain loan agreement or other documents that provide loan terms, including interest rate

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- ii. Recalculate interest expense based on the principal and interest rate provided
- H. All other accounts not already tested
- i. Review general ledger activity and select any items that appear unusual
 - ii. Select all transactions over 1/3 TM and obtain supporting documentation
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 operating expenses. 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 following table represents amounts provided by District 1 from their general ledger for the year ended December 31, 2011. 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. The breakdown of adjustments by area was calculated using the same percentage allocation that was provided by District 1. 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 for the year ended December 31, 2011:

	District 1								
	Area 1	Area 2	Total amount reported	Area 1 adjustments	Area 2 adjustments	Total adjustments	Area 1 adjusted	Area 2 adjusted	Adjusted total amount reported
Pilot compensation									
Salaries (D1-11-01)	\$ 1,257,585	\$ 959,754	\$ 2,217,339	\$ (12,883)	\$ (8,864)	\$ (21,747)	\$ 1,244,702	\$ 950,890	\$ 2,195,592
Employee benefits	77,678	56,709	134,387	-	-	-	77,678	56,709	134,387
Dues and subscriptions	16,773	10,957	27,730	-	-	-	16,773	10,957	27,730
Total pilot compensation	\$ 1,352,036	\$ 1,027,420	\$ 2,379,456	\$ (12,883)	\$ (8,864)	\$ (21,747)	\$ 1,339,153	\$ 1,018,556	\$ 2,357,709
Operating expenses									
Other pilotage costs									
Pilot subsistence/Travel (D1-11-02)	\$ 234,724	\$ 156,246	\$ 390,970	\$ (2,492)	\$ (1,714)	\$ (4,206)	\$ 232,232	\$ 154,532	\$ 386,764
Payroll taxes (D1-11-01)	61,483	47,611	109,094	12,883	8,864	21,747	74,366	56,475	130,841
Other	837	588	1,425	-	-	-	837	588	1,425
Total other pilotage costs	297,044	204,445	501,489	10,391	7,150	17,541	307,435	211,595	519,030
Pilot boat and dispatch costs									
Pilot boat expense	111,772	76,904	188,676	-	-	-	111,772	76,904	188,676
Payroll taxes	8,611	5,925	14,536	-	-	-	8,611	5,925	14,536
Total pilot boat and dispatch costs	120,383	82,829	203,212	-	-	-	120,383	82,829	203,212

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

	District 1								
	Area 1	Area 2	Total amount reported	Area 1 adjustments	Area 2 adjustments	Total adjustments	Area 1 adjusted	Area 2 adjusted	Adjusted total amount reported
Administrative expenses									
Legal	10,592	6,922	17,514	-	-	-	10,592	6,922	17,514
Insurance	23,780	16,492	40,272	-	-	-	23,780	16,492	40,272
Employee benefits	21,282	14,645	35,927	-	-	-	21,282	14,645	35,927
Payroll taxes	5,032	3,463	8,495	-	-	-	5,032	3,463	8,495
Other taxes	5,042	3,470	8,512	-	-	-	5,042	3,470	8,512
Travel	756	520	1,276	-	-	-	756	520	1,276
Depreciation/Auto leasing/Other	38,252	26,319	64,571	-	-	-	38,252	26,319	64,571
Interest	18,484	12,718	31,202	-	-	-	18,484	12,718	31,202
Utilities	4,314	2,941	7,255	-	-	-	4,314	2,941	7,255
Salaries	50,718	34,897	85,615	-	-	-	50,718	34,897	85,615
Accounting/Professional fees	5,752	3,428	9,180	-	-	-	5,752	3,428	9,180
Pilot training	4,200	2,277	6,477	-	-	-	4,200	2,277	6,477
Other	9,959	6,880	16,839	-	-	-	9,959	6,880	16,839
Total administrative expenses	198,163	134,972	333,135	-	-	-	198,163	134,972	333,135
Total operating expenses	\$ 615,590	\$ 422,246	\$ 1,037,836	\$ 10,391	\$ 7,150	\$ 17,541	\$ 625,981	\$ 429,396	\$ 1,055,377
Total pilot compensation and operating expenses	\$ 1,967,626	\$ 1,449,666	\$ 3,417,292	\$ (2,492)	\$ (1,714)	\$ (4,206)	\$ 1,965,134	\$ 1,447,952	\$ 3,413,086

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, 2007 through December 31, 2011 and perform the following procedures:

1. Segregate accounts into groups based on account description.
2. Compute average of the accounts and groups from 2007 to 2011.
3. Compute difference between the actual balance for each year and the average for each account and group.
4. Compute percentage difference between the actual balance for each year and the average for each account and group.
5. Using the results of procedure number 3 above, identify differences that are greater than 1/3 of TM. Using the results of procedure number 4 above, identify differences that are greater than 10%. Review remaining account and group analytics and judgmentally determine if any should be selected for additional review.
6. Review the account and group analysis and perform the following procedures:
 - A. Compute pilot compensation as a percentage of revenue;
 - B. Compute pilot boat expense as a percentage of revenue;
 - C. Compute health insurance per pilot; and
 - D. Compute travel expense per pilot; and
 - E. Compute training 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 2011 expenses were overstated for ratemaking purposes.

Results:

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

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

IV. INVESTMENT BASE CALCULATION

Procedure:

Prepare the Investment Base Calculation using information obtained from the audited financial statements of St. Lawrence Seaway Pilots' Association and Seaway Pilot Inc., for the year ended December 31, 2011:

	Area 1	Area 2	District 1
Recognized assets			
Total current assets	\$ 669,895	\$ 460,921	\$ 1,130,816
Total current liabilities	54,169	37,271	91,440
Current notes payable	24,746	17,026	41,772
Total property and equipment (NET)	369,024	253,907	622,931
Land	13,054	8,981	22,035
Total other assets	-	-	-
	<u>996,442</u>	<u>685,601</u>	<u>1,682,044</u>
Non-recognized assets			
Total investments and special funds	6,243	4,295	10,538
	<u>6,243</u>	<u>4,295</u>	<u>10,538</u>
Total assets			
Total recognized assets	996,442	685,601	1,682,044
Total non-recognized assets	6,243	4,295	10,538
	<u>\$ 1,002,685</u>	<u>\$ 689,896</u>	<u>\$ 1,692,582</u>
Recognized sources of funds			
Total stockholders' equity	\$ 647,677	\$ 445,633	\$ 1,093,310
Long-term debt	318,571	219,193	537,764
Current notes payable	24,746	17,026	41,772
Advances from affiliated companies	-	-	-
Long-term obligations - capital leases	-	-	-
	<u>990,994</u>	<u>681,852</u>	<u>1,672,846</u>
Non-recognized sources of funds			
Pension liability	-	-	-
Other non-current liabilities	-	-	-
Deferred federal income taxes	-	-	-
Other deferred credits	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>
Total sources of funds			
Total recognized sources	990,994	681,852	1,672,846
Total non-recognized sources	-	-	-
	<u>\$ 990,994</u>	<u>\$ 681,852</u>	<u>\$ 1,672,846</u>

Results:

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

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

V. COMPARISON OF PILOT ASSOCIATION ACTIVITIES

Procedure:

Obtain a listing of the expenses incurred by St. Lawrence Seaway Pilots' Association and Seaway Pilot Inc. (collectively known as District 1), Lakes Pilots Association, Inc. (District 2) and Western Great Lakes Pilots Association, LLP (District 3) for the year ended December 31, 2011 and perform the following procedures:

1. Segregate accounts for each District into four categories: a) Pilot Compensation, b) Other Pilotage Cost, c) Pilot Boat and Dispatch Cost and d) Administrative Expenses.
2. For each district, compare 2011 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 for the year ended December 31, 2011:

	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	\$ 3,441,265		\$ 2,845,535		\$ 3,818,957		\$ 10,105,757	
Pilot compensation	\$ 2,195,592	63.80%	\$ 1,159,483	40.75%	\$ 2,679,661	70.17%	\$ 6,034,736	59.72%
Salaries	134,387	3.91%	357,147	12.55%	409,376	10.72%	900,910	8.91%
Employee benefits	27,730	0.81%	24,800	0.87%	33,780	0.88%	86,310	0.85%
Dues and subscriptions								
Total pilot compensation	\$ 2,357,709	68.51%	\$ 1,541,430	54.17%	\$ 3,122,817	81.77%	\$ 7,021,956	69.48%
Operating expenses								
Other pilotage costs								
Pilot subsistence/Travel	\$ 386,764	11.24%	\$ 191,630	6.73%	\$ 363,943	9.53%	\$ 942,338	9.32%
License insurance	-	0.00%	15,420	0.54%	18,810	0.49%	34,230	0.34%
Payroll taxes	130,841	3.80%	91,689	3.22%	159,720	4.18%	382,250	3.78%
Other	1,425	0.04%	57,485	2.02%	4,045	0.11%	62,955	0.62%
Total other pilotage costs	519,030	15.06%	356,224	12.51%	546,518	14.30%	1,421,772	14.06%
Pilot boat and dispatching costs								
Pilot boat costs	188,676	5.48%	262,387	9.22%	450,142	11.79%	901,204	8.92%
Dispatching costs	-	0.00%	15,150	0.53%	161,221	4.22%	176,371	1.75%
Employee benefits	-	0.00%	100,798	3.54%	-	0.00%	100,798	1.00%
Payroll taxes	14,536	0.42%	17,838	0.63%	17,791	0.47%	50,165	0.50%
Total pilot boat and dispatch costs	203,212	5.91%	396,173	13.91%	629,154	16.47%	1,228,539	12.16%

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
Total revenue	\$ 3,441,265		\$ 2,845,535		\$ 3,818,957		\$ 10,105,757	
Administrative expenses								
Legal	17,514	0.51%	93,801	3.30%	22,477	0.59%	133,792	1.32%
Office rent	-	0.00%	65,688	2.31%	9,900	0.26%	75,588	0.75%
Insurance	40,272	1.17%	26,681	0.94%	13,798	0.36%	80,751	0.80%
Employee benefits	35,927	1.04%	40,850	1.44%	135,611	3.55%	212,388	2.10%
Payroll taxes	8,495	0.25%	11,114	0.39%	11,396	0.30%	31,005	0.31%
Other taxes	8,512	0.25%	35,682	1.25%	32,825	0.86%	77,019	0.76%
Travel	1,276	0.04%	-	0.00%	-	0.00%	1,276	0.01%
Depreciation/Auto leasing/Other	64,571	1.88%	39,011	1.37%	49,322	1.29%	152,903	1.51%
Interest	31,202	0.91%	6,931	0.24%	4,966	0.13%	43,098	0.43%
Utilities	7,255	0.21%	38,525	1.35%	36,524	0.96%	82,304	0.81%
Salaries	85,615	2.49%	99,684	3.50%	103,281	2.70%	288,580	2.86%
Accounting/Professional fees	9,180	0.27%	30,274	1.06%	24,850	0.65%	64,304	0.64%
Pilot training	6,477	0.19%	-	0.00%	955	0.03%	7,432	0.07%
Other	16,839	0.49%	22,151	0.78%	8,859	0.23%	47,849	0.47%
Total administrative expenses	333,135	9.69%	510,392	17.93%	454,764	11.91%	1,298,291	12.85%
Total operating expenses	\$ 1,055,377	30.67%	\$ 1,262,789	44.37%	\$ 1,630,436	42.69%	\$ 3,948,602	39.07%
Total pilot compensation and operating expenses	\$ 3,413,086	99.18%	\$ 2,804,219	98.55%	\$ 4,753,253	124.46%	\$ 10,970,558	108.56%

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 draws based on available funds. Therefore, pilot salary expenses are not recorded. All capital drawings 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, 2011. This amount was computed by multiplying total capital drawings by the IRS standard self-employment tax rate of 13.3%, consisting of 10.4% 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 reclassify 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 70%, 80% or 90% of the standard pilot rate. The pilots also receive distributions, which are included in pilot compensation for the purposes of this report. 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 reclassify the expected employer portion of the payroll taxes, using IRS standard tax rates of 6.2% for Social Security and 1.45% for Medicare.

Pilot Subsistence/Travel

- 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 \$59 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 reimbursements were calculated at a rate of \$59 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

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

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 owns pilot boats and incurred costs to operate these boats, such as salaries, fuel and maintenance. 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: Seaway Pilot Inc. is an affiliate of St. Lawrence Seaway Pilots' Association and provides services such as pilot boat operations, bookkeeping and administration services, and equipment rental. Expenses incurred by St. Lawrence Seaway Pilots' Association related to these services were eliminated for these agreed-upon procedures.

District 2: This District leased property from an affiliated entity at a monthly rate of \$5,474, or \$65,688 annually. In addition to the required monthly lease payments, the lease agreement requires payments of utilities, maintenance and property taxes.

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

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

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. 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.

Office Rent:

District 1: This District did not incur office rent expense. It operated in a building owned by Seaway Pilot Inc.

District 2: 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 incurred depreciation on an office building, pilot boats and various pieces of equipment.

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.

VI. RECOMMENDED GENERAL LEDGER ACCOUNTS

Procedure:

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

St. Lawrence Seaway Pilots' Association

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

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 Division for analysis, understanding that more detailed subaccounts would be necessary to accurately classify expenses incurred.

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: D1-11-01

Finding Title: Payroll Taxes - Pilots

Condition:

The Association did not record sufficient 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.

Finding Number: D1-11-02

Finding Title: Travel Expenses

Condition:

The Association did not have appropriate documentation to support certain travel expenses and incurred costs for travel expenses that did not relate to 2011. Revenue was received for

St. Lawrence Seaway Pilots' Association

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

certain taxi expenses, therefore these specific charges are not considered necessary for ratemaking purposes.

Criteria:

The scope of this report is that only 2011 expenses are allowable for ratemaking purposes. Regulation 46 CFR 404.5(a)(8)(i) states that undocumented expenses are not recognized as reasonable for ratemaking purpose. Regulation 46 CFR 404.5(a)(8)(v) states that expenses not directly related to pilotage are not recognized as reasonable for ratemaking purposes. Supporting documentation for certain expenses was not retained.

Effect:

Operating expenses are overstated.

Cause:

The Association did not maintain documentation for certain expenses. In addition, expenses incurred in 2010 were recorded and paid in 2011. Also, the Association received reimbursements for certain taxi expenses that should reduce travel expenses for purposes of this report.

Recommendation:

The Association should maintain proper documentation to substantiate travel expenses. Additionally, 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, 2011

Lakes Pilots Association, Inc.

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INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES

United States Coast Guard
Great Lakes Pilotage Division

We have performed the procedures enumerated in the accompanying Summary of Agreed-upon Procedures and Results, which were 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, 2011, as explained in Section I of the report. 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 in the accompanying 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
November 30, 2012

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS

I. OVERVIEW

The Great Lakes Pilotage Division 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 based on operating expenses. The procedures listed below are designed to assist the Great Lakes Pilotage Division in determining which expenses meet the eligibility requirements to be included in such rates. Procedures are performed on these expenses that were submitted by the pilot association and considered to be eligible for ratemaking purposes.

II. EVALUATION OF REPORTED EXPENSES

Procedure:

Obtain a listing of the expenses submitted by District 2 for the year ended December 31, 2011 and perform the following procedures:

1. For each transaction selected for testing, determine if amounts are a) necessary and reasonable for the provision of pilotage service; b) to be 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
 - 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 Division.
2. Segregate each account into groups of 1) specific or 2) general classes, and determine the methods of testing to be utilized.
3. Identify accounts to be selected for sampling.
 - A. These accounts will include:
 - i. Travel expense
 - ii. Pilot boat and dispatch cost/repair and maintenance expenses
 - iii. Insurance expense

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- iv. Other operating expenses
- B. For accounts to be sampled, calculate planning materiality and tolerable misstatement (TM or 75% of planning materiality) based on total submitted expenses and pilot compensation using industry guidelines.
 - i. Select all individually significant items in each group for testing. Items that are greater than 1/3 of TM are considered individually significant.
 - ii. Using an accounting industry standard sampling form and assessing risk at high, determine remaining sample size to be selected from each group.
 - iii. Obtain supporting documentation for each transaction selected for testing.
- 4. For accounts not selected for sampling, perform the following procedures:
 - A. Pilot compensation
 - i. Review schedule provided by the District for appropriate classification
 - ii. Agree pilot compensation to the audited financial statements of the District as of December 31, 2011
 - B. Depreciation expense
 - i. Review schedule provided by the District for items that may not be eligible
 - ii. Select material fixed asset additions that are greater than 1/3 of TM
 - iii. Recalculate depreciation expense for each fixed asset addition selected for testing
 - C. Payroll (other than pilot compensation) and related expenses
 - i. Review payroll schedule provided by the District for the items that may not be eligible
 - ii. Agree to annual payroll summary register or select three employees and agree to employee W-2
 - iii. Recalculate estimated tax calculation and verify appropriate rates are being used
 - D. Legal expense
 - i. Review all invoices from the attorney shared by the three Districts
 - ii. Review one invoice from every other attorney identified in the general ledger
 - E. Real estate taxes
 - i. Review tax bill for amount, location and tax period
 - ii. Recalculate tax expense based on taxable year
 - F. Pilot subsistence
 - i. Determine that per diem does not exceed 200 days per pilot

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- ii. Where per diem support can be obtained, haphazardly select 5 per diem transactions and agree to supporting expense reimbursement detail
- G. Utility expense
 - i. Review general ledger and verify there are no more than 12 monthly transactions during the year
 - ii. Review any transactions in excess of the 12 monthly expected transactions and determine if the expense is appropriate
- H. Rent expense
 - i. Obtain signed lease agreement and recalculate the expense based on the terms of the lease
 - ii. For lease agreements with affiliated entities, CFR Part 404.5 (3) will 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, 2011, or 3.83%
- I. Interest expense
 - i. Obtain loan agreement or other documents that provide loan terms, including interest rate
 - ii. Recalculate interest expense based on the principal and interest rate provided
- J. All other accounts not already tested
 - i. Review general ledger activity and select any items that appear unusual
 - ii. Select all transactions over 1/3 TM and obtain supporting documentation
- 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 operating expenses. 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 following table represents amounts provided by District 2 from their general ledger for the year ended December 31, 2011. 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. The breakdown of adjustments by area was calculated using the same percentage allocation that was provided by District 2. 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 for the year ended December 31, 2011:

	District 2								
	Area 4	Area 5	Total amount reported	Area 4 adjustments	Area 5 adjustments	Total adjustments	Area 4 adjusted	Area 5 adjusted	Adjusted total amount reported
Pilot compensation	\$ 463,793	\$ 695,690	\$ 1,159,483	\$ -	\$ -	\$ -	\$ 463,793	\$ 695,690	\$ 1,159,483
Salaries	142,859	214,288	357,147	-	-	-	142,859	214,288	357,147
Employee benefits	9,920	14,880	24,800	-	-	-	9,920	14,880	24,800
Dues and subscriptions									
Total pilot compensation	\$ 616,572	\$ 924,858	\$ 1,541,430	\$ -	\$ -	\$ -	\$ 616,572	\$ 924,858	\$ 1,541,430
Operating expenses									
Other pilotage costs									
Pilot subsistence/Travel (D2-11-01)	\$ 79,250	\$ 118,874	\$ 198,124	\$ (2,598)	\$ (3,896)	\$ (6,494)	\$ 76,652	\$ 114,978	\$ 191,630
License insurance	6,168	9,252	15,420	-	-	-	6,168	9,252	15,420
Payroll taxes	36,676	55,013	91,689	-	-	-	36,676	55,013	91,689
Other (D2-11-02)	23,560	35,341	58,901	(566)	(850)	(1,416)	22,994	34,491	57,485
Total other pilotage costs	145,654	218,480	364,134	(3,164)	(4,746)	(7,910)	142,490	213,734	356,224
Pilot boat and dispatch costs									
Pilot boat expense	104,955	157,432	262,387	-	-	-	104,955	157,432	262,387
Dispatch expense	6,060	9,090	15,150	-	-	-	6,060	9,090	15,150
Employee benefits (D2-11-02)	40,419	60,628	101,047	(100)	(150)	(249)	40,319	60,479	100,798
Payroll taxes	7,135	10,703	17,838	-	-	-	7,135	10,703	17,838
Total pilot boat and dispatch costs	158,569	237,853	396,422	(100)	(150)	(249)	158,469	237,704	396,173

* 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								
	Area 4	Area 5	Total amount reported	Area 4 adjustments	Area 5 adjustments	Total adjustments	Area 4 adjusted	Area 5 adjusted	Adjusted total amount reported
Administrative expenses									
Legal	37,520	56,281	93,801	-	-	-	37,520	56,281	93,801
Office rent	26,275	39,413	65,688	-	-	-	26,275	39,413	65,688
Insurance	10,672	16,009	26,681	-	-	-	10,672	16,009	26,681
Employee benefits (D2-11-02)	16,365	24,548	40,913	(25)	(38)	(63)	16,340	24,510	40,850
Payroll taxes	4,446	6,668	11,114	-	-	-	4,446	6,668	11,114
Other taxes	14,273	21,409	35,682	-	-	-	14,273	21,409	35,682
Depreciation/Auto leasing/Other	15,604	23,407	39,011	-	-	-	15,604	23,407	39,011
Interest	2,772	4,159	6,931	-	-	-	2,772	4,159	6,931
Utilities	15,410	23,115	38,525	-	-	-	15,410	23,115	38,525
Salaries	39,874	59,810	99,684	-	-	-	39,874	59,810	99,684
Accounting/Professional fees	12,110	18,164	30,274	-	-	-	12,110	18,164	30,274
Pilot training	-	-	-	-	-	-	-	-	-
Other	8,860	13,291	22,151	-	-	-	8,860	13,291	22,151
Total administrative expenses	204,182	306,273	510,455	(25)	(38)	(63)	204,157	306,235	510,392
Total operating expenses	\$ 508,404	\$ 762,607	\$ 1,271,011	\$ (3,289)	\$ (4,933)	\$ (8,222)	\$ 505,116	\$ 757,673	\$ 1,262,789
Total pilot compensation and operating expenses	\$ 1,124,976	\$ 1,687,465	\$ 2,812,441	\$ (3,289)	\$ (4,933)	\$ (8,222)	\$ 1,121,688	\$ 1,682,531	\$ 2,804,219

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, 2007 through December 31, 2011 and perform the following procedures:

1. Segregate accounts into groups based on account description.
2. Compute average of the accounts and groups from 2007 to 2011.
3. Compute difference between the actual balance for each year and the average for each account and group.
4. Compute percentage difference between the actual balance for each year and the average for each account and group.
5. Using the results of procedure number 3 above, identify differences that are greater than 1/3 of TM. Using the results of procedure number 4 above, identify differences that are greater than 10%. Review remaining account and group analytics and judgmentally determine if any should be selected for additional review.
6. Review the account and group analysis and perform the following procedures:
 - A. Compute pilot compensation as a percentage of revenue;
 - B. Compute pilot boat expense as a percentage of revenue;
 - C. Compute health insurance per pilot;
 - D. Compute travel expense per pilot; and
 - E. Compute training 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 2011 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.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

IV. INVESTMENT BASE CALCULATION

Procedure:

Prepare the Investment Base Calculation using information obtained from the audited financial statements of Lakes Pilots Association, Inc. for the year ended December 31, 2011:

	Area 4	Area 5	District 2
Recognized assets			
Total current assets	\$ 454,465	\$ 681,697	\$ 1,136,162
Total current liabilities	409,366	614,048	1,023,414
Current notes payable	25,822	38,734	64,556
Total property and equipment (NET)	420,422	630,632	1,051,054
Land	-	-	-
Total other assets	60,195	90,293	150,488
Total recognized assets	<u>551,538</u>	<u>827,308</u>	<u>1,378,846</u>
Non-recognized assets			
Total investments and special funds	-	-	-
Total non-recognized assets	<u>-</u>	<u>-</u>	<u>-</u>
Total assets			
Total recognized assets	551,538	827,308	1,378,846
Total non-recognized assets	-	-	-
Total assets	<u>\$ 551,538</u>	<u>\$ 827,308</u>	<u>\$ 1,378,846</u>
Recognized sources of funds			
Total stockholders' equity	\$ 89,537	\$ 134,305	\$ 223,842
Long-term debt	410,357	615,535	1,025,892
Current notes payable	25,822	38,734	64,556
Advances from affiliated companies	-	-	-
Long-term obligations - capital leases	-	-	-
Total recognized sources	<u>525,716</u>	<u>788,574</u>	<u>1,314,290</u>
Non-recognized sources of funds			
Pension liability	-	-	-
Other non-current liabilities	-	-	-
Deferred federal income taxes	-	-	-
Other deferred credits	-	-	-
Total non-recognized sources	<u>-</u>	<u>-</u>	<u>-</u>
Total sources of funds			
Total recognized sources	525,716	788,574	1,314,290
Total non-recognized sources	-	-	-
Total sources of funds	<u>\$ 525,716</u>	<u>\$ 788,574</u>	<u>\$ 1,314,290</u>

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

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

V. COMPARISON OF PILOT ASSOCIATION ACTIVITIES

Procedure:

Obtain a listing of the expenses incurred by St. Lawrence Seaway Pilots' Association and Seaway Pilot Inc. (collectively known as District 1), District 2 and Western Great Lakes Pilots Association, LLP (District 3) for the year ended December 31, 2011 and perform the following procedures:

1. Segregate accounts for each District into four categories: a) Pilot Compensation, b) Other Pilotage Cost, c) Pilot Boat and Dispatch Cost and d) Administrative Expenses.
2. For each district, compare 2011 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

	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	\$ 3,441,265		\$ 2,845,535		\$ 3,818,957		\$ 10,105,757	
Administrative expenses								
Legal	17,514	0.51%	93,801	3.30%	22,477	0.59%	133,792	1.32%
Office rent	-	0.00%	65,688	2.31%	9,900	0.26%	75,588	0.75%
Insurance	40,272	1.17%	26,681	0.94%	13,798	0.36%	80,751	0.80%
Employee benefits	35,927	1.04%	40,850	1.44%	135,611	3.55%	212,388	2.10%
Payroll taxes	8,495	0.25%	11,114	0.39%	11,396	0.30%	31,005	0.31%
Other taxes	8,512	0.25%	35,682	1.25%	32,825	0.86%	77,019	0.76%
Travel	1,276	0.04%	-	0.00%	-	0.00%	1,276	0.01%
Depreciation/Auto leasing/Other	64,571	1.88%	39,011	1.37%	49,322	1.29%	152,903	1.51%
Interest	31,202	0.91%	6,931	0.24%	4,966	0.13%	43,098	0.43%
Utilities	7,255	0.21%	38,525	1.35%	36,524	0.96%	82,304	0.81%
Salaries	85,615	2.49%	99,684	3.50%	103,281	2.70%	288,580	2.86%
Accounting/Professional fees	9,180	0.27%	30,274	1.06%	24,850	0.65%	64,304	0.64%
Pilot training	6,477	0.19%	-	0.00%	955	0.03%	7,432	0.07%
Other	16,839	0.49%	22,151	0.78%	8,859	0.23%	47,849	0.47%
Total administrative expenses	333,135	9.69%	510,392	17.93%	454,764	11.91%	1,298,291	12.85%
Total operating expenses	\$ 1,055,377	30.67%	\$ 1,262,789	44.37%	\$ 1,630,436	42.69%	\$ 3,948,602	39.07%
Total pilot compensation and operating expenses	\$ 3,413,086	99.18%	\$ 2,804,219	98.55%	\$ 4,753,253	124.46%	\$ 10,970,558	108.56%

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Pilot Compensation and Payroll Taxes

- District 1: Pilots were compensated through capital draws based on available funds. Therefore, pilot salary expenses are not recorded. All capital drawings 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, 2011. This amount was computed by multiplying total capital drawings by the IRS standard self-employment tax rate of 13.3%, consisting of 10.4% 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 reclassify 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 70%, 80% or 90% of the standard pilot rate. The pilots also receive distributions, which are included in pilot compensation for the purposes of this report. 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 reclassify the expected employer portion of the payroll taxes, using IRS standard tax rates of 6.2% for Social Security and 1.45% for Medicare.

Pilot Subsistence/Travel

- 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 \$59 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 reimbursements were calculated at a rate of \$59 per day based on approximately

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

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 \$100 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 owns pilot boats and incurred costs to operate these boats, such as salaries, fuel and maintenance. 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: Seaway Pilot Inc. is an affiliate of St. Lawrence Seaway Pilots' Association and provides services such as pilot boat operations, bookkeeping and administration services, and equipment rental. Expenses incurred by St. Lawrence Seaway Pilots' Association related to these services were eliminated for these agreed-upon procedures.

District 2: This District leased property from an affiliated entity at a monthly rate of \$5,474, or \$65,688 annually. In addition to the required monthly lease payments, the lease agreement requires payments of utilities, maintenance and property taxes.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

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. 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.

Office Rent:

District 1: This District did not incur office rent expense. It operated in a building owned by Seaway Pilot Inc.

District 2: 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 incurred depreciation on an office building, pilot boats and various pieces of equipment.

Lakes Pilots Association, Inc.

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

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.

VI. 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 FINDINGS AND RECOMMENDATIONS

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

Finding Number: D2-11-01

Finding Title: Pilot Subsistence/Travel

Condition:

The Association recorded and paid for cost in 2011 that were incurred in 2010.

Criteria:

The scope of this report is that only 2011 expenses are allowable for ratemaking purposes.

Effect:

Operating expenses are overstated.

Cause:

Expenses incurred in 2010 were recorded and paid during 2011.

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: D2-11-02

Finding Title: Workers compensation

Condition:

The Association did not have appropriate documentation to support certain workers compensation expenses.

Criteria:

Regulation 46 CFR 404.5(a)(8)(i) states that undocumented expenses are not recognized as reasonable for ratemaking purpose.

Lakes Pilots Association, Inc.

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Effect:

Operating expenses are overstated.

Cause:

The Association did not maintain documentation for certain expenses.

Recommendation:

The Association should maintain proper documentation to substantiate workers compensation expenses.

INDEPENDENT ACCOUNTANTS' REPORT ON
APPLYING AGREED-UPON PROCEDURES

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

DECEMBER 31, 2011

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 Division

We have performed the procedures enumerated in the accompanying Summary of Agreed-upon Procedures and Results, which were 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, 2011, as explained in Section I of the report. 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 in the accompanying 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.

Reznick Group, P.C.

Bethesda, Maryland
November 30, 2012

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS

I. OVERVIEW

The Great Lakes Pilotage Division 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 based on operating expenses. The procedures listed below are designed to assist the Great Lakes Pilotage Division in determining which expenses meet the eligibility requirements to be included in such rates. Procedures are performed on these expenses that were submitted by the pilot association and considered to be eligible for ratemaking purposes.

II. EVALUATION OF REPORTED EXPENSES

Procedure:

Obtain a listing of the expenses submitted by District 3 for the year ended December 31, 2011 and perform the following procedures:

1. For each transaction selected for testing, determine if amounts are a) necessary and reasonable for the provision of pilotage service; b) to be 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
 - 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 Division.
2. Segregate each account into groups of 1) specific or 2) general classes, and determine the methods of testing to be utilized.
3. Identify accounts to be selected for sampling.
 - A. These accounts will include:
 - i. Travel expense
 - ii. Pilot boat and dispatch cost/repair and maintenance expenses

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- iii. Insurance expense
 - iv. Other operating expenses
- B. For accounts to be sampled, calculate planning materiality and tolerable misstatement (TM or 75% of planning materiality) based on total submitted expenses and pilot compensation using industry guidelines.
- i. Select all individually significant items in each group for testing. Items that are greater than 1/3 of TM are considered individually significant.
 - ii. Using an accounting industry standard sampling form and assessing risk at high, determine remaining sample size to be selected from each group.
 - iii. Obtain supporting documentation for each transaction selected for testing.
4. For accounts not selected for sampling, perform the following procedures:
- A. Pilot compensation
 - 1. Review schedule provided by the District for appropriate classification
 - 2. Agree pilot compensation to the audited financial statements of the District as of December 31, 2011
 - B. Depreciation expense
 - i. Review schedule provided by the District for items that may not be eligible
 - ii. Select material fixed asset additions that are greater than 1/3 of TM
 - iii. Recalculate depreciation expense for each fixed asset addition selected for testing
 - C. Payroll (other than pilot compensation) and related expenses
 - i. Review payroll schedule provided by the District for the items that may not be eligible
 - ii. Agree to annual payroll summary register or haphazardly select three employees and agree to employee W-2
 - iii. Recalculate estimated tax calculation and verify appropriate rates are being used
 - D. Legal expense
 - i. Review all invoices from the attorney shared by the three Districts
 - ii. Review one invoice from every other attorney identified in the general ledger
 - E. Real estate taxes
 - i. Review tax bill for amount, location and tax period
 - ii. Recalculate tax expense based on taxable year

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

- F. Utility expense
 - i. Review general ledger and verify there are no more than 12 monthly transactions during the year
 - ii. Review any transactions in excess of the 12 monthly expected transactions and determine if the expense is appropriate
 - G. Rent expense
 - i. Obtain signed lease agreement and recalculate the expense based on the terms of the lease
 - H. Interest expense
 - i. Obtain loan statement and review for amount of interest expense incurred
 - I. All other accounts not already tested
 - i. Review general ledger activity and select any items that appear unusual
 - ii. Select all transactions over 1/3 TM and obtain supporting documentation
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 operating expenses. 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 following table represents amounts provided by District 3 from their general ledger for the year ended December 31, 2011. 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. The breakdown of adjustments by area was calculated using the same percentage allocation that was provided by District 3. 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 for the year ended December 31, 2011:

	District 3							
	Area 6	Area 7	Area 8	Total adjustments	Area 6 adjusted	Area 7 adjusted	Area 8 adjusted	Adjusted total amount reported
Pilot compensation								
Salaries (01)	\$ 1,469,463	\$ 544,245	\$ 707,519	\$ (10,807)	\$ 1,447,017	\$ 535,932	\$ 696,712	\$ 2,679,661
Employee benefits	221,063	81,875	106,438	-	221,063	81,875	106,438	409,376
Dues and subscriptions	18,241	6,756	8,783	-	18,241	6,756	8,783	33,780
Total pilot compensation	\$ 1,708,767	\$ 632,876	\$ 822,740	\$ (10,807)	\$ 1,686,321	\$ 624,563	\$ 811,933	\$ 3,122,817
Operating expenses								
Other pilotage costs								
Pilot subsistence/Travel	\$ 196,529	\$ 72,789	\$ 94,625	\$ -	\$ 196,529	\$ 72,789	\$ 94,625	\$ 363,943
License insurance	10,157	3,762	4,891	-	10,157	3,762	4,891	18,810
Payroll taxes (D3-11-01)	63,803	23,631	30,720	10,807	86,249	31,944	41,527	159,720
Other	2,184	809	1,052	-	2,184	809	1,052	4,045
Total other pilotage costs	272,673	100,991	131,288	10,807	295,119	109,304	142,095	546,518
Pilot boat and dispatch costs								
Pilot boat costs	243,077	90,028	117,037	-	243,077	90,028	117,037	450,142
Dispatch costs	87,059	32,244	41,917	-	87,059	32,244	41,917	161,221
Payroll taxes	9,607	3,558	4,626	-	9,607	3,558	4,626	17,791
Total pilot boat and dispatch costs	339,743	125,830	163,580	-	339,743	125,830	163,580	629,154
Administrative expenses								
Legal	12,138	4,495	5,844	-	12,138	4,495	5,844	22,477
Office rent	5,346	1,980	2,574	-	5,346	1,980	2,574	9,900
Insurance	7,451	2,760	3,587	-	7,451	2,760	3,587	13,798
Employee benefits	73,230	27,122	35,259	-	73,230	27,122	35,259	135,611
Payroll taxes	6,154	2,279	2,963	-	6,154	2,279	2,963	11,396
Other taxes (D3-11-02)	19,339	7,163	9,311	(777)	17,726	6,565	8,534	32,825
Depreciation/Auto leasing (D3-11-03)	34,341	12,719	16,534	(3,711)	26,634	9,865	12,823	49,322
Interest	2,682	993	1,291	-	2,682	993	1,291	4,966
Utilities	19,723	7,305	9,496	-	19,723	7,305	9,496	36,524
Salaries	55,772	20,656	26,853	-	55,772	20,656	26,853	103,281
Accounting/Professional fees	13,419	4,970	6,461	-	13,419	4,970	6,461	24,850
Pilot training	516	191	248	-	516	191	248	955
Other (D3-11-04)	5,394	1,998	2,597	-	5,394	1,998	2,597	9,989
Total administrative expenses	255,505	94,631	123,018	(4,782)	245,575	90,953	118,236	454,764
Total operating expenses	\$ 867,921	\$ 321,452	\$ 417,886	\$ 6,025	\$ 880,437	\$ 326,087	\$ 423,911	\$ 1,630,436
Total pilot compensation and operating expenses	\$ 2,576,688	\$ 954,328	\$ 1,240,626	\$ (4,782)	\$ 2,566,758	\$ 950,650	\$ 1,235,844	\$ 4,753,253

* Includes \$1,809,916 of 2011 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

III. VARIANCE ANALYSIS

Procedure:

Obtain a listing of the expenses incurred by District 3 for the years ended December 31, 2007 through December 31, 2011 and perform the following procedures:

1. Segregate accounts into groups based on account description.
2. Compute average of the accounts and groups from 2007 to 2011.
3. Compute difference between the actual balance for each year and the average for each account and group.
4. Compute percentage difference between the actual balance for each year and the average for each account and group.
5. Using the results of procedure number 3 above, identify differences that are greater than 1/3 of TM. Using the results of procedure number 4 above, identify differences that are greater than 10%. Review remaining account and group analytics and judgmentally determine if any should be selected for additional review.
6. Review the account and group analysis and perform the following procedures:
 - A. Compute pilot compensation as a percentage of revenue;
 - B. Compute pilot boat expense as a percentage of revenue;
 - C. Compute health insurance per pilot;
 - D. Compute travel expense per pilot; and
 - E. Compute training 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 2011 expenses were overstated for ratemaking purposes.

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

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

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

IV. INVESTMENT BASE CALCULATION

Procedure:

Prepare the Investment Base Calculation using information obtained from the audited financial statements of Western Great Lakes Pilots Association, LLP for the year ended December 31, 2011:

	Area 6	Area 7	Area 8	District 3
Recognized assets				
Total current assets	\$ 658,934	\$ 244,050	\$ 317,265	\$ 1,220,249
Total current liabilities	64,869	24,025	31,233	120,127
Current notes payable	3,869	1,433	1,863	7,165
Total property and equipment (NET)	21,905	8,113	10,547	40,564
Land	-	-	-	-
Total other assets	540	200	260	1,000
	<hr/>	<hr/>	<hr/>	<hr/>
Total recognized assets	620,379	229,771	298,702	1,148,851
Non-recognized assets				
Total investments and special funds	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
Total non-recognized assets	-	-	-	-
Total assets				
Total recognized assets	620,379	229,771	298,702	1,148,851
Total non-recognized assets	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
Total assets	<u>\$ 620,379</u>	<u>\$ 229,771</u>	<u>\$ 298,702</u>	<u>\$ 1,148,851</u>
Recognized sources of funds				
Total stockholders' equity	\$ 606,164	\$ 224,505	\$ 291,857	\$ 1,122,525
Long-term debt	6,478	2,399	3,119	11,996
Current notes payable	3,869	1,433	1,863	7,165
Advances from affiliated companies	-	-	-	-
Long-term obligations - capital leases	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
Total recognized sources	616,511	228,337	296,839	1,141,686
Non-recognized sources of funds				
Pension liability	-	-	-	-
Other non-current liabilities	-	-	-	-
Deferred federal income taxes	-	-	-	-
Other deferred credits	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
Total non-recognized sources	-	-	-	-
Total sources of funds				
Total recognized sources	616,511	228,337	296,839	1,141,686
Total non-recognized sources	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
Total sources of funds	<u>\$ 616,511</u>	<u>\$ 228,337</u>	<u>\$ 296,839</u>	<u>\$ 1,141,686</u>

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

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

V. COMPARISON OF PILOT ASSOCIATION ACTIVITIES

Procedure:

Obtain a listing of the expenses incurred by St. Lawrence Seaway Pilots' Association and Seaway Pilot Inc. (collectively known as District 1), Lakes Pilots Association, Inc. (District 2) and District 3 for the year ended December 31, 2011 and perform the following procedures:

1. Segregate accounts for each District into four categories: a) Pilotage Compensation (which includes pilot distributions and dividends), b) Other Pilotage Costs, c) Pilot Boat and Dispatch Costs, and d) Administrative Costs.
2. For each District, compare 2011 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.

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

Results:

The following are the results of performing such procedures for the year ended December 31, 2011:

	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	\$ 3,441,265		\$ 2,845,535		\$ 3,818,957		\$ 10,105,757	
Pilot compensation	\$ 2,195,592	63.80%	\$ 1,159,483	40.75%	\$ 2,679,661	70.17%	\$ 6,034,736	59.72%
Salaries	134,387	3.91%	357,147	12.55%	409,376	10.72%	900,910	8.91%
Employee benefits	27,730	0.81%	24,800	0.87%	33,780	0.88%	86,310	0.85%
Dues and subscriptions								
Total pilot compensation	\$ 2,357,709	68.51%	\$ 1,541,430	54.17%	\$ 3,122,817	81.77%	\$ 7,021,956	69.48%
Operating expenses								
Other pilotage costs								
Pilot subsistence/Travel	\$ 386,764	11.24%	\$ 191,630	6.73%	\$ 363,943	9.53%	\$ 942,338	9.32%
License insurance	-	0.00%	15,420	0.54%	18,810	0.49%	34,230	0.34%
Payroll taxes	130,841	3.80%	91,689	3.22%	159,720	4.18%	382,250	3.78%
Other	1,425	0.04%	57,485	2.02%	4,045	0.11%	62,955	0.62%
Total other pilotage costs	519,030	15.06%	356,224	12.51%	546,518	14.30%	1,421,772	14.06%
Pilot boat and dispatching costs								
Pilot boat costs	188,676	5.48%	262,387	9.22%	450,142	11.79%	901,204	8.92%
Dispatching costs	-	0.00%	15,150	0.53%	161,221	4.22%	176,371	1.75%
Employee benefits	-	0.00%	100,798	3.54%	-	0.00%	100,798	1.00%
Payroll taxes	14,536	0.42%	17,838	0.63%	17,791	0.47%	50,165	0.50%
Total pilot boat and dispatch costs	203,212	5.91%	396,173	13.91%	629,154	16.47%	1,228,539	12.16%

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	17,514	0.51%	93,801	3.30%	22,477	0.59%	133,792	1.32%
Office rent	-	0.00%	65,688	2.31%	9,900	0.26%	75,588	0.75%
Insurance	40,272	1.17%	26,681	0.94%	13,798	0.36%	80,751	0.80%
Employee benefits	35,927	1.04%	40,850	1.44%	135,611	3.55%	212,388	2.10%
Payroll taxes	8,495	0.25%	11,114	0.39%	11,396	0.30%	31,005	0.31%
Other taxes	8,512	0.25%	35,682	1.25%	32,825	0.86%	77,019	0.76%
Travel	1,276	0.04%	-	0.00%	-	0.00%	1,276	0.01%
Depreciation/Auto leasing/Other	64,571	1.88%	39,011	1.37%	49,322	1.29%	152,903	1.51%
Interest	31,202	0.91%	6,931	0.24%	4,966	0.13%	43,098	0.43%
Utilities	7,255	0.21%	38,525	1.35%	36,524	0.96%	82,304	0.81%
Salaries	85,615	2.49%	99,684	3.50%	103,281	2.70%	288,580	2.86%
Accounting/Professional fees	9,180	0.27%	30,274	1.06%	24,850	0.65%	64,304	0.64%
Pilot training	6,477	0.19%	-	0.00%	955	0.03%	7,432	0.07%
Other	16,839	0.49%	22,151	0.78%	8,859	0.23%	47,849	0.47%
Total administrative expenses	333,135	9.69%	510,392	17.93%	454,764	11.91%	1,298,291	12.85%
Total operating expenses	\$ 1,055,377	30.67%	\$ 1,262,789	44.37%	\$ 1,630,436	42.69%	\$ 3,948,602	39.07%
Total pilot compensation and operating expenses	\$ 3,413,086	99.18%	\$ 2,804,219	98.55%	\$ 4,753,253	124.46%	\$ 10,970,558	108.56%

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 draws based on available funds. Therefore, pilot salary expenses are not recorded. All capital drawings 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, 2011. This amount was computed by multiplying total capital drawings by the IRS standard self-employment tax rate of 13.3%, consisting of 10.4% 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 reclassify 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 70%, 80% or 90% of the standard pilot rate. The pilots also receive distributions, which are included in pilot compensation for the purposes of this report. 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 reclassify the expected employer portion of the payroll taxes, using IRS standard tax rates of 6.2% for Social Security and 1.45% for Medicare.

Pilot Subsistence/Travel

- 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 \$59 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 reimbursements were calculated at a rate of \$59 per day based on approximately

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

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 \$100 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 owns pilot boats and incurred costs to operate these boats, such as salaries, fuel and maintenance. 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: Seaway Pilot Inc. is an affiliate of St. Lawrence Seaway Pilots’ Association and provides services such as pilot boat operations, bookkeeping and administration services, and equipment rental. Expenses incurred by St. Lawrence Seaway Pilots’ Association related to these services were eliminated for these agreed-upon procedures.

District 2: This District leased property from an affiliated entity at a monthly rate of \$5,474, or \$65,688 annually. In addition to the required monthly lease payments, the lease agreement requires payments of utilities, maintenance and property taxes.

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

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. 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.

Office Rent:

District 1: This District did not incur office rent expense. It operated in a building owned by Seaway Pilot Inc.

District 2: 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 incurred depreciation on an office building, pilot boats and various pieces of equipment.

Western Great Lakes Pilots Association, LLP

SUMMARY OF AGREED-UPON PROCEDURES AND RESULTS - CONTINUED

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.

VI. 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 Division for analysis, understanding that more detailed subaccounts would be necessary to accurately classify expenses incurred.

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: D3-11-01

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.

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.

Western Great Lakes Pilots Association, LLP

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Finding Number: D3-11-02

Finding Title: Other taxes

Condition:

The Association recorded costs in 2011 that were incurred in 2010.

Criteria:

The scope of this report is that only 2011 expenses are allowable for ratemaking purposes.

Effect:

Operating expenses are overstated.

Cause:

Expenses incurred in 2010 were recorded during 2011.

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: D3-11-03

Finding Title: Depreciation/Auto leasing

Condition:

The Association recorded costs in 2011 that were incurred in 2010.

Criteria:

The scope of this report is that only 2011 expenses are allowable for ratemaking purposes.

Effect:

Operating expenses are overstated.

Western Great Lakes Pilots Association, LLP

SUMMARY OF FINDINGS AND RECOMMENDATIONS - CONTINUED

Cause:

Expenses incurred in 2010 were recorded during 2011.

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: D3-11-04

Finding Title: Other Expenses

Condition:

The Association recorded an adjustment to decrease revenue in an expense account.

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 may not be suitable 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.