

Summary of Testimony of Sean Carothers

Corporate Structure/Intercompany Billings

Facility Holding Corp. (FHC) owns directly or indirectly all of the issued and outstanding shares of seventeen (17) subsidiary corporations according to their audited Consolidated Financial Statements dated Feb. 29, 2004. One of the subsidiary corporations, Facility Construction Management, Inc., (FCMI) entered an agreement to provide certain program management services on the Miss. Beef Processors Facility.

The personnel provided by FCMI in performing the services required by their contract were not employees of FCMI but employees of another FHC subsidiary, Facility Management Group Inc. (FMG). The employees of FMG were paid by FMG, and FMG paid all benefits for those employees. FMG then, according to Consolidated Financial Statements of FHC and its subsidiaries, added "a mark-up attributable to intercompany profit" and billed FCMI for the use of the employees. FMG also provided employees to another FHC company, Facility Design Group, Inc.(FDGI) FDGI was employed by FCMI to provide FCMI with certain services required by the FCMI contract. FDGI also applied "a mark-up attributable to intercompany profit" and billed FCMI for the service it provided FCMI. Likewise, FMG purchased all insurance that FCMI had to furnish for the project. As revealed by analyzing FMG's actual cost of purchasing insurance, FMG also applied an intercompany profit to its cost of purchasing the insurance and billed FCMI for the same.

As explained in detail below, the result of these intercompany billings was additional profit for FHC and its subsidiaries, which was strictly prohibited by the services compensation



provisions of the project management agreement. This hidden profit was concealed in what the companies falsely claimed to be cost.

FCMI's Contract

FCMI entered into a Project Management Agreement on July 11, 2003 with Community Bank of Mississippi and the Mississippi Land Water and Timber Resources Board to provide certain services associated with the Beef Plant. FCMI was to complete the design and construction of the project as detailed in the contract. For providing the services as stated in the contract, FCMI was to be paid "a lump sum fee of three million, five hundred forty seven thousand, nine hundred seventy four dollars (3,547,974.00)".

In addition, FCMI was to be paid "at cost" not to exceed \$3,021,418.00 for "Services Compensation", provided that the "minimum Services Compensation shall be \$2,500,000.00, and further provided that if the Services Compensation equals an amount less than \$3,021,418.00, FCMI shall receive an additional amount equal to 50% of the difference between 3,021,418.00 and the total costs constituting the actual Services Compensation." The Services Compensation provision also stated (but not including general overhead and profit), thereby clearly prohibiting FCMI from marking up its costs to include a built in profit.

The Scheme

In summary, an examination of the accounting records of FHC and its subsidiaries clearly reveals that FCMI "double dipped" and obtained additional profit prohibited by its contract in two ways.

First, under paragraph 3.1.2 of the project management agreement, FCMI was only entitled to recover costs. However, through intercompany billings from FMG to FCMI, and

FDGI to FCMI, FCMI generated fictitious cost reports that were used to obtain payments on the contract that in fact did not represent their actual costs, as required by the contract. Rather, FCMI submitted bills that included their actual cost plus a hidden intercompany profit not allowed by the contract. These fraudulent representations resulted in FCMI obtaining approximately \$1,500,000.00 in additional profit that was concealed in what they were claiming was their costs.

Second, FCMI also included in its billings charges for general overhead on an allocated basis that were prohibited by the project management agreement. None of the records provided by FCMI show any basis whatsoever for determining how they came up with the amounts claimed to be costs. This fraudulent representation resulted in FCMI obtaining approximately \$190,000.00 in additional profit specifically not allowed in the contract. FCMI also attempted to obtain an additional approximately \$380,000.00 utilizing the same fraudulent representations. Their request for these monies was denied.

Determining FCMI's Actual Cost

The analysis of the various FHC companies' actual costs that should have been passed on to FCMI for billings on the contract as compared to what FCMI actually billed and collected is contained in exhibits mentioned in the folders containing my analysis and findings. The following is a narrative summary of the methodology used and records consulted in compiling that data. The summary is divided into the same categories as the analysis contained in the folder.

FCMI Labor Overbillings

All employees utilized on the project were employees of FMG, not FCMI. FMG billed

FCMI for these employees. Therefore to determine the actual cost of the employee the FMG payroll records were analyzed.

The number of hours worked by each employee and the names of these employees were provided by FCMI on many of the original billings. Any that were not provided at that time were provided by FCMI at a later date. The FMG individual employee payroll records (which did not display hourly rates) for each individual billed to the project were analyzed to determine what FMG actually paid the employee on an hourly basis. In addition, the indirect labor cost and social burdens were added to the base pay rate to determine the actual gross total employee cost to FMG. That amount was then divided by the number of hours worked by the employee on the beef plant to determine the actual hourly rate that each employee really cost FMG.

The actual hourly rate for each employee was then multiplied by the number of hours FCMI actually charged for the employees work on the Beef Plant. That total was subtracted from the actual amount billed by FCMI for each employee, for each period. The difference is the FCMI labor overbilling amount for each employee. The total labor overbilling amount for each pay period was then determined by totaling labor overbilling amount for each individual billed within each given pay period. These are the labor overbilling amounts indicated in the notebook.

Allocated Cost Overbilling

The allocated cost overbilling analyzes various costs that were either charged to FCMI by FMG including a mark-up for profit, charged to FCMI by FDGI including a mark-up for profit, or arbitrarily allocated cost that were charged to FCMI with no apparent basis whatsoever.

These were general overhead and specifically prohibited from being charged as a cost.

Insurance Overbilling

The insurance required for the project according to FHC's Consolidated Detail Income Statements was a cost incurred by FMG. It was then allocated or billed to FCMI. There were three (3) types of insurance purchased (excluding Workmans Compensation which was analyzed with labor). They include general liability, professional liability and an umbrella policy. They were analyzed as follows:

General Liability.

The cost of general liability insurance is directly related to labor cost. For each dollar of payroll a certain premium is charged based on the classification of the individual. Similar to the labor analysis, the payroll records of FMG were analyzed to determine the payroll dollars attributable to the project. The premium rate charged for each payroll dollar spent was determined by reviewing the audit of FHC's (which includes the FMG payroll) payroll records that was conducted and provided by the insurance provider CNA. The actual rate that CNA's audit indicated was then applied to the payroll cost of FMG for the personnel that worked on the project. This computation revealed what CNA actually charged for general liability insurance associated with the Beef Plant project.

Professional Liability

The professional liability policy was purchased as a blanket policy to cover all FHC companies and projects. However, the Professional Liability policy is for purposes of covering design errors and omissions and therefore, for practical purposes, attributable only to the service provided by FDGI to FCMI. Therefore, the analysis used to determine the actual cost of

professional liability insurance to the project was conducted only on the revenues of FDGI as explained below. It should also be noted that this limitation resulted in allowing a greater percentage of the premium cost for this policy to be attributed to the Beef Plant than would be the case in an overall revenue analysis.

The total cost of the policy was determined by reviewing the policy invoices from CNA. To determine how much of the total premium was attributable to the Beef Plant project, a percentage of FDGI total revenue for the Beef Plant project as a percent of the total revenue for FDGI was established for the period in which the Beef Plant was constructed. That percentage was then applied to the total premium dollars for the policies to determine the actual cost that should have been billed by FCMI on the project. All revenue numbers came from the audited financial statements of FHC.

Umbrella Policy

The umbrella policy, like the professional liability policy, is purchased as a blanket policy to cover all FHC Companies. However, unlike the professional liability policy, its limits and coverages from a practical stand point would apply to any and all covered losses that any FHC company might incur that exceed underlying policy limits. Therefore, the analysis used to determine actual cost of this insurance to the project was conducted taking into account all FHC revenues as explained below.

The total cost of the policy was determined by reviewing the policy invoices from CNA to determine how much of the total premium was attributable to the Beef Plant project, FCMI's total revenue billed for the Beef Plant project as a percentage of the total revenue recognized by FHC for the period which the Beef Plant was constructed was determined. That percentage was

then applied to the total premium dollars for the policies to determine the actual cost that should have been billed by FCMI on the project. All revenue numbers came from the Audited Financial Statements of FHC.

Conclusion on Insurance Overbilling

After determining the actual cost of each policy as explained above, the total actual cost attributable to the Beef Plant of all policies was compared to what FCMI fraudulently represented in its billings to represent cost and the difference was determined. FCMI's billings represented its cost to be approximately 1% of the guaranteed maximum price contained in its contract (app \$434,000) and they billed that amount to the project over a period of 10 months. This resulted in FCMI obtaining approximately \$400,000.00 in additional profit over and above the actual cost of their insurance.

Design - FDGI Overbillings

The design services that were a part of FCMI's contractual responsibility were actually performed by employees of FMG who charged FDGI an hourly rate for those employees that contained an additional mark-up for profit that was not allowed in the FCMI contract. FDGI then, through intercompany billings charged FCMI a lump sum amount of approximately \$580,000 for those services.

To determine the actual cost of these services the payroll records of FMG were analyzed in the same manner utilized in the labor overbilling analysis. This defined the actual cost incurred by FMG in providing personnel to FDGI who provided the services to FCMI. To the actual labor cost were added other expenses and incidentals that FDGI's accounting records indicate it incurred to determine the total cost to FDGI in providing the design services required

by the FCMI contract on the Beef Plant. The total cost was then compared to the amount FDGI billed FCMI, which FCMI in turn billed on the Beef Plant, and the difference is the overbilling. This resulted in FCMI obtaining approximately \$260,000.00 in additional hidden profit specifically not allowed in the contract.

Other Allocated Overbillings

The balance of the allocated overbillings consist of data processing, office telephone, and office supplies and equipment. These are items that are all general overhead to FHC and subsidiary companies, which is specifically excluded from recovery in the contract. There were specific expenses that fed into each of these categories that were utilized at the project site itself and/or charged to the project elsewhere and they were allowed by contract. However the amounts billed in these particular line items were apparently arbitrary and FCMI has not been able to provide any backup whatsoever indicating these items to be costs incurred for which they are entitled to payment. This resulted in FCMI obtaining approximately \$190,000 in additional profit specifically not allowed in the contract. In determining intercompany billings the Consolidated Detail Income Statements provided by FCMI were utilized in each instance.

ACCOUNTING

In the construction industry accounting is not directly billed to clients as a cost. It is considered overhead. The Facility Group billed its accounting as a cost directly to the Mississippi Beef Processors and Community Bank. This was also in violation of the contract. In addition, The Facility Group did not bill actual hours worked by its accountants. Instead, a fictitious schedule of hours was created and used. In addition, false time sheets were also created that did not reflect the actual hours worked by employees.

In summary, by utilizing intercompany billings from other FHC subsidiaries that “include a markup as attributable to intercompany profit”, as clearly stated in FHC’s audited financial statements, FCMI fraudulently represented its actual cost and overbilled on the contract.