insero&co
Certified Public Accountants | Business Advisors

To: Laura J.S. Brown
Environmental Defense Section
Environment & Natural Resources Division
U.S. Department of Justice

From: Vincent A. Leo, CPA

Date: February 21, 2018

Re: *United States v. Brace et al.*, Civ. No 17-006 (W.D. Pa.)

I. Summary of Opinions

I have been retained by the United States Department of Justice (DOJ) to evaluate the financial condition and ability of Defendants Robert Brace, Robert Brace and Sons, Inc. ("Brace and Sons") and Robert Brace Farms, Inc. ("Brace Farms") (collectively referred to as the Defendants) to pay a civil penalty if found liable for Clean Water Action violations in the above civil action. Based on my analysis, it is my expert opinion that a penalty of $400,000 would be sufficient to deter future violations of the law but would not cause significant financial hardship to the defendants.

II. Expertise and Basis for Opinion

My opinions are based on my education and my 34 years' experience in the field of accounting and auditing including financial analysis as a certified public accountant. My resume, testimony history, and compensation are included in Appendix A to this report.

To evaluate the Defendants' ability to pay a civil penalty, I have reviewed the following categories of financial information:

- Corporate tax returns for Brace and Sons and Brace Farms from 2012-2016 and supporting work papers;
- Individual tax returns for Robert H. Brace from 2012-2016 and supporting work papers;
- QuickBooks accounting records for Brace and Sons, and Brace Farms through December 2017;
- Information regarding real property ownership, including appraisal summaries.

I also attended the deposition of Defendants' accountant, Thomas Roberts, CPA, and part of the depositions of Brace and Sons and Brace Farms, which included testimony about both companies' financials.

EXHIBIT
89

III. Financial Analysis

A. RELATIONSHIP BETWEEN THE ENTITIES

Both Brace and Sons and Brace Farms are closely held corporations primarily owned and controlled by Robert Brace.[1] The companies are generally engaged in the same business (farming, which currently includes the production and sale of corn) and the companies' operations appear to be managed as one, i.e., the companies share use of farming equipment as needed and share storage of crops. The Defendants produce corn on (1) approximately 261 acres owned by Mr. Brace in his personal capacity, (2) 275 acres owned by Brace Farms, (3) 1,208 acres owned by Brace and Sons; and approximately 286 acres leased by Brace and Sons. A chart describing the parcel ownership, acreage, and value is attached to this report as Appendix B.

The two corporate defendants, Brace and Sons and Brace Farms, are essentially run as one entity from a treasury, cash and debt perspective and in some cases, revenue and expenses.[2] The companies transfer funds on "loan accounts" to the other entity as cash is needed on an interest free basis. Additionally, on multiple occasions one entity borrowed on its available line of credit and shortly thereafter transferred the money to the other entity. While the loans from the companies to their officers accrued interest, the intercompany debt was loaned on an interest free basis.

As revenue was collected, there were instances where the deposits for corn sales were subsequently allocated to one of the other entities or the personal account of Mr. Brace. This cash management approach also included the personal expenses of Mr. Brace and his sons as certain personal expenses were incurred via the business credit cards and later charged back through the officer loan accounts. For example, during May 2012, the Defendants used funds from Brace & Sons to purchase the Marsh property on behalf of Mr. Brace. The purchase price was $40,454.50. Brace & Sons issued the check for $40,454.50 to the seller and subsequently, on the same day, the purchase price was netted against the loan due to Mr. Brace within the general ledger of Brace & Sons as Mr. Brace was the purchaser of that property. In summary, except for the tax returns, the businesses act as one operating entity in terms of cash management. This type of activity would justify evaluating the financial position of Mr. Brace, Brace Farms and Brace & Sons on a combined basis.

B. ANALYSIS OF BALANCE SHEETS

The Defendants own 29 properties in Erie and Warren Counties with a combined fair value of approximately $4.036 million. This total value is based on (1) appraisals completed on behalf of defendants for 25 of the properties between 2011 and 2012 and (2) the purchase price paid by defendants for the remaining four properties for which no appraisal was provided. The individual value of each property is identified in Appendix B.

---

[1] Robert Brace holds 51% interest in Robert Brace and Sons, Inc., and his sons, Randall Brace and Ronald Brace, each own 24.5% respectively. Robert Brace and his wife, Beverly Brace, own 100% Robert Brace Farms, Inc. as tenants in the entirety.

[2] Mr. Brace is also the majority shareholder in BCD Properties, Inc. BCD is in the oil and gas mining business. Brace Farms and Brace and Sons provide the collateral for BCD's line of credit.

The combined data obtained from the tax returns for balance sheet data is summarized as follows:

- Reported Combined Cash per fiscal year end (from 2012-2016) ranged from $4,597-$38,052 and averaged approximately $14,000
- Reported Combined Total Assets (net book value) per fiscal year end (from 2012-2016) ranged from $1,821,720-$2,184,714 and averaged approximately $2,013,000
- Reported Combined Total Equity (net book value) per fiscal year end (from 2012-2016) ranged from $169,207-$183,510 and averaged approximately $176,000

The fixed assets include farm equipment and trucks, which based on their age, appear to be almost fully depreciated and do not represent a significant amount of value to the combined total assets noted above.

The Brace entities currently have the following lines of credit:

Entity	Line Amount
• Brace & Sons	$400,000
• Brace Farms	$400,000
• BCD	$150,000

The lines of credit for Brace & Sons and Brace Farms both have had a significant amount of activity in terms of borrowings and repayments over the last few fiscal years, but have each remained at approximately $400,000 outstanding for the last 9 months. BCD had $50,000 outstanding at December 31, 2017. The total amount owed under the combined lines of credit was approximately $850,000 at December 31, 2017.

The collateral for each line as described in the respective agreement is as follows:

- Brace & Sons – inventory, equipment, accounts, instruments, farm equipment and general intangibles
- Brace Farms – inventory, equipment, accounts, instruments, farm equipment and general intangibles
- BCD – inventory, equipment, accounts, instruments, farm equipment and general intangibles for Brace Farms and Brace & Sons.

Brace & Sons also has debt, at December 31, 2017, described as personal life insurance loans totaling approximately $542,000 and other bank debt in the amount of approximately $73,000.

The total of the third party debt described above is approximately $1.465 million.

The Brace entities also have significant loans payable and receivable from, and to, the other Brace entities and Mr. Brace.

Mr. Brace testified that he has not sought to obtain mortgages for his properties or to increase the lines of credit.

C. ANALYSIS OF INCOME AND CASH FLOW

The combined data obtained from the tax returns for income and cash flow data is summarized as follows:

- Combined Total Revenue (from 2012-2016) ranged from $988,941-$1,635,923 and averaged approximately $1,266,000
- Combined Total Net Income (Loss) (from 2012-2016) ranged from $(362)-$22,450 and averaged approximately $8,000

As noted above, the businesses have consistently reported taxable income at approximately breakeven each year and generally have a tax liability close to zero. Revenue for Brace Farms was generally from the sale of corn. Revenue for Brace & Sons included sale of corn, rental income from the property owned, gas well management fees, gravel royalties and inter-entity management fees to other Brace entities.

The personal income tax returns (Form 1040) for Robert and Beverly Brace did not report any significant interest or dividends and Adjusted Gross Income (AGI) ranged from a loss of $(80,670) to income of $31,442.

Reducing AGI was the loss from a restaurant, the Deer Head Inn LLC, owned by Mr. /Mrs. Brace with loses ranging from a high of $(143,512) to breakeven. It should be noted that Mr. Brace does not take any salary from Brace Farms or Brace & Sons each year. However, as noted above, a significant amount of personal expenses are paid through the business and are offset against his loan account from the company.

D. SOURCE OF DATA

Upon reviewing the tax returns and the summary of property appraisals I have been able to summarize the following data for Robert Brace Farms, Inc. and Robert Brace & Sons, Inc.:

- Cash – the cash in the bank at the end of the fiscal year;
- Total Assets – including cash, net book value of the land, buildings, improvements and due from other entities;
- Land and Buildings at Fair Market Value – at appraised value
- Total Equity – total assets less total liabilities (also described as "book" net worth);
- Total Revenue – all sources of income including corn sales, royalty income, management fees and rental income; and
- Total Net Income (Loss) – total revenues less expenses.

Except for the land and buildings at fair market value, I obtained this information from each of the Defendants' tax returns which were prepared on a cash basis. Under the cash basis, revenue is recorded when the cash/checks are actually received and expenses are recorded as checks are written which differs from the accrual basis of accounting which would record revenue and expenses when the activity (sale and/or cost) is actually incurred regardless of when cash changes hands. The most significant difference between the cash and accrual method is under the accrual method, revenue is recorded when it is earned versus when it is physically received. While this method is an allowable method for tax return purposes for smaller businesses, it typically defers reporting revenue and earnings to provide a better tax solution.

We also obtained the QuickBooks files for Brace & Sons, Brace Farms, Deer Head Inn and Robert Brace, and noted a significant number of inter-entity transactions that impact the various Brace entities. For example:

- Personal expenses which appear to be run through the business and then adjusted out against the officer loan accounts,
- Borrowings are made on one entity's line of credit and the funds are immediately loaned to another related entity,
- Revenue and/or expenses are recorded in one entity and then subsequently split among the other related entities.

Within the QuickBooks files we noted multiple users logging in via the "admin" credentials. We noted adjusting journal entries and other journal entries which changed previous journal entries, some of which were backdated to an earlier date/period. Many of the entries impacted the officer and inter-entity loan accounts noted above. The Brace & Sons entity has a March 31st year end and the other entities are a calendar (December 31) year end. The ledger included post year end entries impacting the companies' net earnings/loss. While the adjustment and/or correction of journal entries is not necessarily inappropriate, I cannot conclude on the appropriateness or necessity of the adjusting and/or correcting entries without the detail supporting the entries, which were not available.

Summary and Conclusion

Defendants' most significant assets are their real estate holdings. As discussed above Defendant's real property, improvements and buildings are valued at approximately $4.036 million. A penalty of $400,000 represents approximately 10% of the Defendants' real estate's value and approximately 15% of the Defendants' real estate value less third party debt of approximately $1.465 million. It is my expert opinion that a $400,000 penalty would be sufficient to deter future violations of the law but would not cause significant financial hardship to the defendants. To the extent the Defendants do not have the current cash available to pay a penalty in that amount, and to the extent they chose not to liquidate any particular properties to pay it, Defendants should be able to obtain a loan using the properties as collateral. The appraised value of the properties totaling over $4 million should provide a bank with a loan to value ratio to support such a loan, which is why I suggest a penalty valuation at 10% of the property value.

Vincent A. Leo

Vincent A. Leo, CPA

APPENDIX A

CURRICULUM VITAE

VINCENT A. LEO, CPA

89 Oak Lane
Rochester, New York 14610
vincent.leo@inserocpa.com

EDUCATION

Niagara University
Niagara University, New York 14109
Bachelor of Science, Accounting 1983

AWARDS & RECOGNITION

Rochester Forty Under Forty Leadership Award, 1997

CURRENT FIRM:

Insero & Co. CPAs, LLP
2 State Street, Suite 300
Rochester New York 14614
(585) 454-6996

2002 to Present

Partner – Accounting & Auditing
Member – Executive Management Committee

Partner in the Accounting & Auditing Division and one of the Firm's technical experts on accounting and auditing matters. Represents clients in the manufacturing, distribution, high tech, service and employee benefit plan industries. Consults with clients on a wide range of accounting, auditing and business consulting issues. Is experienced in mergers & acquisitions, as well as buy side and sell side due diligence projects. Lectures in the Rochester New York area on a wide variety of accounting, auditing and consulting topics.

FORMER EMPLOYMENT:

Arthur Andersen, LLP
Partner, 1996 to 2002

Coopers & Lybrand, LLP (now PricewaterhouseCoopers, LLP)
Assurance Manager, 1990 to 1996

Deloitte & Touche LLP
Audit Manager, 1983 to 1990

PUBLICATIONS:

No publications authored in the previous 10 years.

LITIGATION SUPPORT SERVICES:

United States v. Port of Tacoma et. Al., No. 11-cv-05253 (W.D. Wa.) (Department of Justice).

United States v. Pikewood National Golf Club et. al. No. 90-5-1-1-19059 (Department of Justice).

United States v. Bobby Wolford Trucking & Salvage, Inc., Eric Klock, and Karl Fredrick Klock Pacific Bison, LLC, No. 90-5-1-1-19923 (Department of Justice)

No testimony as an expert at trial or by deposition during the past four years.

PROFESSIONAL AND COMMUNITY:

Certified Public Accountant, State of New York
Certified Public Accountant, State of Connecticut
Member, American Institute of Certified Public Accountants
Member, New York State Society of Certified Public Accountants
Member, Connecticut State Society of Certified Public Accountants
Finance Committee Member, Oak Hill Country Club
Co-Chair, Disability Services Shuttle, 2019 Senior PGA Championship
Past President, Treasurer & Board Member Genesee Valley Chapter BMW CCA
Past Treasurer & Board Member, Baden Street Settlement of Rochester
Past Board Member, Wilmot Cancer Center

COMPENSATION

I am being compensated at a rate of $315 per hour in this matter.

APPENDIX B

Parcel No.	Owner	County	Acreage	Purchase Date	Value	Source of Value
30-005-034.0-003.01	Robert H. Brace	Erie	1.92	12/23/1983	$40,000.00	Brace 002424
31-016-063.0-002.00 47-011-004.0-003.00	Robert H. Brace	Erie	15.51 4.5	5/14/2012	**$40,000.00**	Brace 000005
47-011-004.0-002.00	Robert H. Brace	Erie	50.88	12/31/1975	$192,000.00	Brace 002424 Brace 002752
47-011-005.0-022.00	Robert H. Brace	Erie	18.15	12/31/1975	$41,000.00	Brace 002424
47-012-028.0-001.00	Robert H. Brace	Erie	65.3	12/31/1975	$80,000.00	Brace 002424
47-023-053.0-003.02	Robert H. Brace	Erie	29	7/29/1975	$61,000.00	Brace 002424
47-032-085.0-005.00	Robert H. Brace	Erie	3.45	5/4/1979	$15,000.00	Brace 002424
47-032-085.0-008.02	Robert H. Brace	Erie	12.53	5/16/1974	$220,000.00	Brace 002424
47-032-085.0-013.00	Robert H. Brace	Erie	0.8035	11/2/1984	$75,000.00	Brace 002424
YV-007-354800-000	Robert H. Brace	Warren	4.52	10/7/2004	$20,000.00	Brace 002777
47-024-056.0-004.00 47-023-055.0-002.00	Robert H. Brace	Erie	39.63 14.93	7/29/1975	$82,000.00	Brace 002424
47-011-005.0-021.00	Robert Brace & Sons	Erie	46.16	7/13/1988	$102,000.00	Brace 002424
47-023-053.0-018.00	Robert Brace & Sons	Erie	168	5/3/2002	$319,000.00	Brace 002424 Brace 002731
47-023-053.0-019.00	Robert Brace & Sons	Erie	105.75	6/18/2008	$282,000.00	Brace 002424 Brace 002660
47-023-055.0-006.00	Robert Brace & Sons	Erie	81.55	5/3/2002	$240,000.00	Brace 002424 Brace 002703
YV-004-715300-000	Robert Brace & Sons	Warren	50	12/6/2012	**$23,700.00**	Warren County Property Records
YV-004-728500-000	Robert Brace & Sons	Warren	9	5/18/2009	$58,681.00	Brace 0027879
YV-004-742200-000	Robert Brace & Sons	Warren	13.34	12/6/2012	**$6,300.00**	Warren County Property Records
YV-007-359000-000	Robert Brace & Sons	Warren	724.16	8/27/2003	$1,250,000 .00	Brace 002560
47-032-085.0-008.01	Robert Brace & Sons	Erie	10.365	2/2/1988	$210,000.00	Brace 002424 Brace 002620
31-017-064.0-001.00	Robert Brace Farms	Erie	20.25	6/15/1983	$47,000.00	Brace 002424
31-017-065.0-001.00	Robert Brace Farms	Erie	49.67	5/25/1983	$114,000.00	Brace 002424
31-017-066.0-003.00	Robert Brace Farms	Erie	65.19	5/25/1983	$137,000.00	Brace 002424
47-024-056.0-008.00	Robert Brace Farms	Erie	22.4	6/8/1983	$49,000.00	Brace 002424 Brace 002687
47-032-085.0-008.00	Robert Brace Farms	Erie	66.695	6/8/1983	$214,000.00	Brace 002424 Brace 002638
47-032-085.0-013.01 47-032-085.0-013.02	Robert Brace Farms	Erie	32.42 18.78	6/8/1983 10/14/1983	$118,000.00	Brace 002424
TOTAL			**1744.9**		**$ 4,036,681**	

Values in bold are based on the purchase price.