

Initial Report to the Court

Robb Evans, Temporary Receiver of TLC Investments & Trade Co., et al.

October 12, 2000

The purpose of this initial report is to inform the Court regarding the activities of the Temporary Receiver and provide information developed regarding the Receivership Defendants during the first week under the Temporary Restraining Order (“Order”). This report does not constitute an audit of financial condition of the Receivership Defendants.

Custody, Control & Possession

On Thursday, October 5, 2000, the day following issuance of the Order, the Receiver and his staff, initially accompanied by agents of the Federal Bureau of Investigation, took possession of the primary office of the Receivership Defendants. Messrs. Cossey and Williams were on the premises, were aware of the issuance of the Order and provided reasonable cooperation. The Receiver served the Order on Mr. Cossey at that time. The Securities and Exchange Commission served Mr. Williams’ counsel the next day.

On October 5, 2000 interviews were conducted with all staff present, the premises secured, locks changed, bank accounts frozen, initial liaison conducted with banks of account, and preliminary reviews made of computer systems and files.

Extensive interviews were conducted with Mr. Williams, the Chief Financial Officer. Mr. Cossey assured cooperation but declined meaningful discussions until October 6, 2000 when discussions could be held in the presence of his criminal defense counsel. On October 6, 2000 meetings were held with Mr. Cossey and his counsel, which were restricted to issues requiring operational attention in the following week or two. In most cases, our questions were posed to Mr. Cossey. Mr. Cossey then met privately with his counsel who then conveyed the answers to the questions regarding current and pending issues. After that meeting Mr. Cossey was invited to depart the premises, which he did. Mr. Williams and other staff were requested to remain and assist my staff, which they did.

The Receiver took steps to assure that transactions in process were in the normal course of business and would increase or liquefy the Receivership Estate and not diminish it. New investment funds in process, but not yet deposited, were held and not processed. Collections from rents or sale of assets were processed and deposited.

The company maintained multiple independent databases. The information that follows has been extracted from one or more of those databases and is also based on interviews with staff. There has not yet been time to reconcile the databases with each other or to confirm their validity with independent sources, such as bank deposits or direct confirmations.

A civil asset forfeiture complaint has been filed by the Department of Justice against Mr. Cossey’s personal residence and against \$225,000 in cash that was seized in an IRS/FBI search of the residence. Estimates of the home’s value exceed \$1.2 million and the property is apparently free of other encumbrances. The Receiver has not yet traced the purchase funds to determine if it was acquired with investor funds. The company’s books have an asset account titled “Y2K Cash” with a balance of \$220,000. A company employee informed one of the Receiver’s staff that this cash was located in Mr. Cossey’s home safe.

Initial Observations and Findings

On October 6, 2000, during the entire weekend thereafter, and after, a review of financial and database records was undertaken. That review is not complete.

Investors and the Nature of Their Investments

The Receiver has not been able to review any significant number of client files at this writing. However, from a limited review, interviews and analysis of company databases some observations can be made.

The average age of investors is 67. Sixty-three percent of the investors are over age 60 and 14%, or 284 are over 80. The oldest person for whom the age is recorded is 99. Eighteen percent of the funds are designated at IRA or other retirement funds.

Most, perhaps all, investors, entered into documentation entitled either "Real Estate Investment Agreement" or "Promissory Note." The language of both instruments, aside from the heading is nearly identical. The Promissory Note says, "Investor may use any qualified custodian to hold their funds. Please give the name of designated custodian." Apparently this is for use in IRA or other retirement funds in custodial hands. Both call for:

- Minimum term of one or two years.
- Interest at 12% to 14% "from real estate opportunity projects."
- Investments in "...tax lien certificates, tax deeds, and real property in various states throughout the United States of America."

In many, perhaps most, instances investors were given a document called a "Warranty Deed" which purportedly conveyed title in a specified amount to a specified parcel of real property in fee simple. To the extent we are aware, the properties are identified by address and a legal description is not provided. The Receiver has seen no evidence that any of these documents were recorded. It is the Receiver's further understanding that the investors were promised interest at the specified 12% to 14% rate without regard to the earnings or proceeds from the property identified in the "Warranty Deed" or any other property. While it appears that there are ledger markings of these instruments in the aggregate for each property and that the amounts are within the marked-up assigned values of the properties, there has been no transfer of title. The Receiver believes that most of the properties are held by the company without encumbrance.

It is the Receiver's understanding that properties were to be assigned to individual investors without consultation with those investors as to the specific property. The database used to account for investors shows that 872 of the current investors are assigned to a property for a total value of \$41,510,907.

At this point the Receiver does not know if all or what percentage of investors were provided with the "Warranty Deeds" but the preliminary analysis is that all investors are claimants against a common pool of all investments, including non real estate investments.

Investor Funds and Commingled Accounts

Although the company maintained numerous bank accounts, some of which may have been designated as trust accounts, it is clear that there were no accounts in which investor funds were segregated apart from general funds of the operating entities. Funds moved freely between accounts on an "as needed" basis.

Investor funds were commingled and, in effect, became part of a common pool. Instruments were issued to investors, some of which referred to specific properties. No specific liens were recorded against any properties on behalf of investors. While specific investors may eventually assert that they have interests in specific properties that may not be a supportable position. What was purported to be interest was either paid or credited to investor “accounts” without regard to the profitability or lack of profitability of any given property. Most “interest” payments were stated from 12% to 14% with an averaged “guaranteed” yield of 13.5%. Repayments of investor funds appear to have been made as requested.

Since the commencement of operations \$159,334,730.27 of investor funds was logged into the customer database. \$48,357,060 was purportedly repaid to investors, of which \$20,487,239.70 was purported to be interest. Therefore, based on the database, which has not yet been reconciled to the bank deposits and the assumption that amounts recorded as interest payments were indeed such, \$131,364,909.61 remains owing to investors. If, as the SEC alleges, this was a Ponzi scheme, some or all of the “interest” payments to investors may actually represent a return of principal.

Real Properties

The Receiver’s initial review indicated that 450 parcels of real property are owned, stretching from Hawaii to Georgia. Concentrations are in California, Texas and Alabama. Properties appear to include raw land and lot developments, commercial and office buildings, apartments and detached residential units, and at least three conversions of old factories to loft condominiums. There appear to be heavy concentrations of substandard properties in depressed neighborhoods.

Inspections were conducted of real estate operations in Birmingham, Alabama, Atlanta, Georgia and Houston, Texas. According to the company’s real estate staff, and the Receiver’s preliminary review of records, construction and development activity is concentrated in these three states. There are significant cash outflows for rental maintenance, construction, commercial tenant improvements, and residential retrofitting and inflows from rentals and property sales through those locations. Assurance was needed that expenditures were appropriate and not diversions. Meetings in those locations and brief inspections of the activities there provided the necessary comfort to continue those operations under our supervision for the time being.

Value and Valuation of Properties

A significant portion of the portfolio consists of properties that appear to have been soundly purchased and managed properly. Another portion of the portfolio consists of non real estate assets or real estate that was purchased outside of normal professional bounds.

The Receiver has antidotal indications that not all real estate purchases were acquired at market. The company’s real estate professionals have advised the Receiver that some distressed properties were purchased at the initial asking price without negotiation and without the advice of the professionals employed by the firm. The Receiver has not found any evidence of appraisals utilized to support the purchase or sale price of properties.

The company had a practice of marking properties “up to market” on company records. The Receiver has found no appraisals to justify that “mark up” and no evidence of any properties marked down. The Receiver knows of no applicable accounting theory that would justify the practice as implemented. In interviews of staff and sampling of transactions, there does appear a basis to believe some of the properties have increased in value and that the assigned valuation may be appropriate. In other cases it is clear that the valuation assigned is arbitrary or highly speculative on future events. The Receiver can suggest no appropriate method of valuation

prior to sale other than cost, unless there is documentary evidence, such as an MAI appraisal, to justify otherwise.

Most property purchases have occurred within the past 24 months. 126 properties purchased in that period have been sold for a profit of \$2,850,580.39. 20 properties purchased in that period have been sold for a loss of \$160,855.00, leaving a net profit on properties sold of \$2,689,732.39 since the inception of the company. It appears that the original cost basis of all real estate still owned is \$46,250,000. About \$15,500,000 was spent on improvements, repairs, taxes, and utilities to those properties. Because expenses were recorded independently of the property managers and on different databases, the actual profitability of each property has not yet to be determined.

According to the company's real estate professionals, the portfolio could, in their opinion, yield approximately \$102 million over a three-year period if all currently known factors and assumptions, including a necessary purchase of additional property for one project, remain constant. The estimated cost to be incurred for achieving this yield is approximately \$30 million. Not included in these numbers are single-family residences located in Birmingham, Alabama. The company's real estate professionals have informed us that the approximate fair market value of these homes is \$6 million. However, information acquired by the Receiver indicates this market is not a market where such homes can be sold for cash. The company would need to carry paper on all sales, age the paper for a year or more, and then sell the paper for a 20 to 25% discount.

Other Assets

Mr. Cossey's counsel informed us of the existence of 45 racehorses and 250 racing dogs.

One of the Receiver's staff members met with the agent who coordinates the care of the horses. There are 47 horses located in four Southern California locations. Two of the horses are a mare and a filly, which accounts for the difference with the number given by Mr. Cossey's counsel. According to the agent, the average monthly cost of horse maintenance is about \$2,000 per horse, or \$94,000 for all of the horses. Only ten horses have ever raced or are currently being raced. Records show that approximately \$4.5 million was spent on horses.

Mr. Cossey's counsel informed the Receiver that the dogs are in many locations around the country and in Mexico, and promised to prepare a list of the locations. To date a list has not been received, and the Receiver has found no information in the company's records about the dogs. The Receiver was informed by Mr. Cossey's counsel that each dog purchased cost between \$1,000 and \$5,000 per dog.

Preliminary Financial Information

As mentioned earlier, these observations and findings are based on a preliminary and incomplete review of records. The Receiver was unable to locate any consolidated records of operations and it will take further time to produce consolidated financial statements that can be viewed with confidence. A very substantial percentage of company records were removed by the F.B.I. and the I.R.S., pursuant to a search warrant, on September 14, 2000. The Receiver has met with the Department of Justice and the I.R.S. regarding a sharing of these records and does not anticipate difficulty in that regard. However, at this writing the Receiver has not reviewed most of the records removed during that search of the office and Mr. Cossey's residence. The information that follows is based on the financial and database records actually reviewed, limited bank statements and interviews with company staff and officers as of October 5, 2000.

Funds raised from investors	\$159,334,730.27
Funds returned to investors as principal	<u>\$ (27,969,820.66)</u>

Principal owed investors, per company records	\$131,364,909.61
Funds paid to investors as interest	\$ (20,487,239.70)
Funds paid to brokers as commissions	\$ (20,334,290.39)
Net funds purported to be invested in Sienna Financial scheme	\$ (10,000,000.00)
Estimated net funds invested in real estate	\$ (46,250,000.00)
Estimated net funds invested in mortgages	\$ (2,250,000.00)
Estimated amount invested in horses and dogs	\$ (5,500,000.00)
Cash in banks	<u>\$ (2,500,000.00)</u>

Funds preliminarily not accounted for before operating profits or losses other than commissions & interest **\$ 24,043,379.52**

Liabilities to 1,876 investors are based on the unreconciled database, which may or may not in every case reflect interest

\$131,364,909.61

Company Profitability

The companies accounting records show operating losses for 1998, 1999, and year to date 2000. The losses for 1998, 1999, and year to date 2000 were \$2.66 million, \$7.53 million, and \$2.97 million, respectively. It appears the cumulative losses approximating \$13.1 million are significantly understated for two reasons. Several million dollars of items that should have been expensed were capitalized and carried as assets. Based on a review of these items, the Receiver is unaware of any accounting principle that supports capitalizing these items. Secondly, the company recorded approximately \$20 million in sales of properties as revenue, but did not adjust asset value with a corresponding entry. This resulted in an overstatement of assets and an overstatement of income of about \$17 million.

Other Matters

Sienna Financial Transactions

A series of transactions occurred with an organization called Sienna Financial, Ltd. (“Sienna”), it’s principal Jim Garro, and various entities related to him, commencing in September of 1999. This was explained to the Receiver by Mr. Cossey, through his attorney, as an attempt to invest funds in some kind of international government bond program that would pay returns significantly in excess of those available to other investors in similar instruments. On the most superficial examination of this transaction, as described to the Receiver, it had all the hallmarks of well-publicized investment scams.

Twenty million was paid to Allison McCloskey Escrow Company on September 13, 1999. Four payments totaling \$10 million were received by the company between November 1999 and January 2000 purportedly in partial repayment of the original investment. According to the representations of Mr. Cossey, via his counsel, he engaged a Nevada attorney, Paul J. Young, to assist in recovering the balance of the money. The Receiver has attempted to contact Mr. Young to obtain additional information, but he has not yet returned telephone calls.

An agreement was reportedly reached with Sienna to wire transfer an additional \$10,000,000 in the past week and to transfer ownership of an ocean front residential property in La Jolla, California as repayment of the obligation. The real property was transferred. The cash was not received.

This is a complex and murky series of transactions. The Receiver has not yet been able to interview many participants or review much of the documentation. It is highly unlikely that there were ever any underlying bond investments. It is clear that this was a usage of investor's funds that were designated for real estate related investments. It appears that, in recent weeks, since the conduct of a FBI/IRS search warrant on September 14, 2000, efforts were made to unwind or complete this series of transactions which, at one time, apparently had investors at risk for \$20 million. With the partial repayment and transfer of the real property mentioned above, assuming no title problems arise and values are substantiated, the current principal exposure to investors is estimated to be approximately between \$2 and \$5 million before accounting for lost interest.

Substantial further investigation is required regarding this series of transactions, including deposition of many participants. However, there appears to be only two alternate theories regarding what occurred.

The first theory is that the company was reckless with investor funds, investing massively in, at best, a very risky scheme, which, even if legitimate, would have been inconsistent with the investment purposes represented to investors. There was inadequate due diligence and documentation. Under this first theory, the company was bilked as a result, although a significant partial recovery was accomplished.

The alternative theory is that the transactions were a collaborative effort of a number of parties, including, but not limited to, the company and its officers, to mask or justify other transactions or to camouflage the transfer of funds abroad.

Forensic work is under way to determine which of these theories is valid, or if in fact, another explanation is forthcoming and to recover the missing funds.

Unusual Transactions

On September 19, 2000 the company wrote a check for \$30,000 to the client trust account of Steward & Miller, the firm defending Mr. Cossey on criminal matters. On September 20, 2000 the company wired \$500,000 to the client trust account of Steward & Miller.

The company made bridge loans in Nevada and Colorado. On one bridge loan in Colorado the company lost \$360,000. There is another \$300,000 bridge loan in Colorado that may be secure. Further investigation is necessary to determine the exact position on this loan. The company made a \$2 million bridge loan in Nevada and had to commence foreclosure proceedings. The property was sold for \$1.2 million resulting in a loss of \$800,000. The company made a \$225,000 loan in March 1999 to a Nevada company. There is no evidence in the company's records of this loan being collected. Further investigation of this transaction is required.

The company purchased a town house in Solana Beach, California for \$260,000. Mr. Cossey reportedly told company employees that this property was purchased for the use of company employees. However, the property was apparently leased to an individual. Company records do not show receipt of any lease payments. A real estate agent reportedly informed a company employee that the lease payments were payable to Mr. Cossey.

The company placed an earnest money deposit of \$50,000 for the purchase of a gas station. According to company employees, Mr. Cossey decided not to proceed with the transaction and forfeited the deposit.

The company's books show transfers of funds totaling about \$164,000 to Golden Age Consulting. According to company employees, Golden Age Consulting is or was a partnership in which Mr. Cossey was a partner. The partnership reportedly sold annuities for college education. The Receiver has not been able to determine any business reason for these transfers.

From 1998 through October 5, 2000, \$1,148,137 was paid to C & A Cloud.

Payments totaling \$764,814.83 were made to Jet Aviation Business Jets, Inc. The Receiver understands this is a charter aircraft service.

According to the company's books and records approximately \$2.32 million was paid to E.F. Cossey Enterprises in the form of bonuses and commissions.

Cashiers check receipts found in Mr. Cossey's residence during the FBI/IRS search and examined by the Receiver's associates were made payable to Mr. Cossey in amounts totaling \$1.5 million. These cashier's checks were purchased by TLC America. At this writing the Receiver is not aware if those checks were accounted for within the bonus and commission amount on the company books or otherwise.

Concluding Remarks

This company maintained multiple, substantially independent, data and financial records. We have found no evidence of outside accountants providing opinions or oversight. There was no attempt to maintain records on the basis of generally accepted accounting principles. Until the data and financial records are reconciled with each other, confirmed with original sources and restated according to generally accepted accounting principles, it is impossible to be definitive about the financial condition of the enterprise or the funds that will ultimately be available for return to investors. That is an undertaking that will take a number of weeks.

However, it is difficult to conceive findings that would provide a basis to reverse the preliminary conclusion that this enterprise was reckless with investor funds, invested funds inconsistently with its understanding with investors, was likely operating a Ponzi scheme, diverted investor funds to personal purposes and failed to observe even the most rudimentary of fiduciary obligations.

It is also abundantly clear that massive hardship will be inflicted on investors, many elderly and dependent on the earnings they anticipated from these investments. Those hardships will be, in many cases, immediate and severe. In the event the Court extends the asset freeze the Receiver believes it imperative to promptly evaluate the amount of funds that can be made available for early return to investors and recommend to this Court an equitable formula for a rapid repayment of some funds.

If the Court grants the motion of the Securities and Exchange Commission, detailed asset inventories, liquidation projections and recommendations for investor repayment should be submitted as early as practical.

Respectfully submitted,

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Robb Evans
Temporary Receiver