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CERTIFIED PUBLIC ACCOUNTANTS
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January 26, 2010

Board of Directors
Pecan Plantation Owners Association, Inc.
Granbury, Texas

In planning and performing our audit of the consolidated financial statements of Pecan Plantation Owners Association (the "Association") as of and for the year ended October 31, 2009, in accordance with auditing standards generally accepted in the United States of America, we considered the Association's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

We consider the following deficiency in the Association's internal control to be a material weakness:

Administrative Oversight/Monitoring/Segregation of Critical Functions

During 2008-09 PPOA reduced the number of personnel in efforts to reduce expenses. The Assistant Controller position was eliminated during the down-sizing. The administrative staff including the accounting department is relatively small, however, the compliance issues can be very complex. The regulatory and legal environment have provided significant challenges to the current management of PPOA. The PPCC was not in good standing with the State of Texas because the franchise taxes had not been filed on a timely basis. Compliance violations cause financial volatility for the Association. Due to the unique nature of the Association (hybrid entity with the recreational and social activities of the Country Club), there are numerous planning and funding decisions that require management's attention and expertise.

The annual reserve study was not conducted timely for the 2009 audit. Maintenance of these records should not be delegated to the accounting department and may require certified engineering surveys and periodic evaluations by external consultants. Any significant changes in future costs could result in the need for external borrowings. Maintenance of proper records that are periodically updated to reflect future estimated costs is a critical component in properly maintaining oversight and fiduciary duty of the common grounds. Understanding the common property components (proper physical assessment), recoverable life of the related asset, and the projected repair/maintenance costs are critical in evaluating the future funding needs of the Association. The Association has an infrastructure committee that provides oversight for the roads. This committee's responsibilities might be expanded to properly maintain the cost and maintenance records for all the component units of the Association.

With efforts to contain administrative costs, PPOA reduced the number of employees in the accounting department. Selected review procedures relating to the bank statements and reconciliations should be performed and initialed by the Treasurer, on a monthly basis. Significant banking transactions (electronic funds) should be compared with the authorized internal document, substantiating the transaction. The reconciliations should be compared to the respective general ledger accounts and any unusual reconciling items should be investigated for propriety. The approved reconciliations should be filed and maintained in the accounting records. Monitoring of financial reporting controls by the Board are volatile with the annual turnover of the Treasurer and the finance committee. Oversight and monitoring responsibilities can become lost if not properly documented for the board members and committees.

The prior year auditor reported several material weaknesses, which we believe are systemic to the monitoring/administrative function of the Association.

We recommend that an association management position be established, reporting directly to the Board of Directors. The duties would include legal/regulatory compliance, liaison with legislative and local government officials, supervision of membership services, accounting, human resources, and the informational systems departments.

The following advisory and operational suggestions were noted during our testing:

- **Fund Accounting** – the operations of the Association are reported in a number of funds, representing the Association, the Country Club, and the Reserve Fund. The balance sheet accounts (assets, liabilities, and fund balances) are not currently segregated by fund type. Operational departments are segregated between the Association, Country Club, and Reserve Fund, and income and expenditures are posted at the department level. The balance sheet should be properly segregated so that accounting transactions are properly posted to the correct fund, providing accurate “fund accounting.”

The reserve and replacement fund includes assessments for several restricted components (roads, bridges, and general). A large inter-fund transfer (between the reserve fund and the operating fund) is recorded during the audit, however details of this activity should be included in the monthly financial information provided to the Board. Capital expenditures should be reconciled to the inter-fund transfers and reviewed by the Treasurer. The capital expenditures should also be compared to the designated assessments to determine that assessment funding has not been diverted for operational costs.

The reserve and replacement fund include the following three designated assessments; general repair and replacement; designated bridge assessments (collateral for note payable); and designated roads assessment (collateral for note payable). Expenditures and transfers are segregated by type (i.e., bridge, designated roads, general repair/replacement), but are recorded as



inter-fund transfers to the operating account. The inter-fund transfers are calculated and recorded during the audit. On a monthly basis we recommend the finance committee review the capital expenditure listing and reconcile all the activity to the respective bank accounts and determine that the expenditure complies with the special assessment. Year to date expenditures by type (general repair, bridge or road repair) should be compared with the annual revenue collected for the designated assessment. Any variances should be reviewed on a timely basis. These reports should be reviewed at each board meeting and any unusual items should be investigated and resolved.

- **Funding Amenities** – several of the revenue centers (food and beverage, inn, golf, recreational activities, security) are not generating sufficient revenue to cover the direct costs of providing those services. Some of these “user fees” have been discussed with the Association’s membership, and we believe that the members understand that the general assessments are subsidizing the amenities. Certain revenues (food, beverage, and inn) might be slightly increased, offsetting the impact to the general assessment fees.
- **Written Governance Policies** – board committees and positions turnover on an annual basis. When transition occurs, written policies requiring board/committee action and involvement would provide continuation of effective oversight for the Association.
- **Physical Inventory** – on a routine basis, selected components of property, plant and equipment should be physically inventoried to determine existence and operational effectiveness. Items susceptible to misappropriation should be monitored closely with the inventory function performed by independent department managers.
- **Investment Policies** – currently the Association has not developed written investment policies or developed long-term strategic investment plans to maximize the earnings for the reserve and replacement fund. At October 31, 2009, there were \$1.7 million invested in several certificates of deposit, earning interest ranging from .65% to 3.55% annually. These certificates mature during the subsequent year and management and the board may wish to develop long-term strategies that will provide higher earnings.
- **Internal Audit of Administrative Charges** – on a daily basis several transactions relating to house charges/receipts and voids require manual adjustments to the revenue accounts. These charges relate to employee and member charges that should be reduced based on related discounts. A detailed listing is generated by the Controller and revenue is reduced for the related charges. We recommend the audit committee periodically review these daily reports, verifying the accuracy of the recorded discounts. Any unusual or excessive charges that have been discounted should be investigated with departmental supervisors.
- **Compensation Review** – compensation for highly compensated employees should be evaluated and assessed annually. The review should include the use of external comparable industry data. All components of compensation (cell phones and other use of organizational assets) should be properly identified and included in the salary analysis, comparing the total salary to the fair value of the service. The human resource committee can be utilized to perform the review function, however their recommendation should then be reviewed, assessed for propriety, then documented in the minutes of the Board. Board action should be supported by proper substantiation of relevant data.



This communication is intended solely for the information and use of management, the Board of Directors, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Rylander, Clay & Opity, LLP

January 26, 2010

