



**Independent Accountant's Report
On Applying Agreed-Upon Procedures**

Mr. Marc Markel
Attorney for Pecan Plantation Owners' Association, Inc.

We have performed the procedures enumerated below, which were agreed to by you, solely to assist you in evaluating the internal controls which failed to prohibit an improper payment of sales tax and the timely request for refund. You are responsible for the requested procedures. 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 parties specified in this 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.

The following procedures we performed have been agreed to by the audit committee of PPOA:

1. Review the supporting contract to determine that funds remitted were in accordance with the vendor requirements.

RCO reviewed the contract and bid document to determine the party responsible for paying the sales tax liability. The bid document states in item 1.58 that PPOA is a governmental entity which means it is not subject to sales tax. Page 19 of the bid document, Sales Tax Information, requires a statement from the contractor if a separated contract was to be used. A separated contract was not used, the bid did not separate materials from labor.

At the least the bid document was confusing regarding sales tax. In one part of the bid document PPOA says it is not subject to sales tax and in another part it indicates it is. The evaluation of JRJ Paving's bid by Wilson & Company noted that the sales tax form was not submitted. This would seem to indicate that JRJ Paving was a lump sum contract. Under that form the contractor pays sales tax on the materials as he purchases them. The contract price includes the sales tax.

2. Document and report on the levels of authorization and additional written documentation regarding subsequent collections from the State of Texas.

See Exhibit A for sequence of events related to the payment and subsequent attempt to collect refund.

3. Provide information or recommendations for improving accounting controls related to this payment.

- The sales tax related to this contract was accrued and subsequently paid in error. At the time the tax was paid no approval was necessary for recurring expenses paid by electronic transfer. Currently all disbursements, even recurring disbursements (manual or electronic), over a certain threshold are reviewed and approved.
- The PPOA could not locate the fully signed contract when the Comptroller requested it. Significant construction contracts should be maintained for at least three years after the expiration of the contract. We recommend a record retention policy be adopted.
- The correspondence from the comptroller specifically details deadlines and procedures for the refund process (see Exhibit B). In a letter dated March 26, 2007 the Comptroller denied the refund request and notified PPOA of the appeals process, which is to request a refund hearing within 30 days. PPOA took no action to request the hearing. Any correspondence from tax authorities should be monitored by the board and handled by professionals who have expertise with complex tax and regulatory issues.
- See items identified and recommendations included in Exhibit A.

If a timely appeal was filed on the first denial there could be no prediction of the outcome of the appeal.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on the information in the first paragraph. 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 audit committee and management of Pecan Plantation Owners' Association and is not intended to be and should not be used by anyone other than these specified parties.

Rylander, Clay & O'Pitz, LLP

March 11 2010



EXHIBIT A

**PECAN PLANTATION OWNERS' ASSOCIATION
SALES TAX REFUND CHRONOLOGY OF EVENTS
IDENTIFIED CONTROL FAILURES**

May, 2005 Pecan Plantation Owners' Association (PPOA) entered into a contract with JRJ Paving Co. (JRJ) for street paving work to be done within Pecan Plantation. The total contract price was \$3,919,049.09. Work commenced almost immediately.

INTERNAL CONTROL FAILURE – PPOA either misplaced the signed contract or never obtained one. **Recommendation** – Contracts should be properly executed by all parties and retained for 4 years following completion of project.

INTERNAL CONTROL FAILURE – The sales tax issues were unclear in the bid document and not addressed in the contract. Wilson & Company's evaluation noted the sales tax form was not completed. This should have triggered a question about the sales tax issue.

INTERNAL CONTROL FAILURE – Tax status of organization was not known and could not be refuted with vendor. **Recommendation** – Understanding tax and other related regulatory compliance requirements are critical for financial and administrative oversight of PPOA. Copies of state exemption should be retained permanently.

July, 2006 As the contract performance was drawing to a close, PPOA accounting personnel discovered that the original contract in our files was signed by PPOA officials only...and not by JRJ. In addition, the Sales tax form in the Contract was not completed because JRJ initially believed PPOA was a municipality. Informed that the PPOA is not a municipality, JRJ took the position that PPOA was therefore responsible for any and all sales/use tax which might apply to the paving of its streets. PPOA accounting personnel contacted the Texas Comptroller and was told that such liability would be limited to the raw materials used in the project, if the materials were segregated in the contract or the billings.

Based on this information, the accounting personnel calculated an estimate of the cost of raw materials (\$2,375,476) and accrued the possible sales/use tax liability to PPOA's books. This recorded liability was not supposed to be paid until it could be determined that it was indeed owed. PPOA was merely trying to be conservative in its financial reporting.

September, 2006 Unfortunately, the accrued tax amount (\$159,542.91) was accidentally paid when the regular sales tax was submitted for the month.

INTERNAL CONTROL FAILURE – The estimated sales tax was paid with no supervisory review for accuracy. Currently, all disbursements including electronic transactions exceeding \$1,000 are reviewed and approved by a board member.

November 8, 2006 PPOA filed an amended return with a letter of explanation for a full refund of the \$159,542.91.



November 17, 2006 In response to a phone call from the Tax Office requesting a detailed explanation, another letter was faxed to "Marcella" that same day explaining what had taken place.

December 4, 2006 PPOA was advised by phone that any refund request over \$25,000 must be reviewed by an auditor. PPOA was given the phone number of the audit department and told they were the ones who would actually handle the refund check.

January 29, 2007 PPOA finally received an email from Harvey Williams, the auditor who had been assigned to the PPOA claim. He requested additional documentation, noted that he was attaching a 30-day letter to the email and explained the consequences for not meeting the 30-day deadline. PPOA apparently responded timely with all documentation requested, except we were unable to obtain JRJ signatures on the contract. Our copy had been signed by PPOA only and at this stage, JRJ refused to answer any requests for the needed documents.

INTERNAL CONTROL FAILURE – Board was apparently not apprised of this regulatory request for documents and no monitoring was in place to meet the required 30-day deadline. Failure in administrative oversight. **Recommendation** – General manager should routinely communicate regulatory requests and status of outstanding items during the monthly board meetings.

March 12, 2007 PPOA filed an amended request for refund based on actual material costs (\$1,796,067) finally obtained from JRJ. The amended refund amount was \$39,193.18.

March 26, 2007 PPOA received notice that their original claim had been denied due to failure to provide requested additional records per 30-day letter dated 1/29/07. The missing information was that JRJ had not signed the contract, only PPOA personnel had signed it. However, the contract contained the bid submitted by JRJ which had been signed by them.

INTERNAL CONTROL FAILURE – The notice received from the Comptroller stated that an appeal could be filed related to the refund denial. No action was taken by PPOA (see copy of notice at Exhibit C). **Recommendation** – See above.

INTERNAL CONTROL FAILURE – Legal counsel with expertise in "sales tax" should have been engaged months prior to this time and used for actions with the State of Texas.

July 16, 2007 PPOA received a 30-day letter from Mr. Williams regarding the amended request for refund, asking for all the same documentation as before. All documents were sent to him prior to 8/16/2007 deadline, but again the contract still lacked JRJ signatures.

INTERNAL CONTROL FAILURE – Board was not updated on appeal process and the failure to obtain signatures. **Recommendation** – See above.

November 20, 2007 Mr. Williams responded to PPOA's inquiry as to the status of the audit...stating that he had been off work due to surgery and that the claim had been assigned to another auditor.

November 28, 2007 New auditor, Penny Gumfory, requested various additional documents, all of which were presented timely. The contract provided, however, still had only PPOA signatures.



January 23, 2008 Penny Gumfory met with PPOA/PPCC controller Robert Osterling and assistant controller Janice Schefsky in their offices at Pecan Plantation. She informed them that a partial refund in the amount of \$41,438.99 would be forthcoming based on her audit. She also stated that they should receive an additional \$118,103.92 refund (total of both refunds equals \$159,542.91) because PPOA/PPCC should never have been assessed any tax on any portion of the project. It was her determination the PPOA should be considered the same as a municipality. She stated she would contact the state office and request the full refund.

INTERNAL CONTROL FAILURE – Failure to communicate timely to Board regarding communications with State of Texas, Administrative/Board oversight and monitoring.
Recommendations – See above.

March 17, 2008 Taxpayer received letter denying claim for refund in accordance with tax Rule 3.325(e)(2) which states that a refund cannot be considered if it has been previously denied due to failure to provide documentation requested... signed by David J. Brown.

April 3, 2008 Taxpayer received a letter from auditor Penny Gumfory stating that the refund she thought would be forthcoming after her audit was being denied for the same reason (see March 17). She further stated that if we disagreed, we could submit a written request for a refund hearing.

April 29, 2008 Mr. Robert Osterling filed a request for a hearing.

INTERNAL CONTROL FAILURE – Administrative delay in requesting hearing and obtaining legal representation to handle filings with State of Texas.

June 12, 2008 Attorney Peggy DeAnda is assigned to the hearing to represent the Comptroller.

October 23, 2008 Trevor Moore replaces Peggy DeAnda.

November 6, 2008 PPOA received a Position Letter asking PPOA to agree or disagree with the denial of the refund claim.

December 17, 2008 PPOA filed a disagreement with tax division's Position Letter.

INTERNAL CONTROL FAILURE – Administrative delay – 6 weeks in corrective action.
Recommendation – Legal counsel should be filing actions.

January 14, 2009 PPOA/PPCC contacted State Senator Kip Averitt's office for assistance.

February 27, 2009 Lynda Tomlinson, PPOA Treasurer, emailed the Comptroller withdrawing the request for refund hearing based on advice from legal counsel.

March 31, 2009 PPOA received notification of Tax Division's dismissal of claim due to PPOA's withdrawal of claim. Comptroller's decision no refund due.





EXHIBIT B

COMPTROLLER OF PUBLIC ACCOUNTS

P.O. BOX 13528
AUSTIN, TX 78711-3528

March 26, 2007

Janice Schefsky
Assistant Controller
Pecan Plantation Country Club, Inc.
8650 Westover Ct.
Granbury, TX 75049-4233

Re: Sales and Use Tax Refund Request
Taxpayer Number 17516407883
Refund Period: August 1, 2006 through August 31, 2006

Dear Ms. Schefsky:

Your refund claim covering August 1, 2006 through August 31, 2006 has been reviewed, and our examination indicates that the requested refund must be fully denied. The refund is being denied for the following reason(s): failure to comply with the 30-day request for additional records dated January 29, 2007.

If you disagree with the denial or believe that your refund request or documents were not properly considered, you are entitled to appeal the denial by requesting a refund hearing. The written request (Statement of Grounds) must be submitted within 30 days of the date of this letter and must state all factual and legal grounds or reasons as to why you disagree with the denial. See 34 TAC §§ 1.5 and 1.7. A copy of the Rules of Practice and Procedures can be found on our website at www.window.state.tx.us. Additional supporting documentation should accompany the request, and the written request should be timely mailed to:

Comptroller of Public Accounts
Audit Processing Section
P.O. Box 13528
Austin, TX 78711-3528

Pecan Plantation Country Club, Inc.
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If you have any questions about hearing procedures, please call our Audit Processing Section at 1-800-531-5441, extension 3-4479. Their Austin number is 512/463-4479. If you have any questions regarding the denial of your claim, please give me a call at 1-817-377-8855, or my beeper at 817-824-6103 and you can email me at harvey.williams@epa.state.tx.us.

Harvey Williams
Auditor

NOTE: The following four pages were prepared after the audit was completed, by PPOA Board Member and PPOA Audit Committee Member Bob Kent, as further research on the sales tax matter. This work was never shared with the audit firm and was included as an attachment to the RCO audit that was sent to some PPOA Members.

Mr. Kent's draft research is included on the following pages for informational purposes.

28 MARCH 2010
DRAFT & PRELIMINARY
RESEARCH RELATED TO TAXES ON 2005-2006 ROAD PROJECT

I conducted this research in response to an issue broached by a member of the association and in anticipation that this matter will be referred to the Audit Committee. In March 2010, a member of Pecan Plantation advised the Board of Directors that in his opinion the 2005-2006 road construction contract (\$4,000,000 plus) was a non-residential remodeling contract and taxes should have been collected and paid by the contractor on the entire amount of the contract. This is related to previous discussion, questions and investigations concerning \$159,000 in taxes that were accrued and paid by Pecan's Comptroller and Pecan's subsequent attempts to recover the money. None of the previous discussions questioned if in fact the taxes owed to the state was \$150,000 (assumed to be the approximately amount of taxes on materials) or if the taxes should have been in excess of \$300,000 on both materials and labor. The past discussions have been on why we paid the taxes and if we could get it back.

In 2005, Pecan plantation retained Wilson and Company (Wilson) to prepare plans and specification for a major road project. Wilson was selected as our consulting engineer after receiving proposals from four engineering companies and interviews by the infrastructure committee.¹ The RFP required the engineers to develop Bid Specifications and each firm estimated construction cost of approximately \$5,000,000. These estimates were probably used to calculate their engineering fees since their fees are typically based on the cost of the project. Wilson also agreed to include in the Bid documents "sales tax information and sales tax disclosure".²

After completion of the design, Wilson developed a list of local contractors and each was sent a copy of the advertisement for bids. Six companies were sent invitations and four attended the pre-bid site walk. They were: Reynolds Asphalt, APAC, JRJ Paving and Jay Mills. Reynolds, APAC and Jay Mills notified the engineer that due to workload they would not bid on the project, leaving JRJ as the sole bidder.³

Prior to the Bid advertisement, Wilson developed an independent cost estimate which was not shared with any of the bidders or the public until the bid opening on May 20, 2005. JRJ's written bid was \$3,919,049.09 (LUMP SUM) which was less than the engineer's estimate of \$4,161,038.00. The engineer noted that "the contractor did not submit the sales tax information form". Wilson recommended to the Board, as did the infrastructure committee, that the sole bid be accepted.

A review of the bid documents and contract reflect that this was a lump sum contract with unit prices for adds or deducts. The concerned member who raised the current issue noted several pages were apparently missing from the bid sheet however it is not clear

¹ Presentation from the Infrastructure Committee to the Board of Directors, January 26, 2005 Workshop

² Wilson and Company Letter to Wes Redden, operations Manager, January 18, 2005, Letter of Agreement

³ Wilson and Company letter to Michael Bartholomew, May 25, 2005, Evaluation of Bids.

that this is correct but could be a page numbering problem. The concerned member believes that the missing sheets contain information on the status of the sales tax.

The bid documents prepared by Wilson and sent to the contractors as part of the bid proposal included a section entitled: "Part I General provisions. Item 1.58 relates to State and Local Sales and Use Taxes, and states that "the Owner qualifies for exemption from the state and local sales and use taxes, pursuant to the provisions of section 151.309 of the Texas Limited Sales, Excise and use Tax Act.⁴ However, 151.309 exemptions refer to government entities and Pecan is not a government entity as defined in the law.⁵

A contract was entered into on June 10, 2005 with JRJ Paving. The document was signed by Marty Murphy on behalf of JRJ on June 14, 2005. The document was also signed by Lloyd Jones (VP) and F.D. Smith (VP) and attested to by Michael Bartholomew on an unknown date. (It is not known if the contractor signed the document first or if Pecan Plantation signed it first). The contract states that the contract documents including all bid provisions, plans, specifications, etc are part of the contract.⁶

Work on the project was overseen by Wilson who tracked progress, units completed, change orders, and cost increases based on unit costs. Marv Nelson from the infrastructure committee also tracked cost and many if not all invoices from the contractor were approved by the infrastructure committee before they were sent to the PPOA Comptroller.

Research on the road contract raises a number of issues and suggests that there was general confusion on the part of the Board of Directors, the General Manager and all others involved in the running of Pecan Plantation as to the tax status of Pecan Plantation, and it appears that many thought that we were a tax exempt organization. I was informed by John McComas that we are not a tax exempt organization although it apparently is true that many thought we were.

In July 2006, the PPOA comptroller placed approximately \$159,000 in an account that PPOA uses to collect sales taxes on items that we sell (food, drinks, merchandise, etc) and later this money was sent to the State of Texas along with other sales taxes we had collected. Currently we do not know what prompted him to accrue this money. The attempts to recover these taxes have been the subject of debate and a review by both our auditors and attorney. Our attorney's opinion is that we should not pursue recovery of the tax. However, neither our attorney nor our auditors have commented on if the amount of taxes we should have paid or the contractor should have paid was \$159,000 or if it should have been \$300,000 plus as suggested by our concerned member.

TAXES ISSUES RELATED TO "NON RESIDENTIAL REAL PROPERTY REPAIR OR REMODELING" or "MAINTENANCE".

⁴ Bid Specs prepared by Wilson (obtained from infrastructure committee files)

⁵ Texas Tax Code, Title 2, Subtitle E, Chapter 151.

⁶ Contract between Pecan Plantation and JRJ, two pages, dated June 2005

The current question by a member is if the road project falls under the tax codes related to Nonresidential Real Property Repair or Remodeling. The member is a contractor and his question is valid. Nonresidential real property repair or remodeling is a taxable service. The service provider must collect sales tax on the total charge to the customer for materials, labor and other expenses.⁷ No tax is due on labor to build new non-residential structures. However if the work performed was maintenance, not remodeling or rehabilitation, then only the materials are taxable. It could be questioned if roads are real property. The definition of real property is: "land, including structures and other improvements that are embedded into or permanently affixed to the land".⁸ It appears that our roads fit into this description. The next question is was the work on the roads considered Nonresidential repair and remodeling or was it maintenance. Repair and remodeling includes rebuilding or upgrading any part of an existing structure. Maintenance is any scheduled or periodic work on real property that is not broken. Maintenance is necessary to keep property in good working order to prevent its deterioration.⁹ The project included significant upgrades to the road and the correspondence regarding this contract used the term rehabilitation. There is some ambiguity in if this was maintenance (tax on materials only) or repair or remodeling (tax on total charges). Where activity such as seal coating or crack filling is probably classified as maintenance, our pavement project was probably a repair or remodeling. A final answer would require an interpretation by a tax attorney or a ruling by the State Comptroller's office. Unfortunately, none of the correspondence, bid proposals or specifications specifically includes the words "repair or remodeling" or "maintenance". Instead, words such as "pavement rehabilitation" or "pavement improvements" or "resurfacing" were used in our documents.

SUMMARY

The work performed by JRJ on the Road Improvement Project in 2005 and 2006 was performed under a lump sum contract. The bid documents were prepared by Wilson and Company and contained a statement that the Owner was a Tax exempt organization. The bid by JRJ does not mention sale tax and nowhere in the documents leading up to the bid is a discussion of the tax issues associated with construction. The only mention of responsibility for taxes was in a Form cover letter from JRJ attached to an invoice that stated that all taxes have been paid.¹⁰ It appears that Pecan 's Board of Directors, Management and the infrastructure committee was confused or not knowledgeable concerning the tax status of Pecan or believed it to be tax exempt or did not read all of the bid documents.

REMAINING ISSUES

It is my understanding that the resolution of this tax issue, and the questions raised by a concerned member, will be referred to the Audit Committee at our Monday March 29,

⁷ <http://www.cpa.state.tx.us/taxinfo/taxpubs/tx94-112.html>

⁸ <http://www.cpa.state.tx.us/taxinfo/taxpubs/tx94-116.html>

¹⁰ JRJ request for partial release, Feb 2006

2010 Board Workshop. I suggest that developing answers to the following questions be included in our tasks.

1. Did Pecan Management think we were a tax exempt organization and if so why?
2. Did the Engineer (Wilson) think we were tax exempt and why?
3. Did the contractor think we were tax exempt and why?
4. Did the contractor pay any taxes on materials or labor to either the suppliers or to the State Comptrollers office?
5. Assuming that the tax on the labor and materials were paid by the contractor and were included in his lump sum bid, can we get back any of our money from the State. (Apparently not based on current advice)
6. Assuming the contractor did not include taxes in his bid and should have, who is responsible for paying them.
7. What are Pecan's obligations, exposure and or liability in this issue?

RECOMMENDATIONS FOR AUDIT COMMITTEE

The audit committee should interview all involved with this issue including our past and current comptrollers, general manager, Board representatives and officers who signed the contract and Wilson and Company. Our auditors and attorney should also be consulted if we have questions. Hopefully we can accomplish the following

1. Resolve the issue related to the amount of tax which should have been paid and who should have paid it.
2. Establish once and for all the status of Pecan Plantation's tax status (historically and currently) and notify all management and staff and committees of our status.
3. Institute a process to insure all work for new construction, remodeling or maintenance is properly classified and noted in bid documents or insert a clause in our bid documents that it is the contractor's responsibility to properly classify the work and to calculate and include any tax in his bid.

Note: All of the above is my preliminary research and some of my conclusions or statements involve questions properly resolved by auditors or attorneys. Accordingly, I submit this for information only and this is my own, **unqualified** opinion.