

Internal Audit Department
NeighborWorks® America

Audit Review of Leases & Leasehold Improvements including a recap of the Headquarters Office Relocation

Project Number: ADMIN.LEASEHOLD.2013

Audit Review of the Leases & Leasehold Improvements

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April 24, 2014

To: NeighborWorks America Audit Committee

Subject: Audit Review of the Leases & Leasehold Improvements

Please find enclosed the final audit report of the Leases & Leasehold Improvements including a recap of the Headquarters Office relocation. Please contact me with any questions you might have.

Thank you.

Frederick Udochi
Chief Audit Executive

Attachment

cc: C. Wehrwein
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Function Responsibility and Internal Control Assessment
Audit Review of the Leases & Leasehold Improvements

| Business Function Responsibility | Report Date | Period Covered |
|---|----------------|--|
| Administrative Services and Finance | April 24, 2014 | as of September 2013 |
| Assessment of Internal Control Structure | | |
| Effectiveness and Efficiency of Operations | | Generally Effective¹ |
| Reliability of Financial Reporting | | Generally Effective |
| Compliance with Applicable Laws and Regulations | | Not Applicable |

This report was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*.

¹ **Legend for Assessment of Internal Control Structure:** **1. Generally Effective:** The level and quality of the process is satisfactory. Some areas still need improvement. **2. Inadequate:** Level and quality of the process is insufficient for the processes or functions examined, and require improvement in several areas. **3. Significant Weakness:** Level and quality of internal controls for the processes and functions reviewed are very low. Significant internal control improvements need to be made.

Executive Summary of Observations, Recommendations, and Management Responses

| Summarized Observation; Risk Rating | Management Agreement with Observation (Yes/ No) | Internal Audit Recommendation Summary | Accept IA Recommendation (Yes/ No) | Management's Response to IA Recommendation | Estimated Date of Implementation (Month/Year) | Internal Audit Comments on Management Response |
|---|---|--|------------------------------------|---|--|--|
| <p>Observation No. 1 Deferred Rent Schedules / Journal Entries – NY and Atlanta</p> <p>Based on our review of the deferred rent schedules, Internal Audit notes the Atlanta deferred rent schedule had not been prepared; therefore, the resulting required deferred rent journal entries had not been recorded in the financial statements. In addition, the deferred rent schedule prepared for the New York office was not accurate.</p> <p>Risk Rating: (b) (4)</p> | Yes | <p>Recommendation No. 1 Adjustment to Deferred Rent/Rent Expense Schedules</p> <p>Internal Audit recommends Management revise the deferred rent schedules for the Atlanta and New York offices and make the recommended entries to the current and prior periods.</p> <p>In addition to updating the deferred rent schedules, Internal Audit also recommends that internal processes be modified to ensure Finance receives a copy of all final lease agreements/amendments to ensure all relevant information is available to generate the deferred rent schedules.</p> | Yes | <p>Management agrees with the recommendations and revised the Atlanta and New York offices deferred rent schedules and made the recommended entries to the current and prior periods. These changes are reflected in the FY2013 audited financial statements. Going forward the correct deferred rent figures will be reported on the financials.</p> <p>Management also developed a system to give appropriate Finance staff access to all office space lease documents upon the execution of new leases or amendments to existing leases. Finance staff will timely adjust the deferred rent /rent expense schedules accordingly.</p> | These recommendations were implemented as of 03/01/2014. | Internal Audit accepts Management's response. |

| Summarized Observation; Risk Rating | Management Agreement with Observation (Yes/ No) | Internal Audit Recommendation Summary | Accept IA Recommendation (Yes/ No) | Management's Response to IA Recommendation | Estimated Date of Implementation (Month/Year) | Internal Audit Comments on Management Response |
|---|---|--|------------------------------------|--|---|--|
| <p>Observation No. 2 Kansas City Office Lease Approval</p> <p>Documentation to support board approval of the Kansas City office lease was not available.</p> <p>Risk Rating: (b) (4)</p> | <p>Yes</p> | <p>Recommendation No. 2 Verify Board Approval prior to Execution</p> <p>Internal Audit recommends Management enhance processes to ensure all new lease agreements and amendments are presented to and approved by the Board prior to execution.</p> | <p>Yes</p> | <p>Management agrees with the recommendation. Staff will ensure that all lease agreements and amendments that require Board approval will be approved by the Board prior to execution and that the approval is appropriately documented.</p> <p>Management has followed this protocol according to policy and it has been very effective. In a recent Board of Directors meeting held on March 27, 2014, Management presented office space lease renewals for the Boston, Cincinnati, Denver and Los Angeles offices, all of which were approved by the Board prior to execution. The approvals were appropriately documented.</p> | <p>03/31/2014</p> | <p>Internal Audit accepts Management's response.</p> |

| Summarized Observation; Risk Rating | Management Agreement with Observation (Yes/ No) | Internal Audit Recommendation Summary | Accept IA Recommendation (Yes/ No) | Management's Response to IA Recommendation | Estimated Date of Implementation (Month/Year) | Internal Audit Comments on Management Response |
|--|---|---|------------------------------------|--|---|--|
| <p>Observation No. 3 MOVE Budget – Budget to Actual Recap</p> <p>The actual expenses incurred to relocate the DC office exceed the board approved budgeted amount. Management communicated that the additional expenses incurred were accounted for through the CORE budget; however, the details of the CORE funding sources (i.e., departmental) and the respective amount of the additional expenses was not disclosed.</p> <p>Risk Rating: (b) (4)</p> | Yes | <p>Recommendation No. 3 Full Disclosure of Project Costs</p> <p>For future office moves and major projects, Internal Audit recommends that Management ensure that the full cost of a project is disclosed to the Board without regards to the source of funds.</p> | Yes | Management will ensure that all costs associated with an office relocation will be fully disclosed and communicated to the Board. | Immediately | Internal Audit accepts Management's response. |
| <p>Observation No. 4 Recordkeeping and IT Assets No Longer In Service</p> <p>Sufficient documentation was not maintained to support the transfer of discarded computer equipment to the disposal vendor during the MOVE process. In addition, IT</p> | Yes | <p>Recommendation No. 4 4A. Policy on the Retirement and Disposition of IT Assets</p> <p>Internal Audit recommends IM establish an Asset Management Policy that addresses procedures and processes to be followed</p> | Yes | 4A. Finance, Information Management and Administrative Services agree to work together to enhance and update the existing policy that addresses the process/procedure for handling fixed IT assets that need to be retired. | 09/30/2014 | Internal Audit accepts Management's response. |

| Summarized Observation; Risk Rating | Management Agreement with Observation (Yes/ No) | Internal Audit Recommendation Summary | Accept IA Recommendation (Yes/ No) | Management's Response to IA Recommendation | Estimated Date of Implementation (Month/Year) | Internal Audit Comments on Management Response |
|--|---|---|------------------------------------|--|---|--|
| <p>computer hardware (disks/tapes) disposed of was not properly removed from the financial records because the required forms were not completed and provided to Finance.</p> <p>Risk Rating: (b) (4)</p> | | <p>when assets are retired.</p> <p>4B. Physical Inventory of IM Assets</p> <p>Internal Audit recommends Information Management in partnership with Finance conduct a physical inventory of its assets. The inventory should verify assets currently within the (b) (4) as well as identify assets not captured in the system but should be. The results of the inventory should properly be reflected in the (b) (4)</p> | <p>Yes</p> | <p>4B. Management will conduct a corporate wide physical inventory of IM assets before the end of FY2014. Information Management will partner with Finance in an effort to ensure that all fixed IT assets are appropriately identified within the (b) (4) is also currently working on a RFP for an ITSM – Information Technology Service Management solution that will have IT asset management integrated.</p> | <p>09/30/2014</p> | <p>Internal Audit accepts Management's response.</p> |

Risk Rating Legend:

Risk Rating: HIGH

A serious weakness which significantly impacts the Corporation from achieving its corporate objectives, financial results, statutory obligations or that may otherwise impair the Corporation's reputation.

Risk Rating: Moderate

A control weakness which could potentially undermine the effectiveness of the existing system of internal controls and/or operational efficiency, integrity of reporting and should therefore be addressed.

Risk Rating: Low

A weakness identified which does not seriously detract from the system of internal control and or operational effectiveness/efficiency, integrity of reporting but which should nonetheless be addressed by management.

| Management Response to Audit Review of the Leases & Leasehold Improvements and recap of the Headquarters Office Relocation | | |
|---|---|-------------------------|
| # Of Responses | Response | Recommendation # |
| 5 | Agreement with the recommendation(s) | 1, 2, 3, 4A, 4B |
| 0 | Disagreement with the recommendation(s) | N/A |

Background

NeighborWorks America has a total of nine leased office locations, including the headquarters office throughout the US, see the chart at Appendix A. NeighborWorks headquarters office located in Washington, DC has the largest leased office of approx. (b) (4) [REDACTED]. The Administrative Services Division of NeighborWorks is primarily responsible for NeighborWorks' lease administration process, which includes serving as the primary contact between NeighborWorks, the landlord and the real estate broker, leading efforts to assess leased space needs, and making office space recommendations to Management regarding renewing or terminating lease agreement.

In May 2013, NeighborWorks America relocated its headquarters office in Washington DC from 1325 G Street NW to 999 North Capitol Street NE. The decision to relocate the headquarters office was a multistep process, which included the procurement of the real estate broker (b) (4) [REDACTED] to assess the office space in the Washington DC area, the procurement of architects to design the space, and surveying current headquarter office employees to better understand commuting habits/office space preferences. In addition, the relocation of the headquarters office resulted in the acquisition/retirement of leasehold improvements, furniture/fixtures, and IT related equipment.

Objective

The objective of the audit was to:

- Review and evaluate NeighborWorks America leases and leasehold improvement policies and procedures;
- Ensure that leases were properly authorized; and
- Ensure that lease and leasehold improvement transactions were properly captured in the financial statements.

Due to the size of this office relocation, Internal Audit also reviewed the following activities related directly to the relocation of the headquarters office:

- Disposal of assets as a result of the move by (donation, auction, or destruction); and
- Management and reporting of the MOVE Budget and related expenses.

Scope and Scope Limitation

Internal Audit selected the Washington DC, Kansas City, New York, and Atlanta Offices to conduct detailed testing over lease management and accounting. However, due to the timing of the review by both Internal Audit and the External Auditors (BDO), testing over leasehold improvements in Kansas City and Washington DC was limited to reduce duplication of efforts.

The review also covered the following specific activities relevant to the relocation of the headquarter office: (a) Assets disposed of via donation, auction, or destruction/discarded and (b) MOVE budget.

Methodology

Internal Audit segmented the audit review into two parts (a) Audit review of the management and accounting for leases and leasehold improvements and (b) Audit review of specific key activities resulting from the relocation of the headquarter office.

Internal Audit judgmentally selected the following office lease locations based on materiality, termination date, and square footage:

- Washington, DC - (b) (4)
- Kansas City - (b) (4)
- New York City - (b) (4)
- Atlanta - (b) (4)

Internal Audit obtained an understanding of lease and leasehold improvement policies and procedures by reviewing the applicable sections of the Administrative Manual and Management responses to an Internal Audit prepared risk questionnaire. Internal Audit reviewed the lease agreements, recalculated the deferred rent schedules, and reviewed rent payment remittances. Internal Audit reviewed leasehold improvements for the new headquarters office and the Kansas City office to ensure proper capitalization.

In relation to the headquarters office relocation, Internal Audit reviewed the budget and asset disposal activity resulting from the move.

Observations and Recommendations

Leases and Leasehold Improvements Observations and Recommendation

Observation No. 1 – Deferred Rent Schedules/ Journal Entries

Under section 840 (Leases) of the FASB Accounting Codification, rent expense should be recorded on a straight-line basis over the life of the lease agreement taking into account escalations in rent payments and rent incentives (e.g., free rent/rent holidays). In order to determine the amount of rent expense to be recorded, a deferred rent schedule is generated to capture the difference between the calculated straight-lined rent and the actual rent payments to be remitted over the life of the lease. Internal Audit reviewed the deferred rent schedules and resulting year-end deferred rent journal entry prepared by finance and noted the following:

- A schedule had not been prepared for the renewal of the Atlanta office resulting in an understatement of deferred rent in the amount of \$(b) (4)
- The schedule prepared for the NYC office did not factor in an additional rent component noted in the lease agreement resulting in an understatement of deferred rent in the amount of (b) (4) (b) (4) (b) (4) of the amount represents a prior period adjustment)

Recommendation No. 1 – Adjustment Deferred Rent Schedules/Rent Expense Schedules

Internal Audit recommends Management revise the Atlanta and New York Offices deferred rent schedules and make the recommended entries to the current and prior periods:

Recommended Entry 1 – Atlanta Lease

| | | |
|-------------------|---------|---------|
| Dr. Rent Expense | (b) (4) | |
| Cr. Deferred Rent | | (b) (4) |

Recommended Entry 2 – New York Lease (FY 2013)

| | | |
|-------------------|---------|---------|
| Dr. Rent Expense | (b) (4) | |
| Cr. Deferred Rent | | (b) (4) |

Recommended Entry 3 – New York Lease (prior period adjustment)

| | | |
|-------------------|---------|---------|
| Dr. Rent Expense | (b) (4) | |
| Cr. Deferred Rent | | (b) (4) |

In addition to updating the deferred rent schedules, Internal Audit also recommends that internal processes be enhanced to ensure Finance receives a copy of all final lease agreements/amendments to ensure all relevant information is available to generate the deferred rent schedules.

Observation No. 2 – Board Approval of Kansas City Office Lease

Internal Audit notes that all office space leases must be approved by the Board. Internal Audit acknowledges that prior to the execution of the Kansas City office space lease, Management had discussed the Kansas City office lease changes with the Board; however, management was unable to provide documentation to support that the office lease for the Kansas City

Office (in the amount of (b) (4) /month) commencing in 2010 was formally approved by the Board of Directors.

Recommendation No. 2 – Verify Board Approval prior to Lease Execution

Internal Audit recommends Management enhance processes to ensure all new lease agreements and amendments are presented to and approved by the Board prior to execution.

Headquarters Office Relocation/MOVE Observations and Recommendations

Observation No. 3 – MOVE Budget – Budget to Actual Recap

In June 2012, the Board approved the decision to relocate NeighborWorks’ headquarter office to its current location of 999 North Capitol Street, NE in Washington, DC. Management presented a budget to the Board as a representation of the anticipated cost and net cash impact of the relocation. The original budgeted amount was \$(b) (4) and the amount was allocated to three cost categories – hard, soft, and specialty costs. In September 2013, Management presented the final budget to the Board, noting the costs totaled \$(b) (4) compared to a budgeted amount of \$(b) (4) with an increase of approx. \$(b) (4) to (b) (4) derived from the major capital investment reserve and other operating budget line items across Finance, Administrative Services, and Information Management.

In order to ensure costs related to the move were tracked, Management assigned project code (b) (4) within (b) (4) to capture costs associated with the relocation of the Headquarter (HQ) Office. Internal Audit requested a listing of all HQ office relocation project expenses (excluding Payroll) incurred noting that the actual incurred expenses totaled approximately (b) (4) which exceeded the budgeted amount by \$(b) (4) (b) (4). Management communicated that the additional expenses incurred were accounted for through the CORE budget; however, details of the CORE funding sources (i.e., departmental) and the respective amount of the additional expenses was not disclosed. Per review of the expenses incurred, Internal Audit notes the following variances:

| Cost Categories | Original Budget | Actuals | \$ Variance | % Variance |
|---|----------------------|----------------------|-------------|------------|
| | (net vendor credits) | (net vendor credits) | | |
| | per FB&PC binders** | per IA | | |
| Hard Costs | (b) (4) | | | |
| Soft Costs | | | | |
| Specialty Costs | | | | |
| Contingency Costs | | | | |
| CORE Budget Capital Investment Reserve Allocation | | | | |
| TOTALS | | | | (b) (4) |
| Landlord Improvement Allowance | | | | |
| Rent Abatement | | | | |
| Food Service Vendor Credit | | | | |
| Net Yr 1 Cash Impact | (b) (4) | | | (b) (4) |
| ** Finance, Budget, and Program Committee Meeting binders | | | | |

Recommendation No. 3 – Full Disclosure of Project Costs

For future office relocations and major Board approved projects, Internal Audit recommends Management ensure that the full cost of a project is disclosed and documented to the Board without regards to the source of such funds.

Observation No. 4 – Recordkeeping and IT Assets No Longer in Service as a Result of the Move

The relocation of an office space often results in the retirement of assets previously acquired by the organization. The Information Management division is the primary custodian and is therefore responsible for information technology related assets and Administrative Services is responsible for all other assets (i.e., furniture) acquired by the organization. Internal Audit requested that both Administrative Services and Information Management provide documentation to support identifying the assets retired and documentation to support how the assets were retired (i.e., destruction, donation, and/or auction).

Internal Audit noted that IM procured the services of the vendor (b) (4) to dispose of and destroy several computer servers (tapes/hard drives) and documentation was provided to support destruction of the related hard drives and tapes; however, the assets remained in the (b) (4) system as in service as of the audit date. In addition, there were several items of computer equipment retired and the vendor - was procured to dispose of the assets; however, documentation was not maintained to support the transfer of the specific assets to the vendor and subsequent destruction by the vendor. As a result, required corporate forms that should have been completed indicating asset disposals/retirements from the asset management system (b) (4) did not occur.

Recommendation 4A: Policy on the Retirement and Disposition of IT Assets

Internal Audit recommends IM establish an Asset Management Policy that addresses its responsibilities and procedures to be executed when assets are retired. At a minimum the policy should include the following:

- Define applicable assets;
- Define IM personnel responsibilities;
- Describe the process to retire IM assets via destruction, donation, and/or auction;
- Specify disposal requirements based on asset type;
- Identify key documentation required to capture the process; and
- Identify the necessary forms designated by Finance for disposal activity to ensure disposal activity is captured in the (b) (4).

Recommendation 4B – Physical Inventory of IM Assets

Internal Audit recommends IM in partnership with Finance conduct a physical inventory of its assets. The inventory should verify assets currently within the (b) (4) System as well as identify assets not captured in the system but should be. The results of the inventory should properly be reflected in the (b) (4).

Conclusion

Lease and leasehold improvements activity while infrequent at NeighborWorks America, is a significant component of NeighborWorks annual budget. Management has effectively designed processes and procedures to understand the workspace needs and continues to identify adequate workspace to accommodate the diverse ever changing needs of the company and its employees. This audit conducted evaluated the design and operational effectiveness of key operational and financial components of this process, and notes that the implementation of the recommendations noted above, will further improve current operations.

APPENDIX A – NeighborWorks America Office Leases as of September 2013

| Office Location | Management Company | Lease Expiration Date | Square Footage | Base Rent |
|-----------------|--------------------|-----------------------|----------------|------------|
| Washington, DC | [REDACTED] | 6/30/2023 | (b) (4) | (b) (4) |
| Boston, MA | [REDACTED] | 11/30/2014 | [REDACTED] | [REDACTED] |
| Kansas City, MO | [REDACTED] | 12/31/2020 | [REDACTED] | [REDACTED] |
| New York, NY | [REDACTED] | 8/31/2018 | [REDACTED] | [REDACTED] |
| Denver, CO | [REDACTED] | 9/30/2014 | [REDACTED] | [REDACTED] |
| Anaheim, CA | [REDACTED] | 7/31/2014 | [REDACTED] | [REDACTED] |
| Cincinnati, OH | [REDACTED] | 6/30/2014 | [REDACTED] | [REDACTED] |
| Atlanta, GA | [REDACTED] | 10/31/2018 | [REDACTED] | [REDACTED] |
| New Orleans, LA | [REDACTED] | 10/31/2016 | [REDACTED] | [REDACTED] |
| TOTAL | | | | |