

Internal Audit Department
NeighborWorks® America

Audit Review of External Business Relationships - Community Housing Capital

Project Number: NWA.EBRCHC.2012

**Audit Review of External Business Relationships -
Community Housing Capital**

Table of Contents

Completion Letter	1
Function Responsibility and Internal Control Assessment.....	3
Executive Summary of Observations, Recommendations, and Management Responses.....	4
Risk Rating Legend	5
Background	6
Objective	8
Scope	8
Methodology.....	8
Observations and Recommendations	9
Conclusion	9

September 19, 2012

To: NeighborWorks America Audit Committee

**Subject: Audit Review of External Business Relationships -
Community Housing Capital**

Please find enclosed the final audit review report of the External Business Relationship with Community Housing Capital. There were no significant observations to report on. Please contact me with any questions you might have.

Thank you.

Frederick Udochi
Director of Internal Audit

Attachment

cc: E. Fitzgerald
M. Forster
C. Wehrwein
J. Bryson
L. Finucane
S. LeGrand

Function Responsibility and Internal Control Assessment
Audit Review of External Business Relationship -
Community Housing Capital

Business Function Responsibility	Report Date	Period Covered
Corporate	September 19, 2012	September 27, 2011 - August 30, 2012
Assessment of Internal Control Structure		
Effectiveness and Efficiency of Operations	Generally Effective¹	
Reliability of Financial Reporting	Not Applicable	
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><i>There were not any reportable observations for this review.</i></p> <p>Risk Rating: N/A</p>	N/A	N/A	N/A	N/A	N/A	N/A

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 the Audit Review of External Business Relationships - Community Housing Capital		
# Of Responses	Response	Recommendation #
N/A	Agreement with the recommendation(s)	N/A
N/A	Disagreement with the recommendation(s)	N/A

Background

Community Housing Capital is one of two related capital corporations serving NeighborWorks® America's Network organizations (the Network). Community Housing Capital (CHC) was established as spin-off from Neighborhood Housing Services of America (NHTA); however, NHTA ceased operations in January 2011. As such, CHC emerged with the primary focus to originate interim development financing (e.g., acquisition and construction loans) and multifamily permanent loans to NeighborWorks Network Organizations and eventually the community development industry. CHC is a certified Community Development Financial Institution (CDFI) and Community Development Entity (CDE). Despite the challenges of the markets and limited access to capital, CHC has been able to emerge in the difficult times as a strong CDFI. CHC has been able to obtain and maintain strategic partnerships with lending institutions for the purposes of increasing available lending capital and lender participation. Some of its partners include [REDACTED]. In addition, CHC has secured funding from the CDFI Fund and NeighborWorks® America to strengthen its balance sheet and leverage its private sector investments.

In September 2011, the business relationship between NeighborWorks America and CHC was formalized in a Master Investment Agreement. The Master Investment Agreement is a five year agreement that establishes parameters for funding to CHC from NeighborWorks, which is contingent upon Congressional Appropriations, CHC's compliance with its annual Business Plan presented to NeighborWorks Management, and other conditions outlined in the Master Investment Agreement. Key components of the Agreement include the following requirements:

- CHC to notify NeighborWorks if there are any significant changes to its business (i.e., Accounting Changes, Investment Policy, business structure changes, etc.).
- CHC to provide NeighborWorks with CFO-certified quarterly financial statements within 45 days of the quarter's end.
- CHC to designate a representative to participate on NeighborWorks Organizational Health Tracking System (OHTS) committee to provide input and analysis on the rating of the NeighborWorks' Network Organizations.
- CHC to provide NeighborWorks with copies of its annual audited financial statements within 120 days of the year end.
- CHC to provide NeighborWorks and its Agent(s) reasonable access to its premises to inspect records.
- CHC to authorize NeighborWorks to communicate directly with its external auditor.
- CHC to meet specific financial and production targets outlined in the agreement.

In addition to the requirements of CHC, the Agreement also outlines rights and responsibilities of NeighborWorks, including the following:

- The right to designate an observer to attend all board meetings. The Director of the National Initiatives Applied Research is NeighborWorks' designated observer.

- The right to nominate one outside board member to CHC's board, whom will be appointed to any committee charged with identifying/selecting CHC's CEO in the event of a departure.
- The right to conduct program reviews (conducted by the Organization Assessment Division) no more than once every two years and CHC is required to remedy Corrective Actions and/or Areas for Improvement.
- The responsibility to provide CHC Operational, Fundraising, communications, Marketing, Training, and Technology support within reason.
- The responsibility of approving all corrective actions plans and other required submittals.

As of the date of this audit report, CHC has received \$2.5 million in grant funds (of which \$2 million was restricted capital and \$500,000 was expendable) from NeighborWorks America for both fiscal year 2011 and 2012. These funds were paid out of the National Initiatives Applied Research budget.

CHC had net assets of \$ [REDACTED] million for the year ended 2011 and total assets of \$ [REDACTED] million at the end of the 2011 fiscal year. In addition, CHC closed \$ [REDACTED] million in loans, which was in excess of its FY 2011 production goal.

Objective

The audit objective was to obtain assurance that adequate oversight controls were in place over the external business relationship with Community Housing Capital.

Scope

The scope of this review included monitoring and oversight activities in place and occurring over Community Housing Capital as a result of the execution of the Master Investment Agreement.

Methodology

Internal Audit met with the Director of National Initiatives and Applied Research to obtain an understanding of the business relationship between NeighborWorks America and CHC. Internal Audit reviewed CHC's website, the Master Investment Agreement, the CHC Program Review Report (performed by OAD in August 2011), and the CHC CARSTTM rating report² (conducted as of December 31, 2010) to obtain background information on the business relationship and CHC's operations.

Internal Audit developed an audit program focused on key components of the Master Investment Agreement. Internal Audit reviewed documentation to ensure the following:

- CHC provided NeighborWorks with the required closing date deliverable documents (i.e., CHC governing documents, Board Resolutions authorizing execution of the Agreement, Conflicts of Interests Policy, Certificate of the Secretary of the State of California with Articles of Incorporation, executed Trademark License Agreement, etc.);
- CHC provided NeighborWorks with Quarterly and Annual financial statements and certifications within the required timeframe;
- CHC attended and participated on the OHTS committee; and
- NeighborWorks attended CHC board meetings (as a Board observer).

Furthermore, Internal Audit reviewed documentation to support NeighborWorks' evaluation of CHC for FY 2012 funding to ensure CHC met the financial and production targets outlined in the Master Agreement. See the targets below:

- Production Volume - as defined in the annual Business Plan presented to NeighborWorks Management
- Operating Efficiency - equal to greater than 80% at year end
- Operating Cash Reserve - minimum 3 months
- Deployment Ratio - 60% at year end
- Net Interest Margin - minimum 1.1 at year end
- Leverage - 80% of loan production leveraged by third party investment

² CARSTTM, the CDFI Assessment and Ratings System, is the only comprehensive, third-party assessment of a CDFI's impact performance *and* financial strength and performance. CARSTTM helps investors confidently assess CDFIs that match their social objectives and risk parameters

Observations and Recommendations

There were not any significant observations to report as a result of the testing and examination of documents performed by Internal Audit.

Conclusion

Based on the audit performed, Internal Audit concludes that there is sufficient assurance that NeighborWorks America currently has adequate controls and oversight activities in place that if consistently performed would identify and mitigate risks associated with the Community Housing Capital external business relationship. Management should however continue to update the protocols in place based on new information or trends that may emerge.