To: Ken Wade, Eileen Fitzgerald, Michael Forster, Jeff Bryson

From: Frederick Udochi

cc: Jeanne (Reitz) Fekade-Sellassie, [redacted] (Internal Audit Consultant)

Date: August 25, 2008

Subject: Audit Review: ACORN Housing Corporation (AHC)

As part of our continuous monitoring within the context of the Internal Audit Plan for the National Foreclosure Mitigation Counseling (NFMC) Program, please find below an internal audit report pertinent to the ACORN Housing Corporation (AHC). Please review and let me know if you have any comments or questions.
## Summary of Observations and Recommendations

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<tr>
<th>Summarized Observation; Risk Rating</th>
<th>Management Agreement with Observation (Yes/No)</th>
<th>Internal Audit Recommendation</th>
<th>Accept IA Recommendation (Yes/No)</th>
<th>Management’s Response to IA Recommendation (Received on 9/29/08)</th>
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<th>Internal Audit Comments on Management Response</th>
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<td>A. An unqualified audit opinion was provided on the consolidated financial statements of AHC with 6 control deficiencies noted in the report on Internal Control over Financial Reporting and on Compliance and Other Matters based on an audit of financial statements performed in Accordance with Government Auditing Standards.</td>
<td>Yes. Through a competitive process, Mayer, Hoffman, McCann PC, a national public accounting firm was selected to review the audits submitted to NFMC through the NFMC grant application; and our Organizational Assessment Division reviewed MHM’s report in detail and assigned risk ratings. Acorn Housing Corporation’s unqualified audit was reviewed and all deficiencies itemized were noted during the review and related to sub-standard reconciliations, timing and practices for supervisory reviews, etc.; these factors resulted in an NFMC compliance risk rating of [Redacted]; the materiality of the deficiencies did not qualify the auditor’s opinion and thus did not elevate the overall risk to warrant follow-up in the pre-award phase. Only two organizations had findings that required follow-up before grant awards could be made. Grants for two additional organizations were delayed until an up to date audit was received.</td>
<td>It is recommended that AHC be immediately placed on a priority listing for an on-site compliance visit and request for management’s response to the findings in a Corrective Action Plan. In addition, a copy of the most recent audited financial statements, presumably FY 2007, should be provided to NeighborWorks® America.</td>
<td>Yes.</td>
<td>On-site compliance visit: Yes. AHC has already been identified through our regular risk-scoping system as an organization that will be granted an on-site compliance review. AHC’s corporate office will be visited as well as 3 of their branch offices: San Diego, Kansas City, and Phoenix. Management will request a copy of the Corrective Action Plan developed by AHC’s management in response to the deficiencies noted in their audit. Note however that in MHM’s independent review of AHC’s audit during the grant review process for NFMC Round 1, it was determined that the six control deficiencies did not rise to a level that made AHC ineligible to receive a grant. In the event any issues are uncovered during the NFMC compliance visit, management will appropriately address them at that time. Regarding audited financial statements: it is anticipated that AHC will be applying for NFMC Round 2 funds and will be required to submit these with their application when/if they apply. We will share the updated reports with Internal Audit.</td>
<td>On-site compliance visit: These will occur before the end of the Calendar Year. Audited financial statements: we will supply these to the Internal Audit team before October 30, 2008.</td>
<td>Internal Audit accepts Management’s response</td>
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1 The observations and recommendations in this section are summarized at a high level for informational purposes. To obtain a full, detailed explanation of each, please refer to the “Observations and Recommendations” section. Management’s response is directly related to the detailed observations and recommendations noted in the “Observations and Recommendations” section.
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<td>B. It was observed that there is a vendor contract with ACORN (Texas branch office).</td>
<td>Yes. AHC made us aware of this prior to entering into a contractual relationship with ACORN and our Office of General Counsel vetted the request in terms of whether AHC could enter into a vendor rather than sub-recipient agreement with ACORN.</td>
<td>It is recommended that Management also obtain as part of its due diligence on AHC any intended action or non-action in respect of Section 10.3.2 in the Vendor Agreement between AHC and Texas ACORN given the public disclosures from the New York Times.</td>
<td>Yes.</td>
<td>Management will request that AHC inform us of any intended action or non-action in respect to this section of their vendor agreement with ACORN.</td>
<td>We will request this be submitted by October 15, 2008.</td>
<td>Internal Audit accepts Management’s response.</td>
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**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.
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<th># Of Responses</th>
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<tr>
<td>2</td>
<td>Agreement with the recommendation(s)</td>
<td>A, B</td>
</tr>
<tr>
<td>0</td>
<td>Disagreement with the recommendation(s)</td>
<td>N/A</td>
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Background

On 24 February 2008, NeighborWorks® America (NWA) awarded a grant of $7.9 million to ACORN Housing Corporation (AHC) in connection with the NFMC program, to act as an intermediary in the provision of foreclosure counseling services. This amount would serve to roughly double AHC’s total revenue base (approx. $8 million in FY2006).

On 01 May of this year, NWA disbursed approximately $3.2 million to AHC to launch the grant. Of the 130 NFMC disbursements affected since the inception of the program, this was the fifth largest grant disbursed. The grant balance yet to be disbursed is $4.7 million.

On 09 July 2008, the Internal Audit department located a New York Times article\(^2\) reporting an embezzlement and cover-up involving the Association of Community Organizations for Reform Now (ACORN). Internal Audit was made privy to a letter received by management from AHC with the purpose of assuring NWA that AHC and ACORN are entirely separate organizations and that ACORN’s reported problems would not have implications for AHC’s work under NFMC.

Audit Objective

On 16 July 2008, Internal Audit proposed to initiate a project, within the context of the NFMC Continuous Auditing workstream, to:

- Assess the risks to NFMC and NWA stemming from its grant to AHC and in light of this new information;
- Provide timely recommendations for action (as appropriate) to Management balancing risks and financial / operational considerations.

Scope Limitations on Information

Internal Audit has based its opinions in respect of AHC solely on the grant materials submission from AHC, which included financial statements; AHC’s letter to the NWA management; the Mayer Hoffman McCann P.C. independent accountants report\(^3\). Internal Audit has conducted its assessment based on information currently in its possession.

Methodology

To perform the project, Internal Audit examined:

- The grant agreement between NWA and AHC;

\(^2\) The New York Times, July 9, 2008
\(^3\) Firm contracted by the NFMC team to undertake an analysis of Grant Applicant financial statements applying “agreed upon procedures” provided by NWA.
- The audit opinion and financial statements supplied by AHC (related to its fiscal years 2005 and 2006) as part of its application for NFMC funding (Mayer Hoffman McCann P.C. report);
- Correspondence between NWA and AHC regarding the events involving ACORN and its affiliates;
- Vendor agreement entered into by AHC with ACORN for outreach services.

Inherent within the assessment of risk would be *(inter alia)*:

- Consideration of the nature of the financial and management relationship between AHC and ACORN affiliates;
- The extent to which AHC’s NFMC grant execution depends on AHC’s affiliates for implementation;
- Any indications regarding the state of internal controls in place at AHC;
- Potential implications to the implementation of NFMC with ACORN in a contractual relationship with AHC.

*Appendix A* below shows a brief risk assessment as processed with current information.

**General Observations**

**Relationship between AHC and ACORN Affiliates:**

In form and structure AHC and ACORN might be incorporated as separate entities, however observed transactions suggest otherwise in substance based on information from the FY 2006 financial statements.

(i) **Financial Links:** In FY 2005 and 2006, at least $2.5 million, or 30% of AHC revenues, were channeled through its affiliated organizations, including ACORN proper and Citizens’ Consulting Incorporated (CCI). CCI provides bookkeeping, accounting, corporate and administrative services to AHC as well as other ACORN affiliates. AHC incurred costs of at least $350K and $329K to CCI in FY2005 and FY2006, respectively over the sharing of offices and facilities. The sharing of overhead expenses between the sister organizations is also extensive, including over $100K just in office space expenses to ACORN proper.

(ii) **Control:** While recognizing that AHC and its affiliates are overseen by independent boards of directors, the notes to AHC’s FY 2005-2006 financial statements states that AHC “is one of a number of nonprofit organizations dedicated to various community service projects. These nonprofit organizations are also under certain common controls by individuals who could exercise influence over their day-to-day decisions.”
(iii) **Common Bookkeeping Service Provider:** Based on the FY 2005-2006 financial statements AHC employs CCI for its bookkeeping and accounting services, as do ACORN and other ACORN affiliates. CCI is registered as a non-profit corporation in the state of Louisiana with an address the same as ACORN and its affiliates.

**Observations noted for Recommendations**

**A. Reliability of Accounting & Reporting**

An unqualified audit opinion was provided on the consolidated financial statements of AHC with 6 control deficiencies in the *Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*. Five were considered to be significant deficiencies and one a material weakness. There was no information provided showing that these deficiencies had been resolved. The nature of these deficiencies ranged from poor cutoff of receipts and payables, improper reconciliation of accounts receivable to general ledger and related payables and receivables in inter-company transfers not reconciled.

**B. Vendor Contract with ACORN (Texas branch office)**

Prior to the *New York Times* disclosures AHC had entered into a contractual vendor agreement for the purchase of outreach services with ACORN in the total amount of $291,330 with the Texas branch of ACORN. This contract was dated April 15th 2008 and inclusive in the contract agreement is mention of a Termination for Cause clause as follows:

*Under Section 10.3 Termination for Cause it also states that this Agreement may be terminated for cause, in whole or in part, by AHC upon written notice to the Vendor. The term “cause” shall include, but not be limited to:*

*Section 10.3.1 a material breach of any term of the Agreement, provided that Vendor shall have fifteen (15) days to cure the such breach (which period may be extended in the sole discretion of AHC) after receiving notice of the material breach thereof from AHC;*

*Section 10.3.2 the occurrence or public disclosure of, or criminal indictment for, any past or present act or omission by Vendor or any of its related companies, employees, agents, accountants, or contractors that is reasonably determined by AHC to be materially detrimental to the reputation, operation or activities of AHC;*

As part of our due diligence on the grant funds awarded to AHC by NWA, it would be appropriate in the Corporation’s role as grant administrator to request if AHC
intends to invoke this clause in light of the recent public disclosure by the *New York Times* which to date has not been refuted by ACORN.

**Recommendations**

NWA has a fiduciary responsibility as grant administrators of the NFMC program in the disbursement of grant funds to its recipients. Based on the foregoing, we recommend the following for Management’s consideration:

**A.** It is recommended that AHC be placed immediately on a priority listing for an on-site compliance visit as part of the quality control/compliance monitoring function. The Corporation has currently contracted this function out. Inclusive with the scope for the compliance visit with AHC should be the request for Management’s response to the findings in a Corrective Action Plan. In addition, a copy of the most recent audited financial statements, presumably FY 2007, should be provided to NWA.

**B.** It is recommended that management also obtain as part of its due diligence on AHC any intended action or non action in respect of Section 10.3.2 in the Vendor Agreement between AHC and Texas ACORN given the public disclosures from the *New York Times*.

The results of all inquiries and recommendations should be communicated to NWA’s Management and Internal Audit department.