



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General  
Office of Audit Services

REGION IV  
61 Forsyth Street, S.W., Suite 3T41  
Atlanta, Georgia 30303

DEC - 6 2004

Report Number: A-04-04-03501

Mr. Leo Turner, Board Chairperson  
Friends of Children of Mississippi, Inc.  
939 N. Presidents Street  
Jackson, Mississippi 39202

Dear Mr. Turner:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled, *Review of Head Start Compensation at Friends of Children of Mississippi, Inc.* The objective of our audit was to determine whether Friends' compensation practices for teachers and the top five key executives were reasonable and consistent with Federal requirements and guidelines.

Final determination as to actions taken on all matters reported will be made by the HHS action official. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise (see 45 CFR part 5). As such, within 10 business days after the final report is issued, it will be posted on the Internet at <http://oig.hhs.gov>.

To facilitate identification, please refer to report number A-04-04-03501 in all correspondence.

Sincerely,

Charles J. Curtis  
Regional Inspector General  
for Audit Services, Region IV

Enclosures: As stated

**Direct Reply to HHS Action Official:**

Mrs. Carlis Williams  
Regional Administrator, Region IV  
Administration for Children and Families  
Atlanta Federal Center – Suite 4M60  
61 Forsyth Street, S.W.  
Atlanta, Georgia 30303-8909

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF HEAD START  
COMPENSATION AT FRIENDS OF  
CHILDREN OF MISSISSIPPI, INC.**



**DECEMBER 2004  
CIN: A-04-04-03501**

# *Office of Inspector General*

<http://oig.hhs.gov>

---

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

## *Office of Audit Services*

The OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the department.

## *Office of Evaluation and Inspections*

The OIG's Office of Evaluation and Inspections (OEI) conducts short-term management and program evaluations (called inspections) that focus on issues of concern to the department, the Congress, and the public. The findings and recommendations contained in the inspections reports generate rapid, accurate, and up-to-date information on the efficiency, vulnerability, and effectiveness of departmental programs. The OEI also oversees State Medicaid fraud control units, which investigate and prosecute fraud and patient abuse in the Medicaid program.

## *Office of Investigations*

The OIG's Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil monetary penalties.

## *Office of Counsel to the Inspector General*

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops compliance program guidances, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

# *Notices*

---

**THIS REPORT IS AVAILABLE TO THE PUBLIC**  
at <http://oig.hhs.gov>

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

## **OAS FINDINGS AND OPINIONS**

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



## **EXECUTIVE SUMMARY**

### **BACKGROUND**

#### **Head Start**

Head Start began under Title V of the Economic Opportunity Act of 1964 and is administered by the Administration for Children and Families (ACF) within the Department of Health and Human Services (HHS). The purpose of the Head Start program is to: (1) promote school readiness by enhancing the social and cognitive development of low-income children through the provision of comprehensive health, educational, nutritional, social and other services; and (2) involve parents in their children's learning and to help make progress toward the parents' educational, literacy, and employment goals. To carry out the program, grants are awarded primarily to community-based, non-profit organizations and school systems.

Following news articles and congressional inquiries relating to excessive executive compensation at some Head Start agencies, Federal Head Start officials asked the Office of Inspector General (OIG) to initiate a nationwide review of nine Head Start agencies' compensation practices. Head Start officials agreed on our selection of Friends of Children of Mississippi, Incorporated (Friends) for review.

#### **Friends of Children of Mississippi, Incorporated**

Friends is a nonprofit organization that provides complete childcare services emphasizing a quality education, and health and nutrition programs for children. In its early years, Friends provided Head Start services as a delegate agency to Tougaloo College. In 1980 Friends became a Head Start grantee. The primary programs Friends administered were the Head Start and Early Head Start programs that provide comprehensive family-focused services. Services that Friends provided include educational services, health services, family development services, such as male and parent involvement, and community partnership. Other projects that Friends participated in include, Parent Literacy Upgrade and Support (PLUS), Substance Abuse and Awareness Project, and a Micro-Loan Demonstration Project funded by the U.S. Department of Labor.

For the 2001 - 2002 grant year, Friends employed 356 teachers and teacher associates, 72 percent of which had an Associate of Arts degree or above. For the 2001-2002 grant year, Friends employed 891 individuals and provided services to 3,569 Head Start/Early Head Start enrollees at 34 sites.

Friends' total Head Start expenditures for grant years 2000, 2001, and 2002, were \$19,434,600, \$21,600,800, and \$23,999,534 respectively. Expenditures for other (non- Head Start) programs during the same grant years were \$2,268,476, \$2,871,032, and \$2,341,421, respectively. Total compensation packages for Friends' top five key executives ranged from \$55,389 to \$102,850 during grant year 2000 and the range increased from \$72,209 to \$144,340 for grant year 2002. The compensation packages were composed of salary and incentive pay, health insurance, and retirement.

## **OBJECTIVE**

The objective of our audit was to determine whether Friends' compensation practices for teachers and the top five key executives were reasonable and consistent with Federal requirements and guidelines.

## **SUMMARY OF FINDINGS**

Friends' compensation practices for teachers appeared reasonable and consistent with Federal requirements when compared to other Head Start grantees in Mississippi as well as teachers employed by the State. Also, cost of living allowances were allocated and quality improvement funds used in a manner consistent with ACF program instructions. However, compensation practices for executives needed improvement. The following conditions were found.

- (1) Compensation practices for executives did not meet Federal requirements of the Office of Management and Budget (OMB) Circular A-122 and § 653 of the Head Start Act.
- (2) Friends did not comply with the OMB Circular A-122 when allocating executive compensation charges to Head Start and other programs.

In addition to the compensation practices specific to the top five key executives and teachers, we identified two aspects of Friends' financial operations that need improvement.

## **REVIEW OF EXECUTIVE COMPENSATION PRACTICES**

### **Executive Compensation May Not Have Been Reasonable**

Friends' could not demonstrate that their compensation practices for executives met the requirements of OMB Circular A-122 and § 653 of the Head Start Act. As a result, Friends may have charged the Head Start program for unreasonable salaries of its top executives. Head Start may have been overcharged because the information Friends used in its wage study, as a basis for the salaries of the top executives, was not supported by adequate documentation.

### **Executive Compensation May be Excessively Allocated to Head Start**

Friends did not comply with the OMB Circular A-122 when allocating executive compensation charges to Head Start and other programs. The total compensation packages for Friends' top five key executives were fully allocated to Head Start, although the executives had responsibilities over other programs which were funded from other Federal departments, State, and private/non-profit grants. As a result, executive compensation may have been excessively allocated to Head Start. Friends' management said that they spent very little of their time on programs other than Head Start and Early Head Start, and thus had not conducted a personnel activity survey in order to support charging the Head Start program for all of their compensation costs.

## OTHER FINANCIAL OPERATIONS ISSUES

In addition to the compensation practices relative to the executives, we identified two aspects of Friends' financial operations that need improvement. Specifically:

- (1) Friends may have violated a State statute governing charitable solicitations. Friends occasionally solicited charitable donations through small local fundraisers. However, Friends was not registered with the State. According to the Mississippi Secretary of State's Office, it is illegal to make charitable solicitations without registering with the State. Failure to comply with the State's charitable solicitations law could subject Friends to an administrative penalty up to a maximum of \$25,000 for each violation. Friends' officials expressed surprise that they were covered by the State statute and said they would immediately take steps to comply with the State statute.
- (2) Friends underreported, on its Federal Information Form 990, the compensation and employee benefit plan contributions for its top 5 executives by \$147,480 for the 3 grant years. Form 990 instructions require filers to report the compensation of the five highest paid employees other than officers, directors, and trustees and the payments to employee benefit plans on behalf of these individuals. As a result of inaccurate reporting, Friends may be subject to penalties for failing to file a complete return. The compensation amounts were not accurately reported because Friends did not reconcile Form 990 amounts to general ledger amounts prior to filing the form. The errors in reporting employee benefit plan contributions occurred primarily because Friends' officials were not aware that all its contributions to employee health benefit plans had not been reported on the Form 990s.

## RECOMMENDATIONS

We recommend that Friends:

- **improve its executive compensation practices** by ensuring future wage comparability surveys meet the requirements in Section 653 of the Head Start Act and any future clarification, guidance or requirements ACF might specify;
- **establish a time and effort reporting system** that complies with OMB Circular A-122 to ensure that costs are equitably allocated when employees have responsibilities for more than one program; and
- **improve general financial operations by:**
  - (1) registering under the State's Charitable Solicitations Act, as appropriate; and
  - (2) reviewing more carefully the amounts listed for Executive Compensation and Employee Benefit Plan Contributions on future Form 990s before they are filed.



## **Friends' Comments – Executive Compensation**

In written comments to the draft report, Friends' officials generally disagreed with our findings and recommendation regarding executive compensation practices. Friends' officials said that their executive compensation was reasonable.

Friends' officials said that they recalculated the Executive Director's salary using "corrected" salary information based on data that was supported by "verifiable" documentation. Based on this recalculation, Friends' officials were of the opinion that the Executive Director's salary was reasonable and conformed with Federal requirements. The complete text of Friends' comments is included in the Appendix.

## **OIG Response - Executive Compensation May Not Have Been Reasonable**

Our assessment of the reasonableness of Friends' executive compensation practices was based on a review of wage survey records obtained from Friends' officials and from the consultant that prepared Friends' wage survey. The additional information that Friends' officials provided in response to our draft report did not provide assurance that Friends' executive compensation practices were reasonable.

Therefore, we continue to recommend that Friends improve its executive compensation practices by ensuring future wage comparability surveys meet the requirements in Section 653 of the Head Start Act and any future clarification, guidance or requirements ACF might specify.

## **Friends' Comments – Executive Compensation May Have Been Excessively Allocated to Head Start**

Friends' officials generally agreed with our findings and recommendation regarding the allocation of executive compensation. Friends' officials said that they have developed a formal cost allocation plan that will be in place December 1, 2004.

## **Friends' Comments – State Charitable Solicitation Statute**

Friends' officials generally agreed with our findings and recommendation regarding the need to adhere to the State's charitable solicitation statute. Friends' officials said that they have neither solicited nor plan to solicit any charitable contributions for 2004. Friends' officials also said that prior to soliciting any contributions they would file with the State a "Notice of Exemption".

## **Friends' Comments – Inaccurate Federal Information Returns**

Friends' officials generally agreed with our findings and recommendation regarding inaccurate Federal information returns. Friends' officials said that its independent auditor would contact the IRS and determine if Friends needed to correct its Form 990 filings for grant years 2000, 2001, and 2002.

# TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
BACKGROUND .....	1
Head Start.....	1
Friends Of Children Of Mississippi, Incorporated .....	1
Regulations .....	2
OBJECTIVE, SCOPE AND METHODOLOGY .....	2
Objective.....	2
Scope.....	2
Methodology.....	2
FINDINGS AND RECOMMENDATIONS.....	3
REVIEW OF EXECUTIVE COMPENSATION PRACTICES .....	3
Executive Compensation May Not Have Been Reasonable.....	3
Executive Compensation May Have Been Excessively Allocated to Head Start .....	5
OTHER FINANCIAL OPERATIONS ISSUES .....	5
State Charitable Solicitations Statute.....	5
Inaccurate Federal Information Returns .....	6
RECOMMENDATIONS.....	7
Friends’ Comments – Executive Compensation May Not Have Been Reasonable.....	7
OIG Response - Executive Compensation May Not Have Been Reasonable.....	8
Friends’ Comments – Executive Compensation May Have Been Excessively Allocated to Head Start.....	9
Friends’ Comments – State Charitable Solicitation Statute.....	10
Friends’ Comments – Inaccurate Federal Information Returns.....	10
FRIENDS OF CHILDREN OF MISSISSIPPI WRITTEN COMMENTS.....	Appendix

## **INTRODUCTION**

### **BACKGROUND**

#### **Head Start**

The Head Start program began under Title V of the Economic Opportunity Act of 1964 and is administered by ACF within HHS. The Head Start program's purpose is to: (1) promote school readiness by enhancing the social and cognitive development of low-income children through the provision of comprehensive health, educational, nutritional, social and other services; and (2) involve parents in their children's learning and to help make progress toward the parents' educational, literacy, and employment goals. To carry out the program, grants are awarded primarily to community-based, non-profit organizations and school systems.

Following news articles and congressional inquiries relating to excessive executive compensation at some Head Start agencies, Federal Head Start officials asked us to initiate a nationwide review of nine Head Start agencies' compensation practices. Head Start officials agreed on our selection of Friends for review.

#### **Friends of Children of Mississippi, Incorporated**

Friends is a nonprofit organization that provides complete childcare services emphasizing a quality education, and health and nutrition programs for children. The primary programs Friends administered were the Head Start and Early Head Start programs that provide comprehensive, family-focused services. Services that Friends provided include educational services, health services, family development services, such as male and parent involvement, and community partnership. Other projects that Friends participated in include, PLUS, Substance Abuse and Awareness Project, and a Micro-Loan Demonstration Project funded by the U.S. Department of Labor.

Friends was originally created to plan and coordinate support for over 60 volunteer centers. In its early years, Friends provided Head Start services as a delegate agency to Tougaloo College. In 1980 Friends became a Head Start grantee.

For the 2001 - 2002 grant year, Friends employed 356 teachers and teacher associates, 72 percent of which have an Associate of Arts degree or above. For the 2001-2002 grant year, Friends employed 891 individuals and provided services to 3,569 Head Start/Early Head Start enrollees at 34 sites.

Friends' total Head Start expenditures for grant years 2000, 2001, and 2002, were \$19,434,600, \$21,600,800, and \$23,999,534, respectively. Expenditures for other (non- Head Start) programs during the same grant years were \$2,268,476, \$2,871,032, and \$2,341,421, respectively. Total compensation packages for Friends' top five key executives ranged from \$55,389 to \$102,850 during grant year 2000 and the range increased from \$72,209 to \$144,340 for grant year 2002. The compensation packages were composed of salary and incentive pay, health insurance, and retirement.

## **Regulations**

The Head Start Act is Title VI, Subtitle A, Chapter 8, Subchapter B of the Omnibus Budget Reconciliation Act of 1981. The Head Start Act sets forth the requirements specific to Head Start programs.

The OMB Circular A-122, entitled “Cost Principles for Non-Profit Organizations”, establishes the cost principles applicable to Friends.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

### **Objective**

The objective of our audit was to determine whether Friends’ compensation practices for teachers and the top five key executives were reasonable and consistent with Federal requirements and guidelines.

### **Scope**

Our review covered Friends’ grant years 2000, 2001, and 2002, which ran from December 1st through November 30th.

The top five key executives were the highest paid employees who received some or all of their compensation, either directly or indirectly, from Head Start funding. We defined compensation as anything that increased the personal assets of the individual, such as salary and wages, fringe benefits, bonuses, and retirement.

Our review of internal controls was limited to those controls related to the approval of compensation packages and the processing of payroll.

We performed our on-site fieldwork from December 2003 to March 2004 at the Region IV ACF office in Atlanta, Georgia and Friends’ Central Office in Jackson, Mississippi. Friends’ officials did not desire an exit conference. However, on November 8, 2004, Friends’ officials did provide written comments to the draft report.

### **Methodology**

To accomplish our objective, we:

- reviewed Federal regulations relating to the Head Start program and the OMB cost principles for non-profit organizations;
- interviewed Region IV ACF, State of Mississippi, and Friends’ officials;
- reviewed payroll journals, W-2s, Forms 990, and general ledger printouts to determine the total compensation and funding sources for Friends’ top five key executives;

- reviewed Friends’ policies, procedures, and board of director meeting minutes to determine the compensation approval process;
- reviewed wage comparability surveys and met with a representative of the survey consultants to determine the basis and reasonableness of the surveys;
- compared the wages Friends paid to its teachers to the wages paid to teachers employed by the State of Mississippi and other Head Start grantees in the State;
- reviewed Friends’ teachers’ wage data to determine the range of wages paid to teachers, as well as the average wage paid to teachers; and
- determined if cost of living adjustment and quality improvement funds were used in accordance with Head Start program instructions.

Our audit was conducted in accordance with generally accepted government auditing standards.

## **FINDINGS AND RECOMMENDATIONS**

Friends’ compensation practices for teachers appeared reasonable and consistent with Federal requirements when compared to other Head Start grantees in Mississippi as well as teachers employed by the State. Also, cost of living allowances were allocated and quality improvement funds used in a manner consistent with ACF program instructions. However, compensation practices for executives needed improvement. The following conditions were found:

- (1) Compensation practices for executives did not meet Federal requirements of the OMB Circular A-122 and § 653 of the Head Start Act.
- (2) Friends did not comply with the OMB Circular A-122 when allocating executive compensation charges to Head Start and other programs.

In addition to the compensation practices specific to the top five key executives and teachers, we identified two aspects of Friends’ financial operations that did not comply with either a State law or Federal requirements.

## **REVIEW OF EXECUTIVE COMPENSATION PRACTICES**

### **Executive Compensation May Not Have Been Reasonable**

Friends could not demonstrate that their compensation practices for executives met the requirements of OMB Circular A-122 and § 653 of the Head Start Act, because not all of the salaries in the wage comparability survey that Friends implemented were adequately documented.

OMB Circular A-122, Attachment A, Section A.2.g, provides that, in order to be allowable, costs must be adequately documented. Without sufficient salary documentation, Friends cannot demonstrate that it complied with § 653 of the Head Start Act (42 U.S.C. 9848), which provides that Head Start employees may not receive compensation:

*. . . in excess of the average rate of compensation paid in the area where the program is carried out to a substantial number of persons providing substantially comparable services or in excess of the average salary paid to a substantial number of persons providing substantially comparable services in the area of the employee's immediately preceding employment . . . .*

Friends consistently followed its human resource policies in reviewing and approving compensation for the top five key executives and the executives received raises based on the results of a wage comparability survey. However, Friends' compensation practices for executives did not meet Federal requirements for adequate documentation. As a result, Friends may have charged the Head Start program for unreasonable salaries of its top executives. The following table shows the effect of Friends' use of undocumented comparable salaries in its wage comparability survey.

<b>Position</b>	<b>Hourly Rate Prior to Salary Survey</b>	<b>Hourly Rate Recommended in Initial Survey</b>	<b>Hourly Rate Recommended in Revised Survey (Rate Paid)</b>
<b>Executive Director</b>	\$44.24	\$53.75	\$59.41
<b>Deputy Director</b>	\$31.07	\$29.69	\$39.67
<b>Director of Finance</b>	\$29.88	\$33.64	\$36.40
<b>Director of Family and Community Partnership</b>	\$23.62	\$24.40	\$26.11
<b>Director of Program Design &amp; Management</b>	\$23.62	\$27.23	\$28.23

The differences in the hourly rates shown in the initial and revised surveys represents the amount by which undocumented salaries increased the hourly rates for each of the top five executives. These increases ranged from 3.69 percent to 33.61 percent.

Friends could not provide supporting documentation for several of the salary figures used in its wage comparability survey. According to Friends' officials, the salary data for the Executive Director was partially based on information obtained from survey data provided by ACF, Region IV. However, ACF, Region IV did not have any documentation to support the salary survey data Friends used.

For the Executive Director, Friends' wage comparability survey showed comparative rates that ranged from \$43.28 to \$79.33 per hour. The \$79.33 figure was 20 percent higher than the next highest comparative rate in the range. Friends' use of this undocumented \$79.33 hourly rate resulted in the final salary recommendation for the Executive Director being about 9 percent higher than it otherwise would have been.

Furthermore, additional salary information Friends used for comparison purposes for the top five executives relied on survey data that Friends said was provided by their independent auditors. We contacted the independent auditors in order to obtain a copy of the survey. Neither Friends, nor the independent auditors, were able to locate a salary survey that supported the “outlier” salary amounts Friends used. The independent auditors did provide us a letter that stated, “... some several years ago we verbally furnished a range of low to high salary figures based upon our personal knowledge [to the outside consulting firm conducting Friends’ wage comparability survey]...”

### **Executive Compensation May Have Been Excessively Allocated to Head Start**

Friends did not comply with the OMB Circular A-122 when allocating executive compensation charges to Head Start and other programs.

OMB Circular A-122, *Cost Principles for Nonprofit Organizations*, Attachment B, § 7M provides that salaries and wages charged to awards must be supported by personnel activity reports that account for the total activity for which an employee is compensated.

The total compensation packages for Friends’ top five key executives were fully allocated to Head Start, although the executives had responsibilities over other programs which were funded from other Federal departments, State, and private/non-profit grants. Friends did not maintain any type of personnel activity reports to support charging the Head Start program for all of its compensation costs. As a result, executive compensation may have been excessively allocated to Head Start.

Friends’ management said that they spent very little of their time directly in connection with programs other than Head Start and Early Head Start and thus had not conducted a personnel activity survey in order to support charging the Head Start program for all of their compensation costs.

### **OTHER FINANCIAL OPERATIONS ISSUES**

In addition to the compensation practices specific to the top five key executives and teachers, we identified two aspects of Friends’ financial operations that needed improvement. Specifically:

- (1) Friends may have violated a State statute governing charitable solicitations.
- (2) Friends did not accurately complete its Federal information returns (Forms 990) for all 3 grant years.

#### **State Charitable Solicitation Statute**

According to the Mississippi Secretary of State’s Office, it is illegal to make charitable solicitations without registering with the State.

An exemption applies to any charitable organization that does not intend to solicit and receive and does not actually receive contributions in excess of \$4,000 during any State fiscal year. In order to secure the exemption, the State requires a one-time filing of a “Notice of Exemption.”

As part of our inquiry into other local or State laws that may impact Friends as an agency, we identified a State statute that governs charitable solicitations. During the course of its operations as a Head Start grantee, Friends occasionally solicited charitable donations through small local fundraisers. However, Friends was not registered with the State.

Failure to comply with the State’s charitable solicitations law could subject Friends to an administrative penalty up to a maximum of \$25,000 for each violation.

Friends’ officials expressed surprise that they were covered by the State statute. Friends’ officials said that although Friends occasionally solicits funds through charity events, they do not operate as a “charity” within the State. Friends’ officials said that they would immediately take steps to comply with the State statute.

**Inaccurate Federal Information Returns**

Internal Revenue Form 990, “Return of Organization Exempt From Income Tax”, is a report that nonprofit entities must file each year. It serves two essential purposes. First, it provides information that helps the Internal Revenue Service and State charity regulators enforce the laws that govern nonprofits. Second, Form 990 provides a great deal of financial information about the filing organization’s financial condition, about its financial strength or weakness and about such things as the sources of its income.

Form 990 instructions require filers to report the compensation of the five highest paid employees other than officers, directors, and trustees and the payments to employee benefit plans on behalf of these individuals. These plans provide benefits such as medical, dental, life insurance, severance pay, and disability.

Friends underreported on its Federal Information Form 990 the compensation and employee benefit plan contributions for its top five executives by \$147,480 for the 3 grant years.

The differences were as follows:

**Compensation Differences**

<b>Filing Year</b>	<b>Amount Per Accounting Records</b>	<b>Amount on Form 990</b>	<b>Underreported Amount</b>
<b>FY 2000</b>	<b>\$271,560</b>	<b>\$251,824</b>	<b>\$19,736</b>
<b>FY 2001</b>	<b>\$298,966</b>	<b>\$260,027</b>	<b>\$38,939</b>
<b>FY 2002</b>	<b>\$367,280</b>	<b>\$362,591</b>	<b>\$ 4,689</b>



**Employee Benefit Plan Contribution Differences**

<b>Filing Year</b>	<b>Amount Per Accounting Records</b>	<b>Amount on Form 990</b>	<b>Underreported Amount</b>
<b>FY 2000</b>	<b>\$44,089</b>	<b>\$11,331</b>	<b>\$32,758</b>
<b>FY 2001</b>	<b>\$43,396</b>	<b>\$15,017</b>	<b>\$28,379</b>
<b>FY 2002</b>	<b>\$43,114</b>	<b>\$20,135</b>	<b>\$22,979</b>

As a result, Friends may be subject to penalties for failing to file a complete return.

The compensation amounts were not accurately reported because Friends did not reconcile Form 990 amounts to general ledger amounts prior to filing the form. The errors in reporting employee benefit plan contributions occurred primarily because Friends’ officials were not aware that all its contributions to employee health benefit plans had not been reported on the Form 990s.

**RECOMMENDATIONS**

We recommend that Friends:

- **improve its executive compensation practices** by ensuring future wage comparability surveys meet the requirements in Section 653 of the Head Start Act and any future clarification, guidance or requirements ACF might specify;
- **establish a time and effort reporting system** that complies with OMB Circular A-122 to ensure that costs are equitably allocated when employees have responsibilities for more than one program;
- **improve general financial operations by:**
  - (1) registering under the State’s Charitable Solicitations Act, as appropriate; and
  - (2) reviewing more carefully the amounts listed for Executive Compensation and Employee Benefit Plan Contributions on future Form 990s before they are filed.

**Friends’ Comments – Executive Compensation May Not Have Been Reasonable**

Friends’ officials generally disagreed with our findings and recommendation regarding executive compensation practices. Friends’ officials said that their executive compensation was reasonable. Friends’ officials also said that the OIG auditors:

- failed to request documentation from Friends’ consultant who prepared the entity’s wage plan; and
- used preliminary wage survey data that Friends’ consultant subsequently updated.

According to Friends' officials, the auditors should have relied only on the completed wage survey dated October 2001.

In regard to the salary data Friends' independent auditors provided, Friends' officials said that at the time of OIG's request, its independent auditors could not find the letter that documented the salary data the independent auditors had given to Friends. Subsequently, Friends' officials said they were able to obtain a copy of the letter.

In regard to wage survey data that Friends' said was obtained from ACF, Region IV, Friends' officials said that its consultant had relied on wage information obtained through a telephone conversation with an ACF wage survey contractor and that this telephone inquiry was documented by the consultants' "memorandum to the file".

Friends' officials further stated that they used incorrect salary information for two of the "comparables" - Institute of Community Services, Inc. (ICS) and Mississippi Action for Progress, Inc. (MAP) in their wage study. Friends' officials said that they recalculated the Executive Director's salary: (1) using the correct wage information for these two entities and (2) disregarding the average salary rate information obtained from the Region IV, ACF wage survey contractor. Based on this recalculation Friends' officials were of the opinion that the Executive Director's hourly rate was reasonable.

### **OIG Response – Executive Compensation May Not Have Been Reasonable**

Our assessment of the reasonableness of Friends' executive compensation was based on a review of wage survey records obtained from Friends' and from the consulting firm that Friends employed to perform its wage study. We also had discussions with: (1) the consultant that prepared Friends' wage study, (2) a Region IV ACF official that had first-hand knowledge of Friends' Head Start program, (3) a partner in the firm that served as Friends' independent auditors, (4) Friends' Chief Financial Officer, (5) Friends' Executive Director, and (6) a representative from the University of Western Kentucky.

In regard to the letter from Friends' independent auditor that Friends' officials said could not be located at the time we were on site, we do not believe this letter constitutes "verifiable" documentation. The letter stated that the auditing firm was familiar with several nonprofits in the area that were similar in size and complexity to Friends. The letter also showed what appeared to be the high and low salary ranges for three positions: *Executive Director*, *Assistant Director*, and *Department Heads*. In addition, the letter contained hand-written hourly rates for the high, low and average salary for each of the positions. However, the letter did not:

- identify the number and names of nonprofits from which the information was gathered;
- note the time period covered by the salary ranges;
- indicate the individuals who occupied the positions listed; or
- include a description of the duties of the individuals listed.

Furthermore, Friends appeared to use the higher salary range shown in the letter for the *Assistant Director* position for at least one of its *Department Heads* (Director of Finance). Also, the handwritten hourly rates were computed based on a 2,080-hour work-year, which may or may not be the correct number of actual annual hours worked by the individuals who occupied the positions. In addition, the average salary hourly rates were computed using only the high and low salary amounts shown. For example, the range shown for the Executive Director position was \$110,000 - \$125,000 (average hourly rates of \$52.88-\$60.10<sup>1</sup> for this range). However, to arrive at the average hourly rate for the executives that Friends used in its salary survey, Friends computed an average of the high and low hourly rates ( $\$52.88 + \$60.10 = \$112.98 / 2 = \$56.49$  average hourly rate). Without additional documentation, we cannot verify the validity of Friends' calculation methodology.

Similarly, the "memorandum to the file" that Friends' said supported the salary data that was obtained from ACF, Region IV only showed programs based on the number of enrollees broken down into three ranges and three average annual salary amounts for each range. For example, the memorandum shows under the heading "Program Size", 3,500-6,000 enrollees and an "Average Annual Salary" of \$165,000 for this program size. The memorandum does not show what programs were surveyed or how the average annual salary for each range of enrollees was developed. In its written comments, Friends elected not to rely on this unverifiable information to support its salaries. Instead, Friends recomputed the Executive Director's salary using revised salary amounts from the 990s for two other Head Start programs. We do not believe that Friends recalculation of the Executive Director's salary using "corrected" wage information obtained from the ICS and MAP Form 990s documents that the Executive Director's salary is reasonable.

Because of the problems discussed above with the support documentation, Friends' officials have not provided assurance that the agency's overall executive compensation practices are reasonable. Consequently, we continue to recommend that Friends improve its executive compensation practices by ensuring future wage comparability surveys meet the requirements in Section 653 of the Head Start Act and any future clarification, guidance or requirements ACF might specify.

### **Friends' Comments – Executive Compensation May Have Been Excessively Allocated to Head Start**

Friends' officials generally agreed with our findings and recommendation regarding the allocation of executive compensation. Friends' officials said that they have developed a formal cost allocation plan that meets the requirements of OMB Circular A-122 for both direct and indirect costs. According to Friends' officials, the cost allocation plan will be in place December 1, 2004.

---

<sup>1</sup> Friends computed the average hourly rates as follows:  $\$110,000 / 2,080 \text{ hours} = \$52.88/\text{hr.}$  and  $\$125,000 / 2,080 = \$60.10/\text{hr.}$

### **Friends' Comments – State Charitable Solicitation Statute**

Friends' officials generally agreed with our findings and recommendation regarding the need to adhere to the State's charitable solicitation statute. In their written comments, Friends' officials said that they have neither solicited nor plan to solicit any charitable contributions for 2004. Friends' officials said that prior to soliciting any contributions they would file with the State a "Notice of Exemption".

### **Friends' Comments – Inaccurate Federal Information Returns**

Friends' officials generally agreed with our findings and recommendation regarding inaccurate Federal information returns. Friends' officials said that the errors in reporting compensation on its Federal form 990 occurred because its independent auditors used wages that were paid on a calendar year basis rather than wages that were paid on a fiscal year basis. Friends' officials said that, in the future, Friends would reconcile to payroll records the gross wages paid on a fiscal year basis.

Friends' officials said that the errors in reporting employee benefit plan contributions on its Federal form 990 resulted from Friends using estimates for retirement pay benefits. According to Friends' officials, the retirement pay benefits were estimated because the retirement plans' annual report was not yet processed at the time the Form 990 was prepared. Friends' officials also said that health insurance premiums were not reported on the Form 990 as employee fringe benefits because Friends has a self-funded health care plan. In the future, Friends plans to use an estimate of the premium cost based on similar costs in funded plans.

Friends' officials further stated that its independent auditor would contact the IRS and determine if Friends needed to correct its Form 990 filings for grant years 2000, 2001, and 2002.

# APPENDIX



**FRIENDS OF CHILDREN OF MISSISSIPPI, INC.**

939 N. President Street Jackson, Mississippi 39202-2563 Telephone (601) 353-3264 Fax (601) 353-3220

Marvin Hogan  
Executive Director

Leo Turner  
Chairperson

November 4, 2004

Mr. Charles J. Curtis  
Regional Inspector General  
for Audit Services, Region IV  
Department of Health and Human Services  
Office of Inspector General  
61 Forsyth Street, S.W., Suite 3T41  
Atlanta, Georgia 30303

VIA FEDERAL EXPRESS

RE: Review of Head Start Compensation at Friends of Children of Mississippi, Inc.; Report Number A-04-04-03501

Dear Mr. Curtis:

This letter is in response to the results of your audit following your review of Head Start Compensation at Friends of Children of Mississippi, Inc. Please consider this our formal response to your request for written comments on your draft report. We respect the nature of your inquiry and will do our fullest to comply with any necessary recommendations. However, we are of the opinion that some of the conclusions in the report may be based on incorrect data and may warrant further consideration. We have consulted with and gathered information from our internal auditors (Banks, Finley & White), our independent auditors (Watkins, Ward & Stafford), the consulting firm that drafted our wage plan (Systems Consultants Associates, Inc.) and our general counsel (Bob Owens & Rajita Iyer Moss) in preparing our response. The following is our itemized response to the findings along with supporting documentation:

**ISSUE # 1:**

Compensation practices for executives did not meet Federal requirements of the Office of Management and Budget (OMB) Circular A-122 and § 653 of the Head Start Act.

***"AN EQUAL OPPORTUNITY EMPLOYER M/F"***  
*"63,000 MOMENTS OF TRUTH EACH DAY"*

Accredited by the  
National Academy  
of Early Childhood  
Programs



- *Executive Compensation May Not Have Been Reasonable. FCM, Inc., could not demonstrate that their compensation practices for executives met the requirements. The report also concluded that Head Start may have been overcharged because the information that FCM, Inc., used in its wage study, as a basis for the salaries of the top executives, was not supported by adequate documentation.*

**RESPONSE:**

Although the findings were phrased as “may be”, we conducted an extensive review of the issue and determined that Executive compensation at Friends of Children of Mississippi, Inc., is indeed reasonable and adequately supported by verifiable documentation. The following is our rationale and proof to support our determination:

- ✓ During the Office of Inspector General (OIG) review, documentation was not requested from Systems Consultants Associates, Inc., the consulting firm that completed the survey and prepared the wage plan, and, accordingly, was not furnished to the auditors at the time.
- ✓ Some of the information that was submitted to OIG during its review was based on a partial preliminary survey that was conducted by the consultant. The consultant used/ additional data in formulating a revised survey and this information was not available to OIG at the time of its review. This preliminary survey dated September 2001 was incomplete and should not have been used for comparison purposes.
- ✓ The completed survey dated October 2001 is the only data that should have been relied upon by the OIG.
- ✓ Included is documentation on the two survey sources questioned by the OIG auditors, namely, (1) Watkins, Ward and Stafford, PLLC and (2) DHHS Administration for Children and Families (ACF) Region IV.
- ✓ Also, we have included information on executive director compensation from two other sources previously included in the survey results, namely (1) Mississippi Action for Progress, Inc. and (2) Institute of Community Services, Inc.
- ✓ Following the OIG’s inquiry we obtained 990 information on ICS and MAP and this information was relied upon by Systems Consultants Associates, Inc., in evaluating our wage plan.

- ✓ Documentation from these sources is attached hereto as Exhibits 1-4 and is discussed briefly below.
- ✓ The draft audit report indicates that the ACF data was not obtainable through Region IV and could not be substantiated. The only documentation in our possession regarding the ACF data is the memorandum that memorializes the telephone inquiry. Consequently, we have included a table from our wage consultant that excludes the ACF data to show that the compensation rates are reasonable and within the average even without the ACF data.

**Exhibit 1:**

Correspondence dated September 20, 2001, from Watkins, Ward and Stafford providing the salary range data for the positions of Executive Director, Assistant Director, and Department Heads in several nonprofit organizations of similar size and complexity to Friends of Children that are audited by Watkins, Ward and Stafford, PLLC, an independent CPA firm. Watkins, Ward and Stafford, PLLC, could not find the letter at the time of OIG's request but Friends of Children of Mississippi, Inc., was able to secure a copy of the correspondence. This correspondence is included in our response as Exhibit 1.

**Exhibit 2:**

Systems Consultants Associates, Inc., that drafted the wage plan, relied on information that was obtained from a wage survey contractor for the Administration for Children and Families Region IV through a telephone inquiry on September 19, 2001. Average salary information was obtained for executive directors in the region by enrollment size ranking as follows:

<u>Program size</u>	<u>Annual salary</u>
3500-6000	\$165,000
3000-3499	\$ 96,000
2000-2999	\$ 91,575

This response to the telephone inquiry was documented by Systems Consultants Associates, Inc. Exhibit 2 is a memorandum from the consultant to the file that memorializes the information obtained from the telephone inquiry.

**Exhibit 3:**

The 2001 Federal Form 990 for the period of 2/1/01 to 1/31/02 filed by Institute of Community Services, Inc. (ICS) of Holly Springs, MS, indicated that its CEO's



compensation was \$115,239 (or \$55.40 per hour). (Please refer to Exhibit 3 – Page 3.) This certified hourly rate of pay is substantially higher than the \$43.28 included in the wage survey of October 2001. The logical inference for this disparity is that ICS only disclosed to us the portion of the CEO's salary included in its Head Start budget instead of the full salary amount.

**Exhibit 4:**

The 2000 Federal Form 990 for the period of 12/1/00 to 11/30/01 filed by Mississippi Action for Progress, Inc. (MAP) of Jackson, MS, indicated that its CEO's compensation was \$131,349 (or \$63.15 per hour). (Please refer to Exhibit 4 – Page 2.) This certified hourly rate of pay is substantially higher than the \$52.00 included in the wage survey of October 2001. As with ICS above, a reasonable explanation for this difference is that MAP only disclosed to us the portion of the CEO's salary included in its Head Start budget instead of the full salary amount.

- ✓ Attached as **Exhibit 5** hereto is the Personnel Action forms for the year 2001 that reflect the hourly rates for the Executive Director. The hourly rate for 2001 was \$60.60.

From the foregoing, it is evident that there is adequate documentation to support the reasonableness of the salaries for the top five key executives identified in the OIG draft review report. Concerning the position of Executive Director in specific, even if the \$79.33 figure from data provided by ACF was excluded from the survey, the revised average survey rate using certified and accurate hourly rates is \$60.25 (an amount higher than the previously reported rate of \$59.41 which included the \$79.33 rate), as shown in the table below. Based on the \$59.41 average hourly survey rate, the OIG auditors concluded that the "undocumented \$79.33 hourly rate resulted in the final salary recommendation for the Executive Director being about 9 percent higher than it otherwise would have been."

Since the average hourly survey rate in November 2001 should have been \$60.25, the Executive Director salary recommended at that time was reasonable and conformed to the Federal requirements of OMB Circular A-122 and Section 653 of the Head Start Act.

<b>Data Source</b>	<b>Original Survey Results</b>	<b>Original Survey Results Recalculated by OIG to Exclude DHHS ACF Region IV Data</b>	<b>Original Survey Results Revised to Exclude DHHS ACF Region IV Data and Correct 2001 ICS and MAP Data</b>
Central MS Civic Improvement Association, Inc.	\$65.96	\$65.96	\$65.96
DHHS ACF Region IV	\$79.33		
Institute of Community Services, Inc. (ICS)	\$43.28	\$43.28	\$55.40
Mississippi Action for Progress, Inc. (MAP)	\$52.00	\$52.00	\$63.15
Watkins, Ward & Stafford, PLLC	\$56.49	\$56.49	\$56.49
<b>Average Survey Rate</b>	<b>\$59.41</b>	<b>\$54.43</b>	<b>\$60.25</b>

**ISSUE # 2:**

Friends of Children of Mississippi, Inc., did not comply with OMB Circular A-122 when allocating executive compensation charges to Head Start and other programs.

- *Executive Compensation may have been excessively allocated to Head Start. Total compensation packages for FCM, Inc.'s top five key executives were fully allocated to Head Start, although the executives had responsibilities over other programs which were funded from other Federal departments, State, and private/non-profit grants. FCM, Inc., stated that the executives spent very little time on programs other than Head Start and had thus not conducted a personnel activity survey in order to support charging Head Start for all of their compensation costs.*

**RESPONSE:**

Following an intensive review of this issue/finding presented by the draft audit report, and consultations with our internal auditors (Banks, Finley & White) and the finance department, we have ascertained the following:

- ✓ Executive compensation was charged directly to the Head Start program as opposed to being allocated to Head Start and other programs administered by the organization.
- ✓ However, procedures were in place for other programs to reimburse the organization for time spent by executives. These reimbursements were used to offset the salaries charged to the Head Start program.

- ✓ The reimbursements were based on our estimate of the time and effort the executives and other personnel, such as fiscal office staff, worked on the other grant programs.
- ✓ In addition to being reimbursed for compensation, the reimbursement also included an estimate of the cost of rent, utilities, supplies and other cost incurred that could not be charged as a direct cost to the grant program.
- ✓ The reimbursements for non personnel costs were used to offset the cost charged to Head Start.
- ✓ Although a formal cost allocation plan was not in effect, other programs administered by the organization shared in the administrative burden.
- ✓ This reimbursement, offsets and cost allocation data was available to the OIG auditors through our general ledger details for the relevant fiscal years. We will gladly provide you with this information to let you ascertain and substantiate our findings if you so desire.

Additionally we have taken the following steps to institute the recommended personnel activity survey and to support and substantiate our cost allocations in the future:

- ✓ We, along with our internal auditing firm Banks, Finley & White, have developed a formal cost allocation plan that will be put in place for our fiscal year beginning December 1, 2004.
- ✓ The plan includes the establishment of a general and administrative cost pool to charge cost incurred for common or joint objectives that are not readily identified with a particular program or funding source.
- ✓ The costs included in the administrative cost pool will be allocated to the grant programs monthly based on either direct salaries or total direct costs of the various programs.
- ✓ The plan meets the requirements of OMB Circular A-122 for both direct and indirect costs.

**OTHER FINANCIAL OPERATIONS ISSUES**  
**IDENTIFIED BY THE OIG DRAFT AUDIT REPORT**

- *Friends of Children of Mississippi, Inc., may have violated a State statute governing charitable contributions by failing to register as a charitable organization.*

**RESPONSE:**

The following has been ascertained following our review of this issue:

- ✓ We would like to clarify for the record that Friends of Children of Mississippi, Inc., has never been charged with “violating” a state statute governing charitable contributions.
- ✓ Friends of Children of Mississippi, Inc., received a letter of inquiry from the Secretary of State’s Office regarding an audit of the “charity and its operation.”
- ✓ We fully responded to the inquiry and provided all the necessary information related to the inquiry. Please find attached as **Exhibit 6** a copy of the response that was sent via certified mail to the Secretary of State.
- ✓ We indicated in our response that we would be willing to be of further assistance and in answering any other questions. Friends of Children of Mississippi, Inc., never received any further correspondence from the Secretary of State’s Office.
- ✓ General counsel for Friends of Children of Mississippi, Inc., Rajita Iyer Moss, personally placed a call to the Secretary of State’s Office to ascertain the status of the inquiry.
- ✓ Our counsel was informed that the Secretary of State’s Office was satisfied with the response and was not going to take any further action on the matter. Counsel was also informed that the Secretary of State’s Office had closed their file on the matter.
- ✓ During its audit, the OIG’s office, through Mr. Truman Mayfield, contacted our general counsel and requested that we obtain an independent legal opinion regarding the issue of registration as a charitable organization.
- ✓ We retained the firm of McGlinchey Stafford to provide this independent opinion regarding the registration issue.

- ✓ Bill Mendenhall, by letter dated April 21, 2004, provided the requested independent opinion. A copy of that letter is attached hereto as **Exhibit 7.**
- ✓ The opinion indicated that every charitable organization that solicits funds from the public needed to register with the Secretary of State's office. However, the opinion also indicated that there were certain exemptions to this general filing requirement. As per the opinion, Friends of Children of Mississippi would be exempt from the charitable filing requirement as long as it did not receive contributions in excess of \$4,000 per year and as long as all the fundraising is conducted by unpaid volunteers. If contributions in excess of \$4,000 were received, the organization must file a registration statement within 30 days of receipt of the excess funds. Additionally, in order to secure its exemption the organization would have to file a Notice of Exemption prior to solicitation of contributions.
- ✓ Our independent auditors, Watkins, Ward & Stafford, have opined that our organization does not qualify as a charitable organization and that we do not need to register as such.
- ✓ Friends of Children of Mississippi, Inc., has not solicited any charitable contributions for the year 2004 and does not intend to do so.
- ✓ However, out of an abundance of caution, Friends will file for a Notice of Exemption prior to the solicitation of charitable contributions as per the opinion letter.
- *Friends of Children of Mississippi, inc., under reported on its Federal Information Form 990, the compensation an employee benefit plan contributions for its top five executives by \$147,480 for the three grant years. As a result of inaccurate reporting, Friends of Children of Mississippi, Inc., may be subject to penalties for failing to file a complete return. The errors occurred primarily because FCM, Inc.'s officials were not aware that all its contributions to employee health benefit plans had not been reported on the Form 990s.*

**RESPONSE:**

The following has been ascertained following our review of the issue:

- ✓ The Form 990 is an information return to the Internal Revenue Service.
- ✓ There were errors in reporting compensation amounts.

- ✓ The errors in reporting salaries occurred primarily because our independent auditing firm, Watkins, Ward & Stafford, used W-2 taxable wages on a calendar year basis rather than gross salaries paid on a fiscal year basis.
- ✓ In the future we will reconcile gross wages paid on a fiscal year to our payroll records.
- ✓ Amounts used for retirement pay benefits were estimated because the retirement plan annual report was not yet processed at the time the Form 990 was prepared. Our estimates were close to the actual amounts.
- ✓ Health insurance premiums were not included in employee fringe benefits because we are on a self-funded health care plan.
- ✓ In the future we will use an approximation of a premium cost based upon similar costs in funded plans.

We have attempted to provide an itemized response to all the issues raised and findings made by your office in its Draft Report. As stated earlier, we understand the importance of such audits and the benefit to our organization from such outside reviews. It is our intention to provide your office with the necessary information to accurately reflect the state of affairs at our agency. To that end we have provided you with documentation that substantiates the executive compensation issue. Additionally, we have also provided necessary proof and information on other issues addressed by your office. All relevant corrective action has been implemented as needed.

- ✓ The auditing firm will ascertain from the Internal Revenue Service if any corrective action is needed to rectify the filings (990's) for grant years 2000, 2001 and 2002.

We take great pride in our heritage as a long standing Head Start Agency and in our unwavering commitment to the children and families that we serve.

Please call us if we can be of any further assistance.

Sincerely,



Marvin Hogan  
Executive Director

Enclosures

cc: Mr. Leo Turner

Exhibit 1

08/20/01 15:49 FAX 6014947686

WWS WEST POINT

002/002



**WATKINS, WARD AND STAFFORD**

Professional Limited Liability Company  
Certified Public Accountants

213 Commerce St. P.O. Box 1216 West Point, MS 39773  
Phone (662) 494-5732 Fax (662) 494-7686

James L. Stafford, CPA  
Harry W. Stevens, CPA  
Boyd M. Edwards, CPA  
Paul A. Ray, CPA  
S. Keith Winfield, CPA  
William B. Stagers, CPA  
Aubrey R. Holder, CPA  
David M. Howell, CPA  
Michael W. McCully, CPA

Mort Stroud, CPA  
Gary C. Hamilton, CPA  
R. Steve Sinclair, CPA  
Michael L. Pierce, CPA  
Marsha L. McDonald, CPA  
Wanda S. Holley, CPA  
Robin Y. McCormick, CPA/PFS  
J. Randy Scrivner, CPA

September 20, 2001

Mr. Marvin Hogan  
Friends of Children of Mississippi, Inc.  
4880 McWillie Circle  
Jackson, Mississippi 39206

Dear Mr. Hogan:

Our firm is familiar with several non-profit organizations in this area that are similar in size and complexity to Friends of Children.

Compensation currently paid by these organizations is in the following ranges:

Executive Director	56.49	\$ 110,000 – 125,000	52.88 – 60.10
Assistant Director	39.87	\$ 80,000 – 85,000	38.46 – 40.87
Department Heads	31.25	\$ 60,000 – 70,000	28.85 – 33.65

We would be pleased to answer any questions you might have.

Sincerely,

WATKINS, WARD AND STAFFORD, PLLC

Harry W. Stevens, CPA

HWS/hm

Members of Mississippi Society of Certified Public Accountants  
Members of American Institute of Certified Public Accountants

**Systems Consultants Associates, Inc.**  
**1400 Fourth Avenue, P.O. Box 5197**  
**Jackson, Mississippi 39296-5197**  
**Phone: (601) 355-5911**  
**Facsimile: (601) 355-5915**  
**E-mail: coosystems@aol.com**

**MEMORANDUM**

TO: The File  
FROM: Joshua Ashaka *JA*  
RE: Executive Director Salaries in Region IV  
DATE: 9/19/01

On Wednesday, September 19, 2001, Mr. Marvin Hogan obtained via telephone the following salary data for executive directors in Region IV from a wage survey contractor for the Administration for Children and Families, DHHS Southeast Field Office:

Program Size	Average Annual Salary
3500-6000 enrollees	\$165,000
3000-3499 enrollees	\$ 96,000
2000-2999 enrollees	\$ 91,575



Exhibit 3 - Page 1

Form **990** **Return of Organization Exempt from Income Tax** OMB No. 1545-0047  
**2001**  
 Under Section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)  
 Department of the Treasury Internal Revenue Service **Open to Public Inspection**  
 The organization may have to use a copy of this return to satisfy state reporting requirements

**A** For the 2001 calendar year, or tax year beginning 2/01, 2001, and ending 1/31, 2002

**B** Check if applicable:  
 Address change  
 Name change  
 Initial return  
 Final return  
 Amended return  
 Application pending

Please use IRS label or print or type. See specific instructions.  
**INSTITUTE OF COMMUNITY SERVICES, INC**  
**P O BOX 159**  
**HOLLY SPRINGS, MS 38635**

**D** Employer identification number 64-0440304  
**E** Telephone number 662-252-1582  
**F** Accounting method:  Cash  Accrual  
 Other (specify) \_\_\_\_\_

**H** and **I** are not applicable to Section 527 organizations  
**H (a)** Is this a group return for affiliates?  Yes  No  
**H (b)** If yes, enter number of affiliates: \_\_\_\_\_  
**H (c)** Are all affiliates included?  Yes  No  
 (If no, attach a list. See instructions.)  
**H (d)** Is this a separate return filed by an organization covered by a group ruling?  Yes  No  
**I** Enter 4-digit group GEN: \_\_\_\_\_

**J** Organization type (check only one):  501(c) 3 (insert no.)  4947(b)(1) or  527

**K** Check here  if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS, but if the organization received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.

**L** Gross receipts. Add lines 6b, 8b, 9b, and 10b to line 12: 37,087,651

**M** Check  if the organization is not required to attach Schedule B (Form 990, 990-E, or 990-PF)

**Part I Revenue, Expenses, and Changes in Net Assets or Fund Balances** (see instructions)

<b>1</b> Contributions, gifts, grants, and similar amounts received			
<b>a</b> Direct public support	<b>1a</b>	162,148	
<b>b</b> Indirect public support	<b>1b</b>		
<b>c</b> Government contributions (grants)	<b>1c</b>	36,826,083	
<b>d</b> Total (add lines 1a through 1c) (cash \$ <u>36,988,231</u> noncash \$ _____)	<b>1d</b>		36,988,231
<b>2</b> Program service revenue including government fees and contracts (from Part VII, line 93)	<b>2</b>		96,191
<b>3</b> Membership dues and assessments	<b>3</b>		
<b>4</b> Interest on savings and temporary cash investments	<b>4</b>		3,229
<b>5</b> Dividends and interest from securities	<b>5</b>		
<b>6a</b> Gross rents	<b>6a</b>		
<b>b</b> Less rental expenses	<b>6b</b>		
<b>c</b> Net rental income or (loss) (subtract line 6b from line 6a)	<b>6c</b>		
<b>7</b> Other investment income (describe _____)	<b>7</b>		
<b>8a</b> Gross amount from sales of assets other than inventory	(A) Securities	<b>8a</b>	
<b>b</b> Less cost or other basis and sales expenses		<b>8b</b>	
<b>c</b> Gain or (loss) (attach schedule)		<b>8c</b>	
<b>d</b> Net gain or (loss) (combine line 8c, columns (A) and (B))			<b>8d</b>
<b>9</b> Special events and activities (attach schedule)			
<b>a</b> Gross revenue (not including \$ _____ of contributions reported on line 1a)	<b>9a</b>		
<b>b</b> Less direct expenses other than fundraising expenses	<b>9b</b>		
<b>c</b> Net income or (loss) from special events (subtract line 9b from line 9a)			<b>9c</b>
<b>10a</b> Gross sales of inventory, less returns and allowances	<b>10a</b>		
<b>b</b> Less cost of goods sold	<b>10b</b>		
<b>c</b> Gross profit or (loss) from sales of inventory (attach schedule) (subtract line 10b from line 10a)			<b>10c</b>
<b>11</b> Other revenue (from Part VII, line 103)	<b>11</b>		
<b>12</b> Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)	<b>12</b>		37,087,651
<b>13</b> Program services (from line 44, column (B))	<b>13</b>		34,525,216
<b>14</b> Management and general (from line 44, column (C))	<b>14</b>		2,494,345
<b>15</b> Fundraising (from line 44, column (D))	<b>15</b>		
<b>16</b> Payments to affiliates (attach schedule)	<b>16</b>		
<b>17</b> Total expenses (add lines 15 and 44, column (A))	<b>17</b>		37,019,561
<b>18</b> Excess or (deficit) for the year (subtract line 17 from line 12)	<b>18</b>		68,090
<b>19</b> Net assets or fund balances at beginning of year (from line 73, column (A))	<b>19</b>		133,055
<b>20</b> Other changes in net assets or fund balances (attach explanation)	<b>20</b>		
<b>21</b> Net assets or fund balances at end of year (combine lines 18, 19, and 20)	<b>21</b>		201,145

SCANNED SEP 18 2002

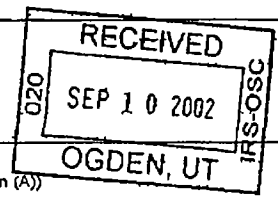




Exhibit 3 – Page 3

<b>2001</b>	<b>FEDERAL STATEMENTS</b>	<b>PAGE 2</b>																									
<b>CLIENT 14235B</b>	<b>INSTITUTE OF COMMUNITY SERVICES, INC.</b>	<b>64-0440304</b>																									
B/20/02		02 11PM																									
<p><b>STATEMENT 5</b> <b>FORM 990, PART IV-A, LINE B(4)</b> <b>OTHER AMOUNTS</b></p> <p>DEPRECIATION</p> <p style="text-align: right;">TOTAL \$ <u>33,829</u></p>																											
<p><b>STATEMENT 6</b> <b>FORM 990, PART IV-B, LINE B(4)</b> <b>OTHER AMOUNTS</b></p> <p>DEPRECIATION</p> <p style="text-align: right;">TOTAL \$ <u>33,829</u></p>																											
<p><b>STATEMENT 7</b> <b>FORM 990, PART V</b> <b>LIST OF OFFICERS, DIRECTORS, TRUSTEES, AND KEY EMPLOYEES</b></p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left; border-bottom: 1px solid black;">NAME AND ADDRESS</th> <th style="text-align: center; border-bottom: 1px solid black;">TITLE AND AVERAGE HOURS PER WEEK DEVOTED</th> <th style="text-align: center; border-bottom: 1px solid black;">COMPEN- SATION</th> <th style="text-align: center; border-bottom: 1px solid black;">CONTRI- BUTION TO EBP &amp; DC</th> <th style="text-align: center; border-bottom: 1px solid black;">EXPENSE ACCOUNT/ OTHER</th> </tr> </thead> <tbody> <tr> <td>AVERN MOORE P O BOX 159 HOLLY SPRINGS, MS 38635</td> <td style="text-align: center;">CEO 40</td> <td style="text-align: right;">\$ 115,239</td> <td style="text-align: right;">\$ 16,126</td> <td style="text-align: right;">\$ 0</td> </tr> <tr> <td>GEORGE LEGGS P O BOX 159 HOLLY SPRINGS, MS 38635</td> <td style="text-align: center;">CFO 40</td> <td style="text-align: right;">83,211</td> <td style="text-align: right;">11,650</td> <td style="text-align: right;">0</td> </tr> <tr> <td>SEE ATTACHED LIST OF DIRECTOR</td> <td style="text-align: center;">1</td> <td style="text-align: right;">0</td> <td style="text-align: right;">0</td> <td style="text-align: right;">0</td> </tr> <tr> <td colspan="2"></td> <td style="text-align: right;">TOTAL \$ <u>198,450</u></td> <td style="text-align: right;">\$ <u>27,776</u></td> <td style="text-align: right;">\$ <u>0</u></td> </tr> </tbody> </table>			NAME AND ADDRESS	TITLE AND AVERAGE HOURS PER WEEK DEVOTED	COMPEN- SATION	CONTRI- BUTION TO EBP & DC	EXPENSE ACCOUNT/ OTHER	AVERN MOORE P O BOX 159 HOLLY SPRINGS, MS 38635	CEO 40	\$ 115,239	\$ 16,126	\$ 0	GEORGE LEGGS P O BOX 159 HOLLY SPRINGS, MS 38635	CFO 40	83,211	11,650	0	SEE ATTACHED LIST OF DIRECTOR	1	0	0	0			TOTAL \$ <u>198,450</u>	\$ <u>27,776</u>	\$ <u>0</u>
NAME AND ADDRESS	TITLE AND AVERAGE HOURS PER WEEK DEVOTED	COMPEN- SATION	CONTRI- BUTION TO EBP & DC	EXPENSE ACCOUNT/ OTHER																							
AVERN MOORE P O BOX 159 HOLLY SPRINGS, MS 38635	CEO 40	\$ 115,239	\$ 16,126	\$ 0																							
GEORGE LEGGS P O BOX 159 HOLLY SPRINGS, MS 38635	CFO 40	83,211	11,650	0																							
SEE ATTACHED LIST OF DIRECTOR	1	0	0	0																							
		TOTAL \$ <u>198,450</u>	\$ <u>27,776</u>	\$ <u>0</u>																							
<p><b>STATEMENT 8</b> <b>FORM 990, PART VIII</b> <b>RELATIONSHIP OF ACTIVITIES TO THE ACCOMPLISHMENT OF EXEMPT PURPOSES</b></p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left; border-bottom: 1px solid black;">LINE #</th> <th style="text-align: left; border-bottom: 1px solid black;">EXPLANATION OF ACTIVITIES</th> </tr> </thead> <tbody> <tr> <td>93A</td> <td>SUMMER DAY CARE FEES WERE COLLECTED FROM CHILDREN THAT WERE ABLE TO PAY FOR SERVICES, THESE FEES HELPED TO PROVIDE SERVICES FOR THESE CHILDREN</td> </tr> <tr> <td>93B</td> <td>FEES WERE COLLECTED FOR AFTER SCHOOL CARE PARTICIPANTS, THESE FEES HELPED TO PROVIDE SERVICES FOR THESE CHILDREN</td> </tr> </tbody> </table>			LINE #	EXPLANATION OF ACTIVITIES	93A	SUMMER DAY CARE FEES WERE COLLECTED FROM CHILDREN THAT WERE ABLE TO PAY FOR SERVICES, THESE FEES HELPED TO PROVIDE SERVICES FOR THESE CHILDREN	93B	FEES WERE COLLECTED FOR AFTER SCHOOL CARE PARTICIPANTS, THESE FEES HELPED TO PROVIDE SERVICES FOR THESE CHILDREN																			
LINE #	EXPLANATION OF ACTIVITIES																										
93A	SUMMER DAY CARE FEES WERE COLLECTED FROM CHILDREN THAT WERE ABLE TO PAY FOR SERVICES, THESE FEES HELPED TO PROVIDE SERVICES FOR THESE CHILDREN																										
93B	FEES WERE COLLECTED FOR AFTER SCHOOL CARE PARTICIPANTS, THESE FEES HELPED TO PROVIDE SERVICES FOR THESE CHILDREN																										

Exhibit 4 - Page 1

Form **990** **Return of Organization Exempt From Income Tax**  
 Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation), section 527 or section 4947(a)(1) nonexempt charitable trust

OMB No 1545-0047  
**2000**  
 Open to Public Inspection

Department of the Treasury  
 Internal Revenue Service

The organization may have to use a copy of this return to satisfy state reporting requirements

**A** For the 2000 calendar year, or tax year period beginning 12/01, 2000, and ending 11/30, 2001

**B** Check if applicable:  
 Change of address  
 Change of name  
 Initial return  
 Final return  
 Amended return

**C** Please use IRS label or print or type. See Specific Instructions.  
**MISSISSIPPI ACTION FOR PROGRESS, INC.**  
 1751 MORSON ROAD  
 JACKSON, MS 39209-6546

**D** Employer identification number  
 64-0440578

**E** Telephone number  
 601-923-4125

**F** Check  if application pending

**G** Organization type (check only one)  501(c)(3) (insert no)  527 OR  4947(a)(1)  
 • Section 501(c)(3) organizations and 4947(a)(1) nonexempt charitable trusts must attach a completed Schedule A (Form 990 or 990-EZ)

**H** Note: H and I are not applicable to section 527 orgs.  
**H(a)** Is this a group return filed for affiliates?  Yes  No  
**H(b)** If "Yes," enter number of affiliates

**I** **H(c)** Are all affiliates included?  Yes  No  
 (if "No," attach a list. See instructions)

**J** Accounting method  Cash  Accrual  Other (specify)

**K** Check here  if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS, but if the organization received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.

**L** Check this box if the organization is not required to attach Schedule B (Form 990 or 990-EZ)

**Part I Revenue, Expenses, and Changes in Net Assets or Fund Balances** (See Specific Instructions on page 16)

<b>1</b> Contributions, gifts, grants, and similar amounts received			
<b>a</b> Direct public support	<b>1a</b>		
<b>b</b> Indirect public support	<b>1b</b>		
<b>c</b> Government contributions (grants)	<b>1c</b>	34,164,907	
<b>d</b> Total (add lines 1a through 1c) (cash \$ <u>34,164,907</u> noncash \$ <u>          </u> )	<b>1d</b>		34,164,907
<b>2</b> Program service revenue including government fees and contracts (from Part VII line 93)	<b>2</b>		59,559
<b>3</b> Membership dues and assessments	<b>3</b>		
<b>4</b> Interest on savings and temporary cash investments	<b>4</b>		
<b>5</b> Dividends and interest from securities	<b>5</b>		
<b>6a</b> Gross rents	<b>6a</b>		
<b>b</b> Less rental expenses	<b>6b</b>		
<b>c</b> Net rental income or (loss) (subtract line 6b from line 6a)	<b>6c</b>		
<b>7</b> Other investment income (describe <input type="text"/> )			<b>7</b>
	(A) Securities	(B) Other	
<b>8a</b> Gross amount from sales of assets other than inventory	<b>8a</b>		
<b>b</b> Less cost or other basis and sales expenses	<b>8b</b>		
<b>c</b> Gain or (loss) (attach schedule)	<b>8c</b>		
<b>d</b> Net gain or (loss) (combine line 8c, columns (A) and (B))	<b>8d</b>		
<b>9</b> Special events and activities (attach schedule)			
<b>a</b> Gross revenue (not including \$ <u>          </u> of contributions reported on line 1a)	<b>9a</b>		
<b>b</b> Less direct expenses other than fundraising expenses	<b>9b</b>		
<b>c</b> Net income or (loss) from special events (subtract line 9b from line 9a)	<b>9c</b>		
<b>10a</b> Gross sales of inventory, less returns and allowances	<b>10a</b>		
<b>b</b> Less cost of goods sold	<b>10b</b>		
<b>c</b> Gross profit or (loss) from sales of inventory (attach schedule) (subtract line 10b from line 10a)	<b>10c</b>		
<b>11</b> Other revenue (from Part VII, line 10)	<b>11</b>		
<b>12</b> Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)	<b>12</b>		34,224,466
<b>13</b> Program services (from line 44, column (B))	<b>13</b>		30,835,543
<b>14</b> Management and general (from line 44, column (C))	<b>14</b>		3,388,923
<b>15</b> Fundraising (from line 44, column (D))	<b>15</b>		
<b>16</b> Payments to affiliates (attach schedule)	<b>16</b>		
<b>17</b> Total expenses (add lines 16 and 44, column (A))	<b>17</b>		34,224,466
<b>18</b> Excess or (deficit) for the year (subtract line 17 from line 12)	<b>18</b>		0
<b>19</b> Net assets or fund balances at beginning of year (from line 73, column (A))	<b>19</b>		0
<b>20</b> Other changes in net assets or fund balances (attach explanation)	<b>20</b>		
<b>21</b> Net assets or fund balances at end of year (combine lines 18, 19 and 20)	<b>21</b>		0

FILMED MAY 02 02  
 RECEIVED  
 APR 14 2002  
 OGDEN, UT

Exhibit 4 – Page 2

Form 990 (2000) **MISSISSIPPI ACTION FOR PROGRESS, INC.** 64-0440578 Page 4

**Part IV-A Reconciliation of Revenue per Audited Financial Statements with Revenue per Return** (See Specific Instructions, page 25)

<b>a</b> Total revenue, gains, and other support per audited financial statements	▶ <b>a</b> 38,170,088
<b>b</b> Amounts included on line a but not on line 12, Form 990	
(1) Net unrealized gains on investments	\$ _____
(2) Donated services and use of facilities	\$ 3,945,622
(3) Recoveries of prior year grants	\$ _____
(4) Other (specify)	\$ _____
Add amounts on lines (1) through (4)	▶ <b>b</b> 3,945,622
<b>c</b> Line a minus line b	▶ <b>c</b> 34,224,466
<b>d</b> Amounts included on line 12, Form 990 but not on line a.	
(1) Investment expenses not included on line 6b, Form 990	\$ _____
(2) Other (specify)	\$ _____
Add amounts on lines (1) and (2)	▶ <b>d</b> _____
<b>e</b> Total revenue per line 12, Form 990 (line c plus line d)	▶ <b>e</b> 34,224,466

**Part IV-B Reconciliation of Expenses per Audited Financial Statements with Expenses per Return**

<b>a</b> Total expenses and losses per audited financial statements	▶ <b>a</b> 38,170,088
<b>b</b> Amounts included on line a but not on line 17, Form 990	
(1) Donated services and use of facilities	\$ 3,945,622
(2) Prior year adjustments reported on line 20, Form 990	\$ _____
(3) Losses reported on line 20, Form 990	\$ _____
(4) Other (specify)	\$ _____
Add amounts on lines (1) through (4)	▶ <b>b</b> 3,945,622
<b>c</b> Line a minus line b	▶ <b>c</b> 34,224,466
<b>d</b> Amounts included on line 17, Form 990 but not on line a.	
(1) Investment expenses not included on line 6b, Form 990	\$ _____
(2) Other (specify)	\$ _____
Add amounts on lines (1) and (2)	▶ <b>d</b> _____
<b>e</b> Total expenses per line 17, Form 990 (line c plus line d)	▶ <b>e</b> 34,224,466

**Part V List of Officers, Directors, Trustees, and Key Employees** (List each one even if not compensated see Specific Instructions on page 25)

(A) Name and address	(B) Title and average hours per week devoted to position	(C) Compensation (if not paid, enter -0-)	(D) Contributions to employee benefit plans & deferred compensation	(E) Expense account and other allowances
BOBBY E BROWN 1927 HAMILTON BLVD JACKSON, MS 39213	CEO 40	131,349	12,838	0
DOROTHY S. FOSTER 6542 FDR DR JACKSON, MS 39213	CFO 40	102,555	9,978	0

75 Did any officer, director, trustee or key employee receive aggregate compensation of more than \$100,000 from your organization and all related organizations of which more than \$10,000 was provided by the related organizations? ▶  Yes  No  
If "Yes," attach schedule see Specific Instructions on page 26

**FRIENDS OF CHILDREN OF MISSISSIPPI, INC. Appendix**  
**Employee Data Change Form Page 17 of 27**

<b>Name:</b> HOGAN, MARVIN	<b>Employee No.:</b> 503
<b>Position:</b> EXECUTIVE DIRECTOR	<b>Social Security No.:</b>
<b>Department:</b> <i>Director's Office</i>	<b>Effective Date:</b> 08/20/2001

CHANGE ITEM	PREVIOUS DATA	NEW DATA
Name*		
Address*		
Position Title Code		
Employee Number*		
Department Code*		
Position Status		
Hourly Rate/Status	44.24	60.60
Annual/Sick Leave*		
State Tax*		
Federal Tax*		
Group Insurance*		
Credit Union*		
Colonial*		
Dental Insurance*		
Burial Insurance*		
Cancer Insurance*		
Other/Retro Pay*		hours: <del>600.00</del> amount: \$9,816.00

\_\_\_\_\_  
 Human Resources Manager

**REASONS FOR ACTION(S)**

<input type="checkbox"/> Resignation	<input type="checkbox"/> Promotion	<input type="checkbox"/> Termination	<input type="checkbox"/> Retirement
<input type="checkbox"/> Demotion	<input type="checkbox"/> Rehire	<input type="checkbox"/> Transfer	<input checked="" type="checkbox"/> Retroactive Pay
<input checked="" type="checkbox"/> Rate Adjustment	<input type="checkbox"/> Cost-of-Living	<input type="checkbox"/> Merit Increase	<input type="checkbox"/> Reduction in Force

**APPROVALS**

SIGNATURE	TITLE	DATE
<i>[Signature]</i>	Department Head	11/26/01
<i>[Signature]</i>	Finance Director	11/26/01
<i>[Signature]</i>	Deputy Director	11/26/01
<i>[Signature]</i>	Executive Director	11/26/01

*Does not require all signatures*



## FRIENDS OF CHILDREN OF MISSISSIPPI, INC.

939 N. President Street Jackson, Mississippi 39202-2563 Telephone (601) 353-3264 Fax (601) 353-3220

April 28, 2003

Marvin Hogan  
Executive Director

Leo Turner  
Chairperson

Mr. Bill Wilkerson  
Director of Regulation and Enforcement  
Secretary of State of Mississippi  
301 North President  
Post Office Box 136  
Jackson, Mississippi 39205-0136

VIA CERTIFIED MAIL

RE: Inquiry dated March 28, 2003

Dear Mr. Wilkerson:

This letter is in response to your inquiry dated March 28, 2003. It is our understanding that your office's partial audit related to the "charity and its operations." We intend to fully cooperate and provide any information related in any way any activities related to our charitable solicitations. However, we feel that a detailed explanation of the nature of our organization is in order.

Friends of Children of Mississippi, Inc., is a federally funded Head Start program. Most of its funding comes from department of Health and Human Services. FCM also receives additional funding from the State of Mississippi (TANF and child care) and USDA reimbursements for its Head Start program related operations. The organization is also required, under a Federal mandate, to provide in-kind matching contributions of at least 20% (reduced to 13.27% by a waiver) every program year. These in-kind contributions range from donations of space from schools, volunteer time, discounted or pro-bono physician services, discounts from businesses etc. (See Attachment #1) All of these grants and expenditures are subject to extensive federal and state oversight. Friends of Children is a registered nonprofit corporation and also registered as a charitable organization in compliance with the Mississippi Charitable Solicitations Act.

Although FCM is registered as a "charitable organization," charitable sales revenues comprised just 0.21% (fiscal year 2000), 0.09% (fiscal year 2001) and 0.05% (fiscal year 2002) of the organization's operations and its budget for the past three years. As part of its Head Start program, the Agency conducts some fund-raising activities from sales of products. Please note that the organization does not solicit any cash donations directly from the general public.

"AN EQUAL OPPORTUNITY EMPLOYER M/F"

Accredited by the  
National Academy



Mr. Bill Wilkerson  
April 28, 2003  
Page 2

We are providing you with a breakdown of the types of fund-raising activities, the gross sales amounts for the past three years. We are also providing you with the disbursements of these amounts for the past two years. Please note that these figures were compiled through a joint effort between our auditors and this organization and the chart has been approved by our auditors. (*See Attachment #2*)

The following is an itemized response to the letter dated March 28, 2003:

ITEM # 1: Pertaining to the answer to question number 12 on the URS form that requests the purposes and programs of the organization and those for which funds are solicited. Our response was "for matching funds of the micro-loan program and for non-federal expenditures." Your office deemed this to be an incomplete response and requested elaboration.

Please see the itemization of funds received and the disbursements listed above. The funds raised through these activities are used for expenditures not covered by the federal or state grants. Some of these expenditures include donations to families in the community with dire needs (crisis intervention), donations and membership dues to the National and Regional Head Start Associations, courtesy/condolences for employees and policy makers, taking out advertisements in support of community events etc.

The response that we provided, while not in depth, was accurate in terms of describing the nature of these expenditures. Please let us know if we need to amend our response to provide a more detailed response in line with the explanation provided in this letter. Also note that the auditor from your office had full access to all our documents and also had discussions with our regular auditor and raised no concerns.

ITEM # 2: Pertaining to the answer to question number 15 on the URS form that requests banks in which the registrant's funds are deposited. At the time of the filing of our registration statement the only account that the solicited funds were deposited in was the account that was provided. Our micro-loan program is not a service offered through our "charitable solicitations" or in our capacity as a "charity." The funds for the micro-loan program are obtained through a federal match for funds received through banking organizations and under the auspices of the Small Business Administration. The matching funds are solicited from banks and not individuals. The breakdown provided above outlines the sources of these matching funds. There is a separate account that these micro loan funds are deposited in. The account information for that is as follows: First American Bank - Acc. #001-75-310132 and Great Southern National Bank - Acc. #7701032368.

We respectfully decline to provide any other bank accounts on the grounds that they are wholly unrelated to any charitable solicitations or disbursements. Also note



Mr. Bill Wilkerson  
April 28, 2003  
Page 3

that the auditor from your office had full access to all our documents and also had discussions with our regular auditor.

**ITEM # 3:** Pertaining to your recommendation that the board minutes be more detailed as to discussions and regarding board involvement in construction bids. We submit that our board minutes are in full compliance with record-keeping requirements of Mississippi Code Annotated §79-11-283, other pertinent statutes and the organization's bylaws. We take your recommendations as to the board minutes into consideration and view it as a recommendation only.

The Regional Head Start Program Guidelines require us to have a Bid and Purchasing Policy. Our Bid and Purchasing Policy is contained in our Financial Policies and Procedures Manual. (*See Attachment #3*) Our Bids are received and approved in accordance with our Bid and Purchasing Policy. Additionally, these policies and the Bids are audited every three years by the Regional authority and audited every year by our auditors.

The members of the Board of Directors for Friends of Children serve without pay and are reimbursed for travel and per diem expenses. Most, if not all, of the Board members have regular full time jobs in addition to their position as members of the Board of Directors. The Board, out of practical concerns, granted a power of attorney to the Executive Director to take care of the organizations contracts and other day to day operations.

Please note that the Board approves all grant awards, organizational budgets and is presented monthly financial reports and all this is part of the board minutes. The board will take your additional recommendations with regard to this item into consideration. Also note that the auditor from your office had full access to all our minutes.

**ITEM # 4:** Pertaining to our statement of purpose and your recommendation that the organization's bylaws be amended to "include all of the services offered by the charity." Article II, Section 1 of our by-laws outlines our primary statement of purpose as outlined in your letter. Additionally, Section 2 states that the organization has the "further purpose to coordinate efforts with other Head Start programs in mobilizing and utilizing all resources, private and public, in order to strengthen and reinforce the struggle to combat poverty." (*See Attachment #4*)

Our micro-loan program is not a service offered through our "charitable solicitations" or in our capacity as a "charity." The funds for the micro-loan program are obtained through a federal match for funds received through banking organizations and under the auspices of the Small Business Administration. However, our statement of purpose under Section 2 does include the objective of the micro-loan program.

Mr. Bill Wilkerson  
April 28, 2003  
Page 4

The organization's initiative titled "Pathways Out Of Poverty" is an initiative focusing on four areas: Early childhood development, expanding economic opportunities, building organized communities and community development. (*See Attachment #5*) It is the organization's service delivery concept that is made available to the parents of our enrollees (e.g.: FCM offers participates in literacy efforts by donating use of its classrooms for GED classes etc.). Please see the attached literature on the same. There are no special programs being offered under this theory other than those already operated in conjunction with the Head Start operations. Even if these were separate services, which they are not, they are again adequately covered under Section 2 of our statement of purpose.

ITEM # 5: Pertaining to a request for explanation on the "PD" notations on the cellular phone bills and the "policy of the charity on personal calls on cellular telephones paid for by the charity." Please let us reiterate that we play a very limited role as a "charity." The breakdown of the charitable solicitations received have been outlined above. The cell phones located on the buses that transport the Head Start children are federally required and paid for by operational funds allocated in the federal grant. (*See Attachment # 6*)

The employees were allowed to obtain cellular phones at a corporate rate provided to the centers. The employees are responsible for their own cell phone bills. However, in early 2002, some of these employees failed to pay their bills and the organization was billed for these items. The organization paid for these items and later sought reimbursement (garnished through their paychecks) from the employees for the same. The "PD" notation indicates items fully "paid" by the employees. Cellular South currently directly bills the employees for their cell phones.

We are of the opinion that these items are unrelated to our solicitation funds but are willing to provide the bills and reimbursement receipts if needed. Also note that the auditor from your office had full access to all our documents.

ITEM # 6: Pertaining to this organization's policy on continuing education of its employees. The organization does have a policy regarding continuing education of its employees. The funds for this are wholly derived from our federal grants and the federal grant in fact mandates certain educational requirements for the teaching staff. We are of the opinion that this item is unrelated to our operation as a "charity" but are willing to provide you with a copy of the policy if needed.

ITEM # 7: Pertaining to your request for W-2s for the past three years for the ten highest paid employees including certain listed employees. The salaries for the organization's staff are wholly funded for by the federal grants and state funds. The charitable solicitations are outlined above. None of the money from these solicitations is applied towards the salaries of any our employees. We respectfully decline to provide any of the requested W-2's on the grounds that they are wholly unrelated to any

Mr. Bill Wilkerson  
April 28, 2003  
Page 5

charitable solicitations or disbursements. Also note that the auditor from your office had full access to all our documents and also had discussions with our regular auditor.

ITEM # 8: Pertaining to your request for competitive bids received for specific centers and for evidence that the board approved these contracts. As stated to you earlier, the Regional Head Start Program Guidelines require us to have a Bid and Purchasing Policy. Our Bid and Purchasing Policy is contained in our Financial Policies and Procedures Manual. Our Bids are received and approved in accordance with our Bid and Purchasing Policy.

The members of the Board of Directors for Friends of Children serve without pay and are reimbursed for travel and per diem expenses. Most, if not all, of the Board members have regular full time jobs in addition to their position as members of the Board of Directors. The Board, out of practical concerns, granted a power of attorney to the Executive Director to take care of the organizations contracts and other day to day operations. Please note that the Board approves all grant awards, organizational budgets and is presented monthly financial reports and all this is part of the board minutes.

The construction projects that you have requested the bids for were all funded by federal grants that the organization receives. None of these projects was funded in any way through any of the monies received through charitable solicitations. You have been provided a breakdown on the charitable solicitations received in the past three years. We respectfully decline to provide these bids on the grounds that they are wholly unrelated to any charitable solicitations or disbursements. Also note that the auditor from your office had full access to all these bids.

ITEM # 9: Pertaining to your inquiry into expenses payable to employees. The Federal grants that the organization receives have an allotment for 2 field trips a year for the children/enrollees. The teachers at the various centers decide the nature and location of the field trips and make their requests to the center managers. The center managers (both employees that you listed in your inquiry were center managers) are sent a check for the student field trips. The center managers in turn cash these checks and disburse it at the appropriate time to the teachers for the benefit of the children. All the funds are accounted for with proof of receipts. Any unused funds are returned to the center manager who in turn returns it to the central office.

Similarly, the federal grants make an allocation for parent activity at the various centers. The allocation is \$5.00 per child. A parent committee decides what it intends to do with the monies allocated for parent activity from a list of approved activities. The parent committee send in their request for approval and a check is sent out to the center managers. The center managers in turn cash this check and have it available for the parent activity. All the funds are accounted for with proof of receipts. Any unused funds are returned to the center manager who in turn returns it to the central office.

Mr. Bill Wilkerson  
April 28, 2003  
Page 6

We stopped paying the vendors directly because of problems encountered in the past (including but not limited to delays in obtaining cancellations or refunds etc.). The system we have in place has proven to be much more accountable than the others we have utilized in the past.

We are of the opinion that these items are wholly unrelated to any of the charitable solicitations we receive. However, out of good faith, we are providing proof of receipts on the items you requested. (*See Attachment #7*)

We appreciate the need for enforcement and regulation of all charitable organizations and solicitations and commend you on your efforts. It is our sincere hope that your agency understands our rationale in these responses. Please call us if we can be of further assistance or if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Leo Turner", with a long, sweeping horizontal line extending to the right across the signature.

Leo Turner, Chairperson  
Board of Directors  
Friends of Children of MS, Inc.

cc: Watkins, Ward & Stafford  
Mr. Marvin Hogan

**McGLINCHEY STAFFORD PLLC**  
WILLIAM S. MENDENHALL  
(601) 960-8421  
Fax (601) 352-7757  
bmendenhall@mcglinchey.com

JACKSON  
NEW ORLEANS  
HOUSTON  
BATON ROUGE  
CLEVELAND  
MONROE

Exhibit 7

April 21, 2004

Rajita Iyer Moss, Esq.  
Owens Law Firm, PLLC  
770 North West Street  
Jackson, MS 39202

*By Facsimile (601) 352-8447*

Re: Friends of Children of Mississippi, Inc.

Dear Rajita:

You have asked us to provide an opinion as to whether Friends of Children of Mississippi, Inc., a Mississippi nonprofit corporation ("FCM"), is exempt from the Secretary of State's charitable organization registration requirements set forth in Section 79-11-501 *et seq.* of the Mississippi Code Annotated of 1972, as amended (the "Code"). It is our understanding that FCM is a federally funded Head Start program that receives additional funding from the State of Mississippi for its Head Start program operations. It is our further understanding that FCM currently conducts some restricted fundraising activities, which are limited to the sale of advertising space in an annual souvenir booklet. To date, \$1,800 worth of ads have been sold in 2004. No ads were sold, nor were any solicitations made during 2003.

Mississippi law requires that every charitable organization (as defined by Section 79-11-505 of the Code) which solicits or intends to solicit contributions by any means whatsoever must file a registration statement with the Secretary of State. There are, however, certain exemptions to this general filing requirement. As set forth in Section 79-11-505(d) of the Code, the charitable registration filing requirement does not apply to "[a]ny charitable organization which does not intend to solicit and receive and does not actually receive contributions in excess of Four Thousand Dollars (\$4,000) during any twelve-month period ending June 30 of any year, provided all of its fund-raising functions are carried on by persons who are unpaid for such services." Therefore, as long as FCM does not receive contributions in excess of \$4000 per year, and as long as all fundraising is conducted by unpaid volunteers, it will be exempt from the charitable filing requirements. If contributions in excess of \$4000 are received for any such period, FCM must file a charitable registration statement with the Secretary of State within thirty (30) days after receipt of the excess funds.

In order to secure its exemption, FCM must file Form CE "Notice of Exemption" for Charitable Organizations prior to the solicitation of contributions. A copy of Form CE is attached to this letter. This is a one-time filing which notifies the Secretary of State that FCM is exempt from filing under Section 79-11-505(1)(d), based upon the fact that it receives gross

153564.1

Rajita Iyer Moss, Esq.  
April 21, 2004  
Page 2

annual contributions in an amount which does not exceed \$4,000. A copy of FCM's Bylaws and IRS determination letter must be submitted with Form CE to the Secretary of State. As stated above, any changes to the information contained in Form CE must be submitted to the Secretary of State within thirty (30) days.

Should you need any additional information, please do not hesitate to call.

Sincerely,

**McGlinchey Stafford, PLLC**



William S. Mendenhall

WSM:kk

FORM CE



# NOTICE OF EXEMPTION FOR CHARITABLE ORGANIZATIONS

Mississippi Secretary of State's Office  
P O Box 136, Jackson MS 39205-0136  
(601) 359-1633 or (888) 236-6167

1. Name and complete address of organization:

Phone number:

List name, address, and phone number of the person to whom correspondence should be directed:

2. Exemption claimed..... §79-11-505 (1) (a)\_\_\_\_ (b)\_\_\_\_ (c)\_\_\_\_ (d)\_\_\_\_  
(e)\_\_\_\_ (f)\_\_\_\_ (g)\_\_\_\_ (h)\_\_\_\_

3. Statement of Purpose:

4. Attach a list of any other offices in this state.

5. Attach a list of all officers, trustees, and directors of the charitable organization. This list must include full names, full addresses, and phone numbers.

6. List name, address, and phone number of individual who has custody of the financial records of the charitable organization:

7. Please give a brief statement of why your organization qualifies under this exemption:

I certify that the information on this document and in the attachments hereto is true and correct. I further certify that I am authorized to submit this form on behalf of the Registrant. I understand that I am under a continuing obligation to notify the Secretary of State's Office of any changes in the information provided to that office.

SIGNATURE OF PRESIDENT \_\_\_\_\_ DATE \_\_\_\_\_

TYPED (or printed) NAME \_\_\_\_\_

NOTARY SEAL

Sworn to and subscribed before me  
This the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_.

\_\_\_\_\_  
Notary Public



## MISSISSIPPI SECRETARY OF STATE

### NOTICE OF EXEMPTION FOR CHARITABLE ORGANIZATIONS

---

#### INSTRUCTIONS

---

1. Complete the "Charitable Organization Statement of Exemption" (FORM CE). If attachments are necessary, indicate the question number on the attachment. **Please type or print clearly.**
2. The president of the Organization must sign the application, and the signature must be notarized.
3. Submit a copy of the Organization's By-laws and IRS determination letter along with the application.
4. Return completed application, By-laws and IRS determination letter to:

Mississippi Secretary of State's Office  
Charities Registration  
P O Box 136  
Jackson MS 39205-0136

*Any changes in the information on file with the Division should be made within 30 days.*

---

#### **ORGANIZATIONS EXEMPT FROM REGISTRATION UNDER SECTION 79-11-505 (Miss. Code Ann. 1972)**

---

- (a) Accredited educational institutions;
- (b) Certain fraternal, patriotic, social, educational, alumni organizations and historical societies who use only their membership to solicit contributions;
- (c) Persons who are soliciting contributions for an individual in need if the solicitations are made solely by persons who are unpaid;
- (d) Organizations which do not intend to solicit or receive more than \$4000 per year in contributions;
- (e) Organizations which receive allocations from registered united funds or community chests and receive less than \$4000 from other sources;
- (f) All volunteer fire departments and rescue units which are chartered as nonprofit organizations by the State of Mississippi.
- (g) Any humane society which contracts with counties or municipalities for the care and keeping of strays.

---

#### **IMPORTANT**

---

Prior to any solicitations for contributions, each charitable organization claiming to be exempt shall file a Notice of Exemption. The burden of proving an exemption, or an exception from a definition, is upon the person claiming it.



# ACKNOWLEDGMENTS

This report was prepared under the direction of Charles J. Curtis, Regional Inspector General for Audit Services. Other principal Office of Audit Services staff that contributed included:

John T. Drake, Sr., *Audit Manager*  
Truman Mayfield, *Senior Auditor*  
Shawn Edwards, *Auditor-in-Charge*  
Wayne Southwell, *Auditor*

Richard Bland, *Audit Manager, Headquarters, Grants and Internal Activities*

Technical Assistance

Elizabeth Zyga, *Administrative Support Specialist*