

# STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR  
BETH A. WOOD, CPA



## FRANKLIN VANCE WARREN OPPORTUNITY, INC.

HENDERSON, NORTH CAROLINA

INVESTIGATIVE REPORT  
APRIL 2017



**NC**  **OSA**  
The Taxpayers' Watchdog

# EXECUTIVE SUMMARY

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## **PURPOSE**

The Office of the State Auditor received a complaint through its Hotline alleging Franklin Vance Warren Opportunity, Inc. (Agency) misused program funds. In addition, the complaint alleged the former Chief Executive Officer (CEO) authorized a salary increase and obtained legal services without approval from the Board of Directors (Board).

## **BACKGROUND**

The Agency is a not-for-profit organization located in Henderson. The Agency provides self-sufficiency services to low-income families and individuals in Franklin, Nash, Vance, and Warren counties.<sup>1</sup> These services include Head Start, Section 8 Housing, Community Services Block Grant, and Weatherization.

The Agency receives approximately 77% of its funding from federal and state governmental agencies, including the North Carolina Department of Health and Human Services, Division of Child Development and Early Education.

## **KEY FINDINGS**

- More than \$361,000 of NC Pre-Kindergarten funds misused
- Former Chief Executive Officer's unauthorized salary increase resulted in \$18,686 additional compensation
- More than \$59,500 spent for legal services without Board approval

## **KEY RECOMMENDATIONS**

- The Agency should reimburse its Pre-K program \$361,284 from its general fund
- The Agency should ensure management complies with the *NC Pre-K Program Fiscal and Contract Manual* and should educate staff on program requirements
- The Board should establish procedures for reviewing and approving all staff salaries, including the CEO's salary, on an annual basis
- The Board should consider pursuing reimbursement from the former CEO for compensation received in excess of her Board-approved salary
- The Board should communicate and emphasize to its members the limits to their individual authority

*Key recommendations are not inclusive of all recommendations in this report.*

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<sup>1</sup> Franklin Vance Warren Opportunity Inc.'s Consolidated Financial Statements, June 30, 2015

STATE OF NORTH CAROLINA  
**Office of the State Auditor**



**Beth A. Wood, CPA**  
State Auditor

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## AUDITOR'S TRANSMITTAL

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The Honorable Roy Cooper, Governor  
Members of the North Carolina General Assembly  
Felicia Gregory, Interim Chief Executive Officer, Franklin Vance Warren Opportunity, Inc.  
Tony Cozart, Board Chair, Franklin Vance Warren Opportunity, Inc.  
Mandy Cohen, Secretary, North Carolina Department of Health and Human Services

Ladies and Gentlemen:

Pursuant to *North Carolina General Statute §147-64.6(c)(16)*, we have completed an investigation of allegations concerning Franklin Vance Warren Opportunity, Inc. The results of our investigation, along with recommendations for corrective action, are contained in this report.

Copies of this report have been provided to the Governor, the Attorney General and other appropriate officials in accordance with *G.S. §147-64.6(c)(12)*. We appreciate the cooperation received from the management and employees of Franklin Vance Warren Opportunity, Inc. during our investigation.

Respectfully submitted,

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor



**Beth A. Wood, CPA  
State Auditor**

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# BACKGROUND

The Office of the State Auditor received a complaint through its Hotline alleging Franklin Vance Warren Opportunity, Inc., (Agency) misused program funds. In addition, the complaint alleged the former Chief Executive Officer (CEO) authorized a salary increase and obtained legal services without approval from the Board of Directors (Board).

Our investigation of the complaint included the following procedures:

- Review of applicable state and agency policies and procedures
- Interviews with Agency personnel and board members
- Interviews with North Carolina Department of Health and Human Services, Division of Child Development and Early Education personnel
- Interviews with Franklin Granville Vance Smart Start, Inc. personnel
- Examination and analysis of available documents and records

This report presents the results of the investigation. The investigation was conducted pursuant to *North Carolina General Statute § 147-64.6 (c) (16)*.

### **Organization Overview**

Franklin Vance Warren Opportunity, Inc. (Agency) is a not-for-profit organization in Henderson. The Agency provides self-sufficiency services to low-income families and individuals in Franklin, Nash, Vance, and Warren counties.<sup>2</sup> These services include Head Start, Section 8 Housing, Community Services Block Grant, and Weatherization.

The Agency receives approximately 77% of its funding from federal and state governmental agencies, including the North Carolina Department of Health and Human Services, Division of Child Development and Early Education (Division).

The Division oversees the North Carolina Pre-Kindergarten (Pre-K) program and administers funding to 91 contractors<sup>3</sup> to provide Pre-K services to eligible children. Contractors may provide Pre-K services directly or subcontract with local Pre-K program sites. The Division provides contractors with a per-child allocation based on a 10-month school year.

Franklin Granville Vance Smart Start, Inc. (FGV Smart Start) is a Pre-K contractor and subcontracts with the Agency to provide direct Pre-K services. As a contractor, FGV Smart Start receives funding from the Division and allocates funds to the Agency based on its site type, teacher qualifications, and child attendance.

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<sup>2</sup> Ibid.

<sup>3</sup> NC Pre-K contractors include local education agencies, Smart Start agencies, and community action agencies.



# FINDINGS AND RECOMMENDATIONS

## 1. MORE THAN \$361,000 OF NC PRE-KINDERGARTEN FUNDS MISUSED

From July 1, 2012, through June 30, 2016, Franklin Vance Warren Opportunity, Inc., (Agency) spent \$361,284 of its \$596,484 NC Pre-Kindergarten (NC Pre-K) direct services funds on general operating expenses<sup>4</sup> in violation of the *NC Pre-K Program Fiscal and Contract Manual*. The following table shows the total NC Pre-K funds received and misused:

Fiscal Year	Total NC Pre-K Funds Received	Total NC Pre-K Funds Misused	Percentage Misused
2012-13	\$ 139,800	\$ 94,050	67%
2013-14	133,300	68,700	52%
2014-15	150,000	96,000	64%
2015-16	173,384	102,534	59%
<b>Total</b>	<b>\$ 596,484</b>	<b>\$ 361,284</b>	<b>61%</b>

The Agency deposited these funds into its general fund bank account. Then, the Agency used the funds for items such as computer equipment, audit fees, and legal services rather than NC Pre-K activities such as salaries and benefits for teaching staff, curriculum materials, and staff training.

Over a four-year period, the Agency had \$361,284 less to serve the children in its NC Pre-K program as a result of the misuse of funds. This reduction in resources limited the Agency's ability to provide high-quality educational experiences to enhance school readiness for its Pre-K students. For example, the Agency could have enhanced its Pre-K program through the purchase of additional classroom equipment, educational materials, or child development tools.

### **Violation of NC Pre-Kindergarten Program Requirements**

The former Chief Executive Officer (CEO) violated NC Pre-K program requirements and approved the Agency's use of program funds for general purposes despite her knowledge of funding requirements. Prior to her promotion, the former CEO served as the Agency's Head Start Director for three years. Based on this experience, the former CEO should have known the allowable uses of NC Pre-K funds for the Agency's Head Start program.

The Head Start Director said the former CEO used the NC Pre-K funds for general purposes because there was not enough money in the Agency's general fund.

### **Lack of Knowledge of NC Pre-Kindergarten Program Requirements**

The Agency's Finance Director lacked knowledge regarding allowable uses of NC Pre-K funds. According to the Finance Director, the former CEO directed her to deposit the NC Pre-K funds from Franklin Granville Vance Smart Start, Inc. (FGV Smart Start) in the Agency's general fund. The practice started prior to the Finance Director's employment with the Agency. As a result, she did not know the NC Pre-K funds could not be used for the Agency's general expenses.

<sup>4</sup> The Agency's general operating expenses supported multiple programs including Section 8 Housing, Community Services Block Grant, and Weatherization.

### NC Pre-Kindergarten Program Requirements

The Agency must follow the requirements set forth in the *NC Pre-K Program Fiscal and Contract Manual* as well as the contract between the NC Department of Health and Human Services, Division of Child Development and Early Education (Division) and FGV Smart Start. Both the *NC Pre-K Program Fiscal and Contract Manual* and the contract require that any approved subcontract be subject to the terms and conditions of the contract between the Division and FGV Smart Start.

According to the approved subcontract between the Agency and FGV Smart Start, “the site [Agency] shall provide all services in accordance with the NC Pre-Kindergarten Program Requirements & Guidance Manual and the Fiscal and Contract Manual.” The *NC Pre-K Program Fiscal and Contract Manual* addresses allowable uses of direct services funds. Specifically, “direct services funds that a Contractor receives must be passed to NC Pre-K providers for payment of direct services to children.”

In addition, the subcontract between the Agency and FGV Smart Start includes the following provision, “the site [Agency] assures that funds received pursuant to this contract shall be used only to **supplement**...the total amount of federal, state and local public funds that the Site...expends for pre-kindergarten services...” The provision also includes, “Funds received under this contract shall be used to provide **additional** public funding for such services.” (*Emphasis Added*)

### RECOMMENDATIONS

- The Agency should reimburse its Pre-K program \$361,284 from its general fund
- The Agency should ensure management complies with the *NC Pre-K Program Fiscal and Contract Manual* and should educate staff on program requirements

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## 2. FORMER CHIEF EXECUTIVE OFFICER’S UNAUTHORIZED SALARY INCREASE RESULTED IN \$18,686 ADDITIONAL COMPENSATION

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On July 1, 2012, the former Chief Executive Officer (CEO) of Franklin Vance Warren Opportunity Inc. (Agency) increased her annual salary from \$75,000 to \$80,000 without the Board of Directors’ (Board) approval. The Board was not aware of the salary increase until a citizen brought it to its attention during the July 2015 Board meeting.

The former CEO’s appointment letter documented her annual salary of \$75,000 but did not address future salary increases. The Board did not approve any salary increases for the former CEO after her March 15, 2011, appointment.

From July 1, 2012, through March 4, 2016, the former CEO received \$18,686 of compensation in excess of her Board-approved salary. As a result, the Agency incurred additional salary and payroll tax expenses and had less funding available for other Agency activities.

**Absence of Board Review**

While the Agency's procedures included the former CEO's annual review of staff salaries, the Board lacked procedures for reviewing the former CEO's annual salary. The Board did not review or approve the former CEO's annual salary from July 2012 until after the unauthorized salary increase was brought to its attention in July 2015.

**Former CEO Abused Her Authority**

The former CEO abused her authority by self-approving her annual salary change form and directing the former Finance Director to process the form despite the absence of the Board Chair's approval.

During the July 2015 board meeting, the former CEO admitted to improperly increasing her salary. She told investigators that the Agency's Administrative Assistant, who had been at the Agency for over 30 years, "encouraged her to sign" the salary change form. According to the former CEO, the Board told her they would increase her salary from \$75,000 to \$80,000 after completing a probationary period. However, the Board never formally voted on nor approved her salary increase.

The Board's review of the Agency's monthly financial reports did not include a review of budget to actual expenses, including a comparison of actual salary expenses to the Agency's approved annual budget. Such a comparison could have revealed the CEO's increased salary.

The Agency's *Personnel Policies and Procedures Manual* states, "Merit increases for the Chief Executive Officer may be granted by the Board of Directors or Executive Committee of the Board of Directors."

**RECOMMENDATIONS**

- The Board should establish procedures for reviewing and approving all staff salaries, including the CEO's salary, on an annual basis
- The Board should consider pursuing reimbursement from the former CEO for compensation received in excess of her Board-approved salary
- The Board should monitor the Agency's monthly financial reports for significant budget to actual variances

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**3. MORE THAN \$59,500 SPENT FOR LEGAL SERVICES WITHOUT BOARD APPROVAL**


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In April 2015, Franklin Vance Warren Opportunity's (Agency) former Board Chair retained legal services without the Board of Directors' (Board) approval. Prior to the agreement, the Board discussed the Agency's need for legal representation. According to the current Board Chair, the Board asked the former Board Chair to research an attorney but did not authorize her to enter into a legal agreement.

The former Board Chair did not notify the Board of the legal agreement until after the contract was signed on April 17, 2015. During the September 2015 board meeting, a

Board member said, “The [former] Board Chairperson entered into an agreement for legal counsel without consultation of the board members.” The Board member further stated the former Board Chair signed the contract at a rate of \$250 per hour, which was not voted on by the Board.<sup>5</sup>

After becoming aware of the agreement, the Board reviewed the Agency’s legal expenses, issued a request for proposal for legal services, and hired a new attorney.

### **Lack of Board Review Results in Unapproved Expenses**

The Board did not have an opportunity to review the legal agreement to determine if it met the needs of the Agency. As a result, from June 2015 through January 2016, the Agency spent more than \$59,500 on legal services without the Board’s approval. In addition, the Board may have incurred unnecessary expenses resulting from the legal agreement.

The former Board Chair assumed she had the Board’s authority to enter into the legal agreement without the Board’s formal approval.

### **Absence of Board Monitoring**

The Board’s review of the Agency’s monthly financial reports did not include a review of budget to actual expenses, including a comparison of actual legal expenses to the Agency’s approved annual budget. Such a comparison could have revealed the increased legal expenses.

The Agency’s *Financial Procedures Manual* states, “The Board of Directors will approve audit and other such significant contracts.” According to the current Board Chair, the former Board Chair did not have authority to enter into legal agreements on behalf of the Board.

## **RECOMMENDATIONS**

- The Board should communicate and emphasize to its members the limits to their individual authority
- The Board should monitor the Agency’s monthly financial reports for significant budget to actual variances

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<sup>5</sup> On September 10, 2015, the Board passed a motion to remove the former Board Chair from her position.



# **MATTERS FOR FURTHER CONSIDERATION**

## FISCAL REVIEWS NEEDED TO ENSURE ACCOUNTABILITY FOR \$139 MILLION IN ANNUAL PRE-KINDERGARTEN FUNDS

The North Carolina Department of Health and Human Services, Division of Child Development and Early Education (Division) should consider performing fiscal reviews of NC Pre-Kindergarten (NC Pre-K) program contractors and subcontractors. The fiscal reviews should ensure that \$139 million<sup>6</sup> per year in state funds “provide high-quality educational experiences to enhance school readiness for eligible four-year-old children.”<sup>7</sup>

The Division’s program manual, *NC Pre-Kindergarten (NC Pre-K) Program Requirements and Guidance Manual*, requires fiscal monitoring to verify that NC Pre-K contractors<sup>8</sup> comply with program requirements. The manual states,

“The Division of Child Development and Early Education, local Contract Administrators and Site Administrators **are required to monitor** for program/policy and **fiscal/contract compliance** for the NC Pre-K Program.”  
(*Emphasis Added*)

Yet, the Division does not perform fiscal reviews to determine how contractors and subcontractors spend NC Pre-K program funds. According to the Division’s Assistant Director of Administrative Services (Assistant Director), the Division focuses its monitoring efforts on programmatic compliance rather than fiscal issues.

However, without fiscal oversight, NC Pre-K funds are at-risk for improper use. As noted in this report as well as a February 2014 investigative report involving a similar organization:

- Franklin Vance Warren Opportunity, Inc. misspent approximately \$361,284 of the \$596,484 (61%) in NC Pre-K funds it received during a four-year period
- Four-County Community Services, Inc. misspent approximately \$196,019 and accumulated more than \$1.1 million in excess NC Pre-K funds<sup>9</sup>

Also, the Division should consider increasing the frequency of its site visits to perform fiscal reviews. The Assistant Director said that from July 2012 to June 2015, the Division conducted 42 programmatic monitoring visits to selected Pre-K contractors. Therefore, on average, the Division visited 14 of 91 (15%) contractor sites per year. At that frequency, the Division monitors each Pre-K contractor approximately once every seven years. Infrequent monitoring visits limit the Division’s ability to identify potential misuse of NC Pre-K funds.

<sup>6</sup> From July 1, 2012 to June 30, 2015, the Division received approximately \$144 million per year in state funds for the NC Pre-K program of which approximately \$139 million was allocated to contractors. The remaining \$5 million was retained for administrative costs.

<sup>7</sup> [http://ncchildcare.dhhs.state.nc.us/general/mb\\_ncprek.asp](http://ncchildcare.dhhs.state.nc.us/general/mb_ncprek.asp)

<sup>8</sup> NC Pre-K contractors include local education agencies, Smart Start agencies, and community action agencies.

<sup>9</sup> North Carolina Office of the State Auditor, *Four-County Community Services, Inc.*, February 2014



# STATE AUDITOR'S RESPONSE

When an agency's response potentially obscures an issue, misleads a reader, or minimizes the importance of our findings and recommendations, the Office of the State Auditor provides additional information or clarifications to ensure that the Governor, the General Assembly, and the citizens of North Carolina receive complete and accurate information.

In its response to Finding 1, Franklin Vance Warren Opportunity, Inc. (Agency) contends that it fulfilled its contractual obligations by "providing services to children in exchange for a fixed payment rate per child per month of service delivered." The Agency did in fact provide pre-kindergarten services to children. However, the primary source of funding for the Agency's pre-kindergarten services came from the federal program entitled Head Start,<sup>10</sup> which totaled \$12,728,226 from July 1, 2012, to June 30, 2016. As noted in Finding 1, the \$361,284 in NC Pre-Kindergarten (NC Pre-K) funds the Agency received under its contract with Franklin Granville Vance Smart Start, Inc. (FGV Smart Start) was deposited in the Agency's general fund operating account and was ultimately used to support other programs such as Weatherization, Section 8 Housing, and Community Development. Thus, the Agency's contention that it provided pre-kindergarten services using NC Pre-K funds is both disingenuous and misleading.

In effect, the Agency misrepresented its actual funding needs by entering into a contract with FGV Smart Start with the knowledge that its Head Start funding was more than adequate to serve its eligible children. The Agency received more public funding than it needed for its pre-kindergarten program and then used the surplus generated through its contract with FGV Smart Start to fund other programs such as Weatherization, Section 8 Housing, and Community Development.

The Agency also contends that "NC Pre-K funds received under the contract between FGVSS [Franklin Granville Vance Smart Start, Inc.] and FVWO [Franklin Vance Warren Opportunity, Inc.] were used to provide additional public funding for such services." The Agency provided no evidence that the NC Pre-K funds received under its contract with FGV Smart Start were used for pre-kindergarten services. As previously stated, all of the NC Pre-K funds the Agency received under its contract with FGV Smart Start supported other programs unrelated to its pre-kindergarten program.

Thus, the Agency violated the provisions of its contract with FGV Smart Start as well as state regulations by using NC Pre-K funds to fund other community programs and activities. The contract between the Agency and FGV Smart Start required the Agency to "provide all services in accordance with the NC Pre-Kindergarten Program Requirements & Guidance Manual and the Fiscal and Contract Manual."<sup>11</sup> The *NC Pre-Kindergarten Program Fiscal and Contract Manual (Fiscal and Contract Manual)* places restrictions on the use of NC Pre-K funds. The *Fiscal and Contract Manual* states that NC Pre-K funds provided by FGV Smart Start "must be used to serve children in NC Pre-K classrooms."<sup>12</sup>

Despite its disagreement with Finding 1, the Agency outlined an eight-part corrective action plan to address the misuse of NC Pre-K funds. As such, it appears the Agency acknowledges the misuse of these funds by its former Chief Executive Officer and Finance Director.

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<sup>10</sup> Head Start is a federal program that "promotes the school readiness of young children from low-income families through agencies in their local community."

<sup>11</sup> Contract Number 1213-2342-015(D) between Franklin Granville Vance Smart Start, Inc. and Franklin Vance Warren Opportunity, Inc.

<sup>12</sup> *NC Pre-Kindergarten Program Fiscal and Contract Manual*, Section 2.B.5.

In summary, the Agency essentially takes the position in its response that once funds designated for NC Pre-K are in its possession those funds are not required to be used for NC Pre-K, but rather can be used for any purpose the Agency desires. Not only does this position contradict the existing contract and the NC Department of Health and Human Services' policies governing these funds, it also conflicts with principles of good stewardship of public funds.

**Note: The findings in this report will be referred to the Inspector General for the United States Department of Education.**



**RESPONSE FROM  
FRANKLIN VANCE  
WARREN  
OPPORTUNITY, INC.**



**FRANKLIN-VANCE-WARREN OPPORTUNITY, INC.**  
*Where Needs Are Met & Success Begins*

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March 10, 2017

The Honorable Beth A. Wood, CPA  
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State of North Carolina  
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Raleigh, NC 27699-0600

*Via e-mail transmission and overnight delivery*

Dear Ms. Wood:

Franklin Vance Warren Opportunity, Inc. (“FVWO”) has reviewed the draft Investigative Report dated March 2017 prepared by your office (the “Draft Report”). Thank you for the opportunity to respond to the Draft Report and your recommendations.

With all due respect to the Office of the State Auditor, we disagree with the findings contained in the Draft Report with respect to the North Carolina Pre-Kindergarten Program (“NC Pre-K”) funds, and believe them to be based on a misunderstanding of FVWO’s contractual relationships with other parties and responsibilities therein. However, notwithstanding our difference of opinion on this point, based on your Draft Report and recommendations, FVWO has taken or agrees to take a number of actions as set forth in this response to improve our processes and activities. Our response below points out our differences of opinion with respect to the NC Pre-K findings, accepts the findings with respect to the former chief executive officer’s compensation and the expenditure of funds for legal services without board approval, and confirms our efforts begun over the past several months to implement and continue better management and governance practices.

**1. Finding #1: More than \$361,000 of NC Pre-Kindergarten Funds Misused**

**A. Response:**

FVWO disagrees with the findings related to the alleged misuse of NC Pre-K funds. The Draft Report’s conclusions with respect to NC Pre-K funds are based upon the following analysis in the Draft Report:

The Agency must follow the requirements set forth in the *NC Pre-K Program Fiscal and Contract Manual* as well as the contract between the NC Department of Health and Human Services, Division of Child Development and Early Education (Division) and FGV Smart Start. Both the *NC Pre-K Program Fiscal and Contract*

*Manual* and the contract require that any approved subcontract be subject to the terms and conditions of the contract between the Division and FGV Smart Start.

According to the approved subcontract between the Agency and FGV Smart Start, "the site [Agency] shall provide all services in accordance with the NC Pre-Kindergarten Program Requirements & Guidance Manual and the Fiscal and Contract Manual." The *NC Pre-K Program Fiscal and Contract Manual* addresses allowable uses of direct services funds. Specifically, "direct services funds that a Contractor receives must be passed to NC Pre-K providers for payment of direct services to children."

In addition, the subcontract between the Agency and FGV Smart Start includes the following provision, "the site [Agency] assures that funds received pursuant to this contract shall be used only to **supplement**...the total amount of federal, state and local public funds that the Site... expends for pre-kindergarten services..." The provision also includes, "Funds received under this contract shall be used to provide **additional** public funding for such services." (*Emphasis Added*)

Draft Report, Page 3.

The Draft report selectively excerpts passages from the *NC Pre-Kindergarten (NC Pre-K) Program Fiscal and Contract Manual* Effective SFY 2016-2017 Revised Date: August 2016 (the "Manual") to allege wrongdoing by FVWO when in fact FVWO met its legal obligations under its contract with Franklin Granville Vance Smart Start ("FGVSS") by providing services to children in exchange for "a fixed payment rate per child per month of service delivered." NC Pre-Kindergarten (NC Pre-K) Program Requirements and Guidance, Effective SYF 2016-2017 ("Guidance"), Glossary-2.

The NC Pre-K funds that FVWO received were paid to FVWO by FGVSS as part of a purchase of service contract. The Manual differentiates between contracts between the North Carolina Department of Health and Human Services, Division of Child Development and Early Education ("DCDEE"), and NC Pre-K contractors such as FGVSS, and subcontracts between NC Pre-K contractors and subcontractors such as FVWO which are purchase of service contracts. See Manual, page 2-1; see also Guidance, Glossary, Page 1, definition of "Contract". While the Manual is made applicable by contract to FVWO, the Manual clearly recognizes the difference between a contract with a contractor and DCDEE and a subcontract with a contractor and a subcontractor. See Guidance, Glossary-2, definition of "Direct Services Funds". The Guidance defines "direct service funds" as "NC Pre-K funds paid to the local Contracting Agency for the NC Pre-K services rendered to eligible children under the contract. Direct services funds that are received by the Contractor must be passed to the local early childhood provider for payment of direct services for eligible children unless the Contractor is a provider of the direct services. *These funds are a fixed payment rate per child per month of service delivered.*" Guidance, Glossary-2,

definition of “Direct Services Funds” (emphasis added). The Draft Report omits the last sentence of this excerpt, which explains how Contractors pay the local early childhood provider for direct services—i.e. *at a fixed payment rate per child per month of service delivered*. The omission alters the definition of “direct services funds” as the direct services funds relate to subcontractors.

Stated differently, FVWO is a vendor under its contract with FGVSS. “Any subcontracts issued by NC Pre-K contractors are considered Purchase of Service, since the subcontracts are for a certain number of children to be served in NC Pre-K classrooms, at an established rate per child. DCDEE does not require NC Pre-K contractors to have detailed budgets for their subcontracts that are Purchase of Service however, local Contractors are encouraged to discuss budget needs with potential NC Pre-K providers about maintaining NC Pre-K program requirements (e.g., teacher compensation, equipment and materials to support classroom quality, formative assessments, curricula, developmental screens). NC Pre-K contractors should use subcontract templates provided by DCDEE.” See Manual, page 2-1 through 2-2.

The fact that the subcontract between FGVSS and FVWO is a purchase of service contract is key to properly understanding this issue. FVWO is **not** a subrecipient; it is a vendor. The North Carolina Department of Health and Human Services, DHHS Policies and Procedures, Section IV, Subrecipient Monitoring Manual states that “the relationship between a Division and another agency may constitute either financial assistance (FA) or purchase of service (POS). Only a FA relationship causes the agency performing the service for the Division to be a subrecipient. A purchase of service relationship is with a vendor. **The distinction is critical because federal and State rules and regulations pertaining to funding do not extend to vendors; therefore, subrecipient monitoring is not necessary.**” See North Carolina Department of Health and Human Services, DHHS Policies and Procedures, Section IV, Subrecipient Monitoring Manual (“Monitoring Manual”) at <https://www2.ncdhhs.gov/info/olm/manuals/dhs/pol-40/man/SMM-Subrecipients1.htm> (emphasis added). The Subrecipient Monitoring Manual clearly states that a vendor relationship “[i]s not subject to compliance requirements of the state or federal program.” Id.

The template contract provided by DCDEE contains the following language:

**This is a Purchase-Of-Service Contract**

DCDEE has determined that all contracts between Lead Agencies and Providers are purchase-of-service contracts even if the Provider determines child eligibility. Consequently:

- (a) The contracts are not subject to the reporting requirements of G. S. §§ 143C-6-22 and -23; and
- (b) Fiscal audits of the contracts are not required.

However, Providers will still be subject to monitoring of:

- (a) Child eligibility;

- (b) Child attendance; and
- (c) Utilization of financial support from sources other than the NC Pre-K Program.

Providers may be subject to program audits as well.

Additionally, because these are purchase-of-service contracts:

- (a) Reimbursement shall be calculated by multiplying the approved reimbursement rates by the number of children served under each rate; and
- (b) The expenditure of direct services funds does not have to be pre-approved or accounted for by line item.

See North Carolina Department of Health and Human Services Division of Child Development and Early Education (“DCDEE”) NC Pre-Kindergarten (“NC Pre-K”) Program Template for Contracts Between Lead Agencies and Providers, pages 1-2. Even more to the point, the “North Carolina Division of Child Development and Early Education (DCDEE) NC Pre-Kindergarten Program Subcontract Template General Guidelines” states that “[u]nspent direct service funds are not returned to the Lead Agency.”

The fact that the subcontract between FGVSS and FVWO is a Purchase of Service contract under which FVWO earns the funds without restriction once services are provided to a certain number of students is reinforced by the fact that the same Manual, Guidance, and contracts are used with for-profit entities. See, e.g., Guidance, Page 2-1 (“The NC Pre-K Program is built upon a system of existing local school boards and districts, private child care providers and other entities that demonstrate the ability to provide high quality pre-kindergarten services for eligible 4-year old children.”); see also Manual, page 3-2 (setting out payment rates in different settings as follows: “Operated by Head Start: Maximum \$400 per child per month; Operated by Public Schools: Maximum \$473 per child per month; Operated by private child care: \$600 per child per month for a Pre-K classroom with a lead teacher with a Bachelor’s degree and \$650 per child per month for a Pre-K classroom with a lead teacher with a BK licensed teacher.”) The subcontractor is a vendor of services and not a subgrantee. See Manual, page 10-2 (“NC Grants system reporting is **not** required for NC Pre-K subcontractors, since they are purchase of service contracts.”) (emphasis in original); Id. at 13-1 (“Subcontractors are purchase of service contracts and are not subject to financial audits.”)

The paragraph quoted above from the Draft Report concerning NC Pre-K funds supplementing existing federal, state and local funds states the obvious but fails to show any wrongdoing by FVWO. The Manual states that

NC Pre-K funding may not supplant other funds. Generally, NC Pre-K funds may not replace other funds but may supplement other funds to serve more eligible at-risk 4-year-olds or to improve the level of service to comply with NC Pre-K requirements. The pool of non-NC Pre-K funds available to the county for pre-k

educational activities (local, state, and/or federal) should not be replaced with NC Pre-K funds.

Manual, page 4-1.

The Draft Report misquotes the subcontract between FGVSS and FVWO in concluding that FVWO misused NC Pre-K funds. The Draft Report states that

"the site [Agency] assures that funds received pursuant to this contract shall be used only to **supplement**...the total amount of federal, state and local public funds that the Site... expends for pre-kindergarten services... " The provision also includes, "Funds received under this contract shall be used to provide **additional** public funding for such services." (*Emphasis Added*)

Draft Report, page 3. In fact, this provision of the subcontract reads as follows:

The Provider [FVWO] assures that funds received pursuant to this contract shall be used only to supplement, not to supplant, the total amount of federal, state and local public funds that the Provider otherwise expends for pre-kindergarten services and related programs. Funds received under this contract shall be used to provide additional public funding for such services; **the funds shall not be used to reduce the Provider's total expenditure of other public funds for such services.**

North Carolina Pre-Kindergarten Program, Provider Contract# 1618-2342-015 (D), Section 8 (emphasis added).

Clearly, non-NC Pre-K funds were not replaced by NC Pre-K funding because FVWO spent all its non-NC Pre-K funds and had NC Pre-K funds left over. See Draft Report, page 2. By providing extra funds above and beyond existing federal, state and local funds, NC Pre-K funds supplemented existing available funds. Nowhere in the Manual, Guidance or contracts is there a restriction that a subcontractor must restrict purchase of service funds that are left over after the cost of providing direct services has been met. As noted above, the same contracts, Manual, and Guidance apply to for-profit entities. A for-profit entity would use any excess funds remaining after paying costs on other business overhead and ultimately could distribute excess funds as profits. NC Pre-K funds supplemented, but did not supplant, non-NC Pre-K funds. Therefore, NC Pre-K funds received under the contract between FGVSS and FVWO were used to provide **additional** public funding for such services. See Draft Report, page 3 (quoting the subcontract between FGVSS and FVWO) (emphasis in original).

The Draft Report does not accurately describe the legal obligations under the applicable contracts, Guidance, and Manual. The report could result in harm to FVWO's reputation with the public and other funding sources. FVWO provides critical services to underprivileged and underserved residents in its service area and has done so for over 50 years. FVWO has undergone a great deal of turmoil, but has made management and governance changes which will assure better accountability.

**B. Actions Planned or Taken:**

Even though FVWO disagrees with the findings in the Draft Report related to NC Pre-K funds as outlined above, FVWO has taken or agrees to take the following actions:

1. FVWO stopped depositing NC Pre-K funds into its general fund bank account in or about June 2016.
2. The former Chief Executive Officer (“CEO”) was terminated.
3. FVWO currently deposits NC Pre-K funds into an account designated for NC Pre-K funds only.
4. The Board will instruct management to review and comply with the NC Pre-K Fiscal and Contract Manual and will require that management educate relevant Agency staff on program requirements. Board action to implement this requirement was taken at the February 7, 2017 Board meeting.
5. The current CEO and Fiscal Officer will review contracts with all funding sources so that both the CEO and Fiscal Officer are educated on the requirements of each contract and management will educate relevant Agency staff on program requirements for each program. All action items described in this paragraph were completed on or before March 1, 2017. The CEO is responsible for this item.
6. Board training has been provided as follows: (1) the Board was trained on Head Start program requirements and the related responsibilities of the governing board on July 18, 2016; (2) the Board received training from Sharon Goodson, Director of the North Carolina Community Action Agency (“NCCA”), and Krystina Dilliard, Training Coordinator of the NCCA, on the subject of fiduciary responsibilities of the Board and a history of community action agencies, and (3) the Board received training from Verna Best, Director of the Office of Economic Opportunity, North Carolina Department of Health and Human Services on October 26, 2016 on organizational standards and board responsibilities and requirements.
7. The Board will continue to have training on its oversight and fiduciary obligations at least annually.
8. The Board will establish a clear method by which employees can report violations of law or policy to a designated Board member or members when an employee is uncomfortable reporting such an issue to management. A Board policy implementing the reporting process was adopted at the February 7, 2017 Board meeting. The CEO is responsible for putting this item on the Board agenda and the Board is responsible for adopting the policy.

**2. Finding #2: Former Chief Executive Officer’s Unauthorized Salary Increase Resulted in \$18,686 Additional Compensation**

**A. Response Summary:**

FVWO's investigation into this matter substantiates that proper procedures were not followed with respect to the former CEO's salary increase from \$75,000.00 to \$80,000.00. FVWO's investigation also determined that better internal controls and policies and procedures needed to be implemented with respect to Board review of CEO performance and pay adjustments.

**B. Corrective Actions Planned or Taken:**

1. The former CEO has been terminated.
2. FVWO will review the possibility of pursuing reimbursement from the former CEO. The review of this matter is underway. No final date of completion will be given because the issues raised by this item involve matters of attorney-client privilege and involve legal judgments based upon a variety of factors. The Agency attorney and the Board are responsible for this item.
3. The Board will review its compensation policies and be sure that appropriate Board policies are in place for review of employee performance and review and approval for pay adjustments for employees at every level including the CEO. Discussion concerning this topic was held at the February 7, 2017 Board meeting and final completion of the review will be completed on or before May 1, 2017. The interim CEO is responsible for putting this matter on the Board agenda.
4. Board training has been provided as follows: (1) the Board was trained on Head Start program requirements and the relating responsibilities of the governing board on July 18, 2016; (2) the Board received training from Sharon Goodson, Director of the North Carolina Community Action Agency ("NCCA"), and Krystina Dilliard, Training Coordinator of the NCCA, on the subject of fiduciary responsibilities of the Board and a history of community action agencies, and (3) the Board received training from Verna Best, Director of the Office of Economic Opportunity, North Carolina Department of Health and Human Services on October 26, 2016 on organizational standards and board responsibilities and requirements.
5. The Board will continue to have training on its oversight and fiduciary obligations at least annually.
6. The Board will establish a clear method by which employees can report violations of law or policy to a designated Board member or members when an employee is uncomfortable reporting such an issue to management. A Board policy implementing the reporting process was adopted at the February 7, 2017 Board meeting.
7. The Board now receives and will continue to receive detailed financial data so that it can monitor the Agency's monthly financial reports for significant budget to actual variances.

**3. Finding #3: More than \$59,500 Spent for Legal Services Without Board Approval**

**A. Response Summary:**

FVWO's investigation into this matter substantiates that proper Board approvals were not obtained prior to hiring the law firm in question.

**B. Corrective Actions Planned or Taken:**

1. The former CEO has been terminated.
2. The former Board Chair was removed as Board Chair on September 10, 2015 and resigned from the Board on December 1, 2015.
3. The Board issued a Request for Qualifications in September 2015 for interested law firms to submit proposals and a new law firm was retained in October 2015.
4. The Board has reviewed and will continue to review its policies and procedures to ensure that all contracts are entered into in accordance with the Agency's Financial Procedures Manual Procurement Policies and Procedures (the "FP Manual") and staff will be trained on the requirements of the FP Manual. An initial discussion and review of this item took place at the February 7, 2017 Board meeting. Thereafter, the Board will receive an annual update on the requirements of the FP Manual and will review the same for any needed additions or revisions. The CEO is responsible for scheduling related agenda items and for developing materials. The Board is responsible for taking any necessary actions.
5. The Board now receives and will continue to receive detailed financial data so that it can monitor the Agency's monthly financial reports for significant budget to actual variances.
6. Board training has been provided as follows: (1) the Board was trained on Head Start program requirements and the relating responsibilities of the governing board on July 18, 2016; (2) the Board received training from Sharon Goodson, Director of the North Carolina Community Action Agency ("NCCA"), and Krystina Dilliard, Training Coordinator of the NCCA, on the subject of fiduciary responsibilities of the Board and a history of community action agencies, and (3) the Board received training from Verna Best, Director of the Office of Economic Opportunity, North Carolina Department of Health and Human Services on October 26, 2016 on organizational standards and board responsibilities and requirements.
7. The Board will continue to have training on its oversight and fiduciary obligations at least annually.

Thank you for your attention to this matter. Please let us know if you would like to meet with us further to discuss the issues raised in this response.

Sincerely,

  
Felicia Gregory  
Interim Chief Executive Officer  
Franklin Vance Warren Opportunity, Inc.

  
James C. Wrenn, Jr.  
General Counsel, FVWO  
Hopper, Hicks, & Wrenn, PLLC

Cc: J. Mitchell Ambruster, Smith Anderson  
Edward T. Burke, CPA, Cherry Bekaert  
Rebecca Faris, Rebecca A. Faris, CPA, PLLC



**RESPONSE FROM THE  
NORTH CAROLINA  
DEPARTMENT OF HEALTH  
AND HUMAN SERVICES**



STATE OF NORTH CAROLINA  
DEPARTMENT OF HEALTH AND HUMAN SERVICES

ROY COOPER  
GOVERNOR

MANDY COHEN, MD, MPH  
SECRETARY

February 14, 2017

Via email and U.S. Mail

The Honorable Beth Wood  
Office of the State Auditor  
20601 Mail Service Center  
Raleigh, NC 27699-0600

RE: Your January 2017 Investigative Report regarding Franklin Vance Warren Opportunity, Inc.

Dear Auditor Wood:

Thank you for the opportunity for the Department of Health and Human Services (DHHS) to review and respond to the Investigative Report concerning Franklin Vance Warren Opportunity, Inc. (FVW Opportunity). FVW Opportunity operates a Head Start program and participates in the NC Pre-Kindergarten (NC Pre-K) Program that is administered by the Division of Child Development and Early Education (DCDEE). FVW Opportunity is a subcontractor of the Franklin Granville Vance (FGV) Smart Start. DCDEE contracts directly with FGV Smart Start to manage the NC Pre-K Program in the community.

In reviewing the Recommendations in the Matters for Further Consideration, we recognize that the NC Pre-K Fiscal and Contracts manual should be improved to provide clarification on the expectations of DCDEE's primary contractors and their subcontractors.

The contracts between DCDEE and the 91 entities who administer the program at the local level (Smart Start partnerships and Local Education Agencies) are Financial Assistance Contracts that require line item budgets and limitations on the use of accepted funds. These Contractors are responsible for determining eligibility for services and for monitoring the provider sites with whom they subcontract. The subcontracts with NC Pre-K sites are Purchase of Services (no line item budget use required) to provide a certain number of slots at specified rates for ten months.

The current Fiscal and Contract manual was intended for use by DCDEE's 91 Financial Assistance Contractors. DCDEE allocates an amount of direct services funds and administrative funds to these Contractors and requires a line item budget outlining how the funds are used.

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Auditor Wood  
February 14, 2017  
Page 2

To clarify responsibilities of Contractors and subcontractors, here are examples of how DCDEE will revise the NC Pre-K Fiscal and Contract manual:

- Information that pertains to the NC Pre-K subcontracts will be separated into its own section and not be included in the other sections that only apply to the 91 DCDEE NC Pre-K Contractors (Financial Assistance). For example, Sections 2 and 3 will be revised to only reference the NC Pre-K Financial Assistance Contracts. In this way, information on direct services funds, administrative funds, start-up funds, and allowable costs will be more clearly understood to apply to DCDEE's Contractors (Smart Start partnerships and Local Education Agencies).
- A new section that pertains only to NC Pre-K subcontracts (Purchase of Service) will explain that sites must follow the subcontract requirements which include adhering to NC Pre-K program standards; providing a specified number of slots for a specified rate for ten months in order to provide services to children; and submitting accurate attendance records to the NC Pre-K Contractor.
- Section 13 on Monitoring will clarify that DCDEE NC Pre-K Financial Assistance Contractors are responsible for monitoring that NC Pre-K subcontracted sites appropriately earned the funds that they were paid – that the number of children billed for actually attended at the site, the site followed NC Pre-K program requirements, and the subcontracted rates were correctly paid.

In addition, DCDEE will update the subcontract template so that the designation of Purchase of Service contract is contained within the subcontract language rather than on the template's instruction cover page that is referenced by the primary Contractor.

The report suggested increasing the frequency of DCDEE's site visits to perform fiscal reviews. DCDEE conducts fiscal monitoring of a sample of one-third NC Pre-K Contractors (Financial Assistance) each year, so that all contractors are monitored in a 3-year cycle. In the past, this monitoring was done through a combination of desk audits and on-site visits. We wanted to let you know that starting in SFY 15-16, DCDEE now conducts on-site monitoring for all NC Pre-K Contractors in the sample.

Thank you for the opportunity to respond to the recommendations presented in this report. We will follow up with FGV Smart Start to specifically confirm that the NC Pre-K funds they paid to FVW Opportunity were appropriately earned. We will confirm that the number of children that they billed for actually attended at the site, that FVW was paid the predetermined rate in the subcontract, and that the site met all NC Pre-K Program standards.

Please feel free to contact me if you have any questions or need additional information.

Sincerely,



Mandy Cohen, MD, MPH  
Secretary

# ORDERING INFORMATION

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For additional information contact:  
Bill Holmes  
Director of External Affairs  
**919-807-7513**



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This investigation required 749 hours at an approximate cost of \$75,433.