



U.S. Department of Agriculture
Office of Inspector General
Southeast Region
Audit Report

THE CLINTON COUNTY EMPOWERMENT
ZONE COMMUNITY, INC.
ALBANY, KENTUCKY
ALLEGATIONS OF CONFLICT OF INTEREST



Report No.
04801-10-At
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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL
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DATE: March 22, 2002

REPLY TO

ATTN OF: 04801-10-At

SUBJECT: The Clinton County Empowerment
Zone Community, Inc., Albany, Kentucky
Allegations of Conflict of Interest

TO: Kenneth Slone
State Director
USDA – Rural Development
711 Corporate Drive, Suite 200
Lexington, Kentucky 40503-5477

This report presents the results of the subject audit. The Rural Development Kentucky State office's November 14, 2001, and Kentucky Highlands Investment Corporation's November 9, 2001, responses to the draft report are included as exhibits B and C, along with excerpts and the Office of Inspector General's (OIG) position incorporated into the relevant sections of the report. Management decisions have not been reached on Recommendations Nos. 1, 2, and 3. Management decisions can be reached on these recommendations once you take action outlined in the OIG Position.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the action taken or planned, and the timeframes for implementation of the recommendations. Please note that the regulation requires a management decision to be reached on all recommendations within a maximum of 6 months from report issuance.

We appreciate the cooperation and assistance provided to OIG staff during the audit.

/S/

RAYMOND G. POLAND
Regional Inspector General

EXECUTIVE SUMMARY

THE CLINTON COUNTY EMPOWERMENT ZONE COMMUNITY, INC. ALBANY, KENTUCKY ALLEGATIONS OF CONFLICT OF INTEREST AUDIT REPORT NO. 04801-10-AT

RESULTS IN BRIEF

The Kentucky Highlands Investment Corporation (KHIC), London, Kentucky, is the lead entity for the Kentucky Highlands Empowerment Zone (KHEZ). KHEZ includes three counties in southeast Kentucky (Clinton, Jackson, and Wayne). Local planning committees in each of the three counties helped develop KHEZ's strategic plan. The local planning committees were incorporated and act as the management body for local projects. The Clinton County Empowerment Zone Community, Inc., (CCEZCI) located in Albany, Kentucky, is the management body for Clinton County. The CCEZCI's mission is incorporated in KHEZ's strategic plan and includes improvements in the areas of economic opportunity, tourism, infrastructure, and quality of life.

The audit was performed in response to allegations cited in Rural Development's (RD), September 2, 1999, referral to the Office of Inspector General - Investigations (OIG-I). The allegations pertain to conflict of interest involving 3 of CCEZCI's 13 board members and 2 City council members of Albany, Kentucky, and of their involvement with a chicken-processing plant (Cagle's-Keystone Foods, LLC (CKF)). The three board members are the Mayor of the City of Albany, Kentucky; the Clinton County Judge-Executive; and the Clinton County Judge-Executive's husband. The Mayor and the two City council members, who were employed by CKF, were alleged to have benefited financially due to their positions as elected officials. Also, the Clinton County Judge-Executive and her husband, who have a contract to launder smocks and other gear worn by plant workers, are alleged to have benefited financially because of their positions as board members.

The audit objective was to assess the validity of the conflict-of-interest allegations involving CCEZCI Board members and elected officials of Clinton County and the City of Albany, Kentucky.

The audit confirmed that the Mayor, the County Judge-Executive, and her husband violated CCEZCI's conflict-of-interest policy. However, CCEZCI's policy does not address the corrective action to take for violations. In addition, we were told by an RD employee relations

specialist that no remedies are available to the Federal Government, since Empowerment Zone (EZ) Board members and employees are non-Federal employees and are not subject to Federal conflict-of-interest laws. Likewise, the State of Kentucky conflict-of-interest laws pertain only to elected State officials and employees in the course of their official duties. However, this report will be provided to the Office of the Kentucky Attorney General and the Kentucky Legislative Ethics Commission for their consideration.

The details of our review are as follows:

- One CCEZCI Board member signed a laundry contract on October 6, 1998, with CKF. The board member is also the husband of the CCEZCI Board Chairperson/County Judge-Executive. The County Judge-Executive and her husband have served on the CCEZCI Board since its inception (March 1995), including when efforts were made to bring CKF to the Clinton County, Kentucky, area. They were also on the board during the time of approval for CCEZCI's strategic plan, which allocated \$475,000 in EZ funds to pay expenses related to a water system project to accommodate CKF plant operations. We found that neither the County Judge-Executive nor her husband informed the CCEZCI Board of their contractual arrangement with CKF.
- CKF's employment records disclosed that the Mayor applied for employment on June 1, 1998, and was hired the same day to manage CKF's hayfield operation. Fifteen days later, the Mayor, in a letter to CCEZCI dated June 16, 1998, requested the release of the balance of the \$475,000 in EZ funds to pay expenses related to the City of Albany's water project. In July 1998, CCEZCI released EZ funds totaling \$26,698 for engineering fees for the City of Albany water project.

The Mayor served on the CCEZCI Board from March 1995 until July 1999. We concluded that the Mayor violated CCEZCI conflict-of-interest policy because he did not inform the board of his employment with CKF.

KHIC officials stated that the board members should have disclosed their involvements with CKF at regular scheduled board meetings. The board members should have removed themselves from any decisions related to CKF. KHIC officials also stated that this provision is specifically outlined in CCEZCI's approved conflict-of-interest policy and procedures.

We also found that the allegations concerning the two City council members were unfounded as it relates to CCEZCI. CKF hired the two City

council members on July 20, 1998, and August 31, 1998, respectively. One City council member was hired as a maintenance worker and the other was hired as the manager of the chicken-receiving department. However, we found that the two City council members had not served on the CCEZCI Board of Directors, therefore, their employment did not constitute a conflict of interest as it relates to CCEZCI.

During our review, other reportable issues were brought to our attention concerning a former official of the CCEZCI. While employed by CCEZCI, the former official entered into an agreement with an acquaintance for a water-testing project without the knowledge or approval of CCEZCI Board members. The former official also received payments, which were intended to reimburse CCEZCI for his time spent on a U.S. Department of Labor (DOL) program. In both instances, the former official misled CCEZCI Board members because they were neither aware that an acquaintance was involved in the water-testing project nor that he received payments for the DOL project. As a result, EZ funds totaling over \$34,000 were paid for excessive and questionable expenditures.

KEY RECOMMENDATIONS

We recommended that RD require CCEZCI to (1) make necessary revisions to their conflict-of-interest policy and procedures that specifically address the cited issues. Emphasize to all board members, that the conflict-of-interest policy and procedures must be strictly enforced to ensure that the integrity in the administration of the EZ program is not jeopardized, (2) recover the \$17,518.92 from the former official that was improperly disbursed for the water-testing project, and (3) recover from the former official \$16,900 in over payments for the Youth Opportunity Development Area (YODA) project.

AGENCY RESPONSE

In its written response to the draft report, RD agreed with KHIC's response. RD also stated that KHIC was the recipient of the EZ award and is the responsible party for the administration of the EZ initiative. KHIC in its written response to the draft report agrees that the information contained in the report is generally correct, however, the conclusions of the report are often arbitrary, and the recommendations are inappropriate and unworkable. Their concerns included the following:

- The two members of the board of directors in question never voted or took any action involving CKF, officially or unofficially, as Board members of CCEZCI while employed by CKF. Therefore, they did not violate CCEZCI's conflict-of-interest policy.
- The Mayor of the city of Albany, Kentucky (one of the two board members in question) was not taking action as a CCEZCI Board

member or as an employee of CKF when he requested the release of \$26,698 in empowerment zone funds for the water improvements project 15 days after his employment by CKF.

- KHIC agreed that a former official of CCEZCI violated CCEZCI's procurement policy (this was a reportable condition in CCEZCI's A-133 audit for fiscal year ending March 31, 2000) because he hired a consultant without written estimates or the board's approval, however, there is no indication that any funds were misappropriated or used for personal benefit. KHIC further stated that the only resolution of this matter is for the Board of Directors of CCEZCI to retroactively approve the invoices and expenditures for the water quality baseline study, as they deem prudent.
- KHIC stated that it appears the former official of the CCEZCI received \$16,900 in YODA funds to administer the project in Clinton County and this was a questionable payment. KHIC stated that a portion (\$5,200) of the \$16,900 in questionable expenditures were reported in an A-133 audit report and presented to the DOL and the Lake Cumberland Area Development District, Inc., (LCADD). KHIC stated that the DOL and LCADD took the appropriate action to resolve the issue and it would be inappropriate for CCEZCI to recover the questionable payments from the former official.

OIG POSITION

Because of the concerns raised by KHIC in its written response, we conducted additional interviews and reviewed additional documents to further support the audit conclusions and recommendations. We found that board members took trips paid for by CKF to CKF's plant in Georgia during 1995 and 1996. Also, an interview with the board member who has the laundry contract with CKF revealed that he took additional trips to the CKF plant in Georgia during 1996, to explore business opportunities. This board member later recanted his statement, saying that the trips were taken after January 1997. Also, we were informed that board members inquired about employment opportunities with the owner of CKF after public hearings and before January 1997. We continued to find that the two board members violated CCEZCI's conflict-of-interest policy because they aggressively sought employment or business relationships with CKF prior to the CCEZCI's Board of Directors vote on January 31, 1997, to help fund a water treatment plant. The water treatment plant was a condition for CKF to build its plant in the EZ.

In accordance to CCEZCI's conflict-of-interest policy, board members are expected to timely disclose to the CCEZCI board of directors any actual or perceived conflict of interest of any kind related to CCEZCI activities, even if not directly covered in CCEZCI's provisions. Based on this provision, the board members should have informed the board of directors of their intentions to seek employment with CKF and recuse themselves from the January 31, 1997, discussion and vote.

In addition, the provisions state that actual or perceived conflict-of-interest possibilities include a board member or their affiliate acquiring a financial interest in a project, asset, or organization in which CCEZCI has an established interest. CCEZCI had an established interest in the CKF plant because it helped fund the water treatment plant project. In addition, CKF requested and received on March 17, 1998, a \$1 million loan from EZ funds to train EZ resident employees. The loan was made by KHIC and provides that if CKF creates and maintains the required number of full-time jobs at the facility, the loan will bear no-interest and will not be repaid.¹ Also, CKF would receive Federal tax incentives by being located in the EZ. During the audit, KHIC officials agreed that the board members should have disclosed their involvement with CKF at regularly scheduled board meetings.

In addition, we continue to find that the former CCEZCI official should be held liable for the misuse of EZ funds by entering into a contract with an acquaintance without the approval of the board of directors. Also, the former official received payments from DOL funds provided through the LCADD which were intended to compensate the CCEZCI for his time spent managing another Federally funded program.

¹ A review of the \$1 million forgivable loan and CKF compliance with loan provisions was not included in this review.

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INTRODUCTION

BACKGROUND

Congress established the Empowerment Zone (EZ) program in the Omnibus Budget Reconciliation Act of 1993 (ACT). Under the ACT, communities that wanted to participate in the program had to (1) meet specific criteria for characteristics such as geographic size and poverty rate and (2) prepare a strategic plan for implementing the program. Under the ACT the Secretary of Agriculture designated three rural communities as EZ's on the basis of their strategic plans. The Federal assistance received by the EZ must be spent in accordance with strategic plans as approved by the Rural Development (RD).

The Kentucky Highlands Investment Corporation (KHIC), London, Kentucky, is the lead entity for the Kentucky Highlands Empowerment Zone (KHEZ). KHEZ includes three counties in southeast Kentucky (Clinton, Jackson, and Wayne). Local planning committees in each of the three counties helped develop KHEZ's strategic plan. The local planning committees were incorporated and act as the management body for local projects. The Clinton County Empowerment Zone Community Inc., (CCEZCI) located in Albany, Kentucky, is the management body for Clinton County. The CCEZCI's mission is incorporated in KHEZ's strategic plan and includes improvements in the areas of economic opportunity, tourism, infrastructure, and quality of life.

On September 2, 1999, RD officials requested a review by Office of Inspector General - Investigations (OIG-I) concerning allegations of conflict-of-interest involving three CCEZCI Board members and two City council members of Albany, Kentucky and their involvement with a chicken-processing plant (Cagle's – Keystone Foods, LLC (CKF)). The three board members are the Mayor of the City of Albany, Kentucky, the Clinton County Judge-Executive, and the Clinton County Judge-Executive's husband. The Mayor and the two City council members, who were employed by CKF, were alleged to have benefited financially due to their positions as elected officials. Also, the Clinton County Judge-Executive and her husband, who was awarded a contract to launder smocks and other gear worn by plant workers, are alleged to have benefited financially because of their positions as board members.

OBJECTIVES

The audit objective is to assess the validity of the conflict-of-interest allegations involving CCEZCI Board members and elected officials of Clinton County and the City of Albany, Kentucky.

SCOPE

We reviewed CCEZCI activities primarily for the period October 1999 through January 2001. We also reviewed CCEZCI, CKF, and the City of Albany activities for other periods as deemed necessary.

The audit fieldwork started on August 22, 2000, and was completed in August 2001. The fieldwork included reviews at the U.S. Department of Agriculture (USDA) RD office, Lexington, Kentucky, and the CCEZCI, CKF, City of Albany, Clinton County Judge-Executive, and Court Clerk offices, all located in Albany, Kentucky.

The audit review was conducted in accordance with the Government Auditing Standards issued by the Comptroller General of the United States.

METHODOLOGY

To accomplish our audit objective, we:

- Reviewed CCEZCI policies and procedures applicable to conflict-of-interest;
- Reviewed CCEZCI financial statements and benchmark reports;
- Reviewed memorandum of agreements between RD and KHEZ, and CCEZCI's articles of incorporation, by-laws, and strategic plan;
- Obtained and reviewed EZ program funding and grants related to the City of Albany water improvement project;
- Reviewed newspaper articles related to CCEZCI administration of the EZ program;
- Reviewed CCEZCI's payroll and canceled check records for expenditures paid to a former CCEZCI's official;
- Interviewed RD's Office of Community Development officials and RD Kentucky State office officials;

- Interviewed officials from Clinton County, City of Albany, KHIC, and CCEZCI Board members;
- Interviewed current and former CKF officials; and
- Researched and reviewed Federal and the State of Kentucky laws and regulation pertaining to conflict-of-interest.

FINDINGS AND RECOMMENDATIONS

FINDING NO. 1

CCEZCI BOARD MEMBERS VIOLATED CCEZCI'S CONFLICT-OF-INTEREST POLICY

We found that several CCEZCI Board members violated CCEZCI's conflict-of-interest policy because they did not disclose to the board their employment or business relationship with CKF. The board members stated that they believed it was not necessary to inform the board of their involvement in CKF. As a result, their financial interest in CKF affected the integrity

and independence of the board when conducting EZ business.

The CCEZCI's conflict-of-interest policy states that there are a number of actual or perceived conflict-of-interest possibilities, of which any reasonable and prudent organization would be wary, and they would include:

- Taking a direct or indirect financial interest in a project, asset, or organization in which an employee, director, or their affiliate has an established interest.
- An employee, director, or their affiliate acquiring a financial interest in a project, asset, or organization in which the CCEZCI has an established interest.

The transactions would be permitted, but only upon the full disclosure by the affected director or employee of his or her interest or intended interest in the transaction, and upon the approval of a two-third vote of the non-involved directors of the particular CCEZCI Board meeting.

Directors and employees are expected to timely disclose to the CCEZCI Board of Directors any actual or perceived conflict of interest of any kind related to CCEZCI's activities, even if not directly covered in the CCEZCI's provisions. The CCEZCI Board, upon such disclosure, shall determine what action should be taken with respect to it on an individual basis.

However, CCEZCI's policy does not address corrective action to take for violations. In addition, we were told by an RD employee relations specialist that no remedies are available to the Federal Government, since EZ Board members and employees are non-Federal officials and are not

subject to Federal conflict-of-interest laws. Likewise, the State of Kentucky conflict-of-interest laws pertain to elected State officials and employees in the course of their official duties.

RD in a letter dated September 2, 1999, to OIG-I alleged that some CCEZCI Board members benefited financially because of their involvement with CKF. The board members included the Mayor of the City of Albany, Kentucky, and the Clinton County Judge-Executive² and her husband.

CCEZCI entered into a written agreement with the City of Albany on January 31, 1997, for \$475,000 to help build a water treatment plant.³ The majority of the EZ funds were for the engineering design portion of the water treatment plant. The water treatment plant was necessary to accommodate CKF's chicken processing plant and was a condition for CKF building its plant in Clinton County.

Information pertinent to the allegations and our audit conclusions follows:

Allegation No. 1 – The Mayor of the City of Albany, Kentucky, and two members of the City council who worked at the plant were alleged to have benefited financially due to their positions as elected officials.

We confirmed that the Mayor of the City of Albany, Kentucky, and two members of the City council were employed at CKF chicken-processing plant. Our review of CKF's employment records disclosed that the Mayor applied for employment on June 1, 1998, and was hired the same day. The Mayor was hired to manage CKF's hayfield operation.⁴ Fifteen days later, the Mayor, in a letter dated June 16, 1998, to CCEZCI requested that CCEZCI release the balance of the \$475,000 in EZ funds to the City of Albany, Kentucky, to pay expenses related to the water treatment plant. Subsequently, \$26,698 in EZ funds was released for unpaid engineering fees for the City of Albany, Kentucky's, water plant.

² The Clinton County Judge-Executive is an elected official responsible for the county's financial operations.

³ The total cost of the project was estimated at about \$7.1 million. The majority of the funds were obtained through loans and grants from the Department of Agriculture's Rural Utility Service and the State of Kentucky.

⁴ A CKF official said that hayfield operation is the irrigation of 175 acres of land with treated waste from the plant. The treated waste contains nutrients to minimize soil erosion.

The Mayor served on the CCEZCI Board from March 1995 to July 1999. According to the July 20, 1999, board-meeting minutes, the board voted to remove the Mayor because he missed four consecutive regular board meetings. However, he had served on the board for over 1-year after he was hired by CKF.

We concluded that the Mayor violated CCEZCI's conflict-of-interest policy because he did not inform the board of his employment at CKF.

We also confirmed that CKF hired two City council members of Albany, Kentucky, on July 20, 1998 and August 31, 1998, respectively. One City council member was hired as a maintenance worker and the other was hired as the manager of the chicken-receiving department. However, we found that the two City council members had not served on the CCEZCI Board of Directors, therefore, their employment did not constitute a conflict-of-interest as it relates to CCEZCI.

Allegation No. 2 – The Clinton County Judge-Executive and her husband, who was awarded a contract to launder smocks and other gear worn by plant workers, were alleged to have benefited financially because of their positions as board members.

We confirmed that a board member (president and owner of Wolf River Oil Co.) signed a laundry contract (based on a set amount for each item cleaned) with CKF on October 6, 1998. Neither the board member nor his company was in the laundry service business prior to the contract with CKF. Wolf River Oil Co. received about \$484,513 from December 3, 1998 through May 31, 2001, for laundry services. The board member is also the husband of the CCEZCI Board chairperson, who also serves as the Clinton County Judge-Executive. These two individuals have served on the CCEZCI Board since its inception (March 1995) and actively supported efforts to bring CKF to the Clinton County, Kentucky, area. They also voted for the approval of CCEZCI's (March 1995) strategic plan and the project, which allocated \$475,000 in EZ funds to pay expenses related to a water treatment plant. We found that neither the County Judge-Executive nor her husband informed the CCEZCI Board about their financial relationship with CKF. Interviews with both board members revealed that they believed it was not necessary to inform other board members of their involvement with CKF.

A former general manager for CKF stated that the laundry contract was awarded to the CCEZCI Board member because he submitted the lowest bid. The former general manager stated that to his knowledge, solicitation letters were sent to other companies in the local area that CKF believed might have been interested in providing laundry services to CKF.

We attempted but were unable to confirm that letters were sent to other companies.

KHIC officials stated that the board members should have disclosed their involvements with CKF at regularly scheduled board meetings. Also, the board members should remove themselves from any future decisions that relate to CKF. KHIC officials stated that this provision is specifically outlined in CCEZCI's approved conflict-of-interest policy and procedures.

We concluded that both board members in question violated CCEZCI conflict-of-interest policy, because they did not inform the board that they had bid on and were awarded the CKF's laundry contract.

RECOMMENDATION NO. 1

Require CCEZCI's to make necessary revisions to their conflict-of-interest policy and procedures to specifically address corrective action for the cited issues. Emphasize to all board members that the conflict-of-interest policy and procedures must be strictly enforced to ensure that the integrity in the administration of the EZ program is not jeopardized.

RD Response

In its written response, RD stated that:

** * * Action taken by City of Albany * * * and * * * in their official capacity could appear as a conflict of interest in retrospect; however, at the time of the vote in their official capacity as mayor and board member, they had no knowledge of actual future events that would relate to the vote.*

** * * Conflict-of-interest policy of CCEZCI's should be amended to include penalties for violations. This will be accomplished within sixty [60] days of OIG acceptance of the remedial measures.*

KHIC Response

In its written response, KHIC did not concur with the recommendation and stated that:

Two members of the board of directors in question never voted or took any action involving CKF either official or unofficial, as Board members of CCEZCI while employed by CKF. Therefore, they did not violate CCEZCI conflict-of-interest policy.

KHIC stated that the last action taken by CCEZCI Board of Directors concerning CKF was on January 31, 1997, and at that time, it was uncertain if the CKF plant would be constructed in the EZ. On January 31, 1997, Rural Utilities Service was in the process of preparing an environmental impact statement on the project. The record of decision allowing the project to go forward was not issued until July 24, 1997. KHIC contends that the two board members had no way of knowing they would one day be employed by CKF when they voted as members of the CCEZCI Board of Directors on January 31, 1997, for the water treatment plant project.

In addition, the Mayor of the city of Albany, Kentucky; (one of the two board members in question) was not taking action as a CCEZCI Board member or as an employee of CKF when he requested the release of \$26,698 in empowerment zone funds for the water improvement project 15 days after his employment by CKF. His official action as Mayor in requesting the final installment was directed by the Albany, Kentucky City Council, who voted to approve paying the engineering fees upon the recommendation of Rural Development. Thus, the letter was written only as an official of the city.

KHIC officials stated that, although the two board members did not enter into the minutes of the CCEZCI that they were employed by CKF, it did not constitute a violation of the CCEZCI conflict-of-interest policy. Their relationship with the company was well known and neither made any effort to disguise their employment. "It would be a violation of the conflict-of-interest policy only if the board members were in a position to affect a transaction of the board of directors and did not disclose and recuse themselves."

Although, KHIC stated that no action is necessary for the recommendation, they felt a need to further strengthen the conflict-of-interest policy of the empowerment zone. The provision below will be recommended to the local empowerment zone offices for consideration.

EZ Conflict-of-Interest Policy Insert

A director or employee violating this conflict-of-interest policy may be required to resign from his or her position with the corporation. In addition, a director or employee may be liable to the corporation for damages for any act or omission constituting a breach of this conflict-of-interest policy where such act or omission: (1) is one in which the director has a material personal financial interest which is in conflict with the financial interests of the corporation or its shareholders;

(2) is not in good faith or involves intentional misconduct or is known to the director to be a violation of law; and (3) is a transaction from which the director derived a material and improper personal benefit.

OIG Position

Because of the concerns raised by KHIC in its written response, we conducted additional interviews and reviewed additional documents to further support the audit conclusions and recommendations.

Additional information revealed that the board members aggressively sought service contracts or employment with CKF. We found that board members took trips paid for by CKF to CKF's plant in Georgia in 1995 and 1996. Also, an interview with the board member who has the laundry contract with CKF revealed that he took addition trips to the CKF plant in Georgia in 1996, to explore business opportunities. This board member later recanted his statement and said that the trips were taken after January 1997. Also, we were informed by a former employee of CKF that board members inquired about employment opportunities with the owner of CKF after public hearings and before January 1997.

We continued to find that the board members violated CCEZCI's conflict-of-interest policy because they aggressively sought employment or a contractual arrangement with CKF prior to the CCEZCI Board of Directors vote on January 31, 1997, to help fund a water treatment plant. Funding of the water treatment plant was a condition for CKF to build its plant within the EZ. In accordance to CCEZCI's conflict-of-interest policy, board members are expected to timely disclose to the CCEZCI Board of Directors any actual or perceived conflict of interest of any kind related to CCEZCI activities, even if not directly covered in CCEZCI's provisions. Based on this provision the board members should have informed the board of their intentions to seek employment or business relationships with CKF and should have recused themselves from the January 31, 1997, discussion and vote. In addition, the provisions state that actual or perceived conflict-of-interest possibilities include a board member or their affiliate acquiring a financial interest in a project, asset, or organization in which CCEZCI has an established interest. CCEZCI had an established interest in the CKF plant because it helped fund the water treatment plant project. In addition, CKF requested and received on March 17, 1998, a \$1 million loan from EZ funds to train EZ resident employees. The loan was made by KHIC and provides that if CKF creates and maintains the required number of full-time jobs at the facility, the loan will bear no-interest and will not be repaid.⁵

⁵ A review of the \$1 million forgivable loan and CKF compliance with loan provisions was not included in this review.

Therefore, we continued to find the two board members violated CCEZCI's conflict-of-interest policy. During the audit, KHIC officials agreed that the board members should have disclosed their involvement with CKF at regular scheduled board meetings.

Although KHIC stated that no action is necessary for Recommendation No. 1, they proposed to strengthen the conflict-of-interest policy by asking local EZ's to consider penalties for violations. We do not accept this management decision. To reach management decision, KHIC must instruct CCEZCI Board of Directors to revise its conflict-of-interest policy and procedures to include provisions for penalties for violations. In addition, the penalty provision, as written, is vague and needs clarification. KHIC needs to (1) clearly state the type of violation(s) which would require a board member or employee to resign, (2) the basis for violations and how damages would be computed, and (3) definition or examples of material financial interest and improper personal benefits.

FINDING NO. 2
EXPENDITURES TOTALING
OVER \$34,000 WERE
QUESTIONABLE

During our review, other reportable issues were brought to our attention concerning a former official of the CCEZCI. The former official entered into an agreement with an acquaintance for a water-testing project without the knowledge of CCEZCI Board members. The former official also received payments, which were intended to reimburse

CCEZCI for his time spent on a U.S. Department of Labor (DOL) project. In both instances, the former official misled CCEZCI Board members. As a result, EZ funds were paid for excessive and questionable expenditures totaling over \$34,000.

CCEZCI's procurement standard procedures were adopted so as to be in accordance with the Office of Management and Budget Publication A-110. The guidelines provide that procurement transactions, regardless of method or dollar value, are to maximize open and free competition. Further, the CCEZCI shall not engage in procurement practices, which may be considered restrictive in trade. The small purchase requirements provide, in part, that purchases of supplies, equipment, and services, which cost between \$10,000 and \$100,000, will require prior approval by the EZ Board of Directors and will require written estimates, but no legal advertisement is required.

In addition, CCEZCI's employment contract, in part, provides that each employee's salary will be set and approved by the board.

WATER-TESTING PROJECT

On August 5, 1998, KHIC notified the CCEZCI chairperson, that United States Department of Agriculture (USDA) and the Commonwealth of Kentucky approved Clinton County's proposed amendments to its strategic plan. Included in the approved amendments, was \$30,000 for a baseline study on water quality in Clinton County. Subsequently, the former CCEZCI official approved water-testing expenses for \$17,518.92. However, checks for these expenses were never presented to the entire board for approval. Instead, the former official presented the checks to the Chairperson and another board member for their approval.

The former official allowed an acquaintance that he knew, when he was the superintendent with the Berea Board of Education, to perform the baseline water-testing services. The acquaintance hired a local resident and two foreign exchange students to assist with the water study. The four individuals were each paid \$250 a day, or \$15,000 of the \$17,518.92 in EZ funds to collect water samples for analysis. The remaining \$2,518.92 was for other water-testing expenses.

With the exception of \$2,750 of the \$17,518.92, there was no evidence that the expenditures were presented to the entire board for approval. In a letter dated July 7, 1999, the CCEZCI Chairperson requested that the former official's acquaintance provide the board a copy of his CCEZCI contract. Instead, the acquaintance had the local resident meet with the Board to explain the purpose and results of the water-testing analysis. During this meeting, the local resident informed board members that she had not received all of her payments and requested that the amounts due to her (\$500) be authorized for payment. The \$500 was subsequently paid to the resident.

After this meeting, the former official's acquaintance submitted \$2,250 in expenditures and requested that the board approve the submitted expenditures. The board members authorized the \$2,250 payments, and voted that no additional funds be disbursed for this water-testing project.

The former official stated that a written contract was not executed. He said that he believed the acquaintance was experienced in water-testing sampling techniques, and had also previously traveled to Russia to train students there in gathering and testing water samples.

Several CCEZCI Board members stated that the former official misled the board and they were unaware that the acquaintance was involved in

the project. The board members stated that the former official informed them that several Russian students would perform the water testing as part of a school project. Also, the board members stated that the water testing was of poor quality and was of little or no use to CCEZCI.

The Former Official Also Received An Additional \$16,900 In Salary Payments

The former CCEZCI official also received questionable salary payments totaling \$16,900 for the period July 1998 through July 1999. The payments (from another Federally funded program) were in addition to his regular salary from the CCEZCI. Board members stated that they were misled and unaware that the official was receiving compensation above his annual salary agreement of \$45,000.

The CCEZCI employment policies provide that all salaries and employment policies are set by the board of directors, and by majority vote, the employment policies can be changed at any board of directors meeting. The former official signed an extension of his full-time employment agreement with CCEZCI on July 21, 1998.⁶ The agreement, in part, provides that compensation shall be \$45,000 per annum.

The CCEZCI entered into an agreement with the Lake Cumberland Area Development District, Inc., (LCADD) to administer the Youth Opportunity Development Area (YODA) program. The DOL is the grantor and provides funding for the project. In accordance with the agreement, CCEZCI received monthly payments for administering the YODA program. Included in the agreement was \$1,300 per month payable to CCEZCI for a project manager. The \$1,300 was intended to reimburse CCEZCI for an employee's time spent managing the project. The former official designated himself as the YODA project manager and wrote CCEZCI checks to himself every two weeks for \$650. From July 10, 1998 through July 16, 1999, the former official received a total of \$16,900.

The CCEZCI's Chairperson and another board member, who were authorized to sign CCEZCI's checks, signed the \$650 bi-weekly checks made payable to the former official. The Chairperson and her husband (board member) stated that the former official misled the board. The board members stated the former official often brought them batches of checks to sign and they were unaware that they were signing bi-weekly checks made out to the official for \$650.

⁶ The first employment contract was signed March 10, 1997, but CCEZCI employees were unable to locate and provide this contract to the auditor. The July 21, 1998, signed employment agreement made reference to this contract as a continuation of the March 10, 1997, employment agreement.

An audit report issued by an independent Certified Public Accounting firm, for the period March 1, 1999, through March 31, 2000, questioned \$5,200 in direct salary payments that the former official received for the YODA program because inadequate procedures were in place for board review of expenditures. The audit concluded that the direct wages were subject to disallowance and refund to the pass-through entity, LCADD.

The former official told us that he worked on the YODA program in 1998 and 1999 and he designated himself as the project manager because of the time that he spent in assisting the YODA program.

A current CCEZCI official told us that he is now responsible for the administration of the YODA program, but he does not receive a direct YODA salary payment. He said that CCEZCI is reimbursed for his time from the monthly program payments that CCEZCI receives from LCADD.

We determined that the former official received questionable salary payments totaling \$7,800 for the period July 10 through December 31, 1998, and \$9,100 for the period January 1 through July 16, 1999, for a total of \$16,900 because the CCEZCI Board did not provide approval for the former official to be compensated as the YODA project manager.

RECOMMENDATION NO. 2

Require CCEZCI to recover \$17,518.92 from the former official that was improperly disbursed for the water-testing project.

RD Response

In its written response, RD stated that:

The water-quality monitoring was a benchmark of the Empowerment Zone strategic plan for Clinton County. The methodology to complete the study and the ultimate results were less than the planned objective; however, some work was completed and the project was terminated when it came to the attention of the CCEZCI Board that the planned objective would not be obtained.

It is our recommendation that no action be taken to recover any disbursed funds. Some work was completed and the checks were signed by the appropriate parties to pay for the services.

KHIC Response

In its written response, KHIC agreed with the facts but did not concur with the recommendation and stated that:

KHIC agrees that a former official of CCEZCI violated CCEZCI's procurement policy because he hired a consultant without written estimates or board approval. This was found to be a reportable condition in the CCEZCI A-133 audit for fiscal year ending March 31, 2000.

"The CCEZCI Board of Directors was well aware that the water quality baseline study was underway in 1998 and 1999. * * *. Further, board minutes from this period indicate the former officials of the CCEZCI reported on the project on several occasions. There is no indication that any funds were misappropriated or used for personal benefit."

** * *. While the quality of work was questionable, the CCEZCI addressed that issue in 1999 when they cancelled the project. The fact that the consultant for the project was an acquaintance of the former official of the CCEZCI and that some of the researchers were not citizens of the United States is irrelevant."*

* * * * *

** * *. Furthermore, the Board of Directors of the CCEZCI chose not to extend the employment contract of the former official in question, due in part to his performance with the water quality baseline study.*

** * *. The recommendation * * *. * * * seeks to impose the authority of the U.S. Department of Agriculture - Office of Inspector General on a private corporation and proposes an unworkable and unreasonable resolution. The violation was of an internal policy of a private corporation and lacking any evidence of misappropriation of funds, pursuing the former officials personally is inappropriate. Fitting penalties have already been imposed, as the former official was removed from his job and the program cancelled.*

KHIC further stated that the only resolution of this matter is for the Board of Directors of the CCEZCI to retroactively approve the invoices and expenditures for the water quality baseline study, as they deem prudent.

OIG Position

We continue to find that the former CCEZCI official should be held liable for the misuse of EZ funds by entering into a contract with a former associate without the approval of the board of directors.

CCEZCI Chairperson stated that the board of directors was not aware of the water study contract with the former official's acquaintance until July 1999. In addition, the Chairperson stated that the water study was of no use to the EZ.

The fact that the consultant for the project was an acquaintance of the former official of the CCEZCI was relevant. In accordance to CCEZCI's procurement standards, transactions regardless of dollar value should maximize open and free competition. Also, the standards require written estimates for services from at least three vendors, which were not sought by the former official.

Also, the water study contract was given to an acquaintance of the former official without regard for open and free competition and without the knowledge of the board of directors, and was of poor quality and no use to the EZ. It would be inappropriate for the board of directors to retroactively approve the invoices and expenditures for the water quality baseline study, which were not authorized and of no benefit to the EZ. Therefore, we concluded that the former official used his position to personally benefit an acquaintance to the financial detriment of the CCEZCI and he should be held personally liable for the misuse of the EZ funds.

To reach management decision for this recommendation, RD should provide OIG with documentation that CCEZCI has recovered the \$17,518.92 improperly disbursed EZ funds from the former official or evidence that CCEZCI is making attempts to recover the funds.

RECOMMENDATION NO. 3

Require CCEZCI to recover from the former official \$16,900 in over payments for the YODA program.

RD Response

In its written response, RD state that:

The YODA project was a [DOL] grant, which was not a USDA, sponsored project, this has been resolved to the satisfaction of the grantee (DOL).

There is nothing to indicate that the work for this contract was not accomplished outside of normal work hours and responsibilities of the former official who was terminated. We concur with the response provided by KHIC.

KHIC Response

In its written response, KHIC stated that:

"The former official of the CCEZCI received \$16,900 in YODA funds to administer the project in Clinton County and this was a questionable expenditure." A portion (\$5,200) of the \$16,900 in questionable expenditures were reported in an A-133 audit report and presented to the DOL and the LCADD. KHIC stated that the DOL and LCADD took the appropriate action to resolve the issue and it would be inappropriate for CCEZCI to recover the questionable payments from the former official.

OIG Position

The fact that the project was a DOL grant rather than a USDA sponsored project was irrelevant because the payments received by the former officials from the grant funds were meant to reimburse the CCEZCI for the time the former official spent on the YODA project. The grant funds were not intended to personally benefit the former official. The board of directors in a written employment contract set the former official's salary, which does not include the payments from the YODA grant.

Neither CCEZCI nor RD has provided OIG with evidence that this issue has been resolved with DOL. There is no evidence that DOL was made aware of this situation. The pass through agency, LCADD, actually forgave CCEZCI for the \$5,200 cited in the A-133 audit. In addition, the A-133 audit did not address the additional \$11,700 (\$16,900 less \$5,200) disclosed by OIG during the audit. Therefore, there was no basis for KHIC to conclude that the appropriate action was taken. Consequently, we will be sending a copy of this report to DOL and DOL-OIG for their action.

As further evidence, the former official's CCEZCI salary included his YODA responsibilities, we reviewed CCEZCI's travel expense records and found that CCEZCI paid the former official for a trip to Houston, Texas, for a YODA training conference. Additionally, he took no annual leave and the trip was done during normal working hours for which CCEZCI compensated him. In addition, a current CCEZCI employee hired to replace the former official received the same annual salary and benefits and his duties include the YODA project at no additional compensation.

RD and KHIC both mentioned in their written responses that the former official was terminated from his position because of his misconduct. Neither RD nor KHIC have provided OIG with evidence that the former official was terminated. Rather, according to CCEZCI Board members, the former official's employment contract, which expired in July 1999, was not renewed. The board members cited the water study contract and the additional payments as factors for not renewing the former official contract.

We continue to find that the former official misled CCEZCI Board of Directors and misappropriated \$16,900 in Federal funds which were intended to reimburse or offset EZ funds for his time and expense for the YODA project.

To reach management decision for this recommendation, RD need to provide OIG with documentation that CCEZCI has recovered the \$16,900 in improperly disbursed EZ funds from the former official or evidence that CCEZCI is making attempts to recover the funds.

EXHIBIT A – SUMMARY OF MONETARY RESULTS

Recommendation Number	Description	Amount	Category
2	EZ funds improperly disbursed for a water-testing project.	\$17,518.92	Questioned Cost -Recovery Recommended
3	Overpayments of direct salary to a former CCEZCI official.	\$16,900.00	Questioned Cost -Recovery Recommended
Total		\$34,418.92	

EXHIBIT B – RD RESPONSE TO DRAFT REPORT

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United States
Department of
Agriculture

Rural
Development

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November 14, 2001

**SUBJECT: Clinton County Empowerment Zone Community, Inc.
Allegations of Conflict of Interest, Albany, Kentucky
[Audit #04801-10-At]**

**TO: Raymond G. Poland
Regional Inspector General
USDA, OIG – AUDIT
401 W Peachtree Str, NW, Suite 2328
Atlanta, GA 30308**

Thank you for the opportunity to respond to the findings contained in the official draft of the U.S. Department of Agriculture OIG Audit Report #04801-10-At. The subject audit was in reference to the activities of the Clinton County Empowerment Zone Community, Inc.

Kentucky Highlands Investment Corporation [KHIC] was the recipient of the Empowerment Zone award and is the responsible party for the administration of the Empowerment Zone initiative. KHIC's response is enclosed.

In general, the Kentucky RD State Office concurs with the KHIC response; however, we would like to provide a short response to each of the allegations.

FINDING #1: CCEZCI BOARD MEMBERS VIOLATED CCEZCI'S CONFLICT OF INTEREST POLICY

OIG RECOMMENDATION #1: Require CCEZCI to make necessary revisions to their conflict of interest policy and procedures to specifically address corrective action for the cited issues.

RESPONSE TO OIG RECOMMENDATION #1:

We concur with KHIC's response. Action taken by City of Albany Mayor James Brown and Daniel Laib in their official capacity could appear as a conflict of interest in retrospect; however, at the time of the vote in their official capacity as mayor and board member, they had no knowledge of actual future events that would relate to the vote.

We **strongly agree** that the conflict of interest policy of CCEZCI should be amended to include penalties for violations. This will be accomplished **within sixty [60] days** of OIG acceptance of the remedial measures.

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**SUBJECT: Clinton County Empowerment Zone Community, Inc.
Allegations of Conflict of Interest, Albany, Kentucky
[Audit #04801-10-At]**

FINDING #2: EXPENDITURES TOTALING OVER \$34,000 WERE QUESTIONABLE

OIG RECOMMENDATION #2: Require CCEZCI to recover the \$17,518.92 from the former official that was improperly disbursed for the water-testing project.

RESPONSE TO OIG RECOMMENDATION #2:

The water-quality monitoring was a benchmark of the Empowerment Zone strategic plan for Clinton County. The methodology to complete the study and the ultimate results were less than the planned objective; however, some work was completed and the project was terminated when it came to the attention of the CCEZCI board that the planned objective would not be obtained.

It is our recommendation that **no action be taken to recover** any disbursed funds. Some work was completed and the checks were signed by the appropriate parties to pay for the services.

OIG RECOMMENDATION #3: Require CCEZCI to recover from the former official \$16,900 in over payments for the YODA program.

RESPONSE TO OIG RECOMMENDATION #3:

The YODA project was a Department of Labor [DOL] grant which was not a USDA sponsored project. **This has been resolved to the satisfaction of the grantee [DOL].**

There is nothing to indicate that the work for this contract was not accomplished outside of normal work hours and responsibilities of the former official who was terminated. We concur with the response provided by KHIC.

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**SUBJECT: Clinton County Empowerment Zone Community, Inc.
Allegations of Conflict of Interest, Albany, Kentucky
[Audit #04801-10-At]**

CONCLUSION:

It is our recommendation that KHIC be required to have CCEZCI revise their conflict of interest policy to include penalties. The water test issue should be accepted as a planned activity with less than expected results. However, the potential for financial recovery is limited when legal costs are considered.

The DOL should resolve the YODA project as they were the grantee and USDA was not involved. According to information provided, this issue has been resolved to the satisfaction of the grantee. It would also appear that the cost of legal action to recover any funds would exceed any expected recovery if the civil action was successful.

The facts that are in the audit did occur; however, in our opinion, the conflict of interest issue is an "appearance after the fact" issue rather than an actual conflict. We do not agree with recovery recommended.

If you require any additional information at this time, please do not hesitate to contact me at 859/224-7300.


KENNETH SLOANE
State Director

Enclosure

EXHIBIT C – KHIC RESPONSE TO DRAFT REPORT

Page 1 of 8

KENTUCKY HIGHLANDS
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November 9, 2001

Mr. Kenneth Slone
State Director
USDA/Rural Development
771 Corporate Drive, Suite 200
Lexington, Kentucky 40503

Re: Inspection General Official Draft Audit Report 04801-10-AT
Clinton County EZ Community, Inc.

Dear Mr. Slone:

Thank you for the opportunity to respond to the information contained in the above-referenced Official Draft Audit from the U.S. Department of Agriculture, Office of Inspector General. We consider the allegations contained in the report to be serious and we appreciate your consideration in allowing us to clarify the conditions examined in the audit.

We find the Official Draft Audit Report 04801-10-AT, issued in October 2001, to be essentially the same as the Discussion Draft Audit Report issued in September 2001. This is a surprise to this office. During a telephone conference call on October 9, 2001 held between representatives of the USDA - Office of Inspector General, USDA/Rural Development - Kentucky State Office and Kentucky Highlands Investment Corporation, we had the opportunity to present additional information on the issues raised in the Discussion Draft Audit Report. We were under the impression that this further information would result in several mutually acceptable changes that would be included in the Official Draft Audit Report. We were mistaken. Therefore, we feel it is important to again supply the U.S. Department of Agriculture, Office of Inspector General accurate information.

In response to the findings and recommendations contained in the Official Draft Audit Report 04801-10-AT, please accept the following information which is accurate to the best of our knowledge:

Response to Finding No. 1.

The Official Draft Audit Report 04801-10-AT states, "We found that several CCEZCI Board members violated the CCEZCI's conflict of interest policy because they did not disclose to the Board their employment or business relationship with CKF (Cagle's - Keystone Foods, LLC). As a result, their financial interest in CKF affected the integrity and independence of the Board when conducting EZ business."

We absolutely reject this finding. The two members of the Board of Directors in question, Daniel Laib and Mayor James Brown, never voted or took any action involving Cagle's - Keystone Foods, LLC, official or unofficial, as Board members of the CCEZI while employed by Cagle's - Keystone Foods, LLC. There was no violation of the Clinton County EZ Community, Inc. Conflict of Interest

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Policy or any other similar policy. For an accurate presentation of the facts, this finding must be revised or be deleted.

As Official Draft Audit Report 04801-10-AT correctly states, the last action taken by the CCEZCI regarding Cagle's - Keystone Foods, LLC was on January 31, 1997 when the board agreed to release \$475,000 to the city of Albany to help construct a water treatment plant. The audit report further states that Mayor James Brown was not employed at Cagle's - Keystone Foods, LLC until June 1, 1998 and that Daniel Laib did not enter into a contract with Cagle's - Keystone Foods, LLC until October 6, 1998. To find that an action taken by the two Board members in favor of the water treatment plant 1½ years prior to their employment by the company is a conflict of interest, is unfounded.

To further emphasize the impossibility of the alleged conflict of interest, the last action taken on Cagle's - Keystone Foods, LLC by the CCEZCI Board of Directors was January 31, 1997. At that time, the likelihood that the Cagle's - Keystone Foods, LLC plant would even be constructed was uncertain. At January 31, 1997, the USDA - Rural Utilities Service was in the early stages of the Environmental Impact Statement (EIS) on the project, having announced their Intent to Prepare an EIS less than sixty days earlier. The Record of Decision allowing the project to go forward was not issued until July 24, 1997. During this period, no one, including the CCEZCI Board of Directors or the company, knew if the project would become a reality.

To tie the actions of the CCEZCI Board of Directors in January 1997 to employment of two of its members by Cagle's - Keystone Foods, LLC more than one year later is unreasonable. Daniel Laib and Mayor James Brown had no way of knowing they would one day be employed by Cagle's - Keystone Foods, LLC when they voted as members of the CCEZI Board of Directors for the water treatment plant project on January 31, 1997. The funds under this Benchmark had always been earmarked for water improvements by the city of Albany long before anyone had ever heard of Cagle's - Keystone Foods, LLC.

The Official Draft Audit Report 04801-10-AT also states that Mayor James Brown requested, by letter dated June 16, 1998, that the CCEZCI release the last installment of \$26,698 of the \$475,000 the CCEZCI had committed to the project. This was fifteen days after his employment by Cagle's - Keystone Foods, LLC.

The letter of June 16, 1998 was from the city of Albany with James Brown signing the letter in his official capacity as mayor. Mayor Brown was taking no action as a CCEZCI board member or as an employee of Cagle's - Keystone Foods, LLC. His official action as mayor in requesting the final installment was directed by the Albany City Council, who voted to approve paying the engineering fees upon the recommendation of USDA - Rural Development. Thus, James Brown's letter of June 16, 1998 was written only as an official of the city. Official Draft Audit Report 04801-10-AT finds similar action taken by two Albany city council members not to be a conflict of interest, therefore

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it must be concluded that Mayor Brown's action of simply signing a city document, as directed by the City Council, is also not a conflict of interest.

The Clinton County EZ Community, Inc. Conflict of Interest Policy is very specific. It was crafted with care and was reviewed by the USDA - Office of General Counsel in 1995. It has not been violated in any manner by any members of the CCEZCI Board of Directors as alleged in Official Draft Audit Report 04801-10-AT.

The Clinton County EZ Community, Inc. Conflict of Interest Policy requires full disclosure of any real or perceived conflicts of interest by a board member prior to any action being taken by the affected director at the "particular Clinton County EZ Community, Inc. Board meeting." Daniel Laib and Mayor James Brown never took any actions as CCEZCI board members involving Cagle's - Keystone Foods, LLC while employed by Cagle's - Keystone Foods, LLC. If the occasion had arisen, then full disclosure would have been required, their presence could not have been necessary to constitute a quorum, they would not have been permitted to vote on any matter related to Cagle's - Keystone Foods, LLC and they would not have been permitted in the room while the issue was discussed.

The fact that Daniel Laib and Mayor James Brown did not enter into the minutes of the CCEZCI at some later date that they were employed by Cagle's - Keystone Foods, LLC does not constitute a violation of the Clinton County EZ Community, Inc. Conflict of Interest Policy or any other similar policy. Their relationship with the company was well known and neither made any effort to disguise their employment. It would be a violation of the conflict of interest policy only if Mr. Laib, Mayor Brown - or any board member - was in a position to affect a transaction of the Board of Directors and did not disclose and recuse themselves. As the Official Draft Audit Report 04801-10-AT acknowledges, this never happened.

Two other items in Finding No. 1 need to be addressed. The audit report includes financial information on the contract between Cagle's - Keystone Foods, LLC and Wolf River Oil Company. This is a transaction between two private companies that was given to the USDA - Office of Inspector General in confidence. The agency never disclosed to either party that the information would be released to the public and the agency has no authority to do so. Furthermore, the disclosure is unnecessary to the report and may affect the bid process when the contract comes up for renewal. Unless written permission is received from both Cagle's - Keystone Foods, LLC and Wolf River Oil Company that the financial information may be contained in the report, we vigorously object to its inclusion.

Finding No. 1 also references Judge/Executive Charlene King as having violated the Clinton County EZ Community, Inc. Conflict of Interest Policy based on a presumed ownership interest in Wolf River Oil Company. In fact, Judge/Executive Charlene King is not a stockholder in Wolf River Oil Company and has no ownership interest, now or at the time the company received a contract from

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Cagle's - Keystone Foods, LLC. All references to Judge/Executive Charlene King should be deleted from Finding No. 1. Furthermore, since no violations of any conflict of interest policies occurred, this provides additional basis to delete all references to Judge/Executive King.

In summary, Finding No. 1 of the Official Draft Audit Report 04801-10-AT takes a set of facts and interprets them incorrectly and unjustly. The purpose of this interpretation by the USDA - Office of Inspector General is unclear. What is clear is that Finding No. 1 must be rewritten or deleted in its entirety if the report is to be considered accurate.

As for recommended actions, none is necessary. The USDA - Office of Inspector General fails to cite a single incident where the Clinton County EZ Community, Inc. Conflict of Interest Policy did not serve its intended purpose. However, in order to even further strengthen the Conflict of Interest policies of the empowerment zone, the provision found immediately below will be recommended to the local empowerment zone offices for consideration.

EZ Conflict of Interest Policy Insert

A director or employee violating this conflict of interest policy may be required to resign from his or her position with the corporation. In addition, a director or employee may be liable to the corporation for damages for any act or omission constituting a breach of this conflict of interest policy where such act or omission: (1) is one in which the director has a material personal financial interest which is in conflict with the financial interests of the corporation or its shareholders; (2) is not in good faith or involves intentional misconduct or is known to the director to be a violation of law; and (3) is a transaction from which the director derived a material and improper personal benefit.

Response to Finding No. 2.

Finding No. 2 of the Official Draft Audit Report 04801-10-AT states that a former official of the CCEZCI took actions that caused the CCEZCI to make more than \$34,000 in questionable expenditures. The questioned expenditures were in two separate actions and we will address them individually.

Water-Testing Project

The Kentucky Highlands Empowerment Zone Strategic Plan includes in its Benchmarks up to \$30,000 to conduct a water quality baseline study in Clinton County. Funds for this project were included in *Benchmark 21. Clinton County Water System Expansion*. This project was added to the Strategic Plan on August 5, 1998 as part of the annual benchmark review process conducted by Kentucky Highlands Investment Corporation as Lead Entity for the empowerment zone.

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The Official Draft Audit Report finds that \$17,518.92 was expended for this project during a period ending July 7, 1999. The report also finds that a former official of the CCEZCI violated the internal procurement policy of the corporation in hiring a consultant to undertake the water quality review without written estimates or board approval and recommends the CCEZCI seek repayment of the entire amount from the former official personally. Further, the report states that board members of the CCEZCI found the work on the project to be of poor quality and "of little use to the CCEZCI."

We concur that the former official of the CCEZCI violated the Procurement Policy of the Clinton County EZ Community, Inc. This was found to be a "Reportable Condition" in the Clinton County EZ Community, Inc. A-133 audit for fiscal year ending March 31, 2000. The Board of Directors of the CCEZCI addressed the problem when reported and the A-133 audit for fiscal year ending March 31, 2001 finds the problem to have been corrected.

Concerning the specific violation of the Procurement Policy in question, the decision to conduct a water quality baseline study was unanimously approved by the CCEZCI Board of Directors. There is no question of their intention to undertake the project.

The CCEZCI Board of Directors was well aware that the water quality baseline study was underway in 1998 and 1999. As the Official Draft Audit Report 04801-10-AT states, the board approved at least one payment to a consultant for the project. Further, board minutes from this period indicate the former official of the CCEZCI reported on the project on several occasions.

In effect, the only valid finding of the USDA - Office of Inspector General is that the former official of the CCEZCI violated the internal procurement policy of a private corporation. There is no indication that any funds were misappropriated or used for personal benefit. While the quality of work was questionable, the CCEZCI addressed that issue in 1999 when they cancelled the project. The fact that the consultant for the project was an acquaintance of the former official of the CCEZCI and that some of the researchers were not citizens of the United States is irrelevant.

The Board of Directors of the CCEZCI monitored the project closely and knew of the problems with the water quality baseline study. They questioned the procurement of the consultant; they examined the quality of the reports; and, when they determined the performance of the project was unsatisfactory, they chose to cancel the program in a timely manner. Furthermore, the Board of Directors of the CCEZCI chose not to extend the employment contract of the former official in question, due in part to his performance with the water quality baseline study.

The CCEZCI Board of Directors recognized the violation of the Procurement Policy by the former official of the corporation and dealt with the issue in the proper manner. The resolution of a violation of a CCEZCI standard operating procedure is solely within its own authority. The Board of Directors cancelled the baseline water study project and terminated the former official. These actions occurred punctually. The recommendation contained in Official Draft Audit Report 04801-

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10-AT goes beyond the remediation deemed appropriate and necessary by the board and their independent auditor. The recommendation in the Official Draft Audit Report 04801-10-AT seeks to impose the authority of the U.S. Department of Agriculture - Office of Inspector General on a private corporation and proposes an unworkable and unreasonable resolution. The violation was of an internal policy of a private corporation and lacking any evidence of misappropriation of funds, pursuing the former official personally is inappropriate. Fitting penalties have already been imposed as the former official was removed from his job and the program cancelled.

As stated in the conference call of October 9, 2001 between representatives of the USDA - Office of Inspector General, USDA/Rural Development - Kentucky State Office and Kentucky Highlands Investment Corporation, the proper and only further resolution of this matter necessary is for the Board of Directors of the Clinton County EZ Community, Inc. to retroactively approve the invoices and expenditures for the water quality baseline study as they deem prudent. No other action is necessary to resolve this finding.

The Former Official also Received an Additional \$16,900 in Salary Payments

The Official Draft Audit Report 04801-10-AT states that a former official of the CCEZCI "received questionable salary payments totaling \$16,900 for the period July 1998 through July 1999. The payments (from another Federally funded program) were in addition to his regular salary from the CCEZI. Board members stated that they were misled and unaware that the official was receiving compensation above his annual salary agreement of \$45,000."

The other federal agency referred to in this finding is the U.S. Department of Labor (USDOL), which is providing funding through their Youth Opportunity Development Area (YODA) program for projects in Clinton County. The USDOL is the grantor. The grant recipient and the organization with whom the USDOL has their grant agreement for the YODA project is the Lake Cumberland Area Development District, Inc. (LCADD). The CCEZCI acts only as a subcontractor to the Lake Cumberland Area Development District, Inc. for the project. The CCEZCI has no direct agreement with the USDOL.

The U.S. Department of Agriculture and Kentucky Highlands Investment Corporation have absolutely no involvement in the YODA project. Neither organization is a party to any agreement on the project, neither maintains any records on the project and neither has any authority to intervene in the project. The parties to the YODA project in Clinton County are only the USDOL, the Lake Cumberland Area Development District, Inc. and the CCEZCI.

From the limited information we have, it appears that the former official of the CCEZCI received \$16,900 in YODA funds to administer the project in Clinton County and this was a questionable expenditure. A portion of these payments was reported as "Questioned Costs" in the A-133 audit for the fiscal year ending March 31, 2000. The audit concluded that the direct wages paid to the former official of the CCEZCI from YODA funds was subject to disallowance and refund to the

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pass-through entity. It should be noted that the pass-through agency is the Lake Cumberland Area Development District, Inc. The Official Draft Audit Report 04801-10-AT incorrectly reports the pass-through agency as the USDOL and mistakenly reports that the CCEZCI had entered into an agreement with the USDOL. The CCEZCI agreement is with the Lake Cumberland Area Development District, Inc. and the CCEZCI acts only as a private subcontractor on the project.

The questionable salary payments to the former official of the CCEZCI were reported in the A-133 audit for the fiscal year ended March 31, 2000 by the Certified Public Accounting firm of Campbell, Myers & Rutledge in their audit report issued August 21, 2000. The CCEZCI Board of Directors, the granting agency (U.S. Department of Labor) and the grant recipient (Lake Cumberland Area Development District, Inc.) were presented a copy of the audit and informed of the questioned costs.

The parties to the YODA program in Clinton County agreed that the payments to the former official were questionable. Each of the parties to the agreement – the U.S. Department of Labor, the Lake Cumberland Area Development District, Inc. and the CCEZCI – then took mutually acceptable actions to resolve the issue.

The A-133 audit report for the fiscal year ending March 31, 2001 completed by Certified Public Accounting firm of Campbell, Myers & Rutledge and issued July 12, 2001, reported “the finding that wages were paid to the former Executive Director without approval of the board” had been resolved. The audit report states, “The Board and the Pass-Through Entity (LCADD) have resolved the finding and questioned cost. No similar findings were noted in the 2001 audit.”

Kentucky Highlands Investment Corporation, and to the best of our knowledge, the U.S. Department of Agriculture/Rural Development - Kentucky State Office, have no records or information on the YODA program. This is solely a U.S. Department of Labor project. That federal agency, their grantee and their subcontractor have resolved the questioned cost issue. We have no standing to enter into this project and are unable to see the basis of the authority for the U.S. Department of Agriculture to do so either.

From the information we have been provided, it is clear that the former official of the CCEZCI received \$16,900 in questionable payments from the U.S. Department of Labor YODA program. Equally clear is that the U.S. Department of Labor and their grantee, Lake Cumberland Area Development District, Inc., were made aware of these questionable payments and took the appropriate action necessary to resolve the issue.

We have no objection to again reporting the questionable payments in the Official Draft Audit Report 04801-10-AT. However, the recommended remediation action for recovery of the questionable payments from the former official of the CCEZCI is entirely inappropriate and must be amended. The issue has been fully resolved by the parties to the YODA agreement, including the government. Kentucky Highlands Investment Corporation and the U.S. Department of Agriculture have no standing or authority to intervene in this contract or the resolution of disputes under it.

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Again, thank you for the opportunity to review and comment on Official Draft Audit Report 04801-10-AT. The information contained in the report is generally correct. However, the conclusions of the report are often arbitrary and the recommendations contained therein are inappropriate and unworkable. The Official Draft Audit Report 04801-10-AT should be revised for it not to be considered biased.

Sincerely,



Jerry Rickett, President
Kentucky Highlands Investment Corporation
as Lead Entity for the
Kentucky Highlands Empowerment Zone

ABBREVIATIONS

ACT	
Omnibus Budget Reconciliation Act.....	1
CCEZCI	
Clinton County Empowerment Zone Community Inc.	i
CKF	
Cagle's - Keystone Foods, LLC	i
DOL	
U.S. Department of Labor	iii
EZ	
Empowerment Zone	1
KHEZ	
Kentucky Highlands Empowerment Zone.....	i
KHIC	
Kentucky Highlands Investment Corporation.....	i
LCADD	
Lake Cumberland Area Development District, Inc.	iv
OIG-I	
Office of Inspector General-Investigation.....	1
RD	
Rural Development.....	i
USDA	
U.S. Department of Agriculture.....	1
YODA	
Youth Opportunity Development Area	iii