INTRODUCTION

This document reflects Kearney & Company's (Kearney) management report on the results of assessing the design and testing the operation of significant internal controls of the Equal Employment Opportunity Commission (EEOC). Kearney's review consisted of two areas (selected by EEOC's management), Payroll and State and Local activities. Kearney provides this report under Contract No. 50120.01.06.

EXECUTIVE SUMMARY

Kearney's internal control testing approach mirrors the approach set forth in the Implementation Guide for Office of Management and Budget (OMB) Circular A-123, Appendix A, issued by the Chief Financial Officer's Council in July 2005 (Implementation Guide). The approach consists of planning activities and an evaluation of the internal controls for the above referenced cycles.

Planning activities consisted of determining significant accounting reports included in the review, materiality, and the key business processes that support the material financial statement line items.

First, Kearney evaluated the two cycles' internal controls using the Government Accountability Office (GAO) checklist. The evaluation included assessments of the effectiveness of implementing each of the following five standards of internal controls in the two areas:

- Control Environment
- Risk Assessment
- Information and Communication
- Control Activities
- Monitoring.

Overall, EEOC's internal control structure for the two reviewed cycles is well designed; operationally effective, appropriately updated to meet changing conditions, and provides reasonable assurance that the objectives of the agency are being achieved.

Second, Kearney evaluated controls at the process-level for the reviewed areas. Key controls were identified and evaluated to determine their design effectiveness. The evaluation focused on the directness of the control technique in relation to the financial reporting assertion, the frequency of the control's application, the experience and skills of the personnel performing the control and control activity review, segregation of duties (to include asset safeguarding), procedural compliance with applicable laws, regulations, and best business practices, procedures followed when a control identifies an exception condition, and procedures documented to ensure continuity of operations.

Overall, although design deficiencies were noted, none were considered to be material weaknesses.

Lastly, Kearney tested key controls at the transaction-level to determine their operating effectiveness. Testing consisted of inquiry, observation, inspection, and re-performance. Although select controls were determined to be ineffective, Kearney identified no material weaknesses.

EEOC's management provided responses to Kearney's findings. In general, EEOC concurred with Kearney's findings and recommendations, and, its responses are included as Appendix A to this document.

PLANNING

Materiality

Kearney prepared a materiality calculation similar to the calculation required under an OMB Circular A-123 compliance review. The computation was based on the financial statements for fiscal year (FY) 2005. OMB Circular A-123 defines materiality as an error, the magnitude of which could affect the day-to-day decisions of management relying on the financial reports included in the assessment. Kearney used the Financial Audit Manual (FAM), which specifies the greater of 1% of total assets or total expenditures, as a benchmark for determining materiality. Kearney recommends materiality of $ 2,634,065 based on FAM guidance, total assets, and an adjustment factor to develop materiality at a level lower than that utilized by the auditors.

Key Processes Supporting Material Line Items

Kearney identified key business processes. Business processes are the foundation of the internal control assessment and support significant material balances on the financial statements. Kearney reviewed desk manuals, other supporting documentation, and interviewed key employees to determine the key business processes at EEOC, validated the flow of information, and identified the internal controls inherent in each process. We identified the following key business processes for the EEOC selected areas:

- Payroll – The procedures used to create and process (i.e., initiate, certify, and release) employees time cards through the Federal Personnel Payroll System (FPPS)
- State and Local Programs – The procedures for selecting Fair Employment Practice Agencies, allocating contracts, monitoring performance and completion, and vouching and paying for services.

The key business processes were then cross-walked to the material line items. The crosswalk ensured that there was at least one business process supporting each material line item.

PROCESS-LEVEL EVALUATION

Identification of Controls

From the business processes identified above, Kearney developed cycle memorandums, flowcharts, and internal control questionnaires for Payroll and State and Local Programs. Kearney prepared cycle memorandums through interviews with key personnel, reviews of supporting documentation (such as desk manuals and internal procedure documents), and by performing walkthroughs to determine that the control functioned as described. As part of the walkthrough process, Kearney gathered standard forms and other documentation utilized in the business process.

In addition, Kearney prepared internal control questionnaires for Payroll and State and Local Programs. Kearney validated its internal control questions by submitting them to management for review. After the management review and approval, the questionnaires were finalized. The State and Local Program questionnaires were sent to fourteen district offices and one field office. The Payroll questionnaires were sent to selected timekeepers, Human Resources personnel, ten headquarters offices, and nineteen field offices.

The cycle memorandums and internal control questionnaires were crucial to the internal control assessment process because they outlined the sequence of processes used to establish, identify, assemble, analyze, classify, and record a particular type (or group) of transaction(s). Within these processes are the controls utilized by EEOC to ensure that operations are effective and efficient, financial reports are reliable, and applicable laws and regulations are complied with. Kearney documented these controls in each business process cycle memorandum.

Control Design

Kearney analyzed the controls identified in the Payroll and State and Local Programs cycle memorandums to determine which were key controls, and their design effectiveness. OMB Circular A-123 defines a key control as a control, or set of controls, that addresses the relevant assertion for a material activity or significant risk. The analysis focused on the following:

- Directness of the control technique in relation to the financial reporting assertion
- Frequency of the control's application
- Experience and skills of personnel performing the control and control activity review
- Segregation of duties (to include asset safeguarding)
- Procedural compliance with applicable laws, regulations, and best business practices
- Procedures followed when a control identifies an exception condition
- Procedures documented to ensure continuity of operations
- Information systems.

TRANSACTION-LEVEL TESTING

Scope

Kearney recommended an internal control operational effectiveness testing plan to the Office of the Inspector General. Since this effort represents the initial implementation of OMB Circular A-123, Kearney recommended testing the operation of all key controls to establish a baseline.

Currently, EEOC is not required to follow OMB Circular A-123, Management's Responsibility for Internal Control, but this review was designed to identify areas in Payroll and State and Local activities cycles which need to be improved before the Circular is implemented agency-wide. Kearney's sample population consisted of controls that occurred in FY 2006 (October 1, 2005 through August 24, 2006). However, there were certain annual controls (i.e., EEOC financial statements) and other infrequent controls (i.e., year-end procedures) that did not occur in FY 2006, where it was necessary to select samples from FY 2005. Kearney judgmentally selected a sample size based upon internal control questionnaire responses.

Testing/Results

Key controls tested, along with their effectiveness and any recommended corrective actions, are summarized below.

State and Local Programs – Kearney tested the following key controls:

- Contracts are properly approved by appropriate personnel
- Proper reviews and approvals are obtained prior to preparing the receiving report
- Disbursement data agrees with the public voucher (invoice) and the receiving report
- For advance payments, the public voucher (invoice) and receiving report do not exceed 50 percent of the total amount awarded for EEOC
- Verified that public voucher (invoice) and receiving report agree in regards to the vendor, quantity, and unit price
- Verified that the State and Local Coordinator runs the Contract Performance 471 Report from Integrated Management System (IMS) to monitor the percent of contract completed and the amount of credit granted before he/she approved the public voucher (invoice).

Overall, internal controls over the accounts payable and cash disbursements processes are operating effectively. However, the following issues were noted:

Voucher Processing:

- The Public Vouchers (invoices) were not signed, demonstrating that they were reviewed or approved by the State and Local Coordinator or any appropriate personnel
- Receiving Reports and Public Vouchers (invoices) were not properly filed
- The State and Local Program Handbook has not been updated since 1997.

Kearney recommends that EEOC formally standardize the voucher process. This process will ensure that State and Local District Offices are also responsible for the approval and reconciliation of vouchers. In addition, this policy will ensure that the amount paid is the correct amount approved for EEOC.

Unresolved Items:

- Two Receiving Reports for contract resolutions were not on file
- Two Receiving Reports for training EEOC/ Fair Employment Practices Agencies (EEOC/FEPA Conference) were not on file.

Human Resources and Payroll Cycle – Kearney tested the following key controls:

- Personnel actions are reviewed, approved, and had proper supporting documentation
- Time and Attendance records are approved
- Time records are reviewed for accuracy and consistency
- Leave requests are approved
- Terminated employees are changed to inactive status in a timely manner.

Overall, internal controls over Human Resources and the Payroll Cycle are operating effectively. However, the following issues were noted during Kearney's testing and survey responses:

- For six employees, the codes shown in the EEOC Cost Accounting Bi-weekly Time Sheet do not match the codes shown in the Time and Attendance view screen (FPPS)
- The cost structure in the Time and Attendance view screen (FPPS) is not used in every line in which the hours were entered
- Exit Clearance procedures for terminated employees were not completed in a timely manner
- For four employees, the hours shown in the EEOC Cost Accounting Bi-weekly Time Sheet did not match the hours shown in the Time and Attendance view screen (FPPS).

Kearney recommends that EEOC enforce the policy concerning the use of the EEOC Cost Accounting Bi-weekly Time Sheet. This policy will ensure that EEOC has adequate procedures in place to promote accurate and consistent coding of activity codes.

Unresolved Items:

- An Office of Personnel Management (OPM) 71, Request for Leave & Approved Absence Form was not in the employee's file
- An Official Personnel Folder (OPF) for an employee was not available for review because the folder is on file in Baltimore
- The Time and Attendance records for an employee were not available to review because the Timekeeper is on leave
- One missing updated Thrift Savings Plan (TSP) Form was not available to review
- An updated Federal Employees Health Benefits Program (FEHB) change is not reflected in Employee Express or OPF

- A Form OPM 470, Employee Clearance Records, was not available for review.

EEOC Management Comments

Kearney received comments from EEOC's management on the above findings, and management concurred with Kearney's findings and recommendations.