City of Ocala
Office of the Internal City Auditor
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To: The Honorable Suzy Heinbockel, President of the Council
The Honorable Mary Sue Rich, President Pro Tem
The Honorable Daniel Owen
The Honorable John McLeod
The Honorable Jay Musleh
The Honorable Kent Guinn, Mayor
Matthew Brower, City Manager

Date: June 19, 2012

Re: Utility Services - Inventory Loss Prevention

Please find attached the Utility Services - Inventory Loss Prevention Audit Report. Management requested Internal Audit to review security and inventory loss prevention controls at the Utility Services Warehouse and Complex. Warehouse supply inventory on hand averages over $5 million. For the first 8 months of FY 2012, $9.6 million in supplies have been issued through the Warehouse.

Based upon the review, additional controls and procedures at the Warehouse and Complex will enhance security and lessen the risk of loss and misappropriation of City assets. Management has proactively strengthened security and continues to improve controls over inventory and access to the Warehouse and Complex.

We appreciate the assistance provided by Utility Services, especially Joe Noel, David Coonfield, Rodney Weaver, and Mary Ann St. Laurent. Management has responded to the recommendations presented at the exit conference and Internal Audit will perform a follow-up review by November 30, 2012.

Generally Accepted Government Auditing Standards and the Institute of Internal Auditors Standards require that we plan and perform our audits to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. The evidence obtained provides a reasonable basis for our observations and conclusions.

Jeanne Covington

Jeanne Covington, Internal Auditor

c: Larry Novak, Assistant City Manager, Utility Services
Joe Roos, Director, Electric Utility Services

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Utility Services - Inventory Loss Prevention
Exit Conference: May 24, 2012

Participants: Larry Novak, Joe Roos, Mike Poucher, Joe Noel, David Coonfield, Mary Ann St. Laurent, Rodney Weaver, and Jeanne Covington

Audit was asked to assist Management with reviewing security with regard to inventory loss prevention at the Utility Services Warehouse and Complex. Two recent losses of copper and other supplies have been identified. Internal Audit thanked staff and Management for their courtesy and cooperation during the investigation. Warehouse supply inventory on hand averages over $ 5 million. For the first 8 months of FY 2012, $9.6 million in supplies have been issued through the Warehouse.

Purpose: To review security over Warehouse inventory and Electric Utilities supplies housed within the Complex.

Scope: Utility Services Warehouse, Electric Utilities truck sheds, and access to the Complex.

Approach: Reviewed procedures, interviewed key personnel, analyzed access controls, toured Warehouse and truck sheds, and observed location of cameras and viewed a sample of camera recordings.

Conclusion: Based upon the review, additional controls and procedures will enhance security at the Complex and lessen the risk of loss and misappropriation of City assets.

Generally Accepted Government Auditing Standards and the Institute of Internal Auditors Standards require that we plan and perform our audits to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations and conclusions.

The following summarizes opportunities identified during the review to further strengthen controls over security, access and inventory.

Observations, Recommendations, and Management's Response

Management's response should include a brief description of an action plan that will mitigate risk and indicate an expected implementation date.

	Observation	*Discussion of Criteria, Cause and Effect*	Recommendations	Management Response with Expected Implementation Date
Complex Access and Security System	Badge holder access to City facilities are controlled by Utility Services Resource Management. Resource Management codes each employee badge for access to City facilities based upon business need for each employee's position. Facilities is responsible for changing the gate codes at the City Complex. Gate 6 is used to access the Complex after hours through the use of a keypad and single access code. The code is periodically changed at which time Facilities notifies all city employees and certain Ocala Police Department employees of the change. On Friday, April 27, 2012, the access code was changed and e-mailed to all city personnel. Gates 1 and 2 at the Complex automatically close and lock after hours. Gates 3,4, and 5 are locked by departments that use the gates with a padlock afterhours. Various City personnel have keys and thus have access to the Complex after hours. SunTran has full access to the Complex through Gate 6.	Benefits of a security system include the ability to limit access to only essential personnel that have a business need to enter a secured area. Assigning unique pass codes or access cards for each employee facilitates identifying who and when secured locations are accessed. Security should be administered through a central location by personnel that can assure that access is granted to only those with a business need. Strong security controls ensure that access to secured areas are restricted to personnel that have a business need to be in the secured area. Limiting access not only protects City assets but also protects City employees that are working during non-business hours. Access should not be granted to non-essential personnel.	The Gate 6 access code should be provided only to essential personnel that have the need to enter the Complex after hours to carry out their job responsibilities. Features of the security system should be reviewed for opportunities that would allow identification of the individual accessing the area after hours through requiring a key card or unique pass code specific to each employee. Management should determine if System Control personnel can grant access to those employees that may have need to access the Complex due to special circumstances without the need for those individuals to have full access with the security code. The access code should never be provided to those that do not have a City business purpose to enter the Complex during non-business hours. Management should coordinate with other City Departments to determine security enhancements to Gates 3, 4, and 5 to eliminate padlocks and keys. Security to City facilities should be managed and controlled by a central area. Management should consider realigning the ability to change access codes to the City's security gates to Utility Services Resource Management. Consideration should be given to redesigning the Complex Gate 6 entrance to segregate SunTran from the City Complex. SunTran personnel should only have access to SunTran facilities.	Utility Services Management will get a quote from security access company to add a card reader to Gate 6. If the quote is deemed fiscally viable, Utility Services Management will coordinate with other City departments to limit complex access to essential staff after hours. Utility Services Management will discuss options for padlock elimination on gates 3, 4, and 5 with other departments. Options might include gate automation, and or camera placement for added security. These options might include the installation of card readers at these gates or the use of changeable combination locks. Utility Services Management will discuss centralizing security of the complex with Utility Services Resource Management if feasible. Utility Services Management will discuss options and pricing for redesigning the SunTran portion of the complex entrance way. Preliminary estimates are approximately $25,000 for fencing and additional gates. At this time, Utility Services believes upgrading cameras and individual card readers will accomplish the necessary level of security. These tasks have an estimated implementation date of August 1st 2012.

	Observation	*Discussion of Criteria, Cause and Effect*	Recommendations	Management Response with Expected Implementation Date
Access to System Control	Currently, 68 badge holders have access to System Control. This includes executive staff, contract cleaning personnel, and non-System Control employees. The System Control area houses critical infrastructure to operate the City Utility Services and controls access to City facilities. System Control is manned 24/7 by System Control employees.	Strong security controls require that access to essential, critical areas be limited at all times to only employees that have a business need to the area. This reduces the risk that inappropriate or inadvertent actions could hinder business operations and service to our customers.	Management should review the badge holders with access to System Control and remove access from non-essential personnel. Anyone with a business need to enter the area can be granted access by System Control personnel. System Control personnel should ensure that access is warranted prior to granting access. Only System Control personnel and specific emergency personnel should have access to the area without this verification. Management should consider additional security to System Control access by requiring dual authentication.	The number of badge holders who have access has been reduced from 68 to 24 as of 5/30/2012. Only key personnel now have access. Management will conduct a periodic review of the access list. At the current time we are meeting the NERC regulations and guidelines for System Control access. Utility Services Management will continue to re-evaluate the use of dual authentications for authorized personnel as new directives come from NERC. This was completed on May 30th 2012.
Security Cameras	The Warehouse and Electric Utility Services truck shed area are monitored by 9 cameras. Gate 6, which is used to access the Complex after hours is monitored by 1 camera. Currently, System Control does not monitor the cameras in real time. The activity from the motion activated cameras is stored for 20 days which allows for review of tapes if needed. The motion detector for the camera monitoring the east entrance to the Warehouse is not functioning properly; the motion sensor is not positioned to activate video surveillance recording.	Florida's General Records Schedule GS1-SL for State and Local Governments, Item #302, requires that electronic video surveillance recordings be retained for a minimum of 30 days. Effective controls over high dollar inventory should allow for immediate, real-time viewing of activity by System Control personnel.	Video surveillance recordings should be retained for at least 30 days to comply with State of Florida regulations. Management has budgeted for the installation of LCD monitors to allow Security Control to view activity in real time and identify any potential inappropriate activity within the Complex. The monitors will be installed on a wall that allows full view from the Forman's room. Management should consider installation of blinds to block the view from non-System Control personnel to prevent knowledge of the areas being monitored which may lead to inappropriate actions through avoiding areas under surveillance. Blinds would allow the viewing area to be open during emergency situations when monitors would be used for viewing system outage areas and non-System Control personnel would have a business need to utilize the monitors. Management should ensure that all existing cameras are functioning appropriately. Management should also assess the need for additional cameras and/or repositioning camera alignment to ensure all critical areas are properly monitored. Management should also consider installing signs around the Complex area to publicize that the area is monitored to deter inappropriate actions.	Utility Services Management is purchasing a replacement server to comply with the State of Florida retentions regulation. Utility Services Management has received multiple quotes for the display wall installation in System Control. After review, we will move forward with the installation project. There is budgeted money for this project. After the display wall has been installed, blinds will be purchased and installed in System Control on the Foreman's Room windows. Utility Services Management is currently auditing the existing camera hardware to identify any malfunctions. After this is complete, Utility Services Management will assess the need for additional equipment and repositioning of camera hardware to meet the security goals of the Complex. Utility Services Management will work with Public Works to install signs identifying the existence of video surveillance. These tasks have an estimated implementation date of October 1st 2012.

	Observation	*Discussion of Criteria, Cause and Effect*	Recommendations	Management Response with Expected Implementation Date
Access to Electric Truck Sheds	Utility service trucks which are stocked with inventory supplies are kept in open truck sheds when not in use. Maintaining supplies on the trucks is necessary to ensure efficient and quick response to service outages and problems. Anyone that has access to the Complex after hours has access to the trucks and inventory that is stored on/in the trucks. System Control personnel are responsible for calling in personnel for after hour service and is aware of who should be in restricted areas.	Good business operations require that supplies be readily available to ensure that response crews have sufficient supply readily available to handle utility outages and problems effectively and efficiently. Security over the areas that house response equipment should be sufficient to reduce the risk of loss and inappropriate use.	Management should consider additional security over the truck sheds and the stock stored on the trucks; additional physical security would require enclosing the truck sheds with locking garage doors or fencing and limiting access to those that have a business need to access the area after hours. Alternatively, Management should consider better cameras (such as rotational viewing, increased motion sensitivity, improved resolution), realigning camera viewing area, and installing some type of notification mechanism to alert System Control personnel to view the camera feed at the time activity in the area occurs. If unauthorized access and activity is observed, System Control personnel should immediately contact authorities to handle the situation.	Adding additional physical security to the truck shed area would be detrimental to Utility operations. It would also be very expensive. Utility Services Management will upgrade existing camera hardware for additional functionality and control as the budget allows. System Control will monitor these cameras to properly react to any situation involving the presence of any unauthorized personnel. These tasks have an estimated implementation date of September 1st 2012.
Warehouse Security	During non-business hours, the Warehouse is locked. Warehouse employees are on-call if inventory stock is needed during non-business hours. The door between Human Resources and the Warehouse is never locked. Anyone from HR can access the Warehouse and likewise, anyone in the Warehouse can access HR at all times. The contracted cleaning crew has access to the Warehouse after hours, although they do not clean the Warehouse. Some cleaning supplies are stored in the warehouse. The cleaning crew also has access to Telecom after hours. Access to Telecom does not require dual authentication. High dollar inventory is easily accessible.	The effective and efficient business operations requires inventory to be on-hand and available. Secured storage facilities with limited access are necessary to properly protect inventory assets on hand from loss and misappropriation.	Management should consider locking the door connecting the Warehouse to Human Resources, especially during non-Warehouse business hours to prevent unauthorized access to both areas. Access to the Warehouse by contracted cleaning personnel should be eliminated. Cleaning supplies should be relocated to eliminate the need for cleaning personnel to enter the Warehouse. Telecom should not be accessed by the cleaning crew afterhours. Management should consider additional security over Telecom by requiring dual authentication for access to the area. Management should consider securing high dollar inventory and limiting access to only Warehouse personnel to prevent loss. Additional monitoring devices, such as motion detector/alerting devices to notify Warehouse personnel of individuals entering the Warehouse during business hours would assist personnel in controlling access to inventory stock.	Utility Services Management will remove after-hours access to and from HR/warehouse. Utility Services Management will coordinate with HR to have cleaning supplies moved to another location, which will eliminate the need for cleaning crew personnel access to the warehouse at any time. Utility Services Management eliminated the access of cleaning crews to the Telecom building. Cleaning personnel will need to be let in to the building at 3:30pm on Tuesdays and Thursdays to clean that designated area. Utility Services Management is implementing dual authentication for the Telecom building effective 6/11/2012. Utility Services Management is considering the addition of motion detectors and alerting devices for the warehouse. These tasks have an estimated implementation date of August 1st 2012.

	Observation	*Discussion of Criteria, Cause and Effect*	Recommendations	Management Response with Expected Implementation Date
Inventory Issuance and Usage	Linemen and grounds men restock truck inventory each morning by filling out a Materials Issue Form. Current procedures allow for the men to pull the stock from the Warehouse and have the Material Issue Form reviewed and validated by Warehouse personnel prior to taking the materials to the truck. However, there are instances where the form is not reviewed prior to leaving the Warehouse. The Transmission and Distribution Supervisor does not review inventory issues that supply the trucks. Currently, the inventory system does not generate a periodic report of manual adjustments made to inventory. Inventory cycle counts are performed as stock is received into the Warehouse. Discrepancies are reviewed by the Warehouse Manager and forwarded to the Administrative Coordinator to manually change quantities on hand in the inventory system. Although not standard operating procedures, the Warehouse Manager has the ability to process inventory adjustments. The inventory system does not generate a monthly report of manual inventory adjustments that would allow the Resource Management Supervisor, to whom Warehouse personnel report, to perform an independent periodic review of manual adjustments to quantities on hand.	Strong controls require that the requisitioning and issuance of inventory stock be segregated. Appropriate detective internal controls require monitoring inventory usage and manual adjustments to inventory quantities on-hand.	Management should review access to the Warehouse inventory, especially high dollar inventory supplies. Those requisitioning supplies should not have access to pull high dollar stock. Inventory usage should be monitored. Management should coordinate with the IT Department to design reports for review by the Transmission and Distribution Supervisor to monitor usage to identify and investigate abnormalities of truck stock inventory. Likewise, Management should coordinate with IT to design a report that would assist the Resource Management Supervisor with reviewing manual adjustments to inventory quantities on hand each month.	The Warehouse personnel now verify all stock leaving the warehouse against requisitions for material. Utility Services Management will work with IT and Warehouse personnel to identify reports used to monitor stock transactions involved in truck stock requisitioning. Utility Services Management will work with IT and Warehouse personnel to identify reports used to monitor adjustments to inventory quantities on a monthly basis or more often if deemed necessary. These tasks have an estimated implementation date of August 1st 2012.

	Observation	*Discussion of Criteria, Cause and Effect*	Recommendations	Management Response with Expected Implementation Date
Control Environment	Thefts have occurred at the Complex.	A strong control environment fosters an atmosphere of professional skepticism. The Association of Fraud Examiners reports that 50% of fraudulent activity is identified through tips.	Management should encourage employees to be the eyes and ears of the City. Employees should feel comfortable to question and report suspicious activity in a confidential and non-retaliatory manner. Timely identification of suspicious activity may prevent loss of City assets and may initiate early intervention to limit the opportunities for inappropriate and detrimental behavior.	Utility Services Management is currently working diligently to communicate the importance of reporting any infractions without fear of retribution

Internal Audit will continue to work with Management to assess controls over the Warehouse, Complex and inventory and will review security within 90 days of the completion of Management's action plans.

Management and Audit mutually agreed at the exit conference that Management would respond in writing by June 7, 2012. Results will be distributed to the members of the Ocala City Council and select members of City Management. If the expected implementation dates or the action plans change, Management will notify Audit of the revisions.

Jeanne Covington — 6/19/12

Internal Audit — Date

Joe Roos — 6-19-12

Management Signature/ Title — Date

6/18/12

Larry Novak, Assistant City Manager, Utility Services — Date