



INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

West Dunbartonshire Council

Interim management report
Audit: Year ended 31 March 2011

15 April 2011

AUDIT

This interim management report is presented under the terms of our appointment by the Accounts Commission.

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of West Dunbartonshire Council and is made available to the Accounts Commission and Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

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Organisation-wide controls

A sound system of internal control is an essential part of robust corporate governance arrangements. We have updated our understanding of entity level controls at the Council to inform our financial statements work and have not identified any significant issues. We will, however, report separately on activities undertaken during 2009-10 to develop the Council's performance management arrangements. We have evaluated the work of internal audit and continue to place reliance on their work to support our audit.

The Council has put in place arrangements to respond to the requirements of the 20010-11 National Fraud Initiative, with overall arrangements well established. The process of reviewing current data matches is underway and management has a formal plan and timetable in place to dealing with this process.

Key financial controls

Since our appointment as the Council's external auditors in 2006 we have reported weaknesses in the operation of key financial controls, with some of these reported in more than one year. In previous years, management accepted most of our recommendations to enhance controls, but some instances where controls do not operate on a consistent basis continue to arise.

While this report raises three recommendations for action, none of these are at grade one (significant), with one at grade two (material) and two at grade three (minor). The key theme of our recommendations continues to involve the enhancement of the audit trail process to evidence the review of controls in place across the Council.

Our testing of the design and operation of controls over significant risk points confirms that, with the exception of some weaknesses, controls are designed appropriately and operating effectively. We have taken into consideration the findings of internal audit where relevant to the scope of this report.

Information technology controls

Information systems are an integral part of a sound system of internal control. Our information technology specialists have performed a detailed review of the Council's information systems relevant to financial reporting, including a follow-up of previous year recommendations. It is clear that action has been taken to progress a number of recommendations previously made, with five recommendations now closed.

There are no new recommendations arising from our work, with eight recommendations from prior years requiring further work to ensure that they are fully implemented. None of these are graded as 'significant'.

We report here the key recommendations which we believe should be actioned by management as a matter of priority, as they have the greater potential to lead to financial loss, or impact on the accuracy of financial reporting. We have provided a separate report to management which details other recommendations which we believe, if implemented, would represent good practice.

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice*. The *Code* specifies a number of objectives for our audit.

A key element of robust corporate governance arrangements is a sound system of internal control. Over the period of our appointment as the external auditors of West Dunbartonshire Council we review not only those systems of internal control that may be considered to be material in relation to the opinion on the financial statements, but also those which require to be considered as part of the wider dimension of public sector audit.

Our approach to the audit is based on understanding and assessing West Dunbartonshire Council's structures and processes for decision-making, accountability, control and behaviours and what risks can affect the financial statements. We then consider the audit procedures to address any identified weaknesses and identified risks. We assess areas with the greatest risk for misstatement and the effectiveness of internal controls at mitigating those risks.

Our audit is carried out in accordance with our responsibilities embodied in Audit Scotland's *Code of Audit Practice* ("the *Code*") and through the application of International Standards on Auditing (UK and Ireland).

Our recent audit fieldwork and this report meets the following objective under the *Code* applicable to 2010-11:

- review and report on (as required by relevant legislation, the *Code* and any guidance issued by Audit Scotland):
 - the Council's corporate governance arrangements as they relate to: its review of systems of internal control; the prevention and detection of fraud and irregularity; standards of conduct; prevention and detection of corruption; and its financial position.
 - the Council's arrangements to achieve Best Value; and
 - other aspects of the Council's arrangements to manage its performance, as they relate to economy, efficiency and effectiveness in the use of resources.

In line with our audit plan overview presented to the audit committee on 16 March 2011, we have completed the 'understanding' and 'evaluating' phases of our audit. We will use the information obtained and the results of our testing to tailor our planned approach to our audit of your financial statements during July, August and September 2011.

The purpose of this report is to report our findings as they relate to:

- review of principal accounting systems to assess whether the related controls are designed appropriately and operating effectively to prevent or detect a material misstatement of the financial statements;
- developing our approach to key risk areas identified during our planning and understanding phases of our audit; and
- review of organisational-wide controls, including internal audit and risk management arrangements.

We undertake our work on your financial statements in four key stages.

1	Planning	<ul style="list-style-type: none">Perform risk assessment procedures and identify risksDetermine audit strategyDetermine planned audit approach
2	Control Evaluation	<ul style="list-style-type: none">Understand accounting and reporting activitiesEvaluate design and implementation of selected controlsTest operating effectiveness of selected controlsAssess control risk and risk of significant misstatement
3	Substantive procedures	<ul style="list-style-type: none">Plan substantive proceduresPerform substantive proceduresConsider if audit evidence is sufficient and appropriate
4	Finalisation	<ul style="list-style-type: none">Perform completion proceduresPerform overall evaluationForm an audit opinionAudit and risk management sub-committee reporting


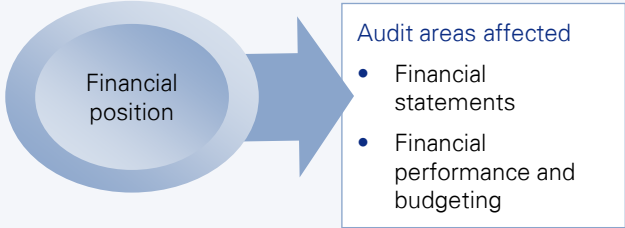
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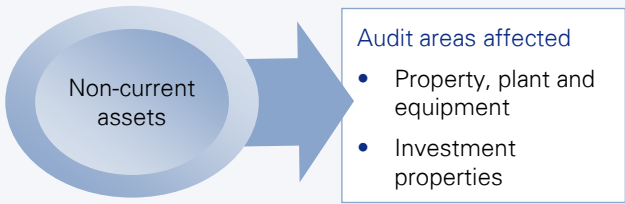
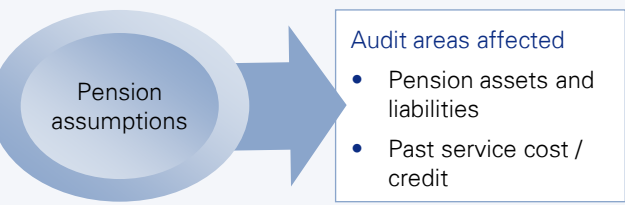
During the planning process we identified a number of key risks for specific consideration during the audit.

We have updated our understanding of the factors impacting on each of these risks to further inform our year end procedures.

During our audit planning work we have identified the following areas which will require particular consideration as part of our audit. This list is not exhaustive; our audit planning and risk assessments are ongoing throughout the audit. An update of our findings is detailed below.

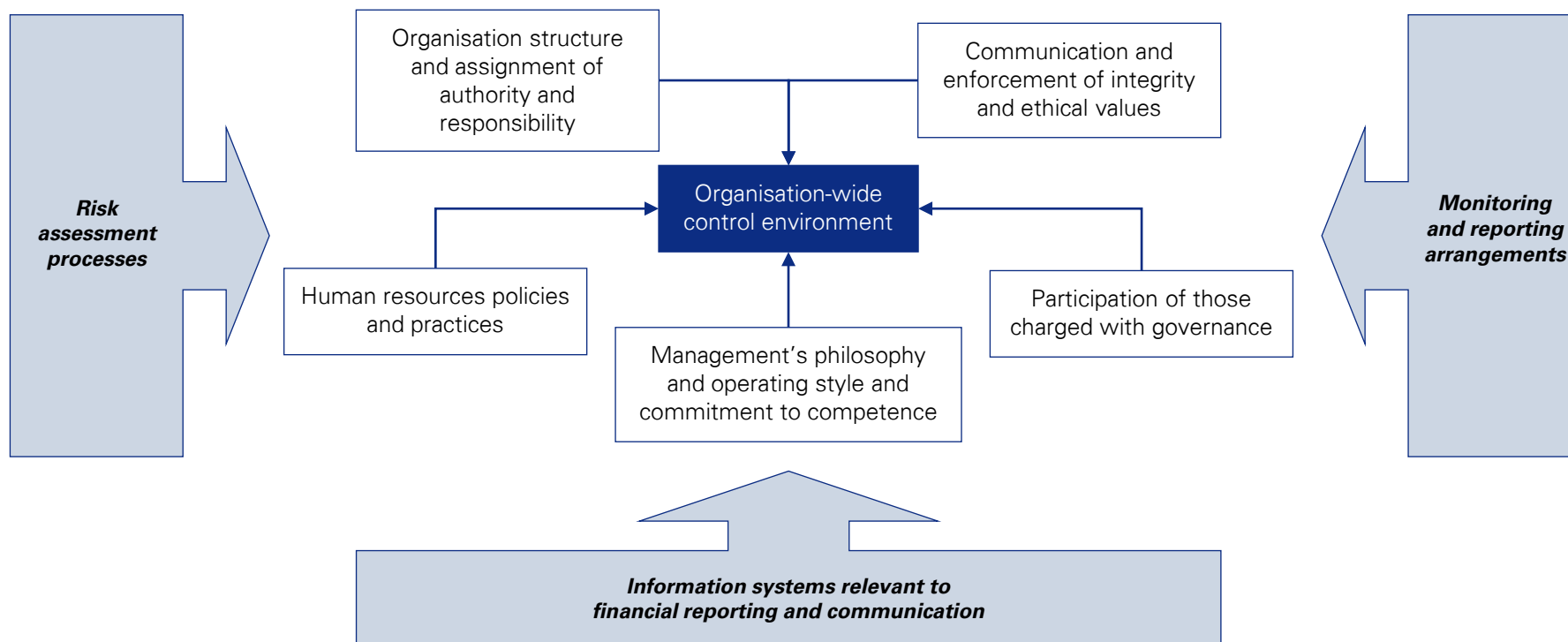
Risk area	KPMG observation
<div><p>Audit areas affected</p><ul style="list-style-type: none">Financial statementsAccounting policies</div>	<p>The Code is the first to be based on International Financial Reporting Standards. The transition to an IFRS-based code from a UK GAAP SORP results in a number of significant changes in accounting practice. These changes need to be adopted at the beginning of the earliest comparative period, being 1 April 2009.</p> <p>Management prepared a restated IFRS based opening balance sheet as at 1 April 2009 as well as a restated IFRS based statement of comprehensive income and expenditure and balance sheet for the year ended 31 March 2010. We have reviewed the restatement and discussed our findings to management.</p> <p>We will continue to liaise with management to ensure that the 2010-11 financial statements and supporting notes are prepared in accordance with the IFRS-based Code.</p>
<div><p>Audit areas affected</p><ul style="list-style-type: none">Financial statementsFinancial performance and budgeting</div>	<p>The Council is forecasting a favourable variance of £3.1 million for the year in respect of general services. If delivered by the year end, this will ensure that the Council's uncommitted general fund balances are restored above the Council's target minimum level general fund balance of £4.1 million.</p> <p>The Council is forecasting general services capital expenditure of £20.7 million against an original budget of £25.8 million. This slippage relates to several large capital projects which have been delayed for various reasons. This slippage in projects will be carried forward into the 2010-11 capital plan.</p> <p>We will continue to monitor financial forecasts of the year end position. We will review actions taken to achieve the 2010-11 to 2013-14 savings targets as part of our review of medium to longer term financial sustainability plans.</p> <p>We will also pay particular attention to those areas that could impact on the level of uncommitted general reserves at 31 March 2011, including commitments utilised, released and carried forward.</p>

Areas of audit emphasis (continued)

Risk area	KPMG observation
 <p>Audit areas affected</p> <ul style="list-style-type: none"> • Property, plant and equipment • Investment properties 	<p>The Code requires the fair value of council dwellings to be measured using a special existing use value basis for social housing (EUV-SH). Although, the Code does not specify a particular valuation methodology to be used to achieve an EUV-SH valuation, most authorities use a beacon approach (adjusted vacant possession) which seeks to obtain a value for the asset based on its vacant possession market value adjusted to reflect it's use for social housing with a sitting tenant. The Council's valuer revalued the Council dwellings under EUV-SV as at 1 April 2009 which resulted in an increase in valuation of £29.6 million. This upward valuation was due to the difference between the discount factor previously used in the valuation and that now required under IFRS between market and social rents.</p> <p>We have reviewed the valuation and confirmed that it is consistent with the requirements of the Code.</p> <p>We will ensure that where expenditure replaces an existing asset the replaced asset is removed from the accounting records. We will also ensure that the Council has applied component accounting in accordance with the Code.</p>
 <p>Audit areas affected</p> <ul style="list-style-type: none"> • Pension assets and liabilities • Past service cost / credit 	<p>The government announced on 8 July 2010 that they will in future use the consumer prices index ("CPI") in place of the retail prices index ("RPI") as the index for determining pension increases for public sector pension schemes. We understand that this will affect minimum required increases, applying to both current and future pension payments. CPI is generally expected to be lower than RPI in the long term and this should lead to lower pension increases. In addition, the cost of benefit accrual will also be correspondingly lower.</p> <p>We have reviewed the information provided to the actuary during the year and confirmed that management have discussed with actuary the impact of the transition from RPI to CPI.</p> <p>CIPFA's Local Authority Accounting Panel ("LAAP") is currently preparing a guidance note on the accounting treatment to be adopted in 2010-11. We will consider the impact that this has on the valuation of the local government pension scheme and the treatment of any gain arising as a result of the change.</p> <p>Our audit of the pension information to be included in the financial will also consider the actuarial assumptions used by comparing these to KPMG's acceptable parameters by involving discussions on these key assumptions with our internal pensions specialists.</p>

Organisation wide controls often have a pervasive impact on control activities, and therefore on our assessment of the risk of significant misstatement.

Entity level controls often have a pervasive impact on control activities over classes of transactions, account balances derived from management estimates, other account balances and disclosures and therefore on our assessment of the risk of significant misstatement. Audit procedures performed to gain an understanding about the design and implementation of relevant controls include inquiring of senior personnel, observing the application of specific controls and inspecting documents and reports.



Our work has included assessment of budget setting and reporting arrangements, financial management, risk management, communication strategies, committee structures, and arrangements for the prevention and detection of fraud and irregularity.

Work on organisation-wide controls has included the review of relevant policies and procedures and consideration of the adequacy and appropriateness of the content. In addition, we reviewed evidence of processes such as risk monitoring and financial reporting, to confirm these were operating as intended. The majority of policies and procedures are available to all staff on the intranet. This ensures that relevant personnel have access to the current version of key documents at all times.

We raised a number of recommendation in this area in our 2009-10 management reports for which management has been progressing. We understand that progress against these recommendations will be captured as part of the routine internal audit follow up progress reports.

Organisation-wide controls (continued)

We have evaluated internal audit arrangements and intend to place reliance on its work in support of accounts audit work.

During our interim audit we evaluated the Council's arrangements for participating in the NFI exercise and we did not identify any significant issues.

Internal audit

Our audit planning process identified the specific areas where we planned to rely on the work of internal audit to minimise duplication of effort. We have continued to liaise with internal audit and updated our understanding of their approach. We have considered and assessed internal audit's technical competence, professional care and objectivity and no material matters have been identified.

We have reviewed the following reports and concluded that we will place reliance on this work:

- treasury management;
- payroll;
- main accounting systems;
- debtors; and
- IFRS arrangements.

The current periods work on statutory performance indicators is carried out in July 2011 and we will review this work at a later date.

Due to additional work required to be carried out on investigations the scheduled internal audit work over regularity has been postponed until 2011-12. We will complete a further review of the remaining internal audit reports prior to commencing our financial statements audit in June 2011.

National Fraud Initiative ("NFI")

The National Fraud Initiative ("NFI") is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. NFI helps participating bodies to identify possible cases of fraud, and to detect and correct any under or overpayments. NFI also helps auditors to satisfy their duties to assess bodies' arrangements for preventing, deterring and detecting fraud.

This exercise runs every two years with the process restarting in the current year. In January 2011 all bodies received the result of the current exercise.

Management has prepared a strategy for the investigation of matches received based on prioritising recommended and high value matches. This strategy sets out the working timetable which aims to complete investigation by 30 September 2011 with the exception of complex cases requiring the involvement of other bodies. Internal audit and the benefits investigation team are conducting this testing and will report their findings. On completion, we will test a sample of matches resolved and consider to support the reported findings.

Our testing, combined with that of internal audit, over the design and operation of controls confirms that, with the exception of the weaknesses noted, controls are designed appropriately and operating effectively

Key financial controls

Our audit plan overview identified the classes of transactions, disclosures and account balances that are significant to the financial statements. We developed audit objectives for each identified assertion. Where we adopt a controls approach to an audit objective, in accordance with *the Code*, we have updated our understanding of accounting and reporting activities over each significant account and identified and tested key financial controls. We have evaluated the design and implementation of these controls and, where appropriate, tested the operating effectiveness. The aim of this work was to ensure that the controls operating over the principal accounting systems were designed appropriately and operating effectively to prevent or detect a material misstatement of the financial statements.

As indicated in our audit plan overview, and based on our evaluation of internal audit, we have placed reliance on the work of internal audit, where appropriate. From the reports that we have reviewed, a number of recommendations have been made, but these were minor in nature and will not have an impact on our approach to the audit.

As in the prior year, the key theme of our recommendations relates to either the documentation or evidence of performance of controls as opposed to the failure or absence of controls. While a small number of actions continue to arise from previous years, the number and priority rating of audit recommendations in respect of financial controls has reduced from the previous year and since the start of our audit appointment.

A summary of our recommendations are included in appendix one, along with management responses to those recommendations. Management has discussed its planned response to our findings and we are satisfied that these actions will resolve the identified recommendations.

Debtors reconciliations

Monthly reconciliations are performed between the debtors, council tax system and the NDR system to the general ledger to ensure the ledger reflects all income and arrears. This exercise is completed by one member of the reconciliations team and reviewed by another member of the same team.

Our testing of these reconciliations identified four reconciliations that were not prepared in a timely manner and two months reconciliations were not reviewed in a timely manner with one further reconciliation had had not been reviewed. In 2009-10 we identified similar findings and management agreed to remind staff of the required procedures which would be closely monitored.

Timely preparation and review of the reconciliations will reduce the likelihood of errors and allows issues to be identified at an early stage. We recommend that key reconciliations are completed within ten days of the period end and subject to a formal and timely review.

Recommendation one

Payroll new starts forms

New employees are required to have a new start form signed as completed by HR and authorised by a certified member of HR staff before the form is provided to the payroll department. Their details are input into the payroll system and the form is signed to confirm this has occurred.

Our testing identified one case where the new form was not signed as completed by HR and one further case where the new start form was not signed as authorised by a certified officer. There is a risk that staff are added to the payroll with incorrect salary information which may not be identified. Management should ensure all payroll amendment forms are signed as prepared by HR staff and signed as authorised by an appropriate member of HR management.

Recommendation two

Payroll leavers forms

Leavers forms are signed as completed by HR staff and signed as authorised by certified HR officer before the form is provided to payroll to process. Payroll staff will input the leavers information in the payroll system.

We tested a sample of staff who left the Council during the year from computer records. Payroll staff were unable to provide us with the leavers form for two employees selected. In addition, we identified one case where the leavers form has not been signed as completed and one further case where the leavers form had not been signed as authorised by any member of staff. Management should ensure that all payroll amendment forms are signed as completed, authorised and retained to provide a clear audit trail.

Recommendation two

Expenses authorisation

Staff complete expenses claim forms which are signed by the employee and authorised by a certifying officer. Payroll staff receive these claim form and sign to confirm the claim has been processed. To confirm the correct details have been input another member of staff checks the payment details and signs the expenses form to confirm this check has been performed.

Our testing of a sample of expenses paid identified three cases where there was no evidence to show the payment had been checked by a member of payroll staff. There is a risk that incorrect expenses could be paid and not identified. We recommend that management ensure that all expense claims are subject to an independent check prior to being paid.

Recommendation three

Our testing over the design and operation of controls confirms that, with the exception of the weaknesses noted, controls are designed appropriately and operating effectively

IT control environment

Information systems are an integral part of a sound system of internal control and form an essential part of managing the Council's use of technology. There is a balance to be achieved between reducing risk and maximising efficiency. Our audit work included discussion with key staff with respect to the use of information technology used to support the key financial systems, in order to gain an understanding of the key IT controls.

The broad objectives of the review were to perform detailed testing in accordance with our audit methodology. We evaluated the design and implementation of IT general controls relevant to key financial systems. We also tested the operating effectiveness of those controls for the period 1 April 2010 to 31 March 2011.

Our testing identified five open issues and recommendations all of which had been previously reported to management with no new recommendations identified as part of this years audit. It is clear that action has been taken to progress a number of recommendations previously made, with five recommendations now closed. None of the open recommendations are graded as 'significant'.

We have prepared a separate IT management report that provides details of lower risk issues identified, as well as a summary of the closed recommendations.

We report here the key recommendations, both of which are 'grade two' findings, which we believe should be actioned by management as a matter of priority, as they have the greater potential to lead to financial loss, or impact on the accuracy of financial reporting.

Leavers process

We were informed by the ICT team that there is no formal leavers process whereby ICT are provided with a notification from Human Resources over upcoming staff departures. There has been an attempt to mitigate this issue through the use of monthly reviews carried out by the Systems Officer in an attempt to determine which employees have left the Council. Whilst this approach helps to reduce the risk of unauthorised use of user accounts belonging to former employees, we do not consider this to be an appropriate leavers process.

An effective leavers process should commence from the point at which the Council is made aware of the departure through to ICT disabling or revoking their access on the various systems.

Recommendation four

Periodic user reviews

We were informed by ICT that whilst they submit user lists to business system owners on a periodic basis for an appropriateness review, they do not always receive a response back.

We recommend that business system owners agree a periodic process with ICT to ensure that these reviews are carried out in a timely and efficient manner.

Recommendation five

Audit Scotland undertakes a programme of studies on financial management, governance and performance on behalf of the Auditor General.

Audit Scotland national studies

Audit Scotland periodically undertakes national studies on topics relevant to the performance of local government bodies. While the recommendations from some of the studies may have a national application, elements of the recommendations are also capable of implementation at individual organisation level, as appropriate. We are required to report periodically to Audit Scotland on how management has addressed the conclusions and recommendations made in recently published reports.

In our audit plan overview we noted that we will be performing more detailed work on the impact of and response to the reports *Improving public sector purchasing* (published July 2009) and *Sustainable waste management* (published September 2007). We have conducted an evaluation of the Councils' response to the findings of these reports and have prepared two short reports which summarises our findings, which will be issued to management in due course.

Appendix one – action plan

Priority rating for recommendations

Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the Council or systems under consideration. The weakness may therefore give rise to loss or error.

Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.

Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the controls to meet their objectives in any significant way. These are less significant observations than grades one and two, but we still consider they merit attention.

No.	Issue and recommendation	Management response	Officer and due date
1	<p>Debtors reconciliations</p> <p>Monthly reconciliations are performed between the debtors, council tax system and the NDR system to the general ledger to ensure the ledger reflects all income and arrears. This exercise is completed by one member of the reconciliations team and reviewed by another member of the same team.</p> <p>Our testing of these reconciliations identified four reconciliations that were not prepared in a timely manner and two months reconciliations were not reviewed in a timely manner with one further reconciliation had had not been reviewed. In 2009-10 we identified similar findings and management agreed to remind staff of the required procedures which would be closely monitored.</p> <p>Timely preparation and review of the reconciliations will reduce the likelihood of errors and allows issues to be identified at an early stage. We recommend that key reconciliations are completed within ten days of the period end and subject to a formal and timely review.</p> <p><i>(Grade three)</i></p>	<p>Staff have been reminded of the importance of timely reconciliations and will endeavour to complete key reconciliations within 10 days of the period end.</p>	<p>Client & Support Manager, corporate services</p> <p>Actioned</p>

Appendix one – action plan (continued)

No.	Issue and recommendation	Management response	Officer and due date
2	<p>Employee amendment forms</p> <p>New employees are required to have a new start form signed as completed by HR and authorised by a certified member of HR staff before the form is provided to the payroll department. Their details are input into the payroll system and the form is signed to confirm this has occurred. Leavers forms are signed as completed by HR staff and signed as authorised by certified HR officer before the form is provided to payroll to process. Payroll staff will input the leavers information in the payroll system.</p> <p>Our testing identified one case where the new form was not signed as completed by HR and one further case where the new start form was not signed as authorised by a certified officer. There is a risk that staff are added to the payroll with incorrect salary information which may not be identified.</p> <p>We tested a sample of staff who left the Council during the year from computer records. Payroll staff were unable to provide us with the leavers form for two employees selected. In addition, we identified one case where the leavers form has not been signed as completed and one further case where the leavers form had not been signed as authorised by any member of staff.</p> <p>Management should ensure that all employee amendment forms are signed as prepared by HR staff and signed as authorised by an appropriate member of HR management.</p> <p><i>(Grade two)</i></p>	<p>Staff have been reminded of the importance of following prescribed procedures relating to authorizing and checking documentation and of accurate document storage procedures.</p>	<p>Manager of Human Resources Actioned</p>
3	<p>Expenses authorisation</p> <p>Staff complete expenses claim forms which are signed by the employee and authorised by a certifying officer. Payroll staff receive these claim forms and sign to confirm the claim has been processed. To confirm the correct details have been input another member of staff checks the payment details and signs the expenses form to confirm this check has been performed.</p> <p>Our testing of a sample of expenses paid identified three cases where there was no evidence to show the payment had been checked by a member of payroll staff. There is a risk that incorrect expenses could be paid and not identified.</p> <p>We recommend that management ensure that all expense claims are subject to an independent check prior to being paid.</p> <p><i>(Grade three)</i></p>	<p>Staff have been reminded of the importance of following prescribed procedures relating to authorising and checking documentation.</p>	<p>Manager of Human Resources Actioned</p>

Appendix one – action plan (continued)

No.	Issue and recommendation	Management response	Officer and due date
4	<p>Leavers process</p> <p>We were informed by the ICT team that there is no formal leavers process whereby ICT are provided with a notification from Human Resources over upcoming staff departures. There has been an attempt to mitigate this issue through the use of monthly reviews carried out by the Systems Officer in an attempt to determine which employees have left the Council. Whilst this approach helps to reduce the risk of unauthorised use of user accounts belonging to former employees, we do not consider this to be an appropriate leavers process.</p> <p>An effective leavers process should commence from the point at which the Council is made aware of the departure through to ICT disabling or revoking their access on the various systems.</p> <p><i>(Grad two)</i></p>	<p>ICT will liaise with HR to undertake a review of leavers process.</p>	<p>Sam Dove, HR September 2011</p>
5	<p>Periodic user reviews</p> <p>We were informed by ICT that whilst they submit user lists to business system owners on a periodic basis for an appropriateness review, they do not always receive a response back. We recommend that business system owners agree a periodic process with ICT to ensure that these reviews are carried out in a timely and efficient manner.</p> <p><i>(Grade two)</i></p>	<p>ICT will continue to issue monthly user lists to departments and escalate to service departments where required. ICT will continue to review process and procedures and identify improvements.</p>	<p>John Martin Section Head IT Connect. Ongoing process.</p>