# 3.3 Report of the Auditor-General to Parliament on vote no. 21: Department of Correctional Services

## REPORT ON THE FINANCIAL STATEMENTS

### *Introduction*

1. I have audited the financial statements of the Department of Correctional Services set out on pages 114 to 161, which comprise the appropriation statement, the statement of financial position as at 31 March 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, the notes, comprising a summary of significant accounting policies and other explanatory information.

### *Accounting officer's responsibility for the financial statements*

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the Departmental financial reporting framework prescribed by the National Treasury and the requirements of the Public Finance Management Act of South Africa, 1999 (Act No.1 of 1999) (PFMA), and the Correctional Service Act,1998 (Act No.111 of 1998), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor-General's responsibility*

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the General Notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## Basis for qualified opinion

### *Prior year additions and disposals of movable tangible capital assets*

6. Non-cash additions stated at R306.9 million and disposals stated at R290.5 million included in the disclosure notes 30.2 and 30.3 respectively, to the 2010/11 financial statements were materially overstated by internal transfers of movable tangible capital assets between departmental stores. This was as a result of the LOGIS system used by the department being unable to account separately for internal transfers.
7. My audit opinion on the financial statements for the period ended 31 March 2011 was modified accordingly.
8. During the current year the Department made adjustments to these disclosure notes in order to properly account for internal transfers of movable tangible capital assets included in prior year additions and disposals. I could however, not satisfy myself as to the completeness of additions and disposals to major movable tangible capital assets since the adjustments made were materially misstated by an estimated amount of R 47 million. Furthermore, the Department could not provide sufficient and appropriate audit evidence to confirm the completeness, occurrence and accuracy of the adjustments to the approximate value of R10 million.
9. My opinion on the current period's financial statements is therefore modified, because of the possible effect of this matter on the comparability of the current period's figures.

### *Major movable tangible capital assets*

10. I was unable to verify the completeness of some of the major movable tangible capital assets to the approximate value of R13 million, included in disclosure note 30.1 to the financial statements, as I was unable to trace these assets physically on hand to the asset register. Furthermore, I was unable to satisfy myself as to the existence of some of the major movable tangible capital assets to an approximate value of R33 million included in disclosure note 30.1 to the financial statements, as they could not be physically identified.
11. The entity's records did not permit the application of alternate audit procedures regarding the existence and completeness of major movable tangible assets.
12. Furthermore, some of the Department's major movable tangible capital assets included in disclosure note 30.1 to the

financial statements did not reflect the cost or fair values and consequently these assets were materially misstated by an approximate amount of R34 million.

*Minor movable tangible assets*

13. I was unable to verify the completeness of some of the minor movable tangible assets to the approximate value of R6 million, included in disclosure note 30.5 to the financial statements, as I could not trace these assets physically on hand to the asset register. Furthermore, I was unable to satisfy myself as to the existence of some of the minor movable tangible assets to the approximate value of R26 million, as they could not be physically identified.
14. The entity's records did not permit the application of alternate audit procedures regarding the existence and completeness of minor movable tangible assets.
15. Furthermore, some of the Department's minor movable tangible assets included in disclosure note 30.5 to the financial statements did not reflect the cost or fair values and consequently these assets were materially misstated by an approximate amount of R2 million.

*Qualified opinion*

16. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Department of Correctional Services as at 31 March 2012 and its financial performance and cash flows for the year then ended, in accordance with the Departmental Financial Reporting Framework prescribed by the National Treasury and the requirements of the PFMA.

*Emphasis of matters*

17. I draw attention to the matters below. My opinion is not modified in respect of these matters.

*Restatement of corresponding figures*

18. As disclosed in note 23 to the financial statements, the corresponding figures for 31 March 2011 have been restated as a result of an error relating to the non-disclosure of lease payments made by the department on state owned properties, as operating lease commitments.

*Material under spending of the budget*

19. As disclosed in the appropriation statement, the Department has materially underspent its total budget. As at 31 March 2012, the underspending amounted to R893.9 million. This underspending was mainly due to the following:
    - Compensation of Employees: The net under spending is mainly due to savings arising from funded vacant posts. Unauthorised expenditure of R483.8 million incurred in 2008/09 financial year and approved without funding in terms of the Finance Act 2012, Act No. 2 of 2012, was charged against this under spending.
    - Goods & Services: The net under spending is mainly due to savings for the procurement of Remand Detainees' uniforms arising from the implementation of Correctional Matters Amendment Act No. 5 of 2011 which was effective from 1 March 2012 not being finalised before the end of the financial year.
    - Buildings and other fixed structures: The net under spending was mainly due to savings on capital works projects as a result of challenges faced by the Department of Public Works which resulted in slow progress in implementation of planned projects.
    - Machinery and equipment: The net under spending was mainly as a result of savings on the procurement of body scanning equipment which was not finalised before the end of the financial year.

*Additional matters*

20. I draw attention to the matters below. My opinion is not modified in respect of these matters.

*Financial reporting framework*

21. The financial reporting framework prescribed by the National Treasury and applied by the Department is a compliance framework. The wording of my opinion on a compliance framework should reflect that the financial statements have been prepared in accordance with this framework and not that they "present fairly". Section 20(2)(a) of the PAA, however, requires me to express an opinion on the fair presentation of the financial statements. The wording of my opinion therefore reflects this requirement.

*Unaudited supplementary schedules*

22. The supplementary information set out on annexures 1 to 4 on pages 159 to 169 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

## Report on other legal and regulatory requirements

23. In accordance with the PAA and the General Notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

*Predetermined objectives*

24. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages 31 to 77 of the annual report.
25. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information (FMPPI)*
    The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
    The material findings are as follows:

## Usefulness of information

*Reported indicators not consistent with planned indicators*

26. Treasury Regulation 5.2.4 requires that the strategic and annual performance plan should form the basis for the annual report, therefore requiring the consistency of indicators between planning and reporting documents. A total of 22% of the reported indicators were not consistent with the indicators as per the approved strategic and annual performance plan. This is due to the lack of alignment between the Strategic Plan indicators and the Annual Performance Plan indicators.

## Reliability of information

*Reported performance not valid, accurate and complete*

27. The FMPPI requires that processes and systems which produce the indicator should be verifiable. The development programme has performance indicators where those participating offenders had to be calculated against those eligible for these programmes. I was unable to obtain all 60% of the information and explanations, I considered necessary to satisfy myself as to the validity, accuracy and completeness of the actual reported performance relevant to these performance indicators. This was due to limitations placed on the scope of my work due to the absence of information systems or the institution's records not permitting the application of alternative audit procedures.

*Achievement of planned targets*

28. Of the total number of planned targets, only 57 were achieved during the year under review. This represents 47% of the total planned targets that were not achieved during the year under review.
    - This was as a result of the institution not considering relevant systems and evidential requirements during the annual strategic planning process.

*Compliance with laws and regulations*

29. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the General Notice issued in terms of the PAA are as follows:

*Strategic planning*

30. The accounting officer did not, always ensure that the Department had and maintained effective, efficient and transparent systems of financial and risk management and internal control as required by section 38(1)(a) of PFMA. Departmental systems to collate and report performance information are not adequate.

*Annual financial statements, performance and annual report*

31. The financial statements submitted for auditing were not prepared in all respects in accordance with the prescribed financial reporting framework and supported by full and proper records as required by section 40(1)(a) and (b) of the PFMA. Material misstatements on accruals, commitments, contingent liabilities, irregular expenditure, fruitless and wasteful expenditure, employee cost, pre payments, capital assets, goods and services and leases identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatement resulted in the financial statements receiving a qualified audit opinion.

*Receivables*

32. The accounting officer did not always take effective and appropriate steps to collect all money due to the Department on time, as required by section 38(1)(c)(i) of the Public Finance Management Act and Treasury Regulations 11.2.1, 15.10.1.2(a) and 15.10.1.2(e).

*Expenditure management*

33. The accounting officer did not always take effective steps to prevent irregular or fruitless and wasteful expenditure, as required by section 38(1)(c)(ii) of the Public Finance Management Act and Treasury Regulation 9.1.1.
34. The accounting officer did not always ensure effective internal controls were in place for payment approval and processing, as required by Treasury Regulation 8.1.1.
35. Sufficient appropriate audit evidence could not be obtained that all money was spent with the approval of the accounting officer or a properly authorised official, as required by Treasury Regulations 8.2.1 and 8.2.2.
36. Contractual obligations and money owed by the Department were not in all instances settled within 30 days or an agreed period, as required by section 38(1) (f) of the Public Finance Management Act and Treasury Regulation 8.2.3.
37. Payments were sometimes made in advance of the receipt of goods or services in contravention of Treasury Regulation 15.10.1.2.

*Procurement and contracts*

38. Sufficient appropriate audit evidence could not, in some cases, be obtained that contracts relating to food, security and maintenance were awarded in accordance with the legislative requirements as some of the documentation is in the possession of outside institutions pending investigations.
39. Awards were sometimes made to suppliers that are listed on the National Treasury's database as persons prohibited from doing business with the public sector in contravention of Treasury Regulations 16A.9.1(c).
40. Some persons in service of the Department whose close family members, partners or associates had a private or business interest in contracts awarded by the Department failed to disclose such interest, as required by Treasury Regulation 16A.8.4.
41. Some persons in service of the Department who had a private or business interest in contracts awarded by the Department failed to disclose such interest, as required by Treasury Regulation 16A.8.4.
42. Some employees of the Department performed remunerative work outside their employment in the Department without written permission from the relevant authority as required by section 30 of the Public Service Act.
43. Goods and services with a transaction value below R500 000 were sometimes procured without obtaining the required price quotations, as required by Treasury Regulation 16A.6.1.

*Compensation of employees*

44. The accounting officer did not always implement effective measures to ensure that employees do not abuse sick leave, as required by Public Service Regulation 1/V/F(c). Furthermore, sufficient appropriate audit evidence could not be obtained that the accounting officer implemented effective measures to ensure that employees do not abuse sick leave, as required by Public Service Regulation 1/V/F(c).
45. Employees received overtime compensation in excess of 30% of their monthly salaries, in contravention of Public Service Regulation I/V/D.2 (d). Furthermore, sufficient appropriate audit evidence could not be obtained that monthly compensation for overtime was limited to 30% of employees' monthly salary as required by Public Service Regulation 1/V/D.2 (d).
46. An approved performance and career management policy for other employees than senior management was still in draft format during the time of the audit.

*Tangible Capital Assets*

47. The accounting officer did not always implement control systems for the safeguarding and maintenance of assets to prevent theft, losses, wastage and misuse as required by Treasury Regulations 10.1.

*Internal control*

48. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the qualified opinion, findings on annual performance report and the findings on compliance with laws and regulations included in this report.

*Leadership*

49. The Department has formal code of ethics which clearly communicates ethical values to all staff members. Based on the high level of fraud and corruption cases taking place in the Department, however, compliance with this code is still a challenge.
50. The appropriate level of management did not regularly review reporting in terms of best practice and as required by the PFMA especially reports emanating from regions. Inaccurate reports are forwarded to Head Office pertaining to both financial information and to predetermined objectives.
51. The Department had key positions that were vacant for significant periods of time. These key positions were occupied by employees in acting capacity.
52. The Department has implemented policies and procedures to enable and support understanding and execution of internal control objectives, processes, and responsibilities and have been documented and communicated to staff members. Understanding and compliance with these policies and procedures is, however, still a challenge.
53. The Department has designed the action plan to address internal control deficiencies identified by external auditors.

During the time of the audit this plan was, however, not fully implemented.

54. An effective IT governance framework was not in place to support and enable the business, deliver value and improve performance.

*Financial and performance management*

55. The Department did not always implement proper record keeping as it did not always provide information as requested or the information was provided after unreasonable long periods of time.
56. Although, most controls have been implemented by the Department, these controls are not functioning effectively as a result of staff shortages and lack of work experience and knowledge.
57. The Department did not always prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.
58. The Department is aware of the laws and regulations that have to be complied with. The monitoring of compliance with these laws and regulations is, however, not effective.
59. A project to overhaul the Department's network and back-end infrastructure has been prioritised and is currently underway. This is a primary requirement to develop a Disaster Recovery Plan. The current information technology hardware is old and not compatible to the software that has been implemented to run the backups at the Department.

*Governance*

60. Risk assessment is conducted by the Department. However, strategies to address risks identified are not always effective, since there are still high numbers of recurring misstatements, fraud cases and persistent control weaknesses in the financial reporting process.
61. The Department has an internal audit function that assists management in maintaining efficient and effective systems of internal controls by evaluating these controls to determine their effectiveness and efficiency, and by developing recommendations for enhancement or improvement. However, during the period under review, internal audit did not focus sufficiently on the audit of predetermined objectives as it did not form part of its audit plan.

## Other Reports

*Investigations in progress during the time of audit*

62. According to the Departmental Investigation Unit (DIU), there are various investigations that were completed during the year under review. These investigations related mainly to fraud, theft and procurement irregularities.
63. There were various investigations that were still in progress as at the reporting date. These investigations also included fraudulent payments on PERSAL system, procurement irregularities, subsistence and travelling fraud, among others.

Auditor-General

Pretoria
31 August 2012

AUDITOR-GENERAL
SOUTH AFRICA