

**REPORT OF THE AUDITOR-GENERAL TO PARLIAMENT ON THE  
FINANCIAL STATEMENTS OF VOTE 20 – CORRECTIONAL SERVICES  
FOR THE YEAR ENDED 31 MARCH 2006**

**1. AUDIT ASSIGNMENT**

The financial statements as set out on pages ..... to ....., for the year ended 31 March 2006, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996, read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004). The fixed asset opening balances have not been audited because of the timing of guidance from National Treasury to the departments relating to the treatment, valuation and disclosure of fixed assets. These financial statements are the responsibility of the accounting officer. My responsibility is to express an opinion on these financial statements, based on the audit.

**2. SCOPE**

The audit was conducted in accordance with the International Standards on Auditing read with *General Notice 544 of 2006*, issued in *Government Gazette* no. 28723 of 10 April 2006 and *General Notice 808 of 2006*, issued in *Government Gazette* no. 28954 of 23 June 2006. Those standards require that I plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

An audit includes:

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements
- assessing the accounting principles used and significant estimates made by management
- evaluating the overall financial statement presentation.

I believe that the audit provides a reasonable basis for my opinion.

**3. BASIS OF ACCOUNTING**

The department's policy is to prepare financial statements on the modified cash basis of accounting determined by the National Treasury, as described in accounting policy 1.1 to the financial statements.

#### 4. QUALIFICATION

##### 4.1 Public-private partnership (AOPS) R195 million (2004-05 - R195 million)

The department discloses AOPS as an operating lease in note 23 instead of a finance lease as per Treasury Regulation 13.2 and the National Treasury guideline on accounting for leases. In terms of the stipulations of the AOPS contract, it is evident that it meets the criteria requirements for a finance lease and must be disclosed as such. The department is of the opinion that it qualifies as an operating lease due to the fact that ownership passes to the Department of Public Works. As there is disagreement on this matter, I recommended that the department obtains a ruling from the National Treasury on the correct accounting treatment relative to the AOPS agreement and the applicable Treasury Regulations.

#### **BACKGROUND TO QUALIFICATION**

*In terms of Treasury Regulations, disclosure requirements and International Financial Reporting Standards (AC437) a lease can be classified as a finance lease or an operating lease.*

*In terms of these classifications certain criteria must be met to classify the lease either as a finance lease or an operating lease.*

*This specific lease meets the requirements of a finance lease. Various technical opinions were obtained in this regard, which all agreed that the classification should be a finance lease.*

*Treasury however was not prepared to express an opinion and referred us to the accounting standards.*

*We also consulted the treasury website, specifically on the accounting for PPP's, and the website indicated Practice Note 9 of 2004. When enquiring on this practice note 9 the following was noted, "Module 8 and module 9 are not yet available." Practice Note 9 is contained in Module 8.*

*At various audit steering committee meetings as well as the final audit committee meeting, this matter was debated at length and the department was given the opportunity to change the financial statements, but the department was in disagreement with this classification and therefore this resulted in a qualification.*

*The department is in the process of facilitating a meeting between the department, AG and accountant general to resolve this matter.*

#### 4.2 Receivables R36 million (2004-05 – R30 million)

##### *Staff debt*

With reference to paragraph 3.3 on page 82 of my previous report [RP178/2005], it was reported that there was insufficient follow-up in terms of staff debt.

The following shortcomings relating to the follow-up of debt were again identified during the year under review:

- Monthly statements were not issued to staff debtors.
- Debtors were not raised at year-end on the Basic Accounting System (BAS).
- Reconciliations were not performed between Persal and the BAS in respect of officials' salaries for debts owing.
- Debtors with credit balances were not followed up on a regular basis.
- Debt files could not in all instances be provided for audit purposes.
- Debt was not recovered when service was terminated.
- Debt was not recovered from current staff debtors.

The above was due to the lack of a control framework to monitor activities. Staff debtors are thus not fairly stated and the valuation thereof in terms of recoverability is a concern.

##### **BACKGROUND TO QUALIFICATION**

*This matter was also qualified in the previous financial year, 2004/05.*

*When the department converted to BAS during the previous financial year, all debt was taken on under head office, not reflecting the staff debt per region/area commissioner.*

*Furthermore, when capturing debt on BAS, the location field is not a compulsory field and when not completed the debt defaults to head office. This makes it impossible to draw accurate reports on regional / area commissioner level.*

*Monthly statements are not submitted to the staff debtors and the debtors are not followed up on a regular basis.*

*This matter can to some extent be resolved by the department by accurately completing the location field on BAS.*

*The area commissioners should also follow-up on staff debt on a regular basis and keep proper documentation.*

*Various debt had to be written off in the current year (2005/06) due to the fact that no / inadequate follow-up was done by the department.*

### 4.3 Asset management

With reference to paragraph 5.2 on page 83 of my previous report [RP178/2005], insufficient capturing of assets was reported, which resulted in the fixed asset register not being adequately maintained and updated.

The following deficiencies with regard to the current year transactions/movements were noted during the year under review:

- Three (3) different computer programs were used for the management of inventory and fixed assets, namely the Provisioning Administration System 2.6 (PAS), Web Asset Tool (WAT) and the BAS. No reconciliation was performed between the three systems.
- At year-end a large number of assets purchased and captured on the BAS had not been captured on the WAT.
- No fixed asset register was maintained for intangible assets.
- Not all assets had been bar-coded and recorded in the fixed asset register.

Due to the above deficiencies, I was unable to verify the accuracy and completeness of the asset register. Management did, however, undertake to introduce manual reconciliation procedures to overcome the interface problems for the following year.

Paragraph 2 of the accounting officer's report provides further clarification of the non-compliance and the role of the National Treasury regarding the systems.

#### **BACKGROUND TO QUALIFICATION**

*The department is apparently the only department using the web asset tool to maintain an asset register.*

*The department currently uses three systems to record and disclose fixed assets.*

*The PAS system is used to register the need by means of a PAS 2 form. When the assets are received the receipt is also captured on the PAS system. Currently not all needs and receipts are captured on the PAS system. Once received and paid on BAS, the assets must be captured on WAT.*

*In other words, the payments on BAS should equate the assets captured on the WAT system. This is currently not the case and no reconciliations are being performed to explain these differences.*

*Monthly reports which are currently being generated from PAS (report number 129) should be reconciled to WAT which should equate BAS. This applies to all additions. The section heads / supervisors of Logistics should perform these reconciliations on a monthly basis. These reconciliations were not performed.*

*These 3 systems do not interface, which necessitates reconciliations.*

*We appreciate the fact that these reconciliations may be difficult to perform, however the department could make an attempt to reconcile at the lowest level.*

*We also take cognisance of the fact that Treasury forces the departments to use certain systems, but in order to comply with disclosure requirements the department will have to perform these reconciliations.*

#### **4.4 Medical expenditure R469 million (2004-05 – R624 million)**

With reference to paragraph 3.1 on page 81 of my previous report [RP178/2005], various shortcomings existed with regard to the management of medical expenditure. The following control deficiencies were identified during the audit of the current year:

- In respect of the continuation members, life certificates were not completed on an annual basis to confirm the existence of the continuation members and their dependants. Thus I could not verify the validity and accuracy of the expense of approximately R143 million.
- The employee/employer contributions were calculated incorrectly in some instances. In certain instances the employer contribution was more than required and vice versa.
- The identity numbers of the members and dependants could not be presented to confirm their existence.
- No procedure manual in respect of the management of the medical aid could be presented for audit.
- Validity/completeness checks could not be done for certain of the medical aids as the information was not readily available.
- In terms of all payments for all medical aids, no certification/validity checks were done by the department.

The above was mainly due to the lack of a proper management framework, monitoring and reconciliation for the verification of medical aid expenditure prior to payment thereof.

## **BACKGROUND TO QUALIFICATION**

*This matter was also reported on in the previous financial year, 2004/05, under emphasis of matter.*

*On various audit steering committee meetings these issues were elaborated on requesting the department to obtain membership records for both current and continuation members. We also requested life certificates for continuation members, which could not be supplied.*

*We furthermore recommended that internal audit be involved in this process, which could not be implemented, due to a lack of staff.*

*As most of the DCS employees belong to Medcor, the AG as a last resort, attempted to obtain documentation from the administrator, MX Health without any positive results.*

*Although there is no contract/agreement between the department and the medical aids, the department, paying the two thirds contribution, should ensure that the two thirds paid are valid and accurate.*

*In terms of the continuation members, the department is still in the process of compiling a proper database, in consultation with MX Health. These invoices for the continuation members are being paid on face value, thus we could not verify the validity and accuracy thereof.*

### **4.5 Housing loan guarantees R73,6 million (2004-05 – R79,6 million)**

The validity and accuracy of housing loan guarantees amounting to R73,6 million could not be confirmed due to the following:

- Guarantees still appeared on Persal even though the housing loan accounts at the financial institutions had been closed.
- Included in the total of 4164 guarantees outstanding as at 31 March 2006, are 1002 guarantees approved prior to 1995. Given the period of redemption and the increase in the value of the property the guarantees should have been redeemed, however still appeared on Persal which indicated that the records were not updated.
- Guarantees existed for employees who did not hold the title deeds to the properties for which guarantees had been issued.

As a result the contingent liabilities are overstated by an unknown amount. This is mainly due to a lack of management framework monitoring controls and reconciliations.

## **BACKGROUND TO QUALIFICATION**

*Insufficient follow up with financial institutions and monitoring of the housing loan guarantees to ensure that the database for the contingent liability is accurate.*

### **5. QUALIFIED AUDIT OPINION**

In my opinion, except for the effect on the financial statements of the matters referred to in the preceding paragraphs, the financial statements present fairly, in all material respects, the financial position of the Department of Correctional Services at 31 March 2006 and the results of its operations and its cash flows for the year then ended, in accordance with the modified cash basis of accounting determined by the National Treasury of South Africa, as described in accounting policy 1.1 to the financial statements and in a manner required by the Public Finance Management Act.

### **6. EMPHASIS OF MATTER**

Without further qualifying the audit opinion, attention is drawn to the following matters:

#### **6.1 Internal control**

Paragraph 5.2 on page 83 of my previous report [RP178/2005] referred to various shortcomings in the internal control, some of which had been reported for the past five years. Although the accounting officer had a documented system of internal control in place, the following shortcomings identified during the current year can be attributed to a lack of independent reviews by management, shortage of staff and inadequate training:

##### **6.1.1 Leave**

There was a lack of independent reviews by management in respect of the administration of leave and the following were found:

- Differences between the attendance register, leave register, leave form and Persal.
- Examination results not submitted for study leave taken.
- Unpaid leave not deducted from employees' salaries.

##### **6.1.2 Salaries**

Payrolls were not certified on the date of payment by the person in charge of the pay-points.

#### **6.1.3 Performance agreements**

Certain performance agreements of senior management did not exist or were only signed after the required three (3) months of the appointment.

#### **6.1.4 Suspensions**

- The completeness of suspensions could not be established as suspension registers were not maintained.
- Standard danger allowances were paid whilst employees were suspended.

#### **6.1.5 Homeowner's allowance**

- Annual declarations confirming the occupation of dwellings had not been completed to ensure further payment of the allowance.
- Proof of registered bonds was not on the personnel/housing files.

#### **6.1.6 BAS/Persal interface**

Monthly reconciliations between the BAS and Persal were not done, which contributed to the salary interface control account reflecting a balance of R800 137 at year-end. However, subsequent to year-end the department has put a process in place to ensure proper and complete reconciliations.

#### **6.1.7 Losses**

Losses were not always properly recorded and followed up. The loss register was not updated and reviewed in good time.

#### **6.1.8 Payments**

Invoices were not always duly certified and/or paid within the prescribed 30 days. Supporting documentation was not made available.

#### **6.1.9 Journals**

Supporting documentation was not always attached to journals when processing took place and therefore the validity of some journals could not be verified.

#### **6.1.10 Budgets**

- Minutes were not kept of monthly finance meetings.
- Input documents, motivations and calculations regarding estimates submitted by cost centre managers were not available for audit purposes.



The above mainly reflects the lack of a proper management framework and monitoring.

#### **BACKGROUND TO EMPHASIS OF MATTER**

*Most of these internal control issues have been reported on for the last five years.*

*Although there was a moderate improvement, the compliance improvement plan did not produce the required results as there was and still is a lack of proper high level management reviews to ensure compliance.*

*Regional / area commissioners do submit returns certifying compliance with the compliance improvement plan, however these returns are not being verified for accuracy.*

#### **6.2 Employee benefit provisions R700,7 million (2004-05 – R667,4 million)**

The leave entitlement and the capped leave commitments amounting to R700,7 million were misstated by an unknown amount due to incorrect leave credits on Persal. These differences can mainly be attributed to internal control shortcomings as mentioned in paragraph 6.1 above and are a result of a lack of monitoring controls.

#### **BACKGROUND TO EMPHASIS OF MATTER**

*This relates directly to a lack of control over leave, referred to under internal control.*

*The department does not fully understand the financial implications linked to the provision on leave entitlement. This matter should be addressed as a matter of urgency as this could lead to future qualifications.*

*The differences between Persal and the manual leave records should get urgent attention and should be reconciled.*

#### **6.3 Vacancies**

Out of an approved and funded establishment of 38,979, only 36,270 posts were filled as at 4 April 2006, which represents a seven (7) per cent vacancy.

Filling the vacancies in the professional field is a challenge as the department has to compete with foreign countries regarding the recruitment of professionals. Note is, however, taken of the steps the department has taken to address the issue.

## **BACKGROUND TO EMPHASIS OF MATTER**

*The critical vacancies in especially the Finance, HR and logistic sections should be addressed as a matter of urgency. This can have a direct impact on the matters reported on under internal control.*

### **6.4 Pharmacies**

With reference to paragraph 5.2 page 83 of my previous report [RP178/2005], insufficient stock control as a result of an ongoing computer system error resulted in differences between stock on hand and stock per the computer system. In addition stock counts were not performed at regular intervals.

This was mainly due to the lack of a proper management/control framework, monitoring and reconciliations

## **BACKGROUND TO EMPHASIS OF MATTER**

*The pharmacy system is inadequate to facilitate proper management of pharmacies and stock control and should be upgraded / replaced as a matter of urgency.*

### **6.5 Vehicle fleet management**

The following deficiencies were noted during the audit:

- Trip sheets and fuel slips were not filed/ maintained.
- Logbooks and trip sheets did not correspond.
- Fleet management report discrepancies were not followed up.
- No reconciliations were performed between logbooks, fuel purchases and fleet management reports.
- Lack of control in the administration of accident and tyre registers. These registers were not reviewed on a regular basis and were incomplete.

This was due to the lack of a proper management/control framework, monitoring and reconciliation.

Similar deficiencies were reported in paragraph 5.2 of my previous report.

## **BACKGROUND TO EMPHASIS OF MATTER**

*This matter has been reported on for the past 5 years.*

*This is mainly due to the fact that transport controllers are not being appointed or are not familiar with their duties.*

### **6.6 Accruals R31,2 million (2004-05 – R42,6 million)**

During the audit of accruals amounting to R31,2 million, cut-off testing revealed that not all unpaid invoices received prior to year-end had been included in disclosure note 28 to the financial statements. This resulted in the accruals being understated by an unknown amount. This was due to the lack of a proper management/control framework and monitoring

## **BACKGROUND TO EMPHASIS OF MATTER**

*The BAS system does not provide for accrual accounting and thus a lot of manual actions must be performed and due to the large volume of transactions country wide this can be difficult. The Finance section at head office is relying on the inputs from the regions.*

### **6.7 Supply chain management**

Following allegations of mismanagement in the supply chain management process, the regularity audit process was extended to specific contracts. Certain aspects of the audit have not yet been finalised and I am also liaising with the Public Service Commission which has conducted a review relating to the same matter. If necessary I shall report on the matter in my next report.

## **BACKGROUND TO EMPHASIS OF MATTER**

*No further comments.*

### **6.8 Subsistence and travelling**

The following shortcomings with regard to the control and administration of subsistence and travelling (S&T) were identified:

- S&T claims were not always submitted within seven days of returning from a trip.
- S&T claims were not always processed within three days after receipt by the department.

- Certain claims could not be submitted for auditing purposes and others were not fully completed.
- Incorrect amounts were paid or claimed.
- Some claims were not authorised or authorised by the incorrect delegation level.

This was due to the lack of a proper management control framework monitoring and reconciliation.

#### **BACKGROUND TO EMPHASIS OF MATTER**

*This matter has been reported on for the past number of years. This is mainly due to the fact that there is insufficient management involvement. DCS staff do not always comply with the existing S&T guidelines from DPSA, and there is also no comprehensive policy in this regard.*

### **6.9 Policies**

During the audit of the department it was noted that various financial policies were still in the process of being reviewed in order to align the policies with the requirements of the BAS and the White Paper on Corrections. In certain instances the required policies had not yet been compiled. This was mainly due to inadequate processes and poor project management.

#### **BACKGROUND TO EMPHASIS OF MATTER**

*No further comments.*

### **6.10 Accommodation**

Correctional centres remained overcrowded and resulted in the detention of offenders in inhumane conditions. This situation resulted in non-compliance with the Correctional Services Act, 1998 (Act No. 111 of 1998), chapter 3, paragraph 7(1).

This is not a simple matter, but one which is influenced by the criminal justice system as a whole and administered by the whole environment of the Justice, Crime, Prevention and Security (JCPS) Cluster.

Reference is also made to this matter in paragraph 1.1 of the accounting officer's report – Overcrowding.

**6.11 Progress with the resolutions of the Standing Committee on Public Accounts (SCOPA) and previously reported matters**

I concur with the progress reported by the department on SCOPA resolutions and recorded in the accounting officer's report.

**6.12 Jali Commission**

With reference to paragraph 59 of the previous report [RP178/2005], the Jali Commission had completed its investigations and the report was handed over to the President on 14 December 2005 and to the Minister of Correctional Services on 13 March 2006. The department is currently in the process of analysing the recommendations in terms of controls and governance. The department has further indicated that many of the problems mentioned in the report have been addressed by the White Paper on Corrections and the transformation process. The progress in this regard will be evaluated over a period and reported on if necessary.

**6.13 Information systems audit (ISA)**

A follow-up information systems (IS) audit of the general controls surrounding the information systems environment of the Department of Correctional Services (DCS) was completed in December 2005 and the findings were reported to the accounting officer.

It was established that some progress had been made in addressing the shortcomings identified during the previous audit, but certain control weaknesses were still present in the general control environment as a whole. These control weaknesses, which related to security administration, segregation of duties and physical security, could potentially compromise the integrity of data.

The shortcomings identified could be attributed to inadequately documented user management procedures and insufficient resource provision to ensure effective monitoring of the information systems environment.

In its management comments the department indicated that corrective actions and initiatives were in progress and would be implemented subsequent to the completion of the audit to address the reported control weaknesses. The effectiveness of these management actions will be verified in the next IS audit.

#### **6.14 Medical expenditure: Forensic investigation**

The forensic investigation performed by the National Prosecuting Authority (NPA) with regard to the submission of excessive claims by members and service providers, and referred to in paragraph 5.7.1 of my previous report, is still ongoing. The intended second phase, relating to the medical boarding of staff of the department, will start as soon as all the preliminary work has been completed. The department has indicated that it would handle the second phase of the investigation.

#### **6.15 Performance audit**

During the year under review a performance audit was conducted of the management and provision of official accommodation to staff at the department. The management report was submitted to management for comment. A separate report will be tabled in this regard.

### **7. APPRECIATION**

The assistance rendered by the staff of the Department of Correctional Services during the audit is appreciated.

**Auditor-General**

**Pretoria**

**31 July 2006**



**A U D I T O R - G E N E R A L**