



SIGMA

Support for Improvement in Governance and Management

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TURKEY

PUBLIC INTERNAL FINANCIAL CONTROL (PIFC)

ASSESSMENT MAY 2008

1. Introduction

This report provides the first standard assessment on Turkey against the baselines that have been applied by Sigma for the assessment of Public Internal Financial Control (PIFC) systems in EU candidate countries.

This report focuses on the internal control, internal audit and accountability areas set out in Part Five of the Public Financial Management and Control Law No. 5018 (PFMC Law), while recognising that these areas constitute an integral part of the wider development of public financial management in Turkey. In this regard, separate Sigma assessment reports cover Public Expenditure Management and External Audit in Turkey.

While the Ministry of Finance is specified by law to be responsible for defining, developing, and harmonising financial management and internal control, a number of other administrations are closely involved in this area due to their role in the budget process (the Undersecretariat of State Planning Organisation and the Undersecretariat of Treasury). Co-ordination of EU matters is carried out by the Secretariat General for EU Affairs. Furthermore, the Ministry of Interior, due to its role in municipalities, is represented on the Internal Audit Co-ordination Board affiliated to the Ministry of Finance. It will be important to ensure that such a diversity of interests does not impact on the prime responsibility of the Ministry of Finance in the area of financial management and internal control. However, successful implementation of PIFC can only be reached once all public budget-spenders apply the new rules in an effective and efficient way.

Turkey produced its first Policy Paper on PIFC in 2002, and it is widely recognised that an updated version is now required; a new draft PIFC Policy Paper is currently under review, with the aim of having it adopted by the Council of Ministers in June 2008. The draft had not been seen by Sigma at the time of preparing this assessment.

2. Baseline Questions

2.1 *Is a coherent and comprehensive statutory base in place, defining systems, principles and functioning of financial control?*

The main legislation covering PIFC is the Public Financial Management and Control Law No. 5018 (PFMC Law)¹. It is supplemented by a range of secondary and tertiary legislation and other documentation. The PFMC Law regulates the broad structure and functioning of public financial management, covering accountability, fiscal transparency, strategic planning, performance-based budgeting, accrual accounting, internal control, and internal and external audit. The Law on Municipalities No. 5393² and the Metropolitan

¹ Public Financial Management and Control Law No. 5018, enacted in December 2003 and amended by Law No. 5436 in December 2005 (hereafter referred to as the PFMC Law).

² Law No. 5393 of 03 July 2005, amended by laws no. 5538, 5568, 5594, 5675 and 5747.

Municipality Law No. 5216 replicate the provisions on financial management and control set out in the PFMC Law.

The PFMC Law covers 176 central government administrations, two social security institutions, and around 2000 local administrations. However, regulatory and supervisory agencies³ are excluded from the requirements of accountability reporting (article 41) and from the whole of Part Five covering internal control, and similar exclusions apply to revolving funds – see below.

Internal Control

The main requirements for internal control are set out in Part Five of the PFMC Law. These requirements are supplemented by the Procedures and Principles on Internal Control and ex ante Financial Control (No. 26040 of 31 December 2005), and a general communiqué on public internal control standards (No. 26738 of 26 December 2007). In addition, there is a By-law on the Preparation of Accountability Reports in Public Administrations (No. 26111 of 17 March 2006), a By-law on the Working Procedures and Principles of Strategic Development Units (No. 26084 of 18 February 2006) and a By-law on Financial Services Expert Profession (No. 25664 of 25 August 2007).

It is noted that the concept of internal control set out in the PFMC Law is based on the COSO/INTOSAI framework model⁴, which includes internal audit within the scope of internal control. While this is an acceptable approach, it should be recognised that the European Commission defines public internal financial control differently and bases its concept on three pillars: financial management and control (FMC), internal audit, and the introduction of Central Harmonisation Units (CHUs) covering FMC and internal audit. While FMC is included as part of internal control (internal audit excluded), the difference in terminology needs to be understood to avoid potential confusion.

Key areas covered in these laws are as follows:

Accountability – Articles 8, 10 and 11 of the PFMC Law specify that officials who are assigned duties are accountable and responsible for the effective, economic and efficient use of resources. Ministers are accountable to the Prime Minister and to the Turkish Grand National Assembly (TGNA), and heads of administrations are accountable to ministers and, in the case of municipalities, to their local councils, for the implementation, monitoring and supervision of internal control systems. Similarly, heads of spending-units (authorising officers) are accountable to the heads of the administration. Moreover, the law specifies that all officials involved in transaction processes are obliged to follow the internal control requirements.

Internal Control: objectives and coverage – The objectives and coverage of internal control are set out in Part Five of the PFMC Law, in the Procedures and Principles on Internal Control and ex ante Financial Control, and in the general communiqué on public internal control standards. These laws cover both financial and other controls, relate to all officials involved in the transaction process, and are based on the five components of the COSO/INTOSAI standards (control environment, risk management, control activities, information and communication, and monitoring). The laws set out the objectives of internal control⁵, the roles of key operators [ministers, heads of administrations (undersecretaries/mayors), authorising officers (heads of spending-units), accounting officers, realisation officers, Strategic Development Unit (SDU), and spending-unit staff], and the necessary qualifications for certain positions. Administrations have until the end of 2008 to compile action plans and related regulations setting out the activities needed to comply with the public internal control standards. While the general harmonisation role of the Ministry of Finance is set out in the law, the precise duties and authorities of the CHU/FMC is not, unlike those for the CHU/IA. This omission needs to be rectified.

Ex ante controls – Part Five of the PFMC Law and the Procedures and Principles on Internal Control and ex ante Financial Control contain details of the ex ante financial control arrangements and those responsible for

³ Radio and Television High Council; Telecommunications Agency; Capital Markets Board; Banking Regulation and Supervision Agency; Energy Market Regulation Board; Public Procurement Agency; Presidency of Competition Agency; and Tobacco, Tobacco Products and Alcoholic Beverages Market Regulation Agency.

⁴ COSO (Committee of Sponsoring Organisations of the Treadway Committee), INTOSAI Guidelines for Internal Control Standards for the Public Sector.

⁵ The objectives of internal control are set out as follows: a) To manage the public revenues, expenditures, assets and liabilities in an effective, economic and efficient way; b) To ensure that public administrations operate in accordance with the laws and other legislation; c) To prevent irregularities and fraud in all kinds of financial decisions and transactions; d) To ensure regular, timely and reliable reporting and acquisition of information for taking decisions and monitoring; e) To prevent the misuse and waste of assets and protect against losses.

specific activities. Broadly, these activities fall into two stages – those undertaken within spending-units and those within each administration’s SDU. These activities are based on long-standing requirements and appear to be well understood and to have appropriate systems in place.

Reporting – Article 41 of the PFMC Law requires annual administration “accountability reports” to be prepared by each head of administration (based on reports provided by each authorising officer in the administration). The “accountability reports” should include general information of the administration, information on activities, and performance information as per the strategic plans and the performance programme, resources used, and reasons for any deviation from appropriations compared to the realisation of the approved budget. Details on the content of these reports are set out in the By-law on the Preparation of Accountability Reports in Public Administrations issued by the Ministry of Finance (No. 26111 of 17 March 2006.) These reports are published by the heads of administrations and copies are sent to the Turkish Court of Accounts (TCA) and to the Ministry of Finance, which issues a general “accountability report” that is also published and sent to the TCA. (Similar arrangements apply for local government, except the copies are submitted via the Ministry of Interior).

Under the Law on the Preparation of Accountability Reports, the Turkish Court of Accounts (TCA) is required to submit this report along with its own opinion to the TGNA, although we understand that this has not yet happened, pending approval of a revised law on the TCA. The TGNA does not yet have legal powers to assess such documents, although a draft by-law has been prepared to address this omission. (For further information regarding the mismatch between the executive’s implementation of the PFMC Law and its requirements for external audit – compared to the actual external audit carried out by the TCA of the executive – see Sigma’s 2008 assessment of External Audit in Turkey.) Both of these issues need to be rectified at an early date.

The By-law on the Preparation of Accountability Reports set out the coverage, procedures and timing for reporting; it required the first reports to be published in 2007, relating to the 2006 fiscal year. The main purpose of the reports is to ensure fiscal transparency and accountability, and the standard content reflects this by including sections on the administration’s mission, authorities and responsibilities, structure (management and control system), information on budget implementation and performance results, together with an evaluation of overall strengths and weaknesses and recommendations with regard to risks. This evaluation is extensive and is supported by *internal control assurance declarations* signed by each authorising officer, the head of the SDU and the head of administration. The declarations are intended to ascertain that resources were used in accordance with sound financial management and that the internal control system in place provided sufficient assurance of legality and regularity. In our opinion the completion of these assurance declarations should have awaited the full implementation of the internal control plans being developed by the SDUs. Sigma was informed that the lack of complete data to support these declarations was recognised during this transition period for PIFC development. Two issues arise: firstly, it would be appropriate, even at this stage where two accountability reports have been issued, to consider phasing in the content of these assurance declarations, with the full assurance to be provided in several years’ time, once the full PIFC controls are in place. Secondly, it would be beneficial if the CHU/IC were to provide more guidance on the internal management controls that are appropriate to enable such declarations to be issued with confidence.

Accounting

Article 49 of the PFMC Law requires the establishment of a financial management information system. Accordingly, the Ministry of Finance has developed the Say2000i system to put the central government accounting system into implementation. This accounting system uses both accrual basis and cash basis forms of accounting – financial transactions are recorded on an accruals basis whereas budgetary transactions are recorded on a cash basis. In order to determine the accounting and reporting standards to be implemented by general government agencies, the Government Accounting Standards Board has been established consisting of nine members⁶. Within the framework of standards-setting, Standards 1 and 2 have been prepared and published. It is planned to issue the next four standards by the end of 2008 and the remainder by the end of 2012. The General Government Accounting Regulation and the Central Government Accounting Regulation regarding the establishment of an accounting system have been issued and put into practice; general

⁶ The Government Accounting Standards Board members are: three from the Ministry of Finance, one each from the Court of Accounts, Ministry of Interior, Council of Higher Education, State Planning Organisation, and Undersecretariat of Treasury, plus one from the social security institution.

communiqués covering the chart of accounts and depreciation practices have also been issued. Secondary legislation relating to the identification of fixed assets and their revaluation is being implemented.

Internal Audit

The fundamental requirements and tasks of internal audit, as well as the qualifications and appointment of internal auditors, are set out in articles 63-65 of the PFMC Law and in the By-law on the Working Procedures and Principles of Internal Auditors (No. 10025 of October 2005) and the By-law on Selection, Training and Certification of Internal Audit Candidates (No. 25960 of October 2005). In addition, a number of other secondary and tertiary laws are in place, setting out detailed procedures for appointments and training and arrangements for awarding certification. Currently, where internal audit units are in place in public administrations, they are developing their own documentation in compliance with audit and reporting standards, codes of ethics, audit charter, audit manual and working procedures and principles⁷ published by the Internal Audit Co-ordination Board (IACB), which is assisted by the CHU for internal audit as a secretariat. Still to be finalised are the quality assurance manual and the IT auditing guide.

Internal Audit Co-ordination Board (IACB)

The legislative framework for the IACB⁸ is set out in articles 66 and 67 of the PFMC Law and in the By-law on the Working Procedures and Principles of the Internal Audit Co-ordination Board (No. 25960 of October 2005). As for the CHU/IA, the IACB is required to regulate and co-ordinate internal audit matters by providing guidance materials, developing training, and monitoring progress through the evaluation of internal audit reports provided by the administrations.

EU Requirements

While the above legislation has been prepared to reflect good international practice, specific arrangements to meet EU requirements for pre-accession funds have been put in place. In 2002 the following steps were taken related to pre-accession funds under the Pre-Accession Instrument for Turkey: establishment of the Central Finance and Contracts Unit (CFCU) and the National Fund (NF) and designation of specific roles and operating procedures covering procurement, payments, reporting, accounting and audit. With the introduction of the new Instrument for Pre-accession Assistance (IPA),⁹ the Turkish administration has needed to adapt existing arrangements and formalise new requirements by designating specific roles/responsibilities and introducing new structures. This work has not yet been completed, and the Framework Agreement for IPA has not yet been signed.

Although the key points on PIFC have been covered in the various laws and documents, gaps remain in terms of setting out detailed internal control requirements, which are being developed through tertiary regulations. There is a need for manuals and methodologies on risk management¹⁰, quality assurance, and internal control evaluation reports.

This need is recognised by the Turkish administration, and for this purpose a new two-year twinning is being prepared. It is also foreseen to issue revised internal control guidelines by the end of 2008. Similar gaps still exist in various administrations with regard to internal audit procedures, which is partly due to delays of the CHU/IA in finalising key documents, e.g. the quality assurance manual and IT auditing guide. In addition, a great deal remains to be done in terms of developing the practical aspects of carrying out internal controls by management and internal audit – see the relevant sections below. No operational audits have been carried out yet.

⁷ These generic documents concern the following: internal audit guide for top managers, audit standards, code of ethics, audit charter, reporting standards, common working procedures, audit plan programme guide, risk assessment, and internal audit strategy.

⁸ The IACB has seven members: one is proposed by the Prime Minister, one by the minister in charge of the Undersecretariat of Treasury, one by the minister in charge of the Undersecretariat of State Planning Organization, one by the Minister of Interior and three, including the chairman, by the Minister of Finance. The IACB members are appointed for a period of five years, in accordance with a decree of the Council of Ministers.

⁹ Council Regulation (EC) No. 1085/2006 dated 17 July 2006; for the implementation of this regulation, a Commission Regulation (EC) No. 718/2007 was published on 12 June 2007.

¹⁰ In developing risk management, the Turkish authorities should take into account pilot exercises currently being undertaken in the Treasury, with the assistance of Sigma.

The current primary and secondary legislation provides the basic requirements for the implementation of public internal financial control. This legislation is supplemented by a range of tertiary laws and supporting documentation, which are partly in place, although gaps remain in a number of key areas.

2.2 *Are relevant management control systems and procedures in place?*

The current primary, secondary and tertiary legislation (mentioned above) provides a basic framework for management control and procedures covering internal control. However, the actual implementation of ongoing and ex post controls and ex ante controls related to non-financial activities is less developed, with many key areas not expected to be completed before the end of 2008 at the earliest, and then training and practical experience will have to follow. While in itself this is fully acceptable, Sigma considers that the revised PIFC Policy Paper should set a realistic timetable. During Sigma's assessment mission, periods of between 5 and 10 years were mentioned, and Sigma would suggest a time scale of 5 to 8 years, which would be a realistic minimum, especially with regard to the development of internal audit.

In setting out the revised timetable it is suggested that consideration be given to making more use of phasing in the introduction of the various internal control components, and in some areas, such as risk management, to have clear stages for its development spread over several years. This development also needs to take account of cost-effectiveness, with consideration being given to less complex (but not less effective) controls in smaller administrations.

It is apparent that the legal framework governing PIFC that has been introduced over the last few years contain a range of deadlines that are not mutually consistent. For example, action plans prepared by SDUs for internal control are not due to be in place until the end of 2008, while internal control assurance statements are already required to support the annual accountability reports and include, inter alia, affirmation that "internal control systems provide sufficient assurance...". Moreover, gaps have been identified in the development of internal control, including risk management, and will be the focus of a new twinning over the next couple of years. Thus whilst the present control mechanisms provide a minimum basis for the current assurance declarations, they are clearly not comprehensive and Sigma therefore suggests that there should be a phasing-in of the content and coverage of these annual declarations – see below section 2.1, sub-paragraph on reporting. It will be important to ensure a coherent development plan as part of the revised PIFC Policy Paper.

Central Harmonisation Unit (CHU)

Article 55 of the PFMC Law states that financial management and internal control are to be harmonised by the Ministry of Finance, and article 9 of the By-law on Procedures on Internal Control and ex ante Financial Control sets out the harmonisation duties in more detail.¹¹ Financial management and internal control harmonisation is the responsibility of the General Director of Budget and Fiscal Control within the Ministry of Finance. Three of the four departments – covering internal control harmonisation, financial management harmonisation, and PIFC training and guidance – are described below. The fourth CHU department, the secretariat for the Internal Audit Co-ordination Board, is described in section 2.3.

The ***Department for Internal Control*** consists of 10 staff (eight budget experts, one data expert plus the head of department). It is this department that has prime responsibility for developing the legislation and guidance on financial management and control as well as for handling queries from other administrations. It is generally recognised that a great deal still needs to be done, especially in raising top managers' awareness, strengthening the relationship with SDUs, further development of guidance based on a proper analysis of current weaknesses, and training. This work will in part be covered by the new two-year twinning. The department also intends to develop a new reporting/monitoring tool for its own use on the development of financial management and control. It is foreseen that many of these developments will be completed by the end of 2009. Developing the relationship between the CHU and the SDUs is important, as the Ministry of

¹¹ The duties of a central harmonisation unit are the following: to determine, follow and improve standards and methods; to determine financial decisions and transactions which are subject to obligatory ex ante financial control and to determine control procedures and principles thereof; to ensure co-ordination among administrations; to disseminate good practices; to act as guidance for administrations; to follow the functionality of the transactions through receiving reports and information on implementation from the administrations; and to contribute to training programmes.

Finance sees its role as setting generic guidance together with specific development, with the SDUs' role focused on ensuring compliance.

The *Department for Financial Management* consists of eight staff. Its key responsibilities relate to developing performance-based budgeting, preparing legislation and setting arrangements for accountability reports and authorising officers, and providing advice to a range of other projects. It would seem that the main work relates to performance-based budgeting, for which the department has developed a draft guide, although the relevant by-law has not yet been published. Pilot performance-based budgeting has been undertaken in seven institutions, and of the 48 administrations that are obliged to prepare their performance programmes in parallel with strategic plans during this transition period, 28 have so far prepared their programmes.

The *Department for PIFC Training and Guidance* consists of four staff (including the head of department and budget expert). It was set up in January 2007 to develop and contribute to training programmes and seminars on financial management and control, internal audit and performance-based budgeting, to develop training methodologies and documentation, and to act as a publication service for the General Director of Budget and Fiscal Control. It was also involved in the assignment of candidates who had passed the examinations for appointment to the SDU. Training has covered internal audit, financial management and control, and performance-based budgeting and has involved a wide range of administrations and personnel. To date most training has concentrated on staff at the central level. Currently the funding is provided by the Ministry of Finance and at the time of this assessment no budget had been agreed for 2009 or beyond.

It is suggested to review the structure and mixture of activities undertaken by these three CHU departments. The development of performance-based budgeting does not sit easy with the harmonisation and co-ordination role of a central harmonisation unit, and consideration should be given to separating these tasks. It should also be considered, in the light of experience, whether a central training function, where much of the specialist training is outsourced, is the most effective or whether the organisation of training should be shared between the CHU departments that are more directly involved – i.e. internal control and internal audit.

More fundamentally, consideration needs to be given to the location of the CHU. It is important for it to be given sufficient authority to develop internal control and resolve difficulties that arise. With this in mind, it is suggested that the CHU report directly to the Undersecretary, as is the case with the current SDU structure and with the IACB. Alternatively, in view of the SDU role in developing internal control within administrations, there would be less fragmentation of responsibilities if the CHU, with its nationwide role, became a separate section within the Ministry of Finance's SDU. This would have the added benefit of enhancing the CHU co-ordination role with all SDUs.

Strategic Development Unit (SDU)

In developing internal control systems, Turkish public administrations need to take account of their strategic plans, goals, objectives and performance indicators. Strategic Development Units (SDUs) have recently been set up in each public administration to develop these and other functions. A phased timetable for the introduction of these strategic plans is set out in a by-law¹². The first group submitted its first plan by December 2006, and the final group will submit its first plan by January 2009.

The SDUs are also responsible for specific internal control requirements, by performing certain ex ante financial control checks, preparing accountability reports, and developing internal control systems for their public administrations.

There are precise guidelines in the by-law for specific ex ante transactions to be assessed by SDUs, ranging from high-value procurement to the approval of free travel cards. In addition, article 17 of the Procedures and Principles on Internal Control and Ex Ante Financial Control (By-law No. 26040 of 31 December 2005) states that if goods or service procurement exceed 1 million TRY (approximately 500 million EUR) and construction works exceed 2 million TRY (approximately 1 million EUR), they should be subject to an SDU check. There appears to be no guidance on the criteria for deciding the value of other transactions that should be checked by the SDU in addition to the checks by the spending-units – this is left to the discretion of each SDU and to the administration head. With the need to sign assurance declarations, there is a natural tendency for the SDU to undertake a high level of ex ante checks in addition to those within spending units. It is suggested that the SDU's ex ante checks, other than those specified in the law, be gradually phased out and

¹² Principles and Procedures for Strategic Planning in Public Administrations (By-law No. 26179 of 26 May 2006).

in the end kept to a minimum and be based on risk assessment. Such an arrangement would require closely monitored phasing-in of this added role, which would be consistent with the increased responsibility given to spending-units and in line with the delegation of responsibilities and managerial accountability expressed in the PFMC Law.

Action plans relating to compliance with public internal control standards need to be completed by each SDU by the end of 2008. During this assessment Sigma noted a varied approach by SDUs with regard to the mechanism for developing their internal control system, with some SDUs tending to rely on the services of outside organisations. While this is acceptable, it is important for the CHU /IC to ensure that a consistent framework is applied to the core requirements.

Accounting Services

Accounting officers are responsible for controlling payment order documentation by checking for the completeness and accuracy of documents. There are stringent requirements concerning the qualifications for the appointment of accounting officers (article 62 of the PFMC Law), and each accounting officer is required to undergo training and to pass an examination, for which he/she receives a certificate. By March 2008 some 4303 accounting officers had received training, and 3904 were entitled to obtain their certificate. A further 2070 accountants have yet to obtain their certificate.

According to article 61 of the PFMC Law, accounting services of the general budget administrations, with the exception of the accountants in the Undersecretariat of Treasury¹³, are rendered by the Ministry of Finance, and the accounting officers in these administrations are personnel of the Ministry of Finance and controlled by the General Directorate of Public Accounts. Accounting services of all other public administrations (e.g. universities) are the responsibility of the respective administrations and are rendered by their own certified accounting officers. The Ministry of Finance has approximately 1600 accounting offices spread across the general budget administrations, which focus on accounting and payment transaction processing - regularity control is placed under the responsibility of the individual administrations.

While the Ministry of Finance sees a benefit for retaining staff in these general budget administrations, it does not fit in with the concept of delegated responsibility, especially with the development of accrual accounting. It is suggested to develop a timetable for the phased transfer of these staff to line administrations.

General Administration

The legislation places equal responsibility for the implementation of internal control on all staff within each administration. Accordingly, accountability reports have to be prepared by the head of each spending-unit (“authorising officers”) and, via the SDU, also by the head of administration. Additionally spending-units undertake ex ante control checks on all financial decisions and transactions relating to revenue, expenditure assets and liabilities, in part through “*realisation Officers*”. Responsibility for the collection of revenue, making of payments, and keeping of accounting records is placed on “accounting officers” who are required to have appropriate qualifications, as set by law.

Thus while an appropriate hierarchical structure and reporting system is in place and ex ante financial procedures are functioning well, the wider implementation of internal control and FMC, including ex post managerial control, needs to be improved and in some cases would not yet appear to be in place. This situation is recognised and, as mentioned above, SDUs are in the process of assessing internal control needs and gaps to ensure harmonisation with public internal control standards, and the CHU/IC is to further develop FMC procedures. This assessment of internal control needs will include a gap analysis, action plan, development of further guidance, and extensive training. These steps will be important as currently there is no overview on how far the wider concept of internal control is understood in spending-units.

¹³ The State Debt Accounting Office, the Domestic Payments Accounting Office, and the Foreign Payments Accounting Office of the Undersecretariat of Treasury are administratively independent from the Ministry of Finance. These three offices are part of the Undersecretariat of Treasury due to the structure and characteristics of their transactions, within the legal framework of article 62 of the Public Financial Management and Control Law No. 5018, article 14 of the Public Finance Law on Regulating Public Finance, the Debt Management Law No. 4749, and the Law on the Structure and Duties of the Treasury Undersecretariat No. 4059.

Municipalities

Part Five of the PFMC Law applies equally to municipalities, although there are variations in areas, such as the submission of accountability reports, for which the Ministry of Interior has responsibility. With more than 2000 municipalities that are subject to internal control there is an obvious logistical problem to ensure that all staff are fully informed and trained. This task will be difficult for the CHU/IC, and while management information systems will assist once arrangements are in hand, there is need for earlier involvement. It is suggested that the CHU/IC discuss the involvement of municipalities with the Ministry of Interior and explore with the ministry whether it would be possible to cascade practical advice to the municipalities, e.g. through the Union of Municipalities.

There might also be benefit in involving municipalities (or the Union of Municipalities) in the new twinning project.

EU Funds

New and enhanced management and control procedures need to be introduced to meet the requirements of the IPA.

The IPA consists of five components. Both the Transition Assistance and the Institution-Building/ Cross-Border Co-operation components are currently subject to an EU accreditation review, and it is hoped that Regional Development and Human Resources Development components will be ready for accreditation by the end of June 2008. The introduction of the Rural Development component is recognised as being more complex, and a revised action plan has been submitted to the EU for review. A twinning programme is currently in place with the Ministry of Agriculture and Rural Affairs for the development of proper functioning requirements for IPARD.

New managing authorities and implementing agencies have been designated, and to assist a smooth transition on operational matters it is understood that staff from these new bodies have been currently assigned to the CFCU to become acquainted with operational aspects. While arrangements are being put in place, operational activities have not yet begun under components III, IV and V in the relevant ministries.

Regulatory and Supervisory Agencies

The eight regulatory and supervisory agencies are specifically excluded from the internal control and accountability reporting requirements of the PFMC Law, although they are subject to the requirements of accountability, and to some of the articles of the public administration budget and the final account law. They are also subject to external audit by the Court of Accounts. While the historical reasoning for these bodies to have financial and administrative autonomy is understood and they have their own laws, during this assessment the extent of internal controls, including internal audit, that these agencies had in place was unclear; it was also unclear whether these controls were consistent with the requirements of the PFMC Law. It is suggested that the Ministry of Finance undertake a review on the controls in place for these agencies so as to determine the extent to which their respective laws should be adapted over time to reflect the controls in the PFMC Law. A different level of internal control in these agencies is difficult to justify.

Revolving Funds

Revolving funds, which comprise 1426 accounting offices with a current budget of around 17,154 billion TRY (approximately 9 billion EUR), accounted for approximately 8% of GDP in 2007. They are a mechanism for agencies that collect considerable fees or other non-tax revenues, such as hospitals (80%), to conduct their activity on a net basis and to have flexible carry-over mechanisms. Those agencies exceeding their capital limit transfer year-end profits to the central government budget; amounted to 918 million TRY (approximately 478 EUR) in 2007. Provisional article 11 of the PFMC Law stated that the revolving funds would be restructured by the end of 2007. While this deadline was not met, it is understood that the Ministry of Finance is to prepare a new law by the end of 2008 to remove, change or incorporate these funds into other budgets. There is no requirement for an accountability report or assurance declaration. It was understood that once the transition period is complete, the revolving funds will be subject to the full requirements of the PFMC Law. It is suggested to prepare a detailed timetable for this transition period and to incorporate it in the proposed PIFC Policy Paper.

Management control procedures and systems are substantially in place for ex ante financial control, and while these structures are largely appropriate for developing the wider internal control and FMC arrangements, the operation of these wider requirements is only partially in place, with processes still being designed. Similarly, provision for meeting the requirements of EU IPA-funded programmes is only partially met.

2.3 *Is there a functionally independent internal audit mechanism in place, with relevant remit and scope?*

The existing legislation and documentation (mentioned above) set out a framework for the appointment, scope and operations of internal audit, but as with internal control the Turkish administration is in a transition stage from theory to practice, except in the area of EU funds, where audits have been taking place but only by a few central units. Key areas to consider are:

Role of Internal Audit Co-ordination Board and CHU/IA

While overall responsibility remains with the Minister of Finance, the key player for developing internal audit is the Internal Audit Co-ordination Board (IACB). The IACB is affiliated to the Ministry of Finance together with its secretariat, which is a department (Central Harmonisation of Internal Audit) within the Budget and Fiscal Directorate of the Ministry of Finance. The duties of the IACB are extensive, covering both technical and broader policy issues. Its technical duties include establishing internal audit and reporting standards, developing manuals and other procedures, organising training programmes and annual risk assessment, and developing co-operation between internal audit bodies. The broader policy issues include proposing specific audits to be undertaken by public administrations, helping to settle conflicts between internal auditors and heads of administrations, regulating the certification system of internal auditors, approving the number of internal auditors in administrations, and evaluating annual summary reports submitted by administrations for incorporation into an annual consolidated report, which is submitted to the Minister of Finance and published.

The IACB has a centralised role in certain areas that would normally be the responsibility of heads of administrations. This role includes taking decisions as to which administrations are to have internal audit units, reviewing individual audit reports, and reviewing reported failures by internal auditors and taking decisions on their continued certification¹⁴. This needs to be reconsidered, as audit reports are primarily addressed to the respective top management of the organisations concerned by the reports. The need to also forward copies of each audit report as quality assurance should be reconsidered because it confuses the top management's responsibility of remedying the findings in the first instance. Secondly, once internal audit is fully operational within the entire administration, the IACB will not have the resources to deal with the extensive number of reports. Quality assessments can be monitored / assessed in part through yearly summary reports to be received from each administration, and through the development of a risk model requiring only limited quality assurance on-the-spot verification.

It is generally recognised within the Turkish administration that the current arrangements need to be reviewed. In Sigma's opinion, the current structure combines the role of an audit committee/board, which is set up to advise top management in administrations on the effectiveness of internal controls, and a CHU for internal audit, which should have the technical capacities and responsibility for developing internal audit. The precise role of audit committees varies from country to country and the audit committees established in the EU-12 function separately from CHUs. Some countries have established high-level sounding boards for providing advice on future developments in internal audit as well as internal control. They thus add to the development of internal control policy rather than to the development of technical aspects. It is suggested that, as part of the proposed review, consideration be given to transferring the technical aspects of internal control from the IACB to the secretariat, which then would become the CHU/IA, reporting to either the Minister of Finance or the Undersecretary (as is the case of the SDU and in the Sigma proposal for the CHU/IC). Such a move would require a review of the staff resources of the CHU/IA (currently nine staff), the appointment of a suitably senior and qualified internal audit head. Both bodies would need to come under the authority of the Ministry of Finance. In making this change, it would be important not to weaken or delay progress in developing internal audit, but this should be avoided by preparing a phased transfer plan. The

¹⁴ Article 6 of the By-Law on Working Procedures of the IACB

IACB could then become a high-level body for monitoring internal control, notably internal audit progress on a regular basis, and help in resolving any difficulties that might arise.

Quality Assurance

An important element of the IACB/CHU responsibility is to evaluate internal audit through a quality assurance programme. This programme includes the evaluation of internal audit reports prior to compiling a consolidated report, and the proposed use of a questionnaire to evaluate the efficiency of audit activities – which raises the fundamental issue of whether it is right for the IACB/CHU to see each individual report, which is primarily a communication between the internal auditor and his/her head of administration. In addition, the review of individual reports may lead to less than full reporting, as it would constitute an unrealistic workload considering the number of reports to review. In Sigma’s opinion, the CHU/IA should not need to receive copies of all audit reports. The need to forward copies of each audit report as quality assurance should be reconsidered, as quality assessments can be partially monitored/assessed through the summary reports received from each administration, and the development of a risk model would require only limited on-the-spot verification. This approach should allow the CHU/IA to review its suggested resource requirement of 40 extra staff and its proposal to outsource such work.

Internal Audit Location and Numbers

The By-law on Working Procedures for Internal Auditors, published in July 2006, lists those administrations (general and specific) where it has been decided to create internal audit units and indicates the number of staff in each unit. The total number of staff to be allocated is 1302, but many individual administrations have an allocation of zero staff. Similar details relating to municipalities were not available, but it is understood that up to 588 posts will be created. At the time of the assessment, 803 auditors had been appointed in 209 administrations, with about 522 having been certified.

Location	Number of Staff Appointed	Number of Administrations
General Budget	232	27
Special Budget	252	65
Social Security	22	2
Municipalities	297	115
Total	803	209

It is understood that a review is taking place over the next few months on the numbers needed in each administration and on how to organise internal audit in the administrations that are too small to justify the creation of their own unit – possibly through a relevant hierarchical body undertaking the work. This is an important issue and it is suggested to include the outcome of the review in the forthcoming PIFC Policy Paper.

Since the recent set-up of internal audit units, many units have indicated that they lacked their own budget, that for some staff the salaries were not comparable with those of other staff (e.g. in the administration’s inspectorate) and that some heads of administration did not appreciate the specific independence of internal audit. Some teething issues are bound to occur, but it is important to ensure that internal audit is recognised in the administration’s structure, that the unit has a sufficient budget, and that salaries are monitored from time to time to ensure that they remain comparable to those of similar posts.

Training and Certification

The law sets out the minimum educational and timing criteria for candidates to be considered for internal audit posts, including those who had previously been inspectors or controllers. In addition, all appointees have to undergo a specific three-month training course. The scope of this training is wide, covering the principles of internal audit and internal control, internal audit standards and methodology, report-writing, computer-assisted techniques, statistical methodology, risk assessment, performance measurement, budget, accounting analysis, and overview of related laws, including EU requirements. It does not include, however,

any practical experience of internal auditing. The trainers include experts from the private and public sectors, including those who have already audited EU funds (e.g. Board of Treasury Controllers).

At the end of this training period the appointees must pass an examination and, if successful, receive a certificate enabling them to take up an internal audit position; the first group received certificates in February 2008. It is suggested that the long-term aim should be that there is a critical mass that has obtained internationally recognised internal audit qualifications.

Need for Internal Audit Pilots

Due to the recent appointment of internal auditors, their role to date has been to set up work programmes; no operational audits have been carried out yet. It will be important in the early stages to ensure that internal audits are working to the appropriate standards, bearing in mind that most training to date has been theoretical. It is suggested therefore to foresee a phased introduction through the use of pilot audits overseen by auditors who are already qualified or versed in the requirements of international standards. This knowledge can then be cascaded down for further practical work.

Timetable

With documentation now largely in place, the emphasis moves to implementation, ongoing training, and eventual qualification to recognised international standards. This will take time, and a period of five to eight years is not unrealistic for such development. It is suggested that the PIFC Policy Paper set out a broad timetable for such development, including the various issues covered in this section.

Role of Internal Audit Inspectorate and Controllers

The need for control bodies has always been recognised in Turkish law but until the adoption of the PFMC Law this control was undertaken by the various inspectorates and controllers. There are general inspectorates in most large administrations, together with some specialist units, all of which report to ministers. Although the Inspection Board of Finance is within the MoF from an administrative perspective and has the appearance of a conventional board, it has broad audit and inspection powers with respect to all financial operations and transactions of the state on the behalf of the Minister of Finance (Decree Law No. 178, article 20, and Law No. 5018, article 75). In addition, there is the Inspection Board of the Prime Ministry, which has a wide remit covering all central and local administrations, and the Board of Treasury Controllers, which covers operations relating to the ownership and shareholding of the Treasury.

Turkey has a culture of inspection that dates back to the 19th century. The inspection boards carry out powers of inspection, investigation and “audit” in the framework of their own ministry’s organisation laws, personnel laws and other laws. Inspectorates conduct their duties on behalf of the ministers and they are part of the constitutional system in Turkey. (Law No. 3046, articles 12 and 23).

Thus the role of inspectors is extensive, ranging from specific investigations of alleged non-compliance with the law to the fight against corruption and money-laundering, with specialists assessing complaints and compliance in areas such as tax, customs and education. Such work is necessary but is quite separate from that of the internal audit, as currently defined by international standards and best practice guidelines. However, some of the work undertaken by these inspectors and controllers is still referred to as “audit” but in reality constitutes control checks, although this concept is not accepted by all inspection boards. Furthermore, around 30% of the newly appointed internal auditors had previously been inspectors. While this experience has many merits, it can perpetuate the confusion between the two roles. This confusion is recognised by the Turkish authorities.

While internal audit is defined in the current law, there is no similar definition for the role of inspectors or of inspectorates. In Sigma’s opinion, this needs to be corrected. In general the modern concept of an inspectorate is that it performs ex post investigations on behalf of management, primarily based on third-party complaints or following the expressed concerns of management. Its role is not to assess financial management controls, which are the functions of both the management and internal audit. Similarly, it is not the role of internal audit to investigate fraud and irregularity.

More fundamentally, there is a need for cultural change so that inspectors recognise the separate role of internal audit and accept both its independent role and in due course rely on its evaluations. In Sigma’s

opinion, a short review is required to define and delineate the respective roles of these two bodies and, if necessary, adjust the responsibilities and resources of the inspectorates to avoid any unnecessary overlap.

Internal audit procedures and systems are for the most part in place, but internal audit units are only partially in place and substantial gaps remain. Other than for EU-funded projects, no audits by the newly appointed auditors have taken place yet in the administrations. Full implementation will take many more years. There is a need to review and delineate the respective roles of internal audit and the inspectorates.

2.4 *Are systems in place to prevent and take action against irregularities and to recover any amounts lost as a result of irregularity or negligence?*

Article 56 of the PFMC Law states that one of the objectives of internal control is to “prevent irregularities and frauds in all kinds of financial decisions and transactions”. Similarly, article 6 of the By-law on Working Procedures for the Internal Audit Co-ordination Board states that the Board is to “provide recommendations to the public administrations as to taking the necessary measures for the prevention and elimination of fraud and irregularities”. A more detailed reference, however, is provided in the Communiqué on public internal control standards (standard 16), issued in December 2007: “The administrations shall develop methods which will ensure that the faults, irregularities and corruptions are notified in a specific order. General requirements of this standard are as follows: Notification methods with regard to the faults, irregularities and corruptions shall be determined and announced. The managers shall perform adequate examination with regard to notified faults, irregularities and corruptions. The personnel who have notified the faults, irregularities and corruptions shall not be subjected to unfair and discriminatory treatment.”

Part Seven of the PFMC Law sets out the sanctions to be applied against officials who are involved in fraud or irregularity, and indicates that they will be subject to the Turkish Penal Code.

The Turkish Court of Accounts (TCA) has the mandate to audit public resources, with some of the major exemptions being municipal enterprises, state economic enterprises as well as the Ministry of Defence. The mandate of the TCA is discharged in a two-phase process: The *first phase is the audit of accounts*, while the *second phase is the trial* of these audited accounts. The end-product of the latter is a legal document called a *writ*, which either acquits officials or holds them responsible for their financial management. The judicial assessment is to establish “public loss” resulting from the misuse of resources as an individual responsibility of the accountant. The TCA has a follow-up instrument for actions on audit findings and recommendations.

In addition, please also refer to the section above regarding the activities of Inspection Boards in the fight against corruption and money-laundering.

With respect to EU funds, specific arrangements are in place, in line with EU regulations; the details of these arrangements are provided in a specific operational manual.

Other than for EU funds, it would seem that no central guidance has yet been provided, with respect to these provisions, to assist administrations in developing appropriate procedures. It is suggested that the CHU prepare appropriate guidance for managers, covering such areas as the definition of fraud and irregularity, the way to handle suspected cases both within and outside administrations, reporting procedures together with the nomination of a contact point (and alternatives if a line manager is allegedly involved), and whistle-blowing arrangements.

Anti-fraud and anti-corruption matters are not within the scope of this assessment, but it is worth noting that the Prime Ministry Inspection Board is temporarily the AFCOS (Anti-Fraud Co-ordinating Service) and the single contact point with OLAF.

Procedures to prevent mistakes and irregularity through ex ante controls of financial transactions are in place, as are appropriate corrective actions. Procedures are also in place covering the EU requirements for pre accession funds. However, more detailed procedures need to be developed by management, with assistance from the CHU, to meet the broader issues related to the prevention of fraud and irregularity as outlined above and in Standard 16.

Capacity to Further Develop the System

The enactment of the Public Financial Management and Control Law No. 5018 (PFMC Law) in December 2003 and the subsequent by-laws and documentation that continue to be issued demonstrate a continuing commitment to introduce public internal financial control in Turkey. The recent creation of internal audit units in public administrations and the elaboration of accountability reports, with supporting internal control assurance statements, training and the foreseen new twinning in financial management and control all constitute further evidence of this commitment, as does the development with regard to IPA requirements. However, the critical stage will be the implementation of these arrangements (SDUs have until the end of 2008 to prepare internal control action plans for their administrations, and internal audit units are still working on their audit programmes). This operational stage and the necessary restructuring, as recommended in this assessment, will need to be closely monitored. Resource capacity is not likely to be a problem but, as elsewhere when internal control is introduced, there is a need to ensure full commitment from the government and from senior management. A revised PIFC Policy Paper is awaited, and it is hoped that this document will reflect a realistic timetable and a broader approach for the development of public internal financial control.

Summary and Next Steps

Since the enactment of the Public Financial Management and Control Law No. 5018 (PFMC Law) in December 2003, there has been a steady development of further laws and documentation on the requirements for internal control and internal audit. New structures have also been put in place, notably the Internal Audit Co-ordination Board, the various departments of the Central Harmonisation Unit in the Ministry of Finance, as well as strategic development units (SDUs) and internal audit units in public administrations. There have also been changes and new responsibilities introduced across the administrations, especially for heads of administrations and heads of spending-units, including the requirement for accountability reports and assurance statements.

Thus from an overall perspective, much of the framework for an appropriate PIFC structure and for the introduction of internal controls is in place. However, not all details are yet in place, staff in key posts – such as in the SDUs and in internal audit units – have only recently been appointed and, most importantly, internal control requirements in administrations have not yet been assessed and the internal audit process has generally not yet begun. It is recognised that change takes time, and so these gaps are not in themselves of significant concern, provided that it is recognised that the existing laws and guidance alone are not sufficient to meet PIFC requirements and that ahead there remains a period for further development, cultural change, training and operational experience. Close monitoring arrangements should be established to ensure that the recent legal framework is gradually implemented and that further guidance is provided on how it should be applied. This will require public relation-type activities within the Turkish administration, and will constitute a substantial task for a very small unit in the Ministry of Finance. Awareness-raising activities should be provided for both the lower levels of the administration and for the top management, focusing on what the new requirements mean in terms of application. Internal control requirements should be partially clarified when the new twinning completes its gap analysis of internal control operations. There will need to be a firm commitment from the Turkish administration, clear and strong co-ordination, and a realistic timeframe.

PIFC Implementation Risks

Any reform carries the risk of not achieving the results intended. In the area of PIFC, special attention should be paid to the following areas:

- The development and introduction of change needs to be “owned” by those involved, at the operational level as well as at senior management and ministerial levels.
- Poorly co-ordinated reform measures diminish their effectiveness. It will be important to ensure good co-ordination between the various actors involved to ensure that concepts are fully understood and to address implementation problems in a timely manner.
- There will be need for adequate resources, both for those developing and co-ordinating the reforms (CHUs) and those implementing the changes and new systems.

- The fact that a modern internal control system and internal audit have not yet been fully established presents risks, particularly with regard to the decentralisation of accountability and responsibilities to line ministries and municipalities.
- The development of internal audit is a priority, but it is necessary to draw a clear distinction between its role and the role of the inspectorates; it is important to ensure that internal audit has a scope covering both financial and non-financial aspects of the administration's operations and that it plays an independent role within the organisation, reporting to the head of administration.
- The magnitude of change and the need for new systems to be put in place should not be underestimated. This will take time and will be best developed through a phased approach over a number of years. Such details should be set out in a high-level action plan and in a more detailed operational plan (roadmap).

Managing Change

The risks highlighted above can be minimised through clearly defined advice and procedures, training, co-ordination and a clear roadmap. Specific areas where changes in management structures are considered to be appropriate are mentioned throughout this assessment and those worthy of special note are as follows:

- The central responsibility of the Minister of Finance in defining and developing financial management and control should continue to be underlined, together with the accountability responsibilities of heads of administrations.
- The key role for the Central Harmonisation Units in developing, training, co-ordinating and monitoring the introduction of internal control and internal audit is recognised, but there is a need to both strengthen their resources and enhance their status and authority. Particular consideration needs to be given to the location of the CHU. It is important for it to be given sufficient authority to develop internal control and to resolve difficulties that arise. It is therefore suggested that the CHU report directly to the Undersecretary, as is the case with the current SDU structure and with the IACB. Alternatively, in view of the SDU role in developing internal control within administrations, there would be less fragmentation of responsibilities if the CHU, with its nationwide role, became a separate section within the Ministry of Finance's SDU. This would have the added benefit of enhancing the CHU co-ordination role with all SDUs.
- It will be important for the CHUs to closely monitor development and in particular to ensure that a consistent framework is being applied throughout the public administrations involved (in excess of 2100), and in the action plans for introducing internal controls that are being prepared by the SDUs.
- There is a need for the CHUs to decide how best to co-ordinate with the large number of municipalities involved.
- Key to ensuring a smooth transition is the development of a suitably detailed roadmap, which should be developed by the CHUs and form part of the revised PIFC Policy Paper.
- Actual progress in implementing the roadmap plans should be regularly monitored and reports submitted to the Minister of Finance and other key players.
- A single high-level body (perhaps the IACB) should be given the responsibility of reviewing progress on a regular basis and of helping to resolve any difficulties that might arise.

Phasing Reform Measures

A significant stage in implementing PIFC reform will be the move from developing laws and guidance to their operational application. In addition to adequate management of change through co-ordination and training, there should be a planned phasing for the introduction of these new measures. Specific areas where phasing is considered appropriate are mentioned throughout this assessment and those worthy of special note are as follows:

- The full implementation of internal control and internal audit throughout the public administrations in Turkey will take several years and, as mentioned previously, Sigma is of the opinion that this will take a minimum of five to eight years, especially with regard to the development of internal audit.

- The phasing should be developed both vertically (across the range of public administrations) and horizontally (within each administration). The former should initially concentrate on the more significant administrations in terms of budget value and risk.
- Phasing within each administration should enable training and implementation of internal control to be cascaded from the top down, thus enabling those trained from the centre to become trainers in their own areas.
- The development of internal control needs to reflect cost effectiveness, with less complex – but not less effective – controls to be applied in smaller administrations or directorates where the risks are fewer. This should be reflected in the development of risk management systems for such bodies.
- The newly established audit units need time to develop fully the range of operational activities, as set out in the law. These activities should be introduced gradually, following more detailed training and the introduction of pilot audits overseen by those already versed in the requirements of international standards. Again, following these pilots those who have been trained can train others. A similar approach can also be applied to those administrations that do not currently have any internal audit units in place.
- While accountability reports and supporting internal control assurance statements are partly in place, consideration should be given to reviewing the content of the assurance statement, with a view to phasing in a comprehensive version once the internal controls are fully in place.
- It will be important to ensure that the various components of internal control are developed so as to be mutually consistent with linked developments within the broad framework of PIFC.