Ministry of Finance, Turkey
(Working Group on PIFC)

POLICY PAPER

On the future developments of the
Turkish Public Internal Financial Control Systems

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EXECUTIVE SUMMARY

Over the years, accumulating problems have eroded the efficiency of financial management in Turkey and this resulted in unsustainable fiscal deficits, which in turn became a major cause of chronic inflation that Turkey has been facing during the last two decades.

The deficiencies of Turkish financial management system are now very well documented and these can be summarized as follows:

- Institutional responsibility for financial management and financial control is highly fragmented.
- General government has not been covered by the budget, which hampers fiscal discipline.
- There is no program performance analysis in the budget system against the objectives set for the line agencies.
- Financial management system in general and the budget in particular lacks transparency.
- The principle of accountability is blurred since precise definitions of accountability for most of the main actors in financial management system have not been specified clearly.
- Budget classification and accounting principles are outdated and not in line with the internationally accepted standards.
- The budget cannot be used as a tool of macroeconomic policy, because there is not a very well established link between the five-year plans and annual programs.
- The budget is lacking in a medium term perspective.
- Since the financial management system cannot function properly, the Ministry of Finance became too interventionist in its relationship with line agencies throughout budget process.
- Financial management system does not have modern internal control and audit functions (i.e. system-based and performance audits) in place. Existing ones are too many and inefficient.

To remedy these over-mounting problems, the government has decisively undertaken a reform program. In shaping the public financial management reform, the Turkish government has closely worked with the IMF and the World Bank. The government has also closely cooperated with the European Union (EU) officials during the process.

This Policy Paper on the future developments of the Turkish public internal financial control (PIFC) systems is prepared and submitted to the EU as part of its accession partnership status. The Policy Paper is also conceived as a
road-map for the Turkish Ministry of Finance to adapt the principles of the Acquis Communautaire, Chapter 28: Financial Control. It aims to respond in some of the above-mentioned problems as well.

The Policy Paper first defines the new concepts to be introduced and describes the current internal financial control environment, after referring to the accession negotiations between Turkey and the EU; it offers an evaluation of the current system. In the next section, the targets towards improving the financial control system are mentioned, together with the three main principles of PIFC to be adhered to, which are:

- Establishing managerial accountability for the collection and spending of public funds, including the responsibility for setting up, maintaining and upgrading financial management and control systems,
- A functionally independent internal audit function, capable of performing system-based and performance audit,
- Centralized harmonization facilities for the financial management & control and internal audit systems with the power to assess the compliance with the standards they will issue.

The Policy Paper is concluded with a time schedule of the action plan, which covers the legislative and administrative measures to be taken, expectations from the EU in this process and the endorsement of the Minister of Finance. Since the Paper is perceived as a manifesto and a reference document in closing Chapter 28 for the Turkish Ministry of Finance, the European Commission’s Glossary on PIFC has been annexed to the end.
1. INTRODUCTION

Turkey’s financial management and internal control systems functioned fairly well probably until late 70’s. The newly established Republic inherited a strong tradition of financial bureaucracy from the Ottoman Empire which itself was influenced by 19th Century European fiscal administrations (particularly the French administration).

The infrastructure for the financial management system was laid down by the approval of “General Accounting Law” in 1927. The Law, which is still in effect, was very instrumental in establishing an efficient and effective financial management system in the war-weary country. It had a very consistent and comprehensive structure, and amendments made to the Law could not damage the legendary integrity of this structure.

As expected, the Law envisaged a strong Ministry of Finance with centralized powers over the line agencies to achieve budgetary discipline. But especially after 80’s, the financial management system started to show signs of weariness. Growing population, expanding public administration and an economy that is becoming increasingly open put a strain on the system. The inability to respond to the changing needs of the new era exposed the rigidity and inflexibility of the financial management system. Excessive control created its own side products; line agencies resorted to extra budgetary and revolving funds more frequently. This was a typical self-perpetuating vicious circle; excessive control causing inflexibility, inflexibility forcing line agencies outside the budget, shrinking budget coverage causing Ministry of Finance further tightening of the budgetary rules.

It may be true that loss of budgetary discipline combined with poor financial management was not the major source of Turkey’s macroeconomic problems. However it was clear that those weaknesses dramatically reduced the efficiency of the financial management and control systems and thus had little positive effect on the road to recovery. Moreover the system failed to guide the policy makers in political and technical decision-making process. Nor was it able to produce reliable information vital for pursuing a sound macroeconomic policy.

The problems were aggravated by loss of transparency in the system. Accountability, which goes hand in hand with transparency, was also compromised. The system of public accountability, which is supposed to generate incentives for efficiency and effectiveness and which should discourage waste and fraud, did not operate as expected.
At that critical juncture, the government decided to undertake a major reform of the system. The reform in a sense was unavoidable and very fortunately coincided with Turkey’s accession negotiations with the EU. The subject was discussed extensively with the officials of the European Commission at a seminar organized by the Commission in Ankara on 4-5 March 2002. The government has also coordinated with the IMF and the World Bank in formulating the reform program. A number of reports have been produced on the subject in this process of coordination and consultation with relevant institutions.

This Policy Paper is prepared by the government to be submitted to the EU in response to the above-mentioned shortcomings of the Turkish financial management and control system. It drives extensively from the discussions held with European Commission officials and other relevant documents such as the Accession Partnership Document, the Progress Reports, and the National Program. The observations, evaluations and recommendations of the European Commission have also been taken into consideration.

The Policy Paper is designed as a mission statement of the Turkish Ministry of Finance to the public to realign its financial management and control functions to modern and internationally accepted standards. In doing so, we aim to achieve these objectives:

- To strengthen the financial management and control systems.
- To re-establish the link between policy-making process and the budget.
- To improve the overall operation of financial management.

At every level of this restructuring process, existing and newly introduced institutional arrangements will be tested against these well-known principles of sound financial management:

- Comprehensiveness.
- Consistency.
- Effectiveness.
- Transparency.
- Accountability.

In the new system, financial control is perceived as a management function and therefore Ministry of Finance will transfer its existing powers to the line agencies. The Ministry will assume the role of a standard setting institution. This role will cover both financial control and audit functions. The Ministry will use all of its resources to enable a smooth transition to the new system by employing modern risk analysis techniques. It is obvious that a successful restructuring and transformation of the system can only be realized
by a radical change of the management culture. New management culture will be developed around the core idea of improving public services by using quality control and quality assurance techniques and by putting customer (citizen) satisfaction at the first place. To achieve this objective, the Ministry will plan and undertake an extensive training program for its own staff and for the staff of the line agencies.

2. LIST OF DEFINITIONS AND ABBREVIATIONS

In this section, abbreviations and definitions of some of the new concepts to be put into practice are given. The definitions of some of the critical institutions of the existing system are listed in the annex for easy reference.

2.1. Abbreviations

- EU: The European Union
- GDBFC: The General Directorate of Budget and Financial Control (the Ministry of Finance)
- GDPA: The General Directorate of Public Accounts (the Ministry of Finance)
- TGNA: The Turkish Grand National Assembly

2.2. New Concepts To Be Put Into Practice

- **Public Internal Financial Control:** PIFC is the overall financial control system performed internally by the Government or by its delegated organisations, aiming to ensure that the financial management and control of its public spending centres (including foreign funds) complies to the relevant legislation, budgetary descriptions, the principles of sound financial management, transparency, efficiency, effectiveness and economy.

- **Managerial Accountability:** This refers to the accountability of authorities before their superiors and the Parliament for determination and enforcement of the rules aiming to ensure efficient, effective and economic use of budgets.

- **Internal Audit:** IA is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
• **Internal Auditor:** The internal auditor is responsible for independently assessing the quality and performance of the financial management and control systems of the budget-spending organisation he is attached to. He is independent of any managerial functions or influences in that organisation and reports directly to the highest manager of that organisation on his findings and recommendations.

• **Internal Audit Standards:** These are the procedures, methodologies and practice to be followed during the preparation, performance and reporting on internal auditing, aiming at sound financial management and ensuring economy, efficiency and effectiveness of the use of public funds.

• **Internal Audit Committee:** A central public organisation will be responsible for developing the internal audit standards, while taking into account relevant internationally accepted standards and practices. This Committee will be responsible for drafting template audit manuals and audit trails, to be used by internal auditors, and for drafting an Audit Charter and a Code of Ethics for the public internal audit profession. The Committee will co-ordinate the introduction of its standards, create a networking for internal auditors to discuss common problems and monitor whether its recommendations are properly implemented.

3. **THE PRESENT PUBLIC FINANCIAL CONTROL ENVIRONMENT IN TURKEY**

The institutions comprising the present public financial control environment are the following.

3.1. The Parliamentary Planning and Budget Commission

The TGNA Planning and Budget Commission plays an important role in the discussions on the draft budget laws and draft final account laws. The Commission is responsible for allocating funds to the general and annexed budget agencies and for evaluating the final accounts of previous years’ budgets. The TGNA considers the Statement of General Conformity, issued by the Court of Accounts, as reference while enacting the draft final account law and discharging the executive body.

3.2. The Court of Accounts

The Court of Accounts is a constitutional institution, responsible for external audit. On behalf of the TGNA the Court audits the revenues, expenditures, assets and liabilities of the general and annexed budget agencies.
and of other institutions, accounts and funds within the scope of its authority. The Court arrives at final decisions on accounts and transactions through a judicial process.

Within this context, the Court of Accounts also conducts ex ante internal financial control activities through giving its visa or prior approval for payment orders and for new hiring positions (cadres), and registers commitments and contracts.

3.3. The Ministry of Finance

The Ministry of Finance has a special role in the execution of the general and annexed budgets. It also performs ex ante financial control through the GDBFC and the GDPA besides the Head Offices of Finance, Budget Departments, and Central Accountancy Directorates which are the affiliated units of the GDBFC and the GDPA, acting at the agency headquarters, and through its Accounting Offices in charge in the local provincial districts. This process, which sounds quite complicated and which is highly centralized is summarized in the following flowchart in a simplified manner.

The Ministry of Finance performs its ex post internal financial audit function through the Finance Inspection Board, Budget Controllers and Accounting Controllers. In local administrations the audit function is performed by Accounting Auditors acting as subordinate to the Chief Officers of Finance in provinces.

Moreover, the GDPA has a controlling function in the administrative sense with respect to recording, monitoring and verifying public accounts, and checking the appropriateness of operations. It is obligatory, during the fiscal year, to send to the central office (GDPA) certifying documents relating to the expenditure as performed by the accountants together with the monthly tables, within thirty days subsequent to spending. These documents must be examined within two months at most after their arrival at the central office, incomplete documents must be returned and the ones deemed to be in good order must be submitted to the Court of Accounts for approval.

Following the end of each fiscal year, the GDPA is responsible for obtaining and examining the final accounts of the general and annexed budget agencies, drafting the general treasury account, and preparing the draft final account law. Within 5 months after the end of the fiscal year, all documentary evidence sent by ministries, together with the general treasury account and draft final account laws will be examined by the GDPA before being sent to the Council of Ministers and to the Court of Accounts.
Figure 1. Budget Execution (Simplified Flowchart)

Ministry of Finance

Budget Department
(MoF staff located in line ministry)

Line Ministry

Accounting Office

Court of Accounts

Agency
3.4. The Ministries and Other Line Agencies

The “chiefs of disbursement”, “assessment officers” and other officials and authorised staff who are part of the payment process of line institutions and agencies and whose responsibilities are legally stated, undertake certain roles within the ex ante financial control process.

Chief of Disbursement: Chiefs of disbursement give written orders and permissions to accountants for the provisional or final payments of the expenditures pertaining to state services. In addition, the chiefs of disbursement must approve public procurements and contracts to be issued at the end of tender procedures. The chief of disbursement, just before the phase of payment, issues documents pertaining to expenditures in the state treasury account.

Assessment Officer: As for an expenditure to be made from the budget, the assessment officer is responsible for the accuracy of the documents he issues and their compliance with legislation, for timely and reasonable use of the appropriations, for the expenditures being correspondent to the actual needs, and for the fulfilment of the programmed services on time.

In addition, at the headquarters of line agencies, there are units of research, planning and co-ordination and departments of administrative and financial services, which are in charge of preparing budgets in line with the provisions of the plans and programs, monitoring their implementation, and conducting services related to financial transactions.

Furthermore, there are inspection boards and other audit units of line agencies that perform compliance audits. However the kind of audit performed by these units are basically financial audits. System-oriented and performance audits (efficiency, economy and effectiveness) are yet to be introduced into the Turkish PIFC systems, although there are some individual examples here and there.

4. FUNCTIONING OF THE CURRENT INTERNAL FINANCIAL CONTROL SYSTEM

The basic legislation defining current financial control system consists of:

- The Constitution of the Republic of Turkey,
- The General Accounting Law number 1050,
- The annual budget laws,
- The Law on Court of Accounts number 832,
- The Public Procurement Law number 2886,
• The auditing provisions stated in the organisational laws of public institutions and agencies, and
• Other financial legislation.

In particular, the General Accounting Law number 1050 is accepted as the basic law regulating the operation of financial system as mentioned above.

In Turkey, ex ante financial control and internal financial audits are basically performed by the Ministry of Finance. The financial control processes in the central and provincial administrative units have similar structures.

4.1. Ex Ante Financial Control in Institutions and Agencies

4.1.1. General and Annexed Budget Agencies

Budgetary allocations released by the Ministry of Finance from the appropriations as defined in the budget law are distributed to the central and provincial organisations of the agencies, after the respective payment orders have been approved by the Court of Accounts (visa). This release by the Budget Departments acting at the headquarters of the line agencies follows the framework of the principles of the annual budget law and is a reply to the demands of the agency.

The ex ante financial control process takes place in four phases. These are the phases of commitment, accrual, payment order and disbursement. As can be seen from the following explanations, the Ministry of Finance, through its units placed at the line agencies, play the most significant role throughout ex ante financial control process. Consequently, financial service units of the line agencies neither have the capacity to play a proactive role in ex ante financial control, nor have a reason to be more active and effective in whole process. In the existing framework, these units merely act as offices where paperwork related to public expenditures and particularly paperwork on the payment orders are completed and therefore they are considered inefficient.

4.1.1.1. The Phase of Commitment

The budget execution directives of the Ministry of Finance determine the principles and methods on the basis of which appropriations are being allocated under the budget law. Before commitments can be made, sufficient appropriation must be allocated and the Ministry of Finance must have released part or all of this appropriation.
Throughout the budgetary implementation, the Ministry of Finance is responsible for any appropriation transfers and for amending existing expenditure programs. The Ministry of Finance may require appropriation transfers between the budgets of institutions or between and within any programs. Moreover, the Ministry of Finance is authorised to require transfers from supplementary appropriation arrangements to institution budgets. Endorsement by State Planning Organisation is required for the transfer of investment appropriations. In the execution of such procedures, ex ante financial control is carried out by officers on the basis of justifications of the agencies in respect to compliance with the plans, programs and budgetary principles.

The registration and accounting procedures on budget appropriations are performed by the Budget Departments, and ex ante financial control on expenditures checks whether the budgetary and appropriation criteria are fulfilled.

There is a regulation that obliges Budget Departments and the Head Offices of Finance to perform prior checks of every document relating to expenditure commitment, to report their opinions to the Minister concerned regarding the compliance with the budget, laws and other rules and to notify the situation to the Ministry of Finance within 24 hours in case the Ministry does not follow up on the opinions made.

The ex ante financial control function for tender procedures is performed by an officer of the Ministry of Finance, appointed as a member to the tender commission established by the chief of disbursement of the institution concerned. Thus, the task of controlling and ensuring the compliance of the procurement procedures with the legal provisions is assigned to this official of the Ministry of Finance.

Furthermore, the tender files exceeding the monetary limits fixed each year through budget laws (draft commitments and contracts requiring expenditures in central and in provincial administrative districts) are submitted to the Ministry of Finance (GDBFC) for visa. Among these files, the Court of Accounts registers the ones subject to the control of Court of Accounts at the same time.

4.1.1.2. The Phase of Accrual

The assessment officers are responsible for ensuring that the appropriations are used in due course, in a reasonable manner and in accordance with the regulations, that the expenditures correspond to the needs, and that the programmed services are timely carried out. The use of
appropriations in due course and in a reasonable manner requires the monitoring of efficiency, effectiveness and economy. In that way, chiefs of disbursement are responsible for monitoring these criteria.

4.1.1.3. The Phase of Preparing Payment Orders

The payment order for a public expenditure is a written order submitted to the accountant by the chief of disbursement for the payment of the expenditures to the rightful holder, for which the commitment and accrual phases have been completed. In this phase, the goods or services, giving rise to expenditure is delivered and the precise amount to be paid to the rightful holder is determined.

The central office of the budget department carries out the procedures for issuing payment orders, after which the payment order is sent to the accountant for carrying out the disbursement. Both the budget department and accountants are in charge of reviewing the compliance of the expenditures with legislation.

4.1.1.4. The Disbursement Phase

An accountant can only perform disbursement on the basis of a payment order signed by the Chief of Disbursement. The accountant checks the identity of the right holder, and the legality & regularity of the payment order to see if there are any material errors.

In case the accountant refuses to disburse funds by taking into account the reasons of perceived non-compliance, the chief of disbursement can override such refusal and force the accountant to perform the disbursement. In such a case the Chief of Disbursement states in writing his reasons for overriding and accepts full responsibility to disburse the funds.

4.1.2. Revolving Funds

Chiefs of disbursement, assessment officers and accountants have responsibilities and tasks to fulfil related to revolving funds. All documents pertaining to payment, owing to the same justifications, are subject to control within every phase mentioned above. Accountants submit their documents to the Court of Accounts at the end of each fiscal year. After a formal review by the Court of Accounts, they are either acquitted or charged for the payment of the expenditure, which is found to be irregular.
4.1.3. Funds

The tasks of the chief of disbursement, the assessment officer and the accountant are performed in a similar manner in the funds; however, the procedures of spending by the funds are subject to their own legislation. The funds are audited in different ways on the basis of their special provisions. Only some of the funds are subject to audit by the Court of Accounts.

4.1.4. Special Budget Agencies

Payment and control procedures provided for the general and annexed budget agencies take place in a similar manner within the concerned legislation of the special budget agencies. In the payment process of these agencies, as well, chiefs of disbursement, assessment officers, and accountants take place. Implementations such as the rejection of payment by the accountant and the cases where the accountant is responsible before the Court of Accounts, again, are valid for special budget agencies. Only the Court of Accounts is registering draft commitments and contracts. Procedures pertaining to final account and discharge process are also present in these agencies. Unlike general and annexed budget agencies, the draft commitments and contracts of these agencies are not subject to visa procedures to be carried out by the Ministry of Finance.

4.1.5. Autonomous Budget Agencies and Social Security Institutions

These institutions do not have the offices of chief of disbursement, assessment officer, or accountant. The board of directors of these institutions takes the decisions upon expenditure. However, the spending authority may be transferred under certain limits to the general director or deputy general directors. When a spending decision requiring a tendering process is taken, the tender legislation of these institutions is taken as basis. Following the transfer of the goods or services, the accounting directorates take care of the expenditure. The accounting directorate checks the legality and regularity of the expenditure documents.

4.2. Internal Financial Audit in Institutions and Agencies

It is worth mentioning that audits carried out by relevant audit units of the Ministry of Finance in the line agencies are of “financial” nature and they fall short of modern “system-based” and “performance” audits.

4.2.1. General and Annexed Budget Agencies
The audit units of the Ministry of Finance basically perform the internal financial audit in the general and annexed budget agencies. The Finance Inspection Board, the Budget and Accounting Controllers in central and local provincial offices, and the Accounting Auditors exclusively in local provincial administrative areas are responsible for the internal financial audit.

4.2.2. Revolving Funds

The internal financial audit procedures in revolving funds function as stated above. The financial statements pertaining to the accounting terms of revolving funds are examined and consolidated by GDA. These institutions, again, are subject to internal financial audit of the Finance Inspection Board, the Accounting Controllers and the Accounting Auditors.

4.2.3. Special Budget Agencies

The records of the revenues and expenditures of special budget agencies are not presented to the Ministry of Finance, but sent to the Court of Accounts. After the end of the fiscal year, all transactions of special budget agencies (including the financial procedures) are audited by the Inspection Board of the Ministry of Interior and by the Local Administration Controllers of the same Ministry.

4.2.4. Funds

The internal financial audit procedure in the funds is performed in a variety of ways. The Ministry of Finance may carry out audit in the funds within the framework of the annual budget laws.

4.2.5. Autonomous Budget Agencies and Social Security Institutions

The internal financial audit in these institutions is subject to various procedures. Some of them are subject to the financial audit by the audit units of the ministries they are affiliated to, while others are audited by the Prime Ministry High Auditing Board and some others by special commissions.

Moreover, when necessary the Finance Inspection Board may carry out financial audits in special budget agencies, funds, and some autonomous budget agencies and social security institutions.
5. ACCESSION NEGOTIATIONS BETWEEN TURKEY AND THE EU

Within the context of the Accession Negotiations, the present issues are succinctly discussed in the key EU document “Regular Reports 2001”.

“… the government has identified the inadequacies and weaknesses in the present financial management and control systems. The 2001 National Programme for the Adoption of the Acquis acknowledges the need to alter the present Turkish systems to align them with internationally accepted and EU-compliant concepts and definitions of internal control and internal audit. The Turkish PIFC systems lack coherence in concept and implementation, lack an integrated legal framework and do not consistently follow internationally accepted principles of sound financial management, transparency, public accountability and performance management. As a result, the current practice of PIFC is not effective in preventing fraud, corruption and/or serious irregularities.

The most relevant issues to be addressed are: the fact that many (including some of the most risky) areas of government expenditure remain outside the scope of control and audit; that responsibilities for specific control and audit roles are not clearly defined among the main actors in the field; that there is no coherent government approach relating to modern PIFC; that there is no overall Law on PIFC, and that the public internal audit profession in Turkey does not exist.

The roles and responsibilities of internal and external financial control are not well defined. The total number of (so-called) internal audit units established by various public agencies and organisations is reported to be 129. A precise definition of the functions of these units is required. Turkey is also invited to describe the audit methods and experience of the Board of Finance Inspectors in order to ensure that the Board's function complies with International Institute of Audit standards.

The current situation leads to multiple auditing of the same activity or, conversely, the exclusion of some areas from the scope of auditing. There is also a lack of clarity within the administrative structure between financial management and control functions, functionally internal audit activities, and external audit functions.

For example, both the Ministry of Finance and the Turkish Court of Accounts (the supreme audit institution in Turkey) carry out extensive ex ante controls. The ex ante control function of the Ministry of Finance is restricted to
commitments and disbursements but all financial decisions, including disbursements are also controlled ex ante by the Court of Accounts. In addition, such audits focus simply on the regularity and legality of expenditure transactions. Turkey is invited to reconsider its position that internal audit should be strictly centralised within a unit in the Ministry of Finance.

All government national budget expenditure and extra-budgetary expenditure, since both have an influence on the government’s financial or budgetary policies, should be subject to ex ante control and internal audit. The continuing existence of extra-budgetary funds leads to an absence of control and audit in many important areas of government expenditure or to a variety of non-harmonised control and audit systems throughout the public sector. The large number of control bodies, which lack an integrated approach to financial control and internal audit, illustrates this situation.

The Turkish Court of Accounts is prevented from properly organising its external audit duties with regard to budget expenditure as a result of its ex ante controls, which conflict with its main ex post external audit functions and obligations. The Court of Accounts should transfer the responsibility for the ex ante control function to the government and focus on the systems-based and performance audits of the PIFC systems established in the budgetary spending centres of the government. The Court should also develop strategies to increase the value of its audit efforts in appropriate reporting and follow-up procedures with line ministries and the parliament.

A Central Harmonisation Unit for co-ordinating control and audit methodology should be set up in the Ministry of Finance. This unit would be responsible for the drafting of financial management and control manuals, audit manuals and audit trails for all sectors of public spending. This unit would also have the power to make on-the-spot checks to see whether its recommendations were being followed up correctly.

With a view to ensuring suitable protection of EC financial interests, Turkey needs to put in place the legislation necessary to allow the competent EC bodies to carry out on-the-spot checks and to develop adequate administrative capacity to implement the Acquis, including the ability of Turkish law enforcement bodies and judiciary to address cases where EC financial interests are at stake.

Overall, the Government should now focus on preparing the policy paper, which it announced in its National Plan for the Adoption of the Acquis would form the basis for appropriate legislation, and on which work is ongoing. This
legislative framework could then become the basis of a financial control structure capable of meeting EC requirements.”

6. EVALUATION OF THE CURRENT PUBLIC INTERNAL FINANCIAL CONTROL SYSTEM

Public resources are subject to various budget specifications, spending procedures, controls and audits. To formulate a well-functioning public internal financial control (PIFC) system, it is essential to clearly determine the concepts “public”, “public resources”, and the scope of financial control. Hence, there is a need to include all direct users of public resources within the scope of PIFC.

The general idea is that the duties of chiefs of disbursement (i.e. heads of public administration), assessment officers, accountants and the other persons must be redefined and chiefs of disbursement must be held accountable before the Court of Accounts for their financial decisions and transactions. Naturally, this does not preclude chiefs of disbursements being accountable to Ministry of Finance. In the new PIFC environment, each head of public administration will have the power to manage his administration’s own budget and will be held accountable to the government (and to the Ministry of Finance for that purpose), for the efficient, effective and economic execution of the budget. Thus, starting from the top (head of public administration), all persons who play a role in the payment chain will share the responsibility and will be accountable.

Whereas under the current system the chief of disbursement signing the payment order is not generally accountable and liable before the Court of Accounts, except where he explicitly has stated in writing that he does take the responsibility (in cases where the accountant refuses to effect the payment). Although the assessment officers and accountants who are at the lower levels of the hierarchy do not have any authority to spend money, they are held accountable for their part in the payment process.

As stated before and elsewhere, the current budget coding structure is not appropriate. Strategic planning has no place in the current systems, while risk analysis has so far not been practised in the budget implementation process. Under the new budget coding structure, the spending agencies shall introduce strategic planning and align the preparation and implementation procedures of their budgets accordingly. The planning will also facilitate the introduction of risk analysis.

Adequate budget classification will introduce new and common accounting and reporting standards, a widespread and efficient use of information processing technologies within account recording systems,
improved recording of accounts and will produce reliable data necessary for the national accounts. In that way the implementation of PIFC will be more effective, easier and expedient.

The implementation of ex ante control by units being part of the Ministry of Finance (because the existing financial services in line ministries are considered to be inefficient), as presently is the case, means a concentration of financial management and control power in these units. This has been perceived as the centralisation of financial control authority.

Because line agencies cannot perform financial control as a management tool, it is difficult to measure the performance of these agencies in an adequate way. It will therefore be necessary to strengthen the financial service units in line agencies and gradually delegate ex ante financial control responsibilities towards the head of public administration and his financial services. This will ensure conformity with modern budget implementation.

The Ministry of Finance in principle agrees on the need for a transfer of ex ante financial control responsibilities to the line agencies. However, in order to keep major financial risks under control, resulting from the dynamics of the transition process, the Ministry of Finance will introduce modern risk analysis techniques enabling it to determine the speed and modalities of the transfer.

There is an organic link between the extension of financial management and control responsibilities towards the heads of public administration and the introduction of internal audit functions. Each head of public administration will appoint an internal auditor to help him assess the quality of the financial management and control systems, for which the head will become responsible. The internal auditor gives advice on the weaknesses of the systems and will make recommendations for improving the systems. The follow-up and the implementation of the recommendations is, however, the full responsibility of the head of public administration. Cases of conflict between the head and the professional opinions of his internal auditor will be brought to the attention of the Internal Audit Committee.

It is expected that the current control and audit systems will benefit from appointing internal auditors in each line ministry and institution and from establishing a central audit committee to co-ordinate internal audit activities. The Committee will be established under the authority of the Ministry of Finance.

The EU strongly suggests creating internal audit services in spending centres for the performance of a wide variety of internal audits, not only the
“classical” financial audits, but especially systems-based and performance audits. The auditors should be functionally independent from any kind of influence that might come from the spending centre’s management. The functions of the internal audit and its independence should be laid down in primary legislation as well as in secondary legislation or directives (e.g. in the form of audit charters, codes of conduct etc.).

In order to establish adequate and effective audit systems, it will be necessary to formulate audit standards, based on internationally accepted and EU-compliant norms, which will be the basis for the functioning and performing of internal audit. The standards and procedures will have to be laid down in an internal audit manual for each spending centre, based on a harmonised template established by the Internal Audit Committee.

The present practice of the Court of Accounts to approve ex ante and to register financial decisions is not consistent with the modern function of a Court of Accounts. The Lima Declaration of the International Organisation of Supreme Audit Institutions (INTOSAI) underlines the need for the Court of Accounts to focus especially on its function as external auditor, assessing the quality of the PIFC systems of the government. This means that the Court should abolish its ex ante control functions. Another reason for abolishing the ex ante control function is that it is not correct that the Court independently assess PIFC systems, in which itself has had part of the management functions (ex ante control).

Based on the above, the Government will draft specific legislation, in which the new elements of the public control and audit systems will be laid down in a consistent and explicit way. This will include bringing Turkish Court of Accounts in line with INTOSAI standards. The primary aim is to create improved sound financial management and control in the area of the public budget. The secondary aim is to create a PIFC system that is compliant with the best practice in the EU.

7. TARGETS TOWARDS IMPROVING THE PUBLIC FINANCIAL CONTROL SYSTEM

The EU does not prescribe to adopt one specific model for PIFC, but based on the internationally accepted and EU compliant standards, the EU suggests three main principles to be adhered to:

1. Managerial accountability for the collection and spending of public funds, including the responsibility for establishing, maintaining and upgrading financial management and control systems;

2. A functionally independent internal audit function, capable of performing systems-based and performance audit,
3. Centralised harmonisation facilities for the financial management and control and internal audit systems with the power to assess (audit) the compliance with the standards it will issue.

Since these principles are part of the Acquis Communautaire, they have become accession criteria under Chapter 28: Financial Control.

Since it is in the interest of all parties involved, the government will develop procedures and a time schedule for the transition from the old to the new PIFC systems, taking into account the present administrative structures and the need to ensure continuous high quality of the control of public means.

7.1. The Scope of Public Financial Control

It is envisaged to bring all public institutions, agencies and other bodies that are responsible for the receipt, management and expenditure of public funds under the scope of one and the same system of PIFC. This will guarantee full harmonisation of standards and procedures.

EU Funds and all other external resources shall also be brought under the same system in principle, although it might be possible for certain funds, extra measures may be needed.

For this purpose it will be necessary to redefine the terms “central government” (covering revolving funds, funds, and autonomous agencies besides general and annexed budget agencies) and “general government” (covering central government, local administrations and social security institutions) in order to ensure budgetary discipline for all of these funds.

7.2. The Change in Management Culture

Managerial accountability is of great importance to satisfy the public opinion on the principle of “sound financial management”. The public should regain trust in the public authorities’ capabilities to ensure that public resources are used in economic, efficient and effective ways. Managers and their staff shall be responsible and accountable for achieving pre-determined targets and should have a thorough understanding of the principles and methods of “sound financial management”.

The GDBFC at DG level carries out a project titled “Continuous Quality Improvement and the Restructuring of the Public Budgetary System”. The project aims at restructuring the budget preparation and auditing systems, trying to enhance the economy, efficiency and effectiveness of the general and annexed budget agencies. Within the scope of this project, activities for the establishment
of a performance management system in the Directorate General (GDBFC) have been initiated. The adoption of these activities by all institutions and agencies is targeted.

7.3. The Establishment of Financial Management and Control Standards

With respect to the development of the public financial management and control system, the better registration of account records and provision of reliable financial statements and other data, the Ministry of Finance is developing common accounting and reporting standards. In this framework, the activities relating to “budget classification” and “accounting standards” in compliance with ESA95 and GFS standards have been completed and implementation at pilot institutions and agencies have started.

On the other hand, the information technology processing ensuring automation in budgetary accounting and registry systems should be used in a wider and more effective way. Therefore, the automation activities related to the accounting and reporting system within the scope of the say2000i project have almost been completed and are currently being extended to other institutions to achieve a comprehensive coverage.

7.4. Redefining functions and responsibilities in the area of Public Internal Financial Control

The authorities, duties and responsibilities of the following functions shall be redefined:

• Chiefs of disbursement who take spending decisions within the process of budget implementation,
• Assessment officers,
• Accountants,
• Heads of budget departments and the heads of finance offices who fulfil their tasks within the process of financial control.

The aims are:

• To accelerate the flow of transactions,
• To enhance the economy, efficiency and effectiveness of financial control as a managerial function,
• To transfer the power of ex ante financial control to the line agencies with the necessary care to avoid any risks during the transition period,
• To avoid duplication of efforts.

Internal financial control shall cover the following areas:
• Financial management and control systems,
• Internal audit system,
• A centralised organisation to develop and harmonise standards and methodology for the systems mentioned above.

A separate coordination unit with the task of developing and harmonising standards and methodology for financial management and control systems will be established in the Ministry of Finance (GDBFC). Another separate unit with similar tasks for internal audit system will again be set up in the Ministry of Finance (Internal Audit Committee, see Section 7.6.).

In principle, the responsibility for establishing, maintaining and upgrading the financial management and control systems shall rest with the line agencies. To ease the transfer of these responsibilities and to give support to developing initiatives by the line agencies, further arrangements will be made and their budgetary functions will be strengthened. The line agencies will have to further develop their financial services towards this goal. A decision has been made to establish a separate function of ex ante financial controller at line agencies for this purpose.

The definition of the transition period is of utmost importance. The Ministry of Finance shall monitor and evaluate each line agency with respect to the efficiency of their financial service units and take necessary measures to avoid a prolongation of the transition period.

The Ministry shall see to avoid possible financial risks within this period. The available in-service training facilities of the Ministry of Finance shall be utilised for the development and training of the financial service units in the line agencies. The central and affiliated units of the Ministry of Finance shall undertake duties such as monitoring the budgetary implementations of the agencies and institutions to which ex ante financial control authorities are given, ensuring co-operation and co-ordination, and providing technical assistance to the financial units of the agencies for budgetary and financial control transactions.

At the same time will it be necessary to redefine political and managerial accountability in an explicit way, and to empower those who are given managerial accountability with the spending authority. These managers will have financial liability and will be accountable to the Court of Accounts.

7.5. The Appointment of Internal Auditors to Line Agencies

Internal auditors shall be appointed directly to the highest management level of each spending centre (agency). The prime responsibility of the internal
auditor is to make independent assessments of the quality (economy, efficiency and effectiveness) of the financial management and control system of that institution. He will report to the highest management level on his findings and submit objective recommendations to the management.

The internal auditor is free to draft his annual audit plan and/or make ad hoc audits, while he may take into account any recommendations by the management. The auditor is free in his choice of the sort of audit to be used. He performs his audit work without interference from management and he will not have any responsibility in the functions of management. Procedures for contradictory meetings on the findings will be developed. Any recommendations to improve the FM/C-systems will have to be followed-up by the management within a time period to be set by the Internal Audit Committee. In case of conflict about the findings or their follow-up, the Internal Auditor may report directly to the Internal Audit Committee.

7.6. The Establishment of the Internal Audit Committee

The audits to be performed by internal auditors must be at the same overall quality level in all line agencies and in compliance with EU Acquis. The same standards will be ensured through a pro-active co-ordination activity on central level. For this reason, a central Internal Audit Committee shall be established.

The Committee shall determine internal auditing standards taking into account international and EU best practice and develop networking between all public internal auditors. The Committee shall develop and publish an audit charter and templates for audit manuals and audit trails, as well as relevant guidelines. The Committee will also be responsible for monitoring on the spot whether the internal auditors follow its guidelines.

The Committee shall be established in the Ministry of Finance. It will also carry out a consolidation and general evaluation of all audit reports received from decentralised internal auditors.

7.7. Enhancing the External Audit

The Court of Accounts is a constitutional body conducting external audit on behalf of the TGNA, independently of the executive body. Within this context, its duties, authorities and responsibilities must be redefined accordingly with respect to the Acquis.
All institutions having responsibility for financial decisions on public funds should become subject to the audit authority of the Court of Accounts. The articles of the special acts enabling exemption from the audit of the Court of Accounts must be abolished, thus, enabling the Parliament to fully audit the use of all public resources by line agencies.

The audit carried out by the Court of Accounts, which is currently mainly limited to “compliance audit”, must be directed towards “systems-based and performance audit” together with the enhancement of performance management.

The ex ante financial control functions of the Court of Accounts and the registration of commitments and contracts should be abolished. This will enable the Court of Accounts to focus on its basic role: that of external audit of the government’s management and control systems.

New procedures to ensure adequate and timely discussion of the Court’s findings and recommendations by the Parliament should be developed. The new set of principles which are summarized above and which would bring the Court in line with the INTOSAI standards require an amendment in Act number 832. To realize these changes and respectively to achieve separation of duties between PIFC and external audit functions are also important components of the ongoing reform program of the Turkish government supported by the IMF and the World Bank.

7.8. Legal Regulations

Apart from an amendment in Act number 832 of the Court of Accounts, various legal regulations must be drafted in order to ensure a better-functioning public financial control system compliant with EU rules and standards. Within this context, it is essential to adopt a comprehensive legal basis describing the new concepts, responsibilities and functions of the new PIFC systems.

Such a set of legislation, which may be referred to as public financial control legislation, must include a number of arrangements to be introduced by laws, regulations and by-laws.

Within this context, a draft framework law on “Public Financial Management and Financial Control” is in the process of preparation. The law aims to substitute the present General Accounting Law number 1050 and to rearrange the public financial management and financial control system. The main principles of internal financial control which are based on the considerations in this Policy Paper shall be:

• The placement of the ex ante financial control authority under the scope of the management function and its transfer to the line agencies within the
framework of the principles clearly determined by the Ministry of Finance subsequent to the transition period,

- The restructuring of the financial service units (units of research planning and co-ordination and departments of administrative and financial services) under the line agencies to ensure a sound transfer of authority,
- Defining the transition period until achieving an effective ex ante financial control capacity within the line agencies and continuation of the utilisation of the financial control authority by the Ministry of Finance throughout this transition period.

The framework law is aimed to be in harmony with the Public Procurement Law (A new law on public procurements has been adopted by the Turkish Grand National Assembly and published in the Official Gazette no 24648 dated 22.01.2002) Personnel Law, Law on Debt Management, Law on Court of Accounts, and Law on Local Administrations.

Moreover, amendments to other financial laws shall be made when necessary in order to ensure better functioning of the financial system.

7.9. The Integration of Public Financial Management and Ensuring Unification of Treasury

In order to eliminate the problems related to the improper structuring of public financial managers and to the failures in co-ordination among decision-makers, policies towards integration shall be pursued and legal regulations to this end shall be made.

8. **TIME SCHEDULE**

8.1. For 2002

A draft “Public Financial Management and Financial Control Law” to ensure a more transparent, economic, efficient and effective public internal financial control system and a more economic use of public resources shall be prepared for discussion, taking into the consideration, opinions and recommendations of the European Commission.

The above-mentioned draft law shall be submitted to the Parliament

8.2. For 2003

The set targets shall be evaluated in co-operation with the European Commission, the required amendments to the administrative structure will be
introduced as well as legislation to meet the concerns of weaknesses mentioned in this paper and for avoiding damage to the public funds in areas of high risk.

8.3. For 2004

The implementation process shall be evaluated in co-operation with the European Commission. The standards required by the Commission in Chapters 28 and 29 of the Acquis Communautaire would have to be achieved by the end of year 2004.

9. EXPECTATIONS FROM THE EUROPEAN UNION IN THE PROCESS OF ATTEMPTING TOWARDS IMPROVEMENT

The Ministry of Finance is of the opinion that the following elements would accelerate the alignment process:

- Technical support for the establishment of the Internal Audit Committee which shall be set up under the Ministry of Finance, for the establishment of the internal financial control standards, for the determination of audit manuals and standards, and for their implementation, monitoring and auditing,
- Technical support for the employment and training of internal auditors and for the determination of their occupational principles and methods,
- Technical support for the reinforcement of internal financial control units,
- Technical support for the establishment of a sound financial management to ensure effectiveness, efficiency and economy,
- Educational support on risk analysis,
- Technical support for conducting external audit on the basis of risk analysis and for enhancing the quality of auditing standards,
- Technical support for managerial accountability, the reporting of external audit results, the publicising of these results, and the monitoring activities to be performed in order to observe to what extent the recommendations related to auditing are obeyed.

10. ENDORSEMENT BY THE MINISTER OF FINANCE

With this endorsement, the Minister of Finance confirms that; attempting towards attaining the standards required for Financial Control as per Chapter 28 of the Acquis Communautaire, the Ministry of Finance shall conclude a Government Policy as stated within this policy paper hereby, harmonising the legislation on the said chapter, putting the harmonised legislation into practice, and sustaining the implementation of these legislation.