



**SIGMA**

**Support for Improvement in Governance and Management**

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**TURKEY**

**PUBLIC EXPENDITURE  
MANAGEMENT SYSTEM**

**ASSESSMENT MAY 2009**

## Summary

### *Main Developments since last year*

Since last year, the Government of Turkey has pursued the implementation of its reform of public expenditure management (PEM). Development of strategic planning and performance budgeting is being undertaken according to schedule. Measures to improve financial reporting and to control on-lending (the government's foreign loans ceded to public entities) are being implemented. Strengthening cash management is being pursued. Further training activities have been undertaken since last year's assessment.

By April 2008 a total of 50 strategic plans had been prepared by line ministries and main agencies. Since that date an additional 50 strategic plans have been prepared and reviewed by the State Planning Organisation (SPO), and 20 draft strategic plans are in the process of being reviewed by the State Planning Organisation (SPO). It is expected that all central government ministries and main agencies will have prepared their first strategic plans by 31 December 2009, in conformity with the implementation schedule. Line ministries and main agencies have started to prepare performance programmes ("performance-based budgets"). Performance programmes were prepared by 28 public administrations in 2008, and 80 public administrations are preparing such programmes in 2009. These programmes are evaluated by the General Directorate of Budget and Financial Control of the Ministry of Finance (MoF).

To ensure comprehensive coverage of the general government in financial reports, articles 52 and 53 of the Public Financial Management and Control Law no. 5018 (PMFC Law) were amended in August 2008 and as from 2009 the General Directorate of Public Accounts (GDPA) is responsible for preparing the general government accounts. The scope of the general government has been redefined in order to make it consistent with ESA 95 standards. However, concerning the transactions of social security funds, some discrepancies will probably remain in 2009.

To improve the management of hospitals' revolving funds, a new mode of remuneration of hospitals by social security funds is being implemented. In 2008, in addition to the limit on guarantees, a limit on government foreign loans ceded to public entities was submitted to the Turkish Grand National Assembly (TGNA) for approval. An electronic public payment system (EPPS) is being implemented since 2008. All regional accounting offices and 14 central accounting offices are being integrated into the EPPS. The EPPS, which is expected to be completed in 2009, will enable the Treasury to monitor cash flows continuously and in real time.

The staff of strategic development units, which are responsible for supervising budget management within line ministries, and of the TGNA Planning and Budget Committee are gradually being reinforced. Training activities have also been pursued. However, further actions are still needed in these areas.

### *Main Characteristics (strengths and weaknesses)*

The Government of Turkey has embarked on a comprehensive budget reform, consisting of moving from a system based on strong ex ante controls performed by central agencies towards a performance-based budget system that makes line ministries responsible and accountable. Generally, such a reform entails difficulties and pitfalls. However, for the moment, the government has been successful in implementing the reform measures. The Turkish administrative tradition in PEM, the continued centralisation of some key functions, such as accounting and cash control, and the screening of investment projects have enabled the SPO to limit any possible fiscal risks related to relaxing ex ante centralised controls. The majority of reform measures are being applied according to schedule due to wide involvement in the reform process and informal co-ordination mechanisms between key actors.

However, some key functions in developing accountability and performance-oriented budgeting are still missing. To bring external audit in line with generally accepted international audit principles, a new Law on External Audit has been before parliament since 2005, but it has not yet been adopted. Parliamentary capacity in scrutinising performance monitoring and audit reports is still insufficient.

Neither accountability reports nor performance programmes prepared by line ministries and agencies are reviewed by parliamentary committees. Rules have been elaborated for a Medium-Term Expenditure Framework (MTEF), but decisions on ministries' expenditure ceilings, which frame budget preparation, are reviewed neither by the Council of Ministers nor even by the key ministries of the social sectors. This limits the effectiveness of the MTEF in reinforcing decision-making processes.

Financial management functions are fragmented as they are shared by the Ministry of Finance, the State Planning Organisation and the Undersecretariat of the Treasury. There is a need to reinforce procedures for deeper professional co-operation. There is also a need to establish formal co-ordination arrangements for monitoring and supervision of the implementation of the reform. For the moment, this situation has not hampered the implementation of reform measures in the public expenditure management area. However, the long-term sustainability of such fragmented arrangements may be questioned, and procedures should be reinforced for closer and deeper co-operative work as well as monitoring and supervision of the reform implementation.

In addition, some measures required for fiscal discipline or allocative efficiency have not yet been implemented. Thus measures to restructure the revolving funds have not yet been decided, and the status of foundations and of the Iller Bank is still unclear. There are several processes that are not strongly interlinked, which may lead to inefficient resource allocation. For example, the recurrent and investment budgets are prepared in separate processes. Control of commitments is lacking, which has an impact on the MTEF and the recurrent budgets.

With the introduction of the new Instrument for Pre-accession Assistance (IPA), the Turkish administration has had to formalise new requirements by designating specific roles/responsibilities and introducing new structures. This work has not yet been completed, although the Framework Agreement for IPA was ratified by the TGNA in December 2008.

### ***Recommendations for Reform***

Reforming a budget system is a continuous learning-by-doing process, which needs to be monitored closely in order to address any implementation risk, assess the results achieved, and take correctives measures in a timely manner. A review of progress already made is currently planned. This review will be supported by the World Bank. It will contribute to better identifying the further steps in the reform process. In the absence of special inter-ministerial arrangements for steering reform implementation, the High Planning Council (HPC) should play a key role and should examine the results of this review.

Participation of line ministries should be reinforced. To reinforce its effectiveness, the MTEF that frames budget preparation should be reviewed in the Council of Ministers. Key line ministers in public service delivery, such as the Minister of Education or the Minister of Health, should be members of the HPC when it considers MTEF. It will be important to consolidate actions to strengthen strategic development units (SDUs), which should include further training and, often, further staffing. It will also be useful to considerably strengthen the SDU network, with a view to sharing experiences and improving working methods.

Ongoing reform measures should be pursued, and additional measures to complete the current phase of reforms should be implemented. The new Turkish Court of Accounts (TCA) Law should be enacted. Procedures to better control and monitor expenditure commitments should be implemented. A restructuring plan for revolving funds and decisions on other extra-budgetary entities, such as foundations and the Iller Bank, has to be prepared with a view to reinforcing fiscal control. Capacities for reviewing performance programmes and accountability reports need to be strengthened within parliamentary committees and the TCA.

In a second stage, further steps in developing performance-based budgeting could be considered, which might include such actions as implementing a programme classification in the budget or developing a contractual approach where relevant. However, it should be kept in mind that haste could derail the reform programme. Therefore, for the moment, efforts in developing performance-based

budgeting should focus on completing ongoing reform measures and strengthening capacities in preparing and reviewing accountability reports and performance programmes.

Ideally, budget and fiscal management processes should be considerably reinforced in accordance with procedures for closer co-operative work between the three institutions, with the aim of having the MoF take an even stronger leadership in budget preparation, improving the SPO activities focusing on strategic issues, and having the Treasury act as a MoF agent for debt and cash management. However, hastily transferring responsibilities from one agency to another could pose difficulties in implementing the planned reform measures and in reaching common objectives. Therefore, in the short term, the focus should be placed on processes (performed by the MoF, SPO and Treasury) rather than on organisations. For example, consideration could be given to more closely co-ordinating the preparation and review of the medium-term programme and the medium-term fiscal plan.

## Introduction

This report is the fourth standard assessment report on Turkey against the baselines that have been applied by Sigma for the assessment of the public expenditure management system in EU candidate countries. This report is an update of the 2008 report and is based on information gathered up to April 2009.

### 1. Budget Legislation

The legal framework governing the Turkish budget system consists mainly of the Constitution and the Public Financial Management and Control Law no. 5018 (PFMC Law), enacted in December 2003, which is a public finance framework law. The PFMC Law was amended on 22 December 2005 by Law no. 5436 and on 25 April 2007 by Law no. 5628 as well as on 24 July 2008 by Law no. 5793. The PFMC Law aims to introduce modern budgeting procedures. It replaces the General Accounting Law dating from 1927, which was modelled after the French financial management system of the time.

Secondary and tertiary legislation to implement the PFMC Law has been developed and is being implemented. This legislation includes several by-laws dealing with internal control, internal audit and performance-based budgeting, which were promulgated between 2005 and 4 February 2009, the most recent rules refer to a regulation on the performance programmes that are to be prepared by each administration was published in the *Official Gazette* on 5 July 2008 as well as the guide for development of action plans also by each administration on establishing reviews to ensure harmonisation and compliance with public internal financial control standards. These action plans were originally due to be completed by administrations by the end of 2008, but this deadline has now been extended to end-June 2009, with an overall time scale of implementation by June 2011.

Debt management is regulated by Law no. 4749 of 2002 on Regulating Public Finance and Debt Management. Law Decree no. 178 of 1983 on the Organisational Structure and Duties of the Ministry of Finance, together with the PFMC Law, makes the Ministry of Finance (MoF) responsible for budget preparation, execution, revenue management, accounting and reporting<sup>1</sup>.

To a large extent, the legal framework covers the basic requirements for sound budgeting<sup>2</sup>. The Constitution (articles 161 to 164) and the PFMC Law (articles 18, 19, 42, 43 and 68) specify the deadlines for presenting the draft budget bill and final accounts to parliament, and regulate parliamentary debates on the budget. The PFMC Law recalls the fundamental principles of public financial management, including the unity of the budget, fiscal transparency and accountability requirements. It specifies the responsibilities and accountability requirements of ministers and heads of public administration (e.g. undersecretaries of ministries). It requires the preparation of medium-term fiscal projections, including a medium-term expenditure framework; this has been implemented since 2005 pursuant to this provision. It also requires public agencies to prepare strategic

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<sup>1</sup> The Presidency of Revenue Administration, which is responsible for revenue collection, has been established as a semi-autonomous public administration, reporting directly to the Ministry of Finance – MoF (Law no. 5345, May 2005), while the MoF General Directorate for Revenue Policy is responsible for tax policy formulation. The Undersecretariat of Customs is organised under the Prime Ministry. A state minister is responsible for customs.

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<sup>2</sup> There is no international standard to define the basic principles and requirements for sound budget management. However, the European Commission Regulations nos. 2342/2002 and 2343/20002 of 23 December 2002 enumerate a number of basic principles (e.g. the principle of universality) that should be found in every budget system, while the IMF Code of Good Practices on Fiscal Transparency (IMF-1998) provides requirements for transparency and accountability. See also

[http://www.oecd.org/LongAbstract/0,3425,en\\_2649\\_34119\\_1905251\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/LongAbstract/0,3425,en_2649_34119_1905251_1_1_1_1,00.html)

plans and to develop performance-based budgets; this provision is being implemented gradually but quality remains a concern.

The PFMC Law outlines the central government budget-preparation process and provides general principles for budget implementation. It only sets down broad appropriation management rules. The law includes provisions for managing assets. It provides detailed requirements for reporting, preparing yearly “accountability reports” and submitting final accounts to the Turkish Grand National Assembly (TGNA). It defines the general principles for accounting and the procedures for preparing the chart of accounts.

The law includes detailed provisions for budget management within spending-units, internal control procedures and internal audit. However, the provisions of the PFMC Law dealing with internal control and internal audit do not cover regulatory and supervisory bodies. The law defines gradual sanctions in case of mismanagement. It also includes some provisions on external audit, which should be completed by the new Law on the Turkish Court of Accounts (TCA). This law has been pending in parliament since 2005.

The PFMC Law has brought significant changes to the distribution of responsibilities in budgeting. Line ministries have been made fully responsible for managing their budgets. The MoF budget offices within line ministries, which were involved in budget preparation and execution controls, were phased out in late-2005. Their activities have been transferred to the line ministries themselves. Within line ministries, the “strategy development units”, which were established in 2006, are responsible for financial management, including performance-based budget preparation, strategic planning and internal control. On the other hand, however, the accounting offices of the central government's general budget are still branches of the General Directorate of Public Accounts (GDPA) of the MoF, with the exception of the accounting offices in the Undersecretariat of the Treasury (see section 8 of this report).

The PFMC Law aims to cover all general government financial transactions and to make the coverage of the central government budget comprehensive. Initially, the transitional article 11 of the ninth part of the PFMC Law stated that the revolving funds, which are managed under special procedures, would be eliminated by the end of 2007. As discussed later on in this report, this elimination of the revolving funds did not happen. However, a regulation on revolving funds, published in the *Official Gazette* on 1 May 2007, has strengthened the requirements for reporting on these funds. In addition, the time for restructuring of revolving funds has been extended to 31 December 2010 by the amendment to the PFMC Law through Law No. 5973.

To ensure a comprehensive coverage of the general government in financial statistics, articles 52 and 53 of the PMFC Law were amended in August 2008. The amendments to articles 52 and 53 of the PFMC Law determine the scope of the general government sector and foresee administrative penalties for administrations that fail to report on time.

Law no. 4749 on Regulating Public Finance and Debt Management stipulates that the Treasury, which is responsible for debt management, is the single borrowing authority for the central government. The law establishes a framework for dealing with contingent liabilities.

The budget is unified, but three central institutions are involved in budget preparation, execution and internal control:

- The MoF is responsible for budget preparation, budget execution, accounting and reporting, and revenue collection.
- The State Planning Organisation (SPO) is responsible, among other duties, for preparing the public investment programme and the macroeconomic framework.
- The Undersecretariat of the Treasury (“the Treasury”) is responsible for debt and cash management and for exercising state ownership rights in state-owned enterprises and public banks.

Generally, such fragmented arrangements are not conducive to efficient budget formulation and control. Currently, informal co-ordination mechanisms limit these risks. However, in the longer term, better unification of processes and responsibilities should be sought to avoid making the quality of budget management dependent on such co-ordination mechanisms.

**The baseline for budget legislation has been partly achieved. The PFMC Law, which is the public finance framework law, constitutes a sound basis for budget management. However, a new Law on the Turkish Court of Accounts (TCA Law), which would enable an external audit of budget execution according to the rules defined in the PFMC Law, has not yet been enacted. This fact constitutes a significant limitation to the progress of the PFMC reform. Also, the provisions of the PFMC Law dealing with internal control and internal audit do not cover regulatory and supervisory bodies. The budget process also needs formalisation and stronger co-ordination processes should also be sought.**

## 2. Parliamentary/Executive Relationship

The relationships between the executive branch and the Turkish Grand National Assembly (TGNA) on budgetary matters are governed by the Constitution and the PFMC Law.

According to Article 162 of the Constitution, the budget must be presented to the TGNA 75 days before the beginning of the fiscal year. As a first step, the bill is reviewed by the TGNA's Planning and Budget Committee. The members of this committee can propose any amendment to the bill. The committee must adopt a revised budget bill within 55 days. As a second step, the TGNA debates the budget bill as amended by the Planning and Budget Committee. Article 162 of the Constitution stipulates that during debates in the plenary session on the draft Budget Act, members of parliament may not propose amendments that would increase expenditures or decrease revenues for each section. According to the PFMC Law, the budget is voted on the basis of functions, i.e. according to the 10 main functions set out in the functional classification of government expenditures.

The budget bill must be approved by the TGNA before the start of the fiscal year. If, exceptionally, the law is not voted by the TGNA by the start of the fiscal year, the TGNA may pass a provisional bill authorising the executive to spend up to a certain percentage of the amount appropriated by the budget of the previous year pending the approval of a new budget (article 19 of the PFMC Law). In recent years, the budget has usually been approved on time.

With the implementation of the PFMC Law, the budget documentation presented to the TGNA has improved. The budget documentation now includes the following documents:

- Budget memorandum, including a medium-term fiscal plan (see sections 5 and 6 below);
- Annual economic report;
- Schedule of tax expenditures (public revenues renounced due to tax exemptions, exceptions, reductions and similar practices);
- Public debt management report;
- Last two years' budget realisations and estimates of the next two years' revenues and expenditures of public administrations within the scope of general government;
- Budget estimates of local administrations, social security institutions, extra-budgetary and revolving funds, for information only;
- List of public administrations that are not within the scope of the government but are subsidised by the central government budget and by other agencies and institutions.

Important progress has been made in recent years in terms of the contents of budget documents. In the future, further progress will consist of including performance programmes (also referred to as performance-based budgets) in budget documents. The preparation of these performance programmes is starting gradually, but these reports have not yet been analysed by the TGNA's Planning and

Budget Committee. However, it is unreasonable to expect the full implementation of the performance budgeting approach supported by the PFMC Law at short notice.

The final accounts are communicated to the Turkish Court of Accounts (TCA) within a time limit of six months after the end of the fiscal year. The final accounts are tabled in parliament with the General Conformity Statement (GCS) of the TCA in the following budgetary session of the TGNA.

“Accountability reports” are prepared by line ministries and main agencies and transmitted to the TGNA and to the TCA. The “accountability reports” 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 deviations from appropriations compared to the realisation of the approved budget. However, the “accountability reports” are neither audited by the TCA nor debated by the TGNA.

The Planning and Budget Committee is one of the 17 committees of the TGNA. It has 40 members, of whom currently 25 represent the governing party and 15 the opposition. Its staff have been reinforced recently with the recruitment of six budget analysts. It currently has 25 staff, including three directors, thirteen experts and nine administrative staff, including six experts that were recruited in 2008. Taking into account the increased budget documentation and the new requirements of the PMFC Law, it is foreseen to restructure this committee into two sub-committees, a budget sub-committee and a public accounts sub-committee.

**The baseline for the parliamentary/executive relationship has to a large extent been achieved. The legal framework defines the relationships between the executive branch and the Turkish Grand National Assembly (TGNA). Budget documentation has improved. Strengthening of the Planning and Budget Committee has begun. Nevertheless, further actions are required to enable the committee to review performance programmes, “accountability reports” and performance audit reports.**

### 3. Scope of the State Budget

According to the PFMC Law (as amended), general government operations are covered by: (i) the central government budget, (ii) the budgets of social security institutions, and (iii) the budgets of local administrations. The central government budget comprises: (i) 50 "general budget agencies", which consist of ministries, main agencies and a few general directorates (listed in Chart I of the PFMC Law); (ii) 126 special budget institutions, including 96 universities and higher education organisations (Chart II); and (iii) eight regulatory agencies (Chart III).

Since December 2000, 61 budgetary funds benefiting from special management arrangements and non-budgeted own revenues and eight extra-budgetary funds (EBFs) have been closed. Nevertheless, there are still five EBFs<sup>3</sup> and more than 1400 revolving funds, which are managed separately from general budget expenditures. Expenditures from EBFs account for about 0.3% of GDP. Total expenditures from revolving funds accounted for 2% of GDP in 2008, while central government expenditures accounted for 23.8% of GDP. The budgets of the revolving funds are attached to the budget documents, for information only. Their financial statements are disclosed and transmitted to the TCA, in conformity with the regulation on revolving funds published in the *Official Gazette* on 1 May 2007. Revolving funds are used by hospitals including university hospitals, schools and various departmental enterprises.

The largest share of revolving funds concerns public hospitals. More than half of the public expenditures in the health sector are made through revolving funds. The revolving funds are financed by the social security institutions and by users' fees. The central government budget finances staff salaries and some other expenditures. The revolving fund resources are used to pay the majority of operating expenses and to give bonuses to staff, through a mechanism called "performance-based payment" system. This system has been put in place gradually since 2004. It now covers all Ministry

<sup>3</sup> The Defense Industry Support Fund, the Social Solidarity and Aid Fund, the Privatisation Fund, the Promotion Fund and the Savings and Deposit Insurance Fund.

of Health (MoH) hospitals. Up until 2008, the social security institutions paid the revolving funds on the basis of individual invoices that were issued for each service provided by hospitals. This system was cumbersome and encouraged over-invoicing by the hospitals. In 2009 a new financing system consisting of a global transfer from the social security institutions to the revolving funds, has been put in place; this global transfer is estimated on the basis of indicators, such as the number of patients.

The transitional article 11 of the PMFC Law (amendment of 22 December 2005) stipulates that the revolving funds are to be restructured by December 2007. This provision has now been extended to 31 December 2010 by Law No. 5793. The MoH is considering consolidating the hospital revolving funds into about 81 regional units, but no firm decision has been made. Special management arrangements for the hospitals are generally desirable for efficiency, but the current arrangements are fragmented. Unifying the budgets of the hospitals will facilitate expenditure control and performance monitoring. However, the reform of the hospital revolving funds must be placed in the wider context of the modernisation of hospital management. It will be necessary to clearly define the objectives and the approach to be developed for streamlining the budget management of hospitals. The required measures should be identified and an implementation plan prepared.

The other revolving funds should be reviewed on a case-by-case basis. Provided that their transactions are included in the budget in gross terms, the revolving funds that were set up for cost recovery may be maintained, while the other funds should be eliminated, unless there is a strong case for justifying their maintenance.

Besides the problems posed by the remaining EBFs and the revolving funds, issues concerning foundations and the Iller Bank (nominally an investment bank, which operates under the Ministry of Public Works and Settlement) have raised some concerns. Foundations solicit public donations, often at the same time as the services are provided. In the past their resources have been used partly to supplement line ministry activities, such as for the purchase of vehicles. The ties between the foundations and line ministries were to have been severed<sup>4</sup>. However, there are still concerns about the financial transactions and expenditures of associations and foundations established under public administrations. The TCA has audited these transactions at the request of the TGNA, but the TGNA committee that requested these audits has been dissolved and the TCA report has not been used for any follow-up. The Iller Bank's financial transactions are included in the local government figures and in the general government balance reported by the State Planning Organisation (SPO). However, according to the IMF, the Iller Bank has many characteristics of an extra-budgetary fund (EBF)<sup>5</sup>.

Quasi-fiscal activities, which consist of policy-driven spending implemented by government-owned banks and enterprises, were a major concern in the 1990s. These quasi-fiscal activities came under better scrutiny after the agreement with the IMF in May 2001, and quasi-fiscal losses began to be explicitly budgeted and reported. The draft budgets of all enterprises in which the Treasury's share is above 50 per cent (37 enterprises) are reviewed by the Treasury in order to address budget issues and expected risks. Duty losses of public corporations are currently monitored. Law no. 4603 of November 2000 on setting the legal framework for financial and organisational restructuring of state banks stipulates that the state may not assign any duties to public banks without paying in advance the amount due. Duty losses are therefore funded from the central government budget. This law stipulates that banks must determine their credit policies according to the amount of the budgeted subsidy. The Treasury pays the subsidy monthly on the basis of losses reported by the bank. At the end of the year, the Treasury controls and compares actual duty losses with Treasury transfers.

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<sup>4</sup> According to the Law on Associations and Foundations no. 5072 of January 2004, none of the activities of these foundations should be within the scope of the general government. In addition, article 72 of the PMFC Law stipulates that "no real or legal person may collect any amount on behalf of the public, nor effect payment from the public revenues unless duly authorised pursuant to the laws".

<sup>5</sup> IMF's Report on the Observance of Standards and Codes (ROSC) – Fiscal Transparency Module of March 2006

Expenditures financed by external aid are in principle included in the central government budget. However, there are probably some exceptions, which may concern military expenditures and some external grants.

**Turkey has made progress in recent years in achieving the baseline related to the comprehensiveness of the central government budget. However, the reform of the revolving funds must still be prepared and implemented, and five extra-budgetary funds (EBFs) remain. In addition, the situation of some entities, such as the İller Bank and the foundations, should be clarified.**

#### **4. Monitoring the Deficit and Government Debt**

The main fiscal policy indicators are the overall balance, the primary balance of the central government budget, and the balances of the “consolidated government sector”, as defined in the agreement passed with the IMF. The “consolidated government sector” defined in the IMF agreements consists of the central government budget data and the balances of three EBFs<sup>6</sup>, the Unemployment Insurance Fund, social security institutions, and 21 state-owned enterprises. This definition is not aimed at exhaustive general government accounting, but focuses on the key – and fiscally most risk-exposed – components of public finances. The SPO publishes annual estimates of general government balances in the annual programmes and in the pre-accession economic programmes submitted to the European Commission<sup>7</sup>.

The Statistics Bureau has recently prepared national accounts according to the ESA 95 standards. However, as there are still some discrepancies with European standards, a number of adjustments are being made to the published general government accounts so as to submit fiscal notifications to the European Commission. According to the European Commission’s 2008 evaluations<sup>8</sup>, some conceptual issues concerned, among others, the delimitation of the government sector and the cash basis of accounting for taxes and social security institutions. The lack of ESA Table 2 (government revenue and expenditure) and of ESA Table 6 (annual financial accounts) prevents the application of consistency tests, which are essential for assessing the quality of fiscal data.

As from 2009 the GDPA is responsible for preparing the general government accounts. The “second general communiqué on general government financial statistics”, published in the *Official Gazette* on 4 February 2009, has redefined the scope of the general government in order to make it consistent with ESA 95 standards. However, concerning the transactions of social security funds, some discrepancies will probably remain in 2009.

According to the IMF, the institutional framework established under the Debt Management Law no. 4749 appears to be well designed and implemented<sup>9</sup>. The Treasury publishes a monthly debt management report that contains detailed information and analyses on borrowing and guarantees. This report clearly distinguishes central-government debt, other public sector debt, external debt and domestic debt. It includes sensitivity analysis for debt servicing. Monthly information on debt is provided to the TGNA, and monthly statistics are published on the Treasury website. The Treasury establishes and publishes a monthly debt management strategy, notably to inform the markets.

Regarding the guarantees, the potential liability they represent for the Treasury on the basis of their risk exposure is not added to direct public debt. However, a “risk account” appropriation is included in the budget to cover possible losses from guaranteed debt stock. In addition, state borrowing and

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<sup>6</sup> The Defense Industry Support Fund, the Social Solidarity and Aid Fund, and the Privatisation Fund

<sup>7</sup> Concerning EBFs, the annual programmes includes data for only the three EBFs that are included in the “consolidated government sector” defined in the IMF agreements.

<sup>8</sup> European Commission Directorate-General for Economic and Financial Affairs (November 2008), *Fiscal Notifications of Acceding and Candidate Countries: Overview and Assessment*, Brussels

<sup>9</sup> IMF (November 2007), *Turkey: Financial System Stability Assessment*

guarantee limits and, since 2008, on-lent foreign loan<sup>10</sup> limits are submitted to the TGNA for approval. Article 5 of the Debt Management Law stipulates that: (i) the annual borrowing limit for the general budget of the central government is defined as the difference between the total initial appropriations and the estimated revenues indicated in the annual budget law; and (ii) the limit of guaranteed facility and on-lent foreign loans to be provided within the fiscal year shall be determined by budget laws every year. Since 2008, a commission of up to 1% on on-lending and on guarantees is perceived by the Treasury, instead of 0.5% previously. According to article 8 of the law, sub-national governments and legal entities with more than half of their capital belonging to the government must obtain permission from the Treasury before receiving external financing without Treasury guarantees.

Law no. 5216 of July 2004 on Metropolitan Municipalities limits the debt stock (including interest) of metropolitan municipalities to no more than 1.5 times their annual revenue, while the debt stock (including interest) of other sub-national governments is limited to their annual revenue<sup>11</sup>. New domestic borrowing of sub-national governments in excess of 10% of annual revenues requires the authorisation of the Ministry of the Interior. There are substantial payment arrears on servicing existing municipal debt, which creates uncertainties for fiscal sustainability<sup>12</sup>. It is unclear whether the available data on domestic borrowing from sub-national governments is complete; it should notably be checked whether suppliers' credits are fully reported.

Build-Operate-Transfer (BOT) schemes and other forms of Public-Private-Partnership (PPP) agreements have benefited from the Treasury's guarantees in the water and energy sectors. The guarantees related to PPPs are monitored in the same way as other guarantees. The related fiscal risk is covered by risk-account appropriation. The government has guaranteed minimum sale and price levels in the electricity sector, and the Treasury runs the risk of having to supplement the difference in the event that market demand and price projections fall below these thresholds.

According to the PFMC Law, the budget can include contingency appropriations, which should not exceed 2% of the general budget appropriations, and the MoF must disclose the use of these contingency appropriations within 15 days of the end of the year. This last provision has been applied since the closure of the 2006 budget year.

**Tools have been put in place to monitor the debt and the deficit. Nevertheless, there are potential risks concerning domestic borrowing of sub-national governments. Measures are being taken to ensure that the fiscal notifications to the European Commission are fully compatible with European standards, but their effectiveness cannot yet be assessed. The baseline for monitoring the deficit and government debt has therefore been partially achieved.**

## 5. Medium-Term Expenditure Framework (MTEF)

Progress has been made in developing a multi-year approach to budgeting. Since the preparation of the 2006 budget, the following activities are being carried out during budget preparation:

- Adoption of a medium-term programme (MTP) by the Council of Ministers by the end of May: this programme, which is prepared by the SPO, includes basic macroeconomic policies, economic targets, and indicators projected for the following three years. It is published in the *Official Gazette*.
- Adoption of a medium-term fiscal plan by the High Planning Council (HPC) by 15 June: this fiscal plan is based on the macroeconomic projections of the MTP. It is prepared by the MoF. It includes the following three years' aggregated fiscal targets and an "aggregate MTEF", which sets out expenditure ceilings for each line ministry and main spending-units by broad

<sup>10</sup> On-lending refers to foreign loans contracted by the central government to finance a third party (generally a State Owned Enterprise) and ceded to this third party through an on-lending agreement passed between the government and this third party.

<sup>11</sup> Law no. 5393 of July 2005 for Other Municipalities and Law no. 5302 of February 2005 for Special Provincial Administrations

<sup>12</sup> IMF, ROSC report, op.cit.

economic categories. This “aggregate MTEF” frames budget preparation. It is published in the *Official Gazette*.

- Then, on the basis of the “aggregate MTEF”, line agencies prepare forward estimates, or a “detailed MTEF”, together with their submissions for the annual budget. These forward estimates are included in the budgetary documents and presented in the same format as the budget.

The High Planning Council (HPC) is composed of the Prime Minister acting as the chair, the Minister of State for Treasury, the Minister of Finance and the ministers managing the most significant investment budgets (Ministers of Transport, Industry and Trade; Energy and Natural Sources; and Public Works and Settlement), and the Undersecretary of the SPO.

Key line ministers in public service delivery, such as the Minister of Education or the Minister of Health, are not members of the HPC. Depending on the topics to be discussed by the Council, the chair may invite other ministers and policy-makers to participate.

The MTEF prepared in June is used to provide a framework for line ministries' budget preparation, but line ministries may present additional requests that exceed the MTEF ceilings. The system is new and will develop over time, although there may be significant discrepancies for the same year “t” between the expenditure projections of the year “t” to “t+2” MTEF and of those of the year “t-1” to “t+1” MTEF, prepared the previous year.

As implementing an effective multi-year budgeting system will take time, efforts have begun to strengthen the MTEF procedure, with a view to ensuring that the MTEF ceilings are more effective during budget preparation. A review by the Council of Ministers of the MTEF expenditure ceilings should be favourably considered, with the view to improving the involvement of line ministries in decision-making on expenditure ceilings. The medium-term programme and the medium-term fiscal plan could be reviewed at the same time by the Council of Ministers.

**Substantial progress has been made in medium-term programming and planning. Since 2006 the budget has been placed within a multi-year perspective. Actions to ensure the effectiveness of the multi-year budgeting approach should be pursued.**

## 6. Budget Process

The budget preparation cycle is organised as follows:

- In May-June, as set out in detail in section 5 above, the medium-term programme (MTP) and the medium-term fiscal plan, which includes an “aggregate MTEF” are adopted and published in the *Official Gazette*.
- By the end of June, following the HPC meeting, the Ministry of Finance issues a budget call and a budget preparation guide. The SPO issues an investment circular and an investment programme preparation guide. These documents, published in the *Official Gazette* by the end of June, reflect general principles and objectives. They include calculation methods, sample schedules and tables to be used for preparing budget submissions. The MTEF provides the expenditure ceilings that set the framework for line ministries' budget preparations. As noted above, separate ceilings are established for broad economic categories of expenditure (personnel, goods and services, investment, etc.).
- In late-June and July, line ministries and other agencies prepare their budget submissions. They submit their budget submissions to the MoF and their investment project proposals to the SPO by the end of July. These proposals must be consistent with the budget submission sent to the MoF. The general budget revenue projections are prepared by the MoF, while for other revenues draft projections are prepared by the relevant agencies.
- In August-September, following submission of the budget proposals to the MoF, meetings are held with line ministries on their budget submissions. The investment project proposals are scrutinised by the SPO.

- In September, the MoF drafts the budget bill and a budget memorandum.
- In the first week of October, the macroeconomic indicators and budget figures are reviewed by the HPC.
- At the beginning of October, the budget bill is approved by the Council of Ministers.
- No later than 75 days prior to the beginning of the fiscal year, the budget bill is tabled in the TGNA and enacted according to the procedure discussed above (section 2).

The budget preparation calendar and the deadlines for presenting the budget bill to the TGNA are respected. The guidelines provided by the MoF and the SPO allow expenditure items, such as personnel expenditure and investment projects, to be reviewed in detail.

Prior to 2005, budget preparation within line ministries was supervised by the MoF budget offices located in line ministries. Since 2006 line ministries have been fully responsible for their budget submissions, which are prepared by “strategy development units”.

Strategic planning is being developed according to the implementation schedule defined in the By-law on "principles and procedures for strategic planning in public administration". In April 2008, 50 strategic plans had been prepared by line ministries and main agencies. Since that date an additional 50 strategic plans have been prepared and reviewed by the SPO, and 20 draft strategic plans are in the process of being reviewed by the SPO. It is expected that all of the 145 central government ministries and main agencies will have prepared their first strategic plan by 31 December 2009, in conformity with the implementation schedule<sup>13</sup>.

In parallel to their strategic planning calendar, line ministries and main agencies have started preparing performance programmes ("performance-based budgets"). Performance programmes were prepared by 28 public administrations in 2008, and 80 public administrations are preparing such programmes in 2009. These programmes are evaluated by the General Directorate of Budget and Financial Control of the Ministry of Finance.

The development of a performance culture throughout the government will take time. Therefore, it is difficult to assess the effectiveness of these recent actions. It will be necessary to ensure the adequacy of the support infrastructure for the exercises that are to be carried out and/or the suitability of the methodology for existing accounting systems and human resource capacities. It will be necessary to assess the results of the current experiences before moving forward and in particular before considering a revision of the budget classification.

Despite progress made, the budgeting process still presents some weaknesses. As noted above, the role of the MTEF, prepared in June, needs to be reinforced. The MoF and the SPO co-ordinate to ensure consistency between the investment programme and the budget. The total investment budgets of line ministries and main agencies are determined by both the MoF and the SPO together. Nevertheless, the recurrent and investment budgets are prepared in separate processes. Separate MTEF ceilings for the investment and the recurrent budgets are prepared in June and announced to line ministries. This procedure could lead to inefficiencies in resource allocation, notably because it does not encourage line ministries to make trade-offs between recurrent spending and investment and to review the recurrent costs of investment projects.

**The implementation of the public financial management and control reform is progressing satisfactorily. The budget-preparation calendar is generally respected, although procedures need to be established to facilitate closer and deeper co-operative work, with the aim of remedying current inefficiencies in resource allocation, which is notably attributable to the fragmented budgeting processes.**

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<sup>13</sup> Regulatory and supervisory bodies, and the organisations founded after the By-law on the Procedures and Bases for Strategic Planning are not covered in the planned implementation schedule. Moreover; according to the regulation on strategic planning, the Ministry of National Defense, Ministry of Foreign Affairs, General Secretariat of National Security Council, Undersecretariat of National Intelligence Organisation, General Commandership of Gendarmerie and Commandership of Coastal Security are not obliged to prepare strategic plans.

## 7. Budget Management of Public Investments

As indicated above, investment programming is co-ordinated by the SPO, which reviews in detail the investment requests of line ministries, verifying whether the projects included in these requests have undergone a feasibility study.

In principle, if the proposed projects have not been studied for feasibility, they cannot be included in the budget. The PFMC Law confirms this procedure and stipulates that an “investment project which does not have a feasibility study, including environmental analysis and cost-benefit or cost-efficiency analysis, and those which are examined and not approved for feasibility by the SPO shall not be included in the investment programme” (article 25).

The investment programme prepared by the SPO sets out in detail the investment component of the budget by project. Its scope is wider than the central government budget, because it also covers the investment projects of state economic enterprises, the Iller Bank, and foreign-financed projects of local administrations. The investment programme is finalised by the SPO after the budget has been enacted. The programme is published in the *Official Gazette* by a decree of the Council of Ministers within 15 days following the entry into force of the Budget Law (article 19 of the PFMC Law). The current procedure ensures consistency between the investment programme and the budget from a financial point of view. As noted above, this arrangement is not conducive to efficient resource allocation. Nevertheless, the activities currently performed by the SPO in the public investment area are essential to ensure that the most cost-effective projects are selected. Therefore, before considering a revision of the current arrangements in investment programming, capacity in investment project preparation and screening should be strengthened within line ministries.

A National Fund has been established within the Treasury to manage EU assistance allocated to Turkey. Specific roles and operating procedures are being defined with regard to procurement, payment reporting, accounting and audit. With the introduction of the new Instrument for Pre-accession Assistance (IPA),<sup>14</sup> the Turkish administration has had to adapt existing arrangements and formalise new requirements by designating specific roles/responsibilities and introducing new structures. This work has not yet been completed, although the Framework Agreement for IPA was ratified by the TGNA in December 2008. Projects to be implemented and financed from EU funds must be included in the investment programme. The national co-financing portion of these projects is currently budgeted as a global item. In the investment programme, domestic counterparts are designated on a project-by-project basis.

In recent years, implementing agencies have been given increasing flexibility during the project implementation process, especially as a result of certain measures that have been taken, such as aggregating several similar projects under a single project and providing investing institutions with enough room to make the necessary changes among the sub-projects. In 2009 public administrations have been granted the authority to transfer capital allocations between projects within the same sector and to initiate projects included in the investment programme.

**Turkey has partially achieved the baseline for budget management of public investments. Procedures have been put in place to supervise investment programming and project selection of line ministries. The SPO, which is staffed by competent professionals, scrutinises investment requests. Since investment programming is somewhat disconnected from recurrent budget preparation, there are risks of inefficiencies in resource allocation, but before considering a revision of the current arrangements in investment programming, capacity in investment project preparation and screening should be strengthened in line ministries.**

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<sup>14</sup> 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.

## 8. Budget Execution and Monitoring

The government's budget reform programme is aimed at streamlining the current budget-execution system. Budget offices and heads of finance offices have been phased out. The personnel of budget offices have been partially transferred to spending-units. In addition, the numerous centralised controls over budget execution of spending agencies previously performed in budget management have been transferred to spending agencies. Turkey has taken a holistic approach to the establishment of an internal control system to assist management in implementing the activities specified in strategic plans and performance programmes. Internal control is being developed and a department for internal control has been established within the strategy-development units of spending agencies; the regulatory framework has been set up. However, the new internal control procedures have not yet been fully implemented, as they have a broader remit than ex ante controls.

Accounting offices are responsible for payment transactions and accounting. Concerning the general budget of the central government, approximately 1600 accounting offices spread throughout the country are MoF offices, and are staffed and controlled by the General Directorate of Public Accounts (GDPA), except for the three accounting offices in the Undersecretariat of the Treasury<sup>15</sup>. According to article 61 of the PFMC Law, accounting services for the general budget continue to be provided by the MoF, but their function focuses on accounting and payment transaction processing, with regularity control being placed under the responsibility of line ministries. The only control performed by the accounting offices is an automated control of payment orders against allotted appropriations. The accounting offices of agencies outside the general budget (e.g. universities) are under the responsibility of the relevant agencies.

The Treasury is responsible for cash management. Borrowing and debt service payments are administered centrally by the Treasury. Funds are released to spending agencies according to a quarterly cash plan prepared by the Treasury in close co-ordination with the MoF and line agencies. Payment transactions are subsequently made through the accounting offices.

At the central level, the cash management system constitutes the "central system", covering the accounting offices of the headquarters of line ministries and main agencies. In this system, bank accounts used by line ministries are kept with the Central Bank. Upon the request of the accounting offices, the Treasury transfers funds to these Central Bank accounts, and the line ministry subsequently effects payments from this account. For the accounting offices of subsidiary units, progress towards a treasury single account (TSA) was made in 2007. The accounts are still kept with the Agricultural Bank (*Ziraat Bankasi*), but under the new system each accounting office holds one account for payments and one account for receipts. Since September 2007 accounting offices can use only the amounts in their payment account that have been transferred from the Treasury for payments, and they cannot use the amounts in their receipt account. Another improvement in the system is that accounting offices are using the Say2000i IT system for their cash requests. The Treasury can therefore monitor the cash needs of these offices one day prior to their payments. Also, transfers of the balances of these accounts to the Treasury are made daily, instead of the previous weekly transfers. An electronic public payment system (EPPS) is under implementation since 2008. All regional accounting offices and 14 central accounting offices have been integrated into the EPPS. The EPPS, which is expected to be completed in 2009, will enable the Treasury to monitor cash flows continuously and in real time.

The revolving funds and EBFs are not integrated into this Treasury cash management system; their bank accounts are kept with commercial banks.

Budget execution is monitored regularly. The Say2000i IT system is implemented in all accounting offices for the central government except four regulatory and supervisory institutions and one special budget. Five public administrations outside the scope of the Say2000i system send their data to the GDPA electronically at the end of the month; the data is included in the system database. This system

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<sup>15</sup> The three accounting offices in the Undersecretariat of the Treasury are the State Debt Accounting Office, the Domestic Payments Accounting Office, and the Foreign Payments Accounting Office.

allows budget execution to be monitored in real time on a cash and accrual basis. Summary budget execution is published monthly on the GDPA's website. This system or its deployment still seems uncompleted, because transactions need to be entered manually for the above-mentioned institutions.

The SPO is responsible for monitoring investment expenditures. Institutions send information on the implementation of investment projects to the SPO on a quarterly basis. This information is consolidated by the SPO and published as a "Public Investment Report".

The PFMC Law includes a general provision that limits transfers between budget items to 5% of the amount of the appropriation, unless a different ratio is specified in the annual Budget Law. No transfer is to be carried out from personnel expenditure, interest expenditure and risk account items to other items. Protecting personnel expenditures does not encourage spending agencies to make savings in this area. A "budget item", specified in the annual Budget Law, corresponds to the lowest level of functional and administrative classifications and to the second level of the economic (input) classification (e.g. nine categories for goods and services). Detailed input controls could hamper efficiency in programme implementation, but to increase the flexibility of budget execution the ratio limiting transfers between budget items has been increased to 20% in the annual Budget Law, as compared with 5% in the PFMC Law. The transfers of up to 20% are carried out by the agencies, while transfers exceeding 20% require the authorisation of the Ministry of Finance.

Systematic commitment accounting and reporting are not carried out. Currently, the Say2000i IT system does not register commitments against appropriations, and there is no monitoring of multi-year commitments. Consequently, commitments may exceed the budget authorisation. It would therefore be advisable to consider the elaboration of instruments for managing and controlling multi-year commitments. The MoF has implemented for its own internal needs an information management system, which includes functionalities for procurement management. This system will contribute to improved expenditure control. A protocol to implement this system has been passed with 13 institutions.

**Significant progress has been made. The baseline for budget execution and monitoring has been partially achieved. The internal controls of central agencies have been partially modernised. However, the new internal control and audit systems still need to be considerably enhanced and made fully operational. Commitment control and reporting should be implemented. Cash management is being streamlined, except for revolving funds and EBFs.**

## 9. Accounting and Reporting

The General Directorate of Public Accounts (GDPA) of the MoF is responsible for government accounting. Detailed accounting records are kept in accounting offices. Data on physical assets are kept by line ministries and agencies, but each transaction is transmitted to the GDPA.

There is a unified accounting and budget classification for budget organisations. Since January 2006 the chart of accounts of local governments has been consistent with the general accounting framework. In 2007 the chart of accounts for revolving funds was harmonised with the chart of accounts for general government. Nevertheless, for the moment extra-budgetary funds (EBFs) have different charts of accounts. Accounting manuals now exist and all institutions have guidelines. Some form of accrual accounting system is applied. Liabilities (excluding superannuation liabilities), financial assets and movable assets are accounted for on accrual basis. Immovable assets acquired since 2004 are also accounted for on an accrual basis, although the accounting methods for some transactions, such as depreciation, may differ from international standards. The IPSAS standards are being implemented progressively; to date five standards have been implemented, and it is expected that all IPSAS standards will be implemented by 2014. In Sigma's opinion this target date is optimistic, as there are many other features that have to be applied before full implementation can be deemed to be completed, especially the requirements to audit the accounts.

The budget classification system includes a functional classification – based on the Classification of Functions of Government (COFOG) – and an economic classification of expenditures compatible with the Government Financial Statistics (GFS) standards.

In-year financial reports of the central government are published monthly. The Say2000i IT system has facilitated in-year reporting. The GDPA publishes on its website monthly financial reports on the central government budget. According to article 53 of the PFMC Law, financial reports of social security institutions and of local government authorities should be published quarterly by the MoF. However, the MoF is facing difficulties in gathering in-year financial reports from social security institutions. To date only budget revenue and expenditure data have been gathered. However, there are plans to also report on data on assets and liabilities in the near future.

The final accounts are prepared by the GDPA and communicated to the TCA within six months of the end of the fiscal year. They are tabled in parliament, together with the General Conformity Statement (GCS) of the TCA, in the subsequent budget session of the TGNA.

At the end of the fiscal year, the public accounts are kept open for a complementary period of one month so that deferred payments can be made. Spending-units that have used up their approved allocation may benefit from advance payments, which should also be regularised within one month of the end of the fiscal year<sup>16</sup> Advanced payments are authorised within the limits of budget appropriations, but nevertheless such a practice often presents potential fiscal risks and should be eliminated.

All ministries and main agencies prepare annual activity reports (referred to as “accountability reports”). The MoF compiles the reports and drafts a consolidated “general accountability report” on central government institutions and social security institutions. Local administrations also prepare their annual accountability reports, which are sent to the Ministry of the Interior (MoI). They are consolidated in the “local administrations’ general accountability report” by MoI and submitted to MoF. Individual reports are copied to the Planning and Budget Committee of the TGNA and to the TCA for audit. However, no such audits have yet been carried out due to the lack of a legal mandate for the TCA.

**The current system of accounting and reporting by institutions meets the basic requirements of monitoring, but the charts of accounts of EBFs still have to be made consistent with the government’s unified accounting framework. The baseline has therefore been partially achieved.**

## 10. Capacity for Upgrading the Public Expenditure Management System

The current reform involves a dramatic change in the budgeting culture. It addresses good governance procedures and the implementation of accountability approaches. Such changes require time and technical capacity, long-term political commitment, and proper arrangements to manage the change. In this regard, there is currently a good commitment to change in the executive branch.

For the moment, the reform measures are being implemented successfully without setting up special arrangements, thanks to good co-operation among the core agencies involved in the reform. However, the reform will face a long phase of trial and error processes, which will require close monitoring so as to draw lessons from experience. This could call for strengthening and formalising supervision mechanisms. In the absence of special inter-ministerial arrangements for steering reform implementation, the High Planning Council (HPC) should play a key role. Thus, the results of the planned review of progress made under the reform should be submitted to the HPC, in order to allow this Council to consider appropriate measures to improve the monitoring and to strengthen the reform process.

The strategic development units (SDUs) of line ministries and main agencies are playing a key role in the arrangements for managing public expenditure. It will be important to pursue actions to strengthen them.

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<sup>16</sup> According to article 51 of the PFMC Law, under special circumstances this period may be extended to five months for non-budgetary transactions (amended by 5793/46 on 06.08.2008).

Training activities have already been carried out. Thus the training department of the General Directorate for Budget and Fiscal Control (GDBFC) of the MoF has delivered various training and awareness seminars for implementing the PFMC Law. In 2008, 105 public administrations have been trained for 18 days on the preparation of performance programmes. A Web site dedicated to strategic planning has been set up. These efforts should be pursued further and should also be addressed to relevant top management levels.

From 2004 to 2008, the Dutch Government has provided support for the implementation of the PFMC Law, through the MATRA programme. In 2007-2008, among other activities, 195 heads and managers of 114 strategy development units have been trained. The GDPA has benefited in 2007-2008 from an Italian twinning project to publish government financial accounts according to the ESA 95 standards.

Further training and exchange of experience with peers will be needed. These activities may concern all PEM areas, but special attention should be paid on performance monitoring and auditing. They should involve line ministries, TCA, and TGNA committees. Training and exchange of experience on performance monitoring within some key sectors should be undertaken for the relevant line ministries.

### ***Recommendations for Assistance***

Officials involved in public expenditure management within the Turkish Government are generally skilled and competent. However, taking into account the nature and complexity of the ongoing reform, further training and exchange of experience with peers will be needed. These activities may concern all PEM areas, but special attention should be paid to performance monitoring and auditing, which should involve line ministries, the TCA and TGNA committees. Training and exchange of experience on performance monitoring within some key sectors should be undertaken for the relevant line ministries.