



SIGMA

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TURKEY

**PUBLIC INTERNAL FINANCIAL
CONTROL (PIFC)**

ASSESSMENT MAY 2009

1. Summary

This report provides the second standard assessment of Public Internal Financial Control (PIFC) in Turkey against the baselines that have been applied by Sigma for the assessment of PIFC systems in EU candidate countries. It focuses on the internal control, internal audit and accountability areas set out in Part Five of the Public Financial Management and Control Law No. 5018 (PFMC Law), while recognising that these areas constitute an integral part of the wider development of public financial management in Turkey. In this regard, separate Sigma assessment reports cover Public Expenditure Management and External Audit in Turkey.

Main Developments since Last Year

Since the 2008 assessment there has been progress in a range of areas, including further development of internal audit, assessment of internal control needs, training and additional guidance, and the establishment of a modified structure for the Central Harmonisation Unit (CHU). But, a number of key areas remain to be developed, and two in particular (the publication of a revised PIFC Policy Paper and the completion of Action Plans by each administration, establishing reviews to ensure harmonisation and compliance with public internal financial control standards) were not completed in 2008 as planned.

The administration now recognises that the transition from the previous system to the new system – as expressed by the PFMC Law as from 2003 and with the latest amendments by Law No. 5793 as from July 2008 – has to be managed over a period time with a phased approach. It is now accepted that the full introduction of internal control will take a number of years, with mid-2011 being set as the target date for full implementation of the financial management and control arrangements and of internal audit, although exceptionally, in certain identified cases (to be reported by June 2009), a longer period will be accepted. In Sigma's opinion this target date is optimistic, especially in respect of internal audit and local administrations.

While most structures are now set out in law, operational implementation has still to be fully developed. Many of these gaps will be addressed by the twinning project for strengthening PIFC and the World Bank project providing training for internal auditors both of which commenced in 2009.

Main Characteristics (strengths and weaknesses)

The current primary, secondary and tertiary legislation provides a basic framework for management control and for procedures covering internal control. While the Ministry of Finance is specified by law to be responsible for defining, developing, and harmonising financial management and internal control, a number of other administrations are closely involved in this area due to their role in the context of the PIFC system, such as the budget process (Undersecretariat of the State Planning Organisation and Undersecretariat of the Treasury). Furthermore, the Ministry of Interior, due to its role with regard to municipalities, is represented on the Internal Audit Co-ordination Board affiliated to the Ministry of Finance. ***It will be important to ensure that such a diversity of interests does not impact on the prime responsibility of the Ministry of Finance in the area of financial management and internal control.***

The law also provides for new structures reflecting accountability and reporting requirements through annual accountability reports, and the setting up of internal audit units. However these are not yet fully in place and a key stage in the further development of PIFC will be the wider operational implementation of the reforms set out in the laws and guidance.

Recommendations for Reform

A number of recommendations are highlighted in ***bold italics*** throughout the assessment, and it is hoped these recommendations will be taken forward by the Turkish authorities and, where appropriate, reflected in a revised policy paper, supported by a high-level action plan and a more detailed operational plan (roadmap). The following are of particular significance:

There is still the perception that top management needs to take fully on board the concept of PIFC ownership and ensure that internal audit is recognised, fully staffed and given full authority.

More generally there is a need to develop procedures for the general oversight of all administrations to ensure that full commitment is achieved. This is particularly so in respect of the local administrations. In particular, it will be important for the new measures to be “owned” at all levels, for operational activities (as well as laws) to be fully implemented with adequate staff and other resources, for there to be full co-ordination with all parties, and for overall monitoring to be provided so as to ensure that internal controls, including internal audit operations, are sufficient. Until internal control systems and internal audit units are fully established and operational in all central and local administrations, there remains a risk of non-compliance with the new features of PIFC, as expressed in PFMC Law No. 5018.

Consideration should be given to ensuring greater transparency, not only by submitting the annual reports of the Internal Audit Co-ordination Board (IACB) on internal control and internal audit to the Minister of Finance, but also by informing the Council of Ministers and the Turkish Grand National Assembly (TGNA) of the current state of affairs with regard to the public internal financial control system.

In addition, consideration should be given to reviewing the role of the IACB by transferring technical issues to the Central Harmonisation Unit for Internal Audit (CHU/IA) and leaving the Board as a high level semi independent body with the policy role of monitoring the overall development of PIFC.

A number of internal control departments of SDUs are not yet staffed or fully operational. These gaps should be filled at an early date in view of their key role on PIFC within administrations

There is also a need to define and delineate the respective roles of internal audit and the inspectorates.

2. Baseline Questions

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

The main legislation covering PIFC is the Public Financial Management and Control Law No. 5018 (PFMC Law)¹. It is supplemented by a range of secondary and tertiary legislation and supporting documentation. The PFMC Law regulates the broad structure and functioning of public financial management, covering accountability, fiscal transparency, strategic planning, performance-based budgeting, accrual accounting, internal control, and internal and external audit. The Law on Municipalities No. 5393² and the Metropolitan Municipality Law No. 5216 replicate the provisions on financial management and control set out in the PFMC Law.

The PFMC Law covers 184 central government administrations, two social security institutions, and around 3000 local administrations. However, regulatory and supervisory agencies³ are excluded from the requirements of accountability reporting (article 41) and from the whole of Part Five of the law, covering internal control, and similar exclusions apply to revolving funds – see below.

Public Internal Financial Control

The requirements set out in Part Five of the PFMC Law are supplemented by the Procedures and Principles on Internal Control and Ex Ante Financial Control (No. 26040 of 31 December 2005), a general communiqué on public internal control standards (No. 26738 of 26 December 2007) and an action plan guide for the harmonisation of internal control standards issued on 4 February 2009. In addition, there is a By-law on the Preparation of Accountability Reports in Public Administrations (No. 26111 of 17 March 2006), a By-law on the Working Procedures and Principles of Strategic Development Units (No. 26084 of 18 February 2006), and a By-law on Financial Services Expert Profession (No. 25664 of 25 August 2007).

Accountability – Articles 8, 10 and 11 of the PFMC Law specify that officials who are assigned duties are accountable and responsible for the effective, economic and efficient use of resources. In an amendment to the PFMC Law (No. 5793 of 24 July 2008) ministers are responsible to the Prime Minister and to the TGNA for effective, economic and efficient use of resources as well as for legal and financial issues⁴. Heads of administrations are accountable to ministers and, in the case of municipalities, to their local councils for the implementation, monitoring and supervision of internal control systems. Similarly, heads of spending-units (authorising officers) are accountable to the heads of the administration. Moreover, the law specifies that all officials involved in transaction processes are obliged to follow the internal control requirements.

Public internal financial control: objectives and coverage – The laws cover both financial and other controls, relate to all officials involved in the transaction process, and are based on the five components of the COSO/INTOSAI standards⁵ (control environment, risk management, control activities, information and communication, and monitoring). The laws set out the objectives of internal control⁶, the roles of key operators [ministers, heads of administrations

¹ Public Financial Management and Control Law No. 5018, enacted in December 2003 and principally amended by Law No. 5436 in December 2005 and Law No. 5793 in July 2008 (hereafter referred to as the PFMC Law)

² Law No. 5393 of 3 July 2005 amended by Laws No. 5538, 5568, 5594, 5675 and 5747

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

⁴ Article 31 of Law No. 5793 of 24 July 2009

⁵ COSO (Committee of Sponsoring Organisations of the Treadway Committee); INTOSAI Guidelines for Internal Control Standards for the Public Sector

⁶ The objectives of internal control are set out as follows: a) To manage the public revenues, expenditures, assets and liabilities in an effective, economic and efficient way; b) To ensure that public administrations operate in accordance with the laws and other legislation; c) To prevent irregularities and fraud in all kinds of financial decisions and transactions; d) To

(undersecretaries/mayors), authorising officers (heads of spending-units), accounting officers, realisation officers, Strategic Development Unit (SDU), and spending-unit staff], and the necessary qualifications for certain positions.

Ex ante controls – Part Five of the PFMC Law and the Procedures and Principles on Internal Control and Ex Ante Financial Control contain details of the ex ante financial control arrangements and indicate those responsible for specific activities. Broadly, these activities fall into two categories – those undertaken within spending-units and those undertaken within each administration’s SDU. These activities are based on long-standing requirements, and appropriate systems are largely in place.

Reporting – Article 41 of the PFMC Law requires administrations to issue annual “accountability reports”⁷. These reports are published by the heads of administrations and are supported by *internal control assurance declarations* signed by each authorising officer, the head of the SDU and the head of the administration. The declarations are intended to attest that resources were used in accordance with sound financial management and that the internal control system in place provided sufficient assurance of legality and regularity. ***Sigma remains of the opinion that the full application of these assurance declarations should have awaited the implementation of the internal control plans being developed by the SDUs and the provision of additional guidance from the Central Harmonisation Unit for Financial Management and Control (CHU/FMC).*** More generally, it is now recognised that there is a need for a review of the quality, content and follow-up assessment of these annual accountability reports⁸.

Copies of annual accountability reports are sent to the Turkish Court of Accounts (TCA) and to the Ministry of Finance, which issues a general “accountability report” that is also published and sent to the TCA. (Similar arrangements apply for local government, except the copies are submitted via the Ministry of Interior). According to the Law on the Preparation of Accountability Reports, the Turkish Court of Accounts (TCA) is required to submit this report along with its own opinion to the TGNA, although we understand that this has not yet happened, pending approval of a revised law on the TCA (see Sigma’s 2009 assessment of External Audit in Turkey). ***This issue needs to be rectified at an early date to ensure transparency and to provide an opportunity for debate in the TGNA.***

Accounting

Article 49 of the PFMC Law requires the establishment of a financial management information system. Accordingly, the Ministry of Finance has developed the Say2000i system to implement the central government accounting system. This accounting system uses both accrual basis and cash basis forms of accounting – financial transactions are recorded on an accruals basis whereas budgetary transactions are recorded on a cash basis. A Government Accounting Standards Board has been established, consisting of nine members⁹. Full implementation of the IPSAS Standards is planned for around 2014. It should be noted that the IPSAS Standards also place high requirements on both internal and external audit. The General Government Accounting Regulation regarding the establishment of an accounting system has been issued and put into practice as have those for central government, local administrations and the social security institution. Various communiqués on

ensure regular, timely and reliable reporting and acquisition of information for taking decisions and monitoring; e) To prevent the misuse and waste of assets and protect against losses.

⁷ The scope of these reports is set out in the By-law on the Preparation of Accountability Reports in Public Administrations issued by the Ministry of Finance (No. 26111 of 17 March 2006). This by-law includes sections on the administration’s mission, authorities and responsibilities, structure (management and control system), information on budget implementation and performance results, together with an evaluation of overall strengths and weaknesses and recommendations with regard to risks.

⁸ This review will be taken forward in part by a project carried out for the State Planning Organisation (SPO) by Sabanci University, “Project on Managerial Capacity Need Analysis Required by Strategic Management and Establishment of Capacity Development Programs in the Public Sector”.

⁹ The Government Accounting Standards Board members are: three officials from the Ministry of Finance, and one each from the Court of Accounts, Ministry of Interior, Council of Higher Education, SPO, Undersecretariat of the Treasury, and the social security institution.

accounting practices have been issued, including procedures for financial and physical assets (in part) and liabilities, although some arrangements for physical assets are to be reviewed.

Internal Audit

The fundamental requirements and tasks of internal audit, as well as the qualifications and appointment of internal auditors, are set out in articles 63-65 of the PFMC Law and in the By-law on the Working Procedures and Principles of Internal Auditors (No. 26226 of July 2006, amended in 2008) and the By-law on Selection, Training and Certification of Internal Audit Candidates (No. 25960 of October 2005). The 2008 amendment to By-law No. 26226 allows for a wider range of eligible qualifications, a lower foreign language examination score, and an increase in the number of internal auditor posts for public administrations from 1369 to 1984. In addition, a number of other secondary and tertiary laws are in place, setting out detailed procedures for appointments and operations¹⁰ published by the IACB. Guidelines on quality assurance and on IT auditing have been prepared and are ready for publication.

Internal Audit Co-ordination Board (IACB)

The legislative framework for the IACB¹¹ is set out in articles 66 and 67 of the PFMC Law and in the By-law on the Working Procedures and Principles of the Internal Audit Co-ordination Board (No. 25960 of October 2005). The IACB is required to regulate and co-ordinate internal audit matters by providing guidance materials, developing training, and monitoring progress through the evaluation of internal audit reports provided by the administrations. Article 67 of the PFMC Law requires the IACB to issue a consolidated annual report on these evaluations, submit it to the Minister of Finance and “publicize it” The first report (covering 2008) is to be issued in May/June 2009 and will provide an assessment of the quality of both internal audit and the operation of internal controls. ***It is regrettable that such a significant report will be given what appears to be limited scope for informed debate and will lack the legislative force to follow up any weaknesses in the PIFC system. It is Sigma’s view that this report, which is seen by the Turkish administration as an “historic” development in transparency, should be made available to the TGNA, as is the consolidated General Accountability Report, so that there is full transparency and an opportunity for debate.***

EU Requirements

In 2002 the Pre-Accession Instrument for Turkey established the Central Finance and Contracts Unit (CFCU) and the National Fund (NF) and designated their specific roles and operating procedures covering procurement, payments, reporting, accounting and audit. With the introduction of the new Instrument for Pre-accession Assistance (IPA),¹² the Turkish administration has needed to adapt existing arrangements and formalise new requirements by designating specific roles/responsibilities and introducing new structures. While the introduction of new structures has been completed, the accreditation process has not yet been finalised, although the Framework Agreement for the Instrument for Pre-accession Assistance (IPA) was ratified in the TGNA in December 2008.

The current primary and secondary legislation (which was expanded and refined in 2008) provides the basic requirements for the implementation of public internal financial control. This legislation is supplemented by a range of tertiary laws and supporting documentation (also expanded in 2008) that are largely in place, although gaps remain in some areas, such as an

¹⁰ These generic documents concern the following: internal audit guide for top managers, audit standards, code of ethics, audit charter, reporting standards, common working procedures, audit plan programme guide, risk assessment, and internal audit strategy.

¹¹ The IACB has seven members: one is proposed by the Prime Minister, one by the minister in charge of the Undersecretariat of the Treasury, one by the minister in charge of the Undersecretariat of the State Planning Organisation, one by the Minister of Interior and three, including the chairman, by the Minister of Finance. The IACB members are appointed for a period of five years, in accordance with a decree of the Council of Ministers.

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

FMC manual on risk management. These and other gaps should be resolved through the current twinning and World Bank projects.

2.2 Are relevant management control systems and procedures in place?

General Development

While an appropriate hierarchical structure for accountability and reporting is in place, and basic ex ante financial procedures are set out in the law, the wider implementation of internal control, including ex post control within administrations, still has to be developed and introduced. A significant development since last year is the recognition that full implementation will take some time, and a target date of mid-2011 has been set although exceptionally, in certain identified cases (to be reported by June 2009), a longer period will be accepted. This target date may be somewhat optimistic. ***Sigma remains of the view that a longer period would be more realistic, with appropriate phasing across and within administrations, and will need to be kept under regular review. An indication both of timing and of how developments will be monitored, and by whom, needs to be set out in the planned Policy Paper.***

In the coming years this development will be taken forward by two main groups – the General Directorate of Budget and Fiscal Control in the Ministry of Finance (CHU/FMC), supported by the current twinning project for strengthening FMC systems in Turkey, as well as the strategy development units within administrations..

Central Harmonisation Unit (CHU)

Since last year's assessment the General Directorate of Budget and Fiscal Control has been reorganised into three departments, with work on performance budgeting having been transferred elsewhere. These departments cover respectively i) FMC, ii) internal audit harmonisation (discussed in section 2.3), and iii) training and guidance.

The role and purpose of the CHU within the General Directorate of Budget and Fiscal Control is now clearly established by law, as is the definition of internal control. As the CHU has a harmonisation responsibility covering all public administrations within the scope of general government (including central government, social security institutions and local administrations, which together exceed 3000 in number, but excluding regulatory and supervisory agencies), it views its role as providing advice on how to develop procedures, leaving the implementation responsibility to individual administrations. ***Although the CHU/FMC has made good progress over the last 12 months in developing documentation and providing advice and training on how administrations need to develop, it has focused less on assessing actual gaps and the state of actual implementation. While this is understandable, there is a need in the coming years to put equal emphasis on the quality of implementation.***

Numerous activities have taken place over the last 12 months, primarily in the area of training but also in the further clarification of practical requirements for internal control operations. The latter included the preparation of an action plan guide for the development of appropriate control systems, based on the 18 standards and supporting 79 general conditions previously issued. 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. This additional guidance and time period have been welcomed by the administration, especially the requirement to set up in each administration a monitoring and steering board, chaired by a deputy head, and a preparation group at director level, with co-ordination undertaken by the SDU. ***However, the guidance still lacks actual examples of the types of minimum controls that are appropriate, and this should be addressed by the CHU/FMC.***

Some 2 500 personnel received training during 2008 and similar numbers are planned for 2009. Emphasis has been on training the financial service experts within the SDUs, but training has also been provided for heads of administrations, authorising officers, realisation officers, internal auditors and other officials in financial services. While there is no specific budget for this interdepartmental

training within the Ministry of Finance (each administration has its own training budget), there has been no funding shortfall against needs to date. The CHU has circulated questionnaires on issues to be discussed, publishes regular bulletins on topical matters, and will be introducing distance-learning courses on the Internet.

The CHU also co-ordinates the training for financial service experts in SDUs. Of some 2200 applicants for these positions in 2008, 526 successfully passed the examinations and 231 have been appointed (against a need for a total of 546 financial service experts for all administrations). ***It is of some concern that a number of the internal control departments of SDUs are not yet fully staffed and operational.***

It is also important to ensure that there is no fragmentation of responsibilities between the SDUs' role in monitoring compliance of internal control within administrations and the CHU's overall harmonisation and co-ordination role as internal control is developed within the administrations.

Strategic Development Units (SDUs)

The SDUs, in addition to developing strategic plans, goals, objectives and performance indicators, are also responsible for setting specific internal control requirements, performing certain ex ante financial control checks, preparing accountability reports, and developing internal control compliance systems for their public administrations. In developing internal controls and action plans, the SDUs co-operate closely with the CHU in the Ministry of Finance

Two concerns emerged during this assessment. The first is that the SDUs are positioned at different hierarchal levels in the administrations, with some reporting directly to undersecretaries or their equivalent, while others report to lower levels, which potentially results in less impact on policy development. The second concern is that, after more than three years of their establishment by law, some SDUs have still not set up fully operational internal control departments that are responsible, inter alia, for developing internal control in the administration. ***Both of these concerns need to be addressed by top management in the respective line ministries, with the Ministry of Finance providing additional guidance as necessary.***

With regard to a more technical aspect, as mentioned previously, while the extent of ex ante checking in some areas, e.g. procurement, is set out by law, for many areas there appears to be no guidance on the criteria for deciding the value of other transactions that should be checked by the SDU in addition to the checks by spending-units – this is left to the discretion of each SDU and of the administration head. In view of the obligation to sign assurance declarations, there is a natural tendency for the SDU to undertake a high number of ex ante checks in addition to those carried out within spending-units. ***It is suggested that the extent of the SDUs' ex ante checks, other than those specified by law, be reviewed and linked to an assessment of risk.*** This review should also take into account the increased responsibility given to spending-units and the delegation of responsibilities and managerial accountability expressed in the PFMC Law.

A new two-year twinning project has recently been approved that will assist the Ministry of Finance in developing internal control practices and in establishing full FMC operations in the SDUs of pilot institutions (Prime Ministry, Undersecretariat of the Treasury, SPO and Ministry of Finance). Besides providing a gap analysis of the current position and preparing an action plan (roadmap), the project will include extensive training (including training of trainers), capacity-building and development of FMC manuals, including on risk management and quality assurance. This twinning project will be an essential part of the development of PIFC in Turkey. It should be recognised that the pilot projects will be limited to a few central organisations, and while this is an important first step, the full benefit of this work will only be achieved once the knowledge gained is disseminated throughout all administrations, which will require much future co-ordination by the CHU/FMC and the SDUs.

General Administration including Municipalities

The legislation places equal responsibility for the implementation of internal control on all staff within each administration. Accordingly, accountability reports have to be prepared by the head of

each spending-unit (“authorising officer”) and, via the SDU, also by the head of the administration. In addition, spending-units undertake ex ante control checks on all financial decisions and transactions relating to revenue, expenditure assets and liabilities, in part by “realisation officers”. Responsibility for the collection of revenue, making of payments, and keeping of accounting records is placed on “accounting officers”, who are required to have appropriate qualifications, as stipulated by law. Part Five of the PFMC Law applies equally to municipalities, although there are variations in areas, such as the submission of accountability reports, for which the Ministry of Interior is responsible.

With nearly 3000 municipalities that are subject to internal control, there is an obvious logistical problem to ensure that all staff are fully informed and trained. Under the PFMC Law this task is the responsibility of the Ministry of Finance (CHU/FMC) although there is cooperation in this area with the Ministry of Interior. While each municipality remains responsible for its own internal control, the Ministry of Interior currently assists through the provision of training, in part provided by the Association of Municipalities of Turkey. Although each municipality’s accountability report is reviewed by a locally elected committee, there appears to be limited oversight of control compliance from a central co-ordination standpoint, which suggests the ***need for more proactive monitoring by the Ministry of Interior’s top management***. The use of inspectors alone is insufficient to meet the requirements of managerial responsibility.

It is unfortunate that the new twinning project does not cover the functions of municipalities, at least on a pilot level.

It is important for top management to take full ownership in developing PIFC within their administrations and to recognise that it is their responsibility to meet the legal and financial requirements. In the course of this assessment we have come across a number of instances where the laws are in place but the operational requirements are either missing or ineffective – for example, the staffing of SDUs’ internal control departments and the staffing of internal audit units. Compliance with PIFC is only met when the laws are supported by day-to-day activities incorporating internal controls. While this shortfall could in part be explained by resource restraints or possibly by an incomplete understanding of the requirements under PIFC, it is a matter that needs to be kept under review, both within each administration and across all public bodies. In this context it is unclear where this wider oversight would rest. It would go beyond the role of the Ministry of Finance, as each administration has its own responsibilities. ***Perhaps this wider oversight should be the role of an interdepartmental committee, such as the IACB (see below). This issue needs to be addressed in the revised Policy Paper.***

EU Funds

While all administrations in Turkey need to meet the requirements of the PFMC Law, additional management and control procedures have to be introduced to meet the requirements for the management of EU funds, including IPA.

Of the five IPA components, Transition Assistance and Institution-Building/ Cross-Border Co-operation have received the conferral of management powers from the European Commission. The Regional Development and Human Resources Development components could achieve this status by the end of June 2009, while the introduction of the Rural Development component should be subject to a compliance audit in the autumn, with conferral not expected before early 2010.

New managing authorities and implementing agencies have been designated, and to assist in ensuring a smooth transition on operational matters it is understood that staff from these new bodies have been assigned to the CFCU, which will continue to act as the accredited procurement body for the next two-three years.

Accounting Services

There are stringent requirements concerning the qualifications of accounting officers (article 62 of the PFMC Law), and each accounting officer is obliged to undergo training and to pass an examination, for which he/she receives a certificate.

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

While the Ministry of Finance sees a benefit in retaining their staff in these general budget administrations, it does not fit in with the concept of delegated responsibility and with the fact that many control activities have already been delegated. ***It is suggested to develop a timetable for the phased transfer of these remaining activities to line administrations and to ensure that there are suitable trained staff to continue these operations.***

Regulatory and Supervisory Agencies

The eight regulatory and supervisory agencies are specifically excluded from the internal control and accountability reporting requirements of the PFMC Law, although they are subject to the requirements of accountability, and to some of the articles of the public administration budget and the final account law. They are however subject to external audit by the Turkish Court of Accounts (TCA). While the historical reasoning for according financial and administrative autonomy to these bodies is understood, it remains unclear whether the internal controls, including internal audit, that these agencies have in place in accordance with their own laws are consistent with the requirements of the PFMC Law. ***It is suggested that the Ministry of Finance assess the laws in place in the eight regulatory and supervisory agencies to determine whether these agencies meet internal control requirements that are similar to those set out in the PFMC Law. If they do not, it is further suggested to develop similar legislation for those agencies.***

Management control procedures and systems are substantially in place for ex ante financial control, and while these structures are largely appropriate for developing wider internal control and FMC arrangements, these wider requirements are only partially operational, and processes are still being designed. Reviews of FMC internal controls have not yet been completed by the SDUs, and these reviews are likely to indicate gaps in the operational controls of public administrations. Gaps also exist with regard to the practical operation of internal audit procedures. Similarly, provisions for meeting the requirements of IPA-funded programmes are only partially met. The hierarchical location and staffing of SDUs in some organisations need to be addressed.

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

Internal Audit Numbers and Progress

The Turkish administration remains in a transition stage in between the stage of producing laws and procedures to the stage of practical application, although at the time of this assessment there were around 800 auditors in situ in 209 administrations (the same as last year). The revised By-law on Internal Audit Working Procedures provides for an allocation of 1984 auditors (previously 1382) for the general, special and social security budget authorities, and municipalities.

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

Location	Number of Staff approved in revised By-law	Number of Staff Appointed	Number of Administrations currently with IAs
General Budget	470	232	27
Special Budget	416	252	65
Social Security	35	22	2
Municipalities	1063	297	115
Total	1984	803	209

We were informed that of the 261 administrations that were to be allocated internal auditors, 209 (80%) had some staff in place, but the total staff in posts compared to the allocation in the law was around 58%. There are also gaps in some key administrations, e.g. the SPO and the Prime Ministry. ***Thus while good progress is being made, significant extra staff will be needed over the next three-five years before the full requirement is met.*** The IACB has reviewed the qualification criteria for applications, and it is hoped that the examinations taking place in the summer of 2009 will result in a further 200 appointments.

Decisions have yet to be taken as to how to cover internal audit in the smaller administrations where a specific unit would not be justified. There are various options including making use of the internal audit units from “parent” organisations or the setting up of a central pool of internal auditors that can be called upon by the management of these smaller administrations.

Since last year 59 administrations have started to produce audit reports; by end-March around 190 had been finalised, with summary pages copied to the IACB. An assessment of the quality of these reports and of their findings was not available at the time of this assessment.

Many internal audit units have indicated that they still lack their own budgets and that some heads of administration do not appreciate the specific role of internal audit. ***Some teething issues are bound to occur, but it is important to ensure that internal audit is recognised and given full authority in an administration’s structure and that the internal audit unit is given a sufficient budget.***

Training

The detailed three-month training course with certification is continuing for new recruits, covering the principles of internal audit and internal control, internal audit standards and methodology, report-writing, computer-assisted techniques, statistical methodology, risk assessment, performance measurement, budget, accounting analysis, and overview of related laws, including EU requirements. This course has been supplemented by a new three-year project with the World Bank, covering the preparation of a quality assurance guide, training including the use of computer-assisted tools, an e learning programme, and five pilot audits concluding with a conference to review future strategies.

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

While overall responsibility remains with the Minister of Finance, the key player for developing internal audit is the Internal Audit Co-ordination Board (IACB). The IACB is affiliated to the Ministry of Finance and its secretariat is a department (Central Harmonisation of Internal Audit) within the Budget and Fiscal Control General Directorate of the Ministry of Finance. The duties of the IACB are extensive, covering both technical and broader policy issues¹⁴. The IACB has a centralised

¹⁴ The IACB’s technical duties include establishing internal audit and reporting standards, developing manuals and other procedures, organising training programmes and annual risk assessment, and developing co-operation between internal audit bodies. The broader policy issues include proposing specific audits to be undertaken by public administrations, helping to settle conflicts between internal auditors and heads of administration, regulating the certification system of internal auditors, approving the number of internal auditors in administrations, and evaluating annual summary reports submitted by

role in certain areas that would normally be the responsibility of heads of administration, e.g. reviewing individual audit reports and reported failures by internal auditors and taking decisions on their continued certification¹⁵.

It is generally recognised within the Turkish administration that the current arrangements need to be reviewed. *In Sigma's opinion, the current structure of the IACB combines the role of an audit committee/board, which is set up to advise top management in administrations on the effectiveness of internal controls, and that of a CHU for internal audit, with the technical capacities and responsibility for developing internal audit. It is suggested that, as part of the proposed review, consideration be given to transferring the technical aspects of internal control and especially internal audit from the IACB to the secretariat, which then would become the CHU/IA and a department within the Budget and Fiscal Directorate of the Ministry of Finance, as is the case for the CHU/FMC. There is also a need to appoint a suitably senior and qualified internal auditor to take responsibility for fulfilling the technical role of developing internal audit. When making this change, it would be important not to weaken or delay progress in developing internal audit, but this problem could be avoided by preparing a phased transfer plan. The IACB could then become a high-level semi-independent body reporting to the Minister of Finance, with the significant policy role of monitoring the overall development of internal control (both internal audit and FMC). If this approach is agreed, it would be appropriate to change the IACB's title, for example to "PIFC Co-ordinating Board".*

Quality Assurance

An important element of the IACB/CHU responsibility is the evaluation of internal audit through a quality assurance programme. This programme includes the evaluation of internal audit reports prior to the compilation of a consolidated report, which raises the fundamental issue of whether it is right for the IACB/CHU to see each individual report (or even each summary page), which should be primarily a communication between the internal auditor and his/her head of administration. The concept of internal audit providing advice to assist the activities of an organisation is important to encourage and helps to draw a distinction between previous sometimes repressive control activities. In addition, the review of individual reports might lead to less than full reporting as it would constitute an unrealistic workload for the IACB/CHU, considering the number of reports to review. During the assessment it was noted that some audit units were expecting the IACB to both review and react to the individual report findings as a further layer of control. *In Sigma's opinion, the IACB/CHU should not receive copies or summary extracts of each individual audit report, as quality assurance can be monitored and assessed through regular combined summary reports received from each administration and through the development of a risk model, with only limited on-the-spot verification. It would also be an unrealistic workload for the IACB/CHU. Furthermore, internal audit reports are intended for the administrations in which the internal audit units operate, and it is important to refrain from adding a further reporting layer, with the inherent risks of creating a policing type control culture.*

Role of Internal Audit, Inspectorates and Controllers

The need for control bodies has always been recognised in Turkish law, but prior to the adoption of the PFMC Law this control was undertaken by the various inspectorates and controllers. The role of inspectors¹⁶ is extensive, ranging from specific investigations of alleged non-compliance with the law

administrations for incorporation in an annual consolidated report, which is submitted to the Minister of Finance and published.

¹⁵ Article 6 of the By-law on Working Procedures of the IACB

¹⁶ There are general inspectorates in most large administrations, together with some specialist units, all of which report to ministers. The Inspection Board of Finance within the Ministry of Finance has broad audit and inspection powers with respect to all financial operations and transactions of the state on the behalf of the Minister of Finance. In addition, there is the Inspection Board of the Prime Ministry, which has a wide remit covering all central and local administrations, and the Board of Treasury Controllers, which covers operations relating to the ownership and shareholding of the Treasury.

to the fight against corruption and money-laundering¹⁷, with specialists assessing complaints and compliance in areas such as tax, customs and education.

Such work is necessary but is quite separate from that of internal audit, as currently defined by international standards and best practice guidelines. However, some of the work undertaken by these inspectors and controllers is still referred to as “audit” but in reality constitutes control checks, although this concept is not accepted by all inspection boards. Furthermore, around 30% of the newly appointed internal auditors had previously been inspectors. While this experience has many merits, it can perpetuate the confusion between the two roles. This confusion is recognised by the Turkish authorities.

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

More fundamentally, there is a need for a cultural change so that inspectors recognise and accept the separate and independent role of internal audit and in due course rely on its evaluations. ***In Sigma’s opinion, it is necessary to define and delineate the respective roles and responsibilities of internal audit and inspectorates and, if necessary, adjust the responsibilities and resources of the inspectorates so as to avoid any confusion and overlap.***

Internal audit procedures and systems are for the most part in place, but internal audit units are only partially in place and operational audits have only started in the last few months. Training, which is planned, will cover many of the current gaps in practical knowledge, but full implementation will take many more years. There is a need to review and delineate the respective roles of internal audit and inspectorates and to assess the role and location of the IACB and the CHU/IA.

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

Article 56 of the PFMC Law states that one of the objectives of internal control is to “prevent irregularities and frauds in all kinds of financial decisions and transactions”, and article 6 of the By-law on Working Procedures for the Internal Audit Co-ordination Board states that the Board is to “provide recommendations to the public administrations as to taking the necessary measures for the prevention and elimination of fraud and irregularities”. A more detailed reference, however, is provided in the Communiqué on public internal control standards (standard 16), issued in December 2007¹⁸. Part Seven of the PFMC Law sets out the sanctions to be applied against officials who are involved in fraud or irregularities, and indicates that they will be subject to the Turkish Penal Code. In addition, inspection boards have a range of powers, including the investigation of corruption and money-laundering, and the Turkish Court of Accounts (TCA) has the mandate to audit public resources (major exemptions being municipal enterprises, state economic enterprises and the Ministry of Defence). This mandate includes the power to issue a *writ*, holding officials responsible for their financial management.

¹⁷ Only the Finance Inspectors Board and Inspection Board of Customs have the role of the fight against money-laundering, according to Article 6 of the Prevention of Laundering Proceeds of Crime Law No:5549

¹⁸ “The administrations shall develop methods which will ensure that the faults, irregularities and corruptions are notified in a specific order. General requirements of this standard are as follows: Notification methods with regard to the faults, irregularities and corruptions shall be determined and announced. The managers shall perform adequate examination with regard to notified faults, irregularities and corruptions. The personnel who have notified the faults, irregularities and corruptions shall not be subjected to unfair and discriminatory treatment.”

Other than for the management of EU funds, where specific arrangements are in place in line with EU regulations, it would seem that no central guidance has yet been provided to assist administrations in developing appropriate procedures for dealing with fraud or irregularities. ***It is suggested that the CHU prepare appropriate guidance for managers***, covering such areas as the definition of fraud and irregularity, the ways of handling suspected cases both within and outside the administrations, reporting procedures together with the nomination of a contact point (and alternatives if a line manager is allegedly involved), and whistle-blowing arrangements.

The Prime Ministry Inspection Board is temporarily the AFCOS (Anti-Fraud Co-ordinating Service) and the single contact point with European Anti-Fraud Office (OLAF).

Procedures to prevent serious mistakes and irregularities through ex ante controls of financial transactions are set out by law, as are appropriate corrective actions. Procedures are also in place with regard to the EU requirements for the management of pre-accession funds. However, more detailed procedures need to be developed by the management, with assistance from the CHU, to meet the broader issues related to the prevention of fraud and irregularities as outlined above and in the Public Internal Control Standard 16 prepared by the CHU/FMC, which covers the notification of faults, irregularities and corruption.

Reform Capacity and Sustainability

Over the last 12 months there has been a steady development in introducing reforms to meet the requirements of PIFC, which include additional laws and procedures to supplement those introduced since the PIFC Law was enacted in 2003. However, progress has been less than had been expected this time last year with regard to a number of key activities that have not yet been completed, including a gap analysis and action plan by SDUs concerning internal control needs and the appointment of internal auditors in all key administrations. The development of PIFC has been supported by a range of training activities and by the requirements for key staff in internal audit and internal control to attain qualifications that meet the specific job competences. This development will be further supported in the next two years by a twinning project on FMC and in the next three years by a World Bank training project on internal audit. Structures are largely in place, but the number of staff in posts has not yet reached full complement levels and some significant gaps remain, although it is foreseen to appoint additional staff. An issue that still needs to be addressed is the perception that some top managers have not yet given their full backing to the introduction of internal control and internal audit. While the development has been slower than planned this time last year, overall the long-term resource capacity is not expected to be a problem. With limited staff turnover, together with the appointment of high quality staff, sustainability in developing and maintaining PIFC should also present no significant problems. The issue of a revised Policy Paper endorsed by the government should provide added assurance in these areas.

The two external assistance projects that commenced in 2008, covering the development of FMC and the ongoing training for internal auditors, will provide a significant input to enhancing the operational requirements of PIFC over the next two /three years. It is nevertheless suggested that, as part of this ongoing work, account is taken of the recommendations in this assessment report.

The respective roles and responsibilities of internal audit and the inspectorates need to be defined and delineated in order to resolve existing confusion and to avoid a possible overlap of activities. Those two areas need to be reinforced individually, and separate support projects could facilitate the internal process.

There is also a recognised need to review the quality, content and follow-up assessment of the annual accountability reports.

It will be important for the new measures to be “owned” at all levels, for operational activities (as well as laws) to be fully implemented with adequate staff and other resources, and for there to be full co-ordination with all parties and overall monitoring to ensure that internal controls, including internal audit operations, are sufficient. Until internal control systems and internal audit units are fully

established and operational in all central and local administrations there remains a risk of non-compliance with the new features of PIFC as expressed in PFMC Law No. 5018.