CHAPTER V STRENGTHENING BUDGETARY INSTITUTIONS FOR EFFECTIVE GOVERNMENT

5.1 ***Longstanding institutional weaknesses in budget and financial management had often contributed to fiscal crises in the past.*** Public expenditure management was hampered by budget fragmentation—in particular, widespread off-budget arrangements; lack of a comprehensive resource framework; and divided responsibilities for formulation, execution, and oversight of the budget. These weaknesses contributed to high degree of non-transparency, which also impeded effective policy guidance to the budget in both aggregate fiscal management and in evaluation and management of sector policy. Turkey's excessive use of quasi-fiscal policies and the poor coverage and control of contingent commitments had exposed the government to fiscal risks. A plethora of control and inspection agencies focused on "catching violators" rather than on fixing the internal control system. The Supreme Audit Institution (SAI) was limited by its restricted mandate.

5.2 ***The government has implemented a number of priority actions to improve budget coverage, formulation, execution, accounting, and audit.*** A far-reaching overhaul of the laws governing public finance management has been undertaken over the past few years. Ensuring the comprehensiveness and transparency of public expenditure was identified as a fundamental priority for reform. Moreover, the new laws go beyond the initial reform strategy in a number of respects—inspired in part by the prospect of EU accession and by the government's desire to introduce greater performance orientation in budget management. However, in some instances implementation of the reform agenda has been hesitant, and some regressive tendencies in the implementation of the PFMC law tend to perpetuate old problems of budgety fragmentation. It is important that the unfinished agenda outlined below be addressed in a focused and determined way.

5.3 ***Although the initial public sector reform program, was initiated to improve the budget and financial management reform, the coverage of the public sector reform has been expanded to cover the administrative aspects of the public sector.*** Therefore several other laws have been or are being enacted (Table 5.1). Expansion of the public sector reform will add additional challenges for the implementation of the reform. Sequencing and complementarity of these reforms needs to be carefully designed for a successful implementation of public sector reforms.

Table 5.1. Public Sector Reform Laws and Draft Laws

Law	Status
The Constitution	The Constitution was amended in October 2005 to adopt the terminology used in the PFMC law and to expand the scope of TCA's mandate to cover all central government institutions, social security institutions, and local administrations.
Special Provincial Administration Law	Reenacted in March 2005; however, several articles have been referred to the Constitutional Court by the President.
Municipalities Law	Enacted in December 2004. The Constitutional Court cancelled the law, and it was reenacted in July 2005. However, one article was referred to the Constitutional Court by the President. Secondary legislation is being prepared.
Metropolitan Municipalities Law	Passed in July 2004. Secondary legislation is being prepared.
SPAs and Municipalities' Revenues Law	A draft is submitted to Parliament in September 2006.
Civil Service Law	A draft is prepared but not submitted to Parliament as of October 2006.
Regional Development Agency Law	Enacted in January 2006.
Turkish Court of Accounts Law	A draft law was submitted to the Parliament in February 2005.

Source: World Bank Staff

5.4 ***Both international experience and Turkey's own experience indicate that implementation of a major budget and public financial management reform by itself needs strong coordination and monitoring.*** Because of their impact on the whole of government, public sector reforms tend to be cross-cutting, and they take time to implement. They require strong high-level leadership to articulate a clear vision of the objectives. Pragmatic mid-stream adjustments must adapt to changing circumstances, and coordination must be effective across government. Weak interagency coordination would pose the inherent risk of provisions being enacted that are inconsistent with or contradict the previous reforms. It is crucial that Turkey maintain the momentum and credibility of these major reforms; so the need for strong, effective coordination to reconcile conflicts cannot be overstated.

5.5 ***This chapter assesses the status of public financial management reform implementation and identifies further actions that would need to be initiated in order to complete the Government's reform agenda.*** The first section provides a short overview of the status of public financial management reforms further to the presentation of the 2006 budget. The following sections break down the challenge to public financial management in Turkey along the following lines: budget formulation, accounting and reporting, budget execution and cash management, revenue, internal control and audit, external audits, legislative oversight, and public procurement.

A. STATUS OF PUBLIC EXPENDITURE MANAGEMENT REFORMS

5.6 ***Enactment of the PFMC Law in 2003 marked a defining moment for public financial management.*** The Public Financial Management and Control (PFMC) Law (No. 5018) enacted by Parliament in December 2003 replaced the 1927 Public Accounting Law (No. 1050), providing a new legal framework for modern public expenditure management and accountability. The law articulates a modern performance-oriented public sector management. It provides the first comprehensive framework for public finance management using a modern Government Finance Statistics (GFS) concept for the coverage of revenue and expenditure. It clarifies to the public the nature of ministerial and official accountability, and it strengthens public expenditure and financial management processes in line with EU practice. The Public Financial Management and Control (PFMC) Law was amended in December 2005 with the main changes indicated in Box 5.1.

A.1 Budget Formulation:

5.7 ***The 2006 budget was prepared and is being implemented according to the PFMC law.*** The 2006 budget and 2007-2008 indicative proposals have been prepared according to the functional, economic and institutional classifications defined under the PFMC law. With this year's budget, the Government Finance Statistics (GFS) analytical budget classification and the accrual based accounting systems have been expanded to all general government institutions, including local governments. The implementation of this year's budget will also be carried out in line with the PFMC structure. This will enable the Ministry of Finance to consolidate the budget realization for all general government institutions. Details on the implementation of the PFMC law are provided in Box 5.2.

5.8 ***Although full implementation of the PFMC law is expected to be completed by the end of 2007, with the 2006 budget the PFMC law has been satisfactorily implemented in key areas***. These areas include: (i) improving budget formulation processes to enable a medium-term fiscal strategy to guide fiscal aggregates and enable sector budgets to be linked to policy priorities; (ii) expanding budget coverage to all central government budget entities; (iii) expanding the GFS-consistent economic and functional budget classification to the entire general government institutions; (iv) delegating more responsibility (with related accountability) to spending agencies through reforming the internal control regime and abolishing central-level ex-ante control; (v) improving accounting through implementation of accrual-based accounting for the entire general government.

(i) Improved Credibility of the Budget Preparation Process

5.9 ***Relative to the pre-2001 situation, there have been steady improvements in budget formulation and preparation processes, including better central guidance to the***

line ministries. The framework for these actions was established by a High Planning Council (HPC) decision issued in June 2001 to accompany the Prime Minister's Budget Call. The HPC decision provided a macro-fiscal framework for the preparation of the 2002 budget. It established indicative ceilings for recurrent and investment budgets for ministries and line agencies, based on an indexation formula applied to the actual budget allocations that each ministry and line agency received in 2001. As a further step, the Prime Minister's Budget Call for the 2003, 2004 and 2005 budgets included individually-specified indicative ceilings for each ministry and line agency, based on the 2002 budget preparation experience.

5.10 ***The policy-planning-budgeting linkage is being strengthened further through top-down budget formulation announced by the Medium Term Program (MTP) and the Medium-Term Fiscal Strategy (MTFS) in the 2006 budget.*** The preparation and political endorsement of an MTFS is expected to reinforce fiscal discipline and management, as well as providing the basis for improved strategic allocation of budgetary resources to priorities. The MTP which was issued in the Official Gazette dated May 31, 2005 as a Council of Ministers' Decision set out a three year (2006-2008) macro-economic framework.[119] The MTP outlined policies and priorities in five development areas and nine main sectors.[120] In addition, the MTFS was issued in July 2, 2005 as a HPC decision and laid out medium term fiscal aggregates and institutional ceilings by economic classification consistent with the MTP.[121]

(ii) Reforms to improve capacity at the institutional level

5.11 ***The PFMC law underlines the need for institutional capacity strengthening by requiring that the fiscal implications of new policies be estimated and policy decisions be made consistent with the MTFS.*** The 2001 PEIR noted that the institutional processes for policy formulation and management, both in ministries and at the level of the Council of Ministers, were weak. Thus in addition to the strengthening of "top-down" processes for setting medium term fiscal strategy, reforms would also have to strengthen "bottom-up" processes to improve policy formulation planning and performance at agency level. It is important to ensure that the capacity of ministries and departments to propose policies in line with strategic objectives is strengthened.

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119 Macro economic targets for 2006-2008 set out in the MTP were consistent with April 2005 SBA with the IMF. Another implicit underlying factor for determining the macro economic framework for has been convergence with the Maastricht criteria of the EU. The 2005 Pre-accession Economic Program document states that securing price stability, reducing the public sector deficit and debt to GDP ratios must be priorities if the macro-economic policies are to converge with the Maastricht criteria.

[120] Five development areas covered in the MTP are (a) improving human resources and employment generation, (b) social inclusion and the fight against poverty, (c) enhancing the competitiveness of enterprises, (d) regional development and reduction in regional development disparities and (e) good governance. And the nine main sectors included in the MTP are (a) education, (b) health, (c) environment and urban infrastructure, (d) science and technology, (e) agriculture, (f) manufacturing industry and mining. (g) energy, (h) transportation and communication, (ix) tourism.

[121] The MTFS provided aggregate fiscal balances for the entire central government institutions. Whereas, institutional ceilings were provided only for general and special budget institutions excluding the regulatory and supervisory institutions in line with the PFMC law.

5.12 ***The PFMC law requires ministries to undertake a strategic planning exercise and performance budgeting in order to clarify policy goals as well as objectives and to prepare budget requests consistent with performance goals.*** The SPO has issued guidelines for strategic planning in key line ministries and departments. In July 2003, the HPC issued a decision announcing the launch of the strategic planning initiative on a pilot basis in eight agencies.[122] The Government launched these pilot cases in 2004 to test the guidelines developed by SPO and MOF for strategic planning and performance related budgeting respectively. With support from SPO, these eight agencies are expected to finalize their strategic plans during 2006 with a view to reflecting these plans in the 2007 Budget. Based on the experiences on these pilots, a phased program to expand strategic planning to the rest of the government has been announced by the SPO. A three year phased approach was decided to expand implementation of strategic planning to the entire central government and social security institutions through the end of 2009.[123]

5.13 ***The Government has initiated an accelerated implementation of strategic planning for local administrations starting in 2006.*** This initiative was part of the Government's decentralization reform efforts, which is expected to lead to an efficient allocation of resources at the local level and improved public service delivery. The Metropolitan Municipalities Law (no: 5216, enacted in July 2004), the Municipality Law (no: 5393 enacted in July 2005), and SPA law (no: 5302, enacted in February 2005) require all the local administrations with more than 50,000 populations to prepare their strategic plans within a year after the effectiveness of these laws. A total of 206 local administrations and 81 Special Provincial Administrations are required to complete their strategic plans by July 2006.

5.14 ***In order to ensure a smooth transition to the new system, new institutional structures have been established.*** The MOF and SPO established new departments to prepare guidelines and the secondary legislation, undertake the piloting activities, provide training, and better respond to the newly defined structure.[124] The performance based budgeting department in the MOF and the strategic planning department in the SPO were established in 2004 and 2005, respectively. The experience of the pilots demonstrates both the difficult challenge posed by these agency level reforms and the need for coordination and careful design in the implementation of performance-based budgeting. It is particularly difficult to undertake major performance reforms in a context where the financial control and management reforms are being implemented with resulting environmental changes and uncertainties. Thus the main challenge for the government is to draw lessons from the pilot cases to design further stages of the reform, including consideration of the appropriate pre-conditions for such reform.

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[122] Ministry of Agriculture and Rural Affairs; Turkish Statistical Institute (TURKSTAT); General Directorate of Health for Borders and Coasts; General Directorate of Highways; Hacettepe University; Denizli SPA; Iller Bank; Kayseri Metropolitan Municipality.

[123] The time table for the regulatory and supervisory institutions which are part of the central government has not been announced yet.

[124] In addition to Pilot agencies, the SPO has adopted a new regulation on strategic planning. The regulation requests public administrations to prepare their strategic plans. Thus, piloting activities have become less necessary now. All the administrative units are requested to prepare their strategic plans within a timeframe set forth in the regulation. However, these administrative units are in need of substantial technical support.

Box 5.1: Amendments to the PFMC Law

The Government amended the PFMC law in December 22, 2005 with law no. 5436. The main motivation behind this amendment was to clarify some of the terminology used in the law, thus eliminating some of the foreseen implementation problems. The most important features of the amendment can be explained as follows.

Change in the Coverage: As a result of this amendment, there have been some changes in the list of the chart I, II and III. Table below provides a summary of these changes.

	Original	After Amendments
Institutions that have been included under another institution's budget		
Court of Jurisdictional Disputes	Chart I	Ministry of Justice (Chart I)
High Council for Elections	Chart I	Ministry of Justice (Chart I)
General Directorate of Mint and Stamp Printing House	Chart I	Treasury
Near and Middle-East Labor Training Center	Chart II	Ministry of Labor (Chart I)
Center of Research on Ataturk	Chart II	Presidency of Ataturk Culture, language and History (PACLH) (Chart II)
Ataturk Cultural Center	Chart II	PACLH budget (Chart II)
Turkish Language Agency	Chart II	PACLH budget (Chart II)
Turkish History Agency	Chart II	PACLH budget (Chart II)
Turkish Industry Management and Administration Institute	Chart II	TUBITAK (Chart II)
Presidency of Legal Medicine	Chart II	Ministry of Justice (Chart I)
Presidency of Refik Saydam Health Center	Chart II	Ministry of Health (Chart I)
Institutions Removed from the Coverage of the PFMC		
Presidency of European Union Educ. and Youth Programs	Chart II	-
GD of the Turkish Radio and Television Agency	Chart II	-
Presidency of Ministry of Defense Carburant Supply and NATO POL Plant Operations	Chart II	-
Presidency of the Mass Housing Administration	Chart II	-
Natural Disaster Insurance Agency	Chart II	-
General Directorate of the National Lottery	Chart II	-
General Directorate of Spor-Toto	Chart II	-
Private Employee's Social Security Fund	Chart II	-
Turkish Accounting Standards Board	Chart II	-
Higher Specialization and Research Hospital	Chart II	-
General Directorate for Rural Services	Chart I	abolished
General Directorate of Building Land Office	Chart II	abolished
Sugar Agency	Chart III	abolished
Savings Deposit Insurance Fund	Chart III	
Eregli Coal Region Workers Savings and Aid Fund	Chart IV	
Recently Included		
Presidency of Revenue Administrations	Newly established	Chart I
DG of Social Assistance and Solidarity	Newly established	Chart I

Structural Changes:

The financial control officer positions have been eliminated and the authority for ex-ante control has been moved to the Financial Services Units in general.

As is the case for regulatory and supervisory institutions, the Parliament and the TCA will submit their budgets directly to the Parliament, with a copy given to the Ministry of Finance.

The Parliament's external audit will be undertaken by an independent audit commission as is the case for the TCA.

Revenue surplus of the regulatory and supervisory institutions will be transferred to the general budget on a quarterly, rather than annual, basis.

The revolving funds, which were scheduled to be closed by the end of 2007, will now be restructured within the same timetable.

(iii) Comprehensiveness of the Budget

5.15 To support the Government's ongoing efforts towards improved budgetary formulation, a number of steps have been taken to achieve comprehensive budget framework for supporting sound fiscal management.

5.16 *Better Budget Definition*: Adoption of new budgetary definitions helped Turkey converge with the international practice. A new general government budget definition has been introduced with the implementation of the PFMC law in 2006. The general government definition covers: (i) central government budget institutions (total of 143); (ii) social security institutions' budgets including the unemployment insurance agency (4); and (iii) local administrations (around 3,305 including 81 SPAs).

5.17 *Improved Coverage of the Budget*: Moreover, the coverage of the central government budget approved by the Parliament has been considerably expanded. The 2006 budget approved by the Parliament covers all the general budget (chart I), special budget (chart II) and regulatory and supervisory institutions (chart III). The previous coverage of the budget (i.e. the consolidated budget) comprised only 61 percent of the total general government expenditures. With this structure, the Parliament is enabled to review the total expenditures under the central government.

5.18 *Improved Budget Classification:* Until recently, Turkey was not implementing the functional classification of government expenditure that is recommended by the IMF's Manual on GFS and which is essential for policy analysis of expenditure. This situation has been addressed by the government's adoption of functional budget classification in line with the GFS 2001 and by parallel amendments of the chart of accounts for all entities forming part of the general government. The GFS classification, including the ten sector functional classification has been applied in the 2004 Budget for consolidated budget agencies. The expansion of the GFS to the entire general government started to be implemented with the 2006 budget.

5.19 *Reduction in off-budget activities:* There has been a drastic reduction in the number and size of off-budget institutions and activities since 2001 but the agenda remains unfinished**.** With the exception of the Support Price Stabilization Fund (DFIF), all budgetary funds and all but five extrabudgetary funds (EBFs) have been eliminated. The remaining EBFs are: Promotion and the Publicity Fund, the Defense Industry Support Fund, the Privatization Fund, the Social Aid and Solidarity Incentive Fund, and the Savings Deposit Insurance Fund (SDIF). However, EBFs still remain outside the scope of the budget discipline (see below). Rationalization and reform of revolving funds, which represent another form of off-budget activity, is under way, but their closure has been delayed further to a 2005 amendment of the PFMC Law (see below).

5.20 *Formalization of providing information outside the central government budget:* The Parliament has been informed about the expenditures and revenues of institutions outside the central government. The revenues and expenditures of local governments (2003-2008), social security institutions (2003-2006), revolving funds (2006-2006) and extra-budgetary funds (2003-2006) have been submitted to the Parliament as an attachment to the central government budget law. The Parliament, however, discussed and approved the central government budget for 2006 only.

5.21 *First effort towards reporting tax expenditures:* The MOF has included a list of tax expenditures and their estimated amount for 2006-2008 as an attachment to the budget for the first time. The coverage of this study is based on the four main tax legislations: personnel income tax (PIT), corporate income tax (CIT), value added tax (VAT) and special consumption tax (SCT). Issues in the estimation of tax expenditures have been addressed in chapter 2.

Box 5.2: Towards Full Implementation of PFMC

The Public Financial Management and Control Law (PFMC), which was enacted in 2003, defines the new principals, rules and structures for the Turkish public financial management systems including budget formulation and execution, financial and internal control systems, and internal and external audit structures. The original effectiveness date of the PFMC was postponed for one year to 2006. The main reasoning behind this postponement was that since the 2005 budget was prepared according to Public Accounting Law no. 1050, its implementation cannot be carried out with a new structure. Although the coverage of the 2005 budget was not in line with the expanded definition of the central government budget, major improvements had been undertaken in terms of the quality of budget reporting. 1/

With the 2006 budget, coverage was expanded to all central budget institutions, the sum of the general budget, special budget, and regulatory and supervisory institutions. With this expansion, a total of 45 new institutions were included in the budget coverage. However, although the PFMC requires the revolving funds to be attached to the general and special budget institutions, these funds were not covered within the 2006 budget. The original plan for the revolving funds was to report them under the relevant institution's budget until their abolishment by the end of 2007. However, with an amendment to the PFMC enacted in December 2005, the government decided not to abolish them but "restructure" them by 2007. Until the restructuring is completed, the rules and principles for their budget preparation, execution, accounting and auditing will be determined by a secondary legislation issued by the Ministry of Finance. As a transitional measure, the revenues and expenditures of the revolving funds have been submitted to the Parliament as an annex to the Central Government budget since 2003 and were submitted along with their projected revenues and expenditures for 2006.

The Parliament was also informed about the revenues and expenditures of the social security institutions and local administration for the 2006-2008 period. This information was provided as an annex to the budget proposal. None of these institutions' expenditures has been discussed in the Parliament. In the case of the social security institutions, the data presented to the Parliament were the estimates of the institutions themselves. As for the local governments, the data produced through consolidation of the individual local administrations' budgets was not used since the GFS budget coding structure was not in effect for the all of the local administrations. Therefore, the projection of the State Planning Organization was used.

Financial services units for all of the general government budget institutions were established in January of 2006, and with the establishment of these units the authority of the MoF for ex-ante spending control was delegated to the line agencies. The accounting responsibility and main budget responsibilities other than the general budget institutions were transferred to the special budget institutions. 2/

The internal audit structure foreseen by the PFMC will be completed before end of 2007. The Ministry of Finance is planning to set up the internal audit structure of the 15 pilot institutions together with their personnel during 2006.

It should be noted that two areas that require more time before full implementation are strategic planning and performance budgeting. The Government has been undertaking pilot activities in these areas since April of 2004. The PFMC authorized the SPO and the MoF to determine the expansion timetable for the institutional strategic planning and performance based budgeting. As expected, the 2006 budgets of the institutions were not based on institutional plans and performance criteria. According to the Municipality law, strategic planning is necessary for local administrations with populations of more than 50,000 in 2006

Implementation of the external audit part of the PFMC depends entirely on the enactment of the new Turkish Court of Account (TCA) law which was submitted to the Parliament in February of 2005. The new draft expands the audit mandate of the TCA to all public sectors and provides a legal basis for expanding the scope of the TCA to include the performance and financial audits along with the compliance audit.

1/ Details of the new features of the 2005 Budget are explained in "Turkey, Discussion Note on the 2005 Budget" prepared by Mediha Agar and Rodrigo Chaves dated January 2005.
2/ In the former structure MoF, staff was in charge of the accounting office and the personnel of some of the annex budget institutions now classified as special budget institutions. As a transitional measure, MoF accounting staff was appointed to the relevant line agencies with temporary duty status

(iv) Unfinished Agenda:

5.22 ***While the linkage between the policy-planning and budgeting has greatly improved through the medium-term budgeting approach in 2006, more efforts are required for further improvements.*** Although 2006 was the first year of implementation, the achievements in linking the policies/priorities with the budget have been quite satisfactory. However, further improvements can be achieved through;

- *Ensuring that the MTP's sectoral classification is appropriately translated into the budget functional classification:* The sectoral breakdown provided in the MTP is not consistent with the functional classification of the budget structure. Due to inconsistent classifications of the MTP and the budget, it is difficult to follow the link between the policies envisaged in the MTP and the related budget allocations. Mapping specific sectoral categories of the MTP priorities into the functional categories of the budget would allow the government to easily translate MTP decisions into budget allocations.

- *Supporting policy objectives with required measures:* Policies and priorities defined in the MTP are too generic and do not provide sufficient guidance for line agencies to translate these policies into their budget proposals. A detailed policy matrix defining priorities/policies accompanied by a set of measures together with their cost estimates and implementation timetables could provide better guidance for the line agencies.

- *Making program budgeting an integral part of the PFMC system.* In addition to mainstreaming MTP, what is equally important is adopting program budgeting approach to annual budgeting. New budget coding will not be enough for program budgeting unless the latter is integrated in the PFMC system. In the absence of program budgeting, strategic planning and performance evaluation will be impeded.

- *Rationalizing the number of policy formulation documents:* Currently, there are too many documents that can be treated as the basis of policy formulation.[125] Although these documents have different stated purposes and perspectives, it would be worth considering options for merging/consolidating some of these documents for a simplified policy guidance structure. This would help eliminate potential sources of confusion for the line agencies; reduce the workload of the key central agencies; and diminish the risk of inconsistencies among these documents.

The Government is aware of these challenges and efforts to improve institutional capacity for medium-term budget planning are under way.

5.23 ***The implementation of strategic planning and performance budgeting will require more efforts of the key central agencies.*** Several issues need to be addressed for a sound implementation of the strategic planning and performance budgeting initiatives. Timing and sequencing is a critical issue. Technical and human resource capacity will be another major challenge for the implementation of strategic planning at the local level. Moreover, coming up with a provincial level strategic plan which was not foreseen by the legislation will be an additional complication for the government given that all municipalities, SPAs and metropolitan municipalities will prepare their own strategic plans without appropriate linkage and sequencing.

5.24 ***Revolving funds continue to operate outside the budget coverage at the risk of distorting budget discipline.*** Many spending units maintain revolving funds financed by their own sources of revenues—more than 1,000 such funds as of December 31, 2005. The original PFMC law required the closure of the revolving funds before the end of 2007. However, as mentioned before, the government decided to restructure the revolving funds attached to the general and special budget institutions by the end of 2007 with an amendment made to the PFMC in December of 2005. More than six percent of the central government expenditures will thus still not be covered by the overall financial management and control structure defined in the PFMC. The MOF started to issue the revenues and expenditures and balance sheets of the revolving funds on a quarterly basis as of June 2005 and provided information to the Parliament on the revolving funds budget as an annex of the 2006 budget proposal.

5.25 ***The share of revolving funds is quite important in health and education sectors.*** As can be seen in Table 5.2, the off-budget revolving fund expenditures of the Ministry

[125] Policy formulation in 2006 was based on the following list of documents prepared by the central agencies: i) 2006 annual program (SPO), ii) general economic targets and investments 2006 (SPO), iii) 2005 Pre-Accession Economic Program (SPO), iv) MTP (SPO), v) MTFS (MOF). Additionally, the ninth Development Plan, the Rural Development Plan, and the Regional Development Plan will be included in the list starting next year.

of Health (MOH) reflect almost 90 percent of the total appropriation allocated to the MOH budget. Therefore, the MOH is spending an amount almost equal to its budget with almost no appropriate financial control mechanism.

Table 5.2: Importance of the Revolving Funds

(million YTL)	2003	2004	2005 e	2006 P
Higher Education Institutions and universities	1,783	2,237	2,360	2,532
Other Central Budget Institutions	3,429	5,732	7,924	8,615
Total	5,212	7,969	10,284	11,146
Memo Items				
Central Government Budget 1/	140,109	151,702	168,549	173,807
Revolving Funds expenditures (% of Central Government Budget)	3.72	5.25	6.10	6.41
Ministry of Health RF expenditures (% of MOH budget)				86.5

1/ 2003-2005 data is for the consolidated budget. For the purpose of comparability, revenue transfers to the local administrations and funds were included in the consolidated budget expenditures. The number for 2006 does not include the regulatory institutions' budgets.

Source: Ministry of Finance and World Bank Staff calculation

5.26 ***Extrabudgetary funds still operate outside of budget discipline.*** The PFMC Law intends to further strengthen the control framework for the EBFs by the following measures: (i) incorporation of extra budgetary funding into the budgets of the related administration submitted for parliamentary approval; (ii) requiring external audit by the Turkish Court of Accounts; and, (iii) monthly reporting by EBF in the consolidated report of the central government. However, implementation of these measures has been delayed. Even though the PFMC Law required incorporation of extra budgetary funds into the budget of the related administration, the 2006 budget fails to do so. Instead, revenues and expenditures (without details) of the EBFs were submitted as an annex to the budget document. Their budgets were neither discussed nor approved by the Parliament. Unlike previous years, however, transfers to EBFs from the general budget are shown as separate line items in the budget. As it is a legal requirement, EBFs should be subject to the internal control and internal audit regime that is defined in the PFMC Law. Total expenditures channeled through the EBFs as a share of the central government budget will be around 2.24 percent for the 2003-2006 period (Table 5.3).

Table 5.3: Extra Budgetary Funds, 2003-2006

(Million YTL)	2003	2004	2005 e	2006 P
Privatization Fund (Privatization Administration, Chart II)	1,120	1,126	1,897	811
Defense Industry Support Fund (Undersecretariat of Defense Industry, Chart II)	1,251	1,233	809	1,053
Promotion Fund (Prime Ministry, Chart I)	41	111	121	128
Social Solidarity Fund (GD of Social Solidarity,	658	1,284	1,262	1,258
Total	3,070	3,754	4,089	3,250
EBFs' expenditures/central government budget (%)	2.2	2.5	2.4	1.9

Source: SPO and MoF

B. BUDGET EXECUTION, ACCOUNTING, AND REPORTING

(i) Developments and Reforms Since 2001

5.27 ***The PFMC Law has balanced the accountabilities and authorities of spending agencies***. The PFMC Law has revoked the authority of the Court of Accounts and Ministry of Finance to grant visas. By setting up Strategy Development Directorates with responsibilities for financial services and internal control in each spending agency, the law has delegated certain authorities and responsibilities to the spending agencies previously in the domain of the Ministry of Finance. For example, the spending agency now has the authority to authorize payments, and the accounting offices of GDPA no longer perform regularity audit and detailed verification of payments. Previously budget officers who worked in spending agencies were employees of Ministry of Finance; now they will be part of the financial service units within each spending agency.

5.28 ***The law clearly defines the role of the Treasury as provider of cash and the Ministry of Finance as the payer of budget expenses.*** The 1994 Law on the Structures and Duties of the Treasury Undersecretariat and the Foreign Trade Undersecretariat (No. 4059) explicitly requires that the treasury find the cash required for state expenditures (Article 2). The PFMC Law (and the earlier Law on Public Accounting) delegated the task of making payments to the GDPA of the Ministry of Finance (Article 61).

5.29 ***There is predictability in terms of allocation of budget funds to line ministries***. The division of responsibility is clear between Treasury and the Ministry of Finance. The explicit requirement that the treasury find the required cash for budget execution has provided predictability to spending agencies executing their budget programs. Other than under exceptional circumstance, rationing of cash has thus been avoided.

5.30 ***An automated system has been implemented to facilitate budget management.*** The General Directorate of Budget and Fiscal Control (GDBFC) has developed an automated Budget Management Information System (BYES – also called eBudget) to keep track of budget appropriations, allocations, and utilization. The interface between

Say2000i and BYES ensures the transfer of data on budget allocations to the Say2000i system as well as actual expenditures from Say2000i back to BYES.

5.31 ***Legislation to restructure and strengthen Turkey's tax administration has been enacted and is under implementation.*** Revenue Administration has been established as a semiautonomous entity under the Ministry of Finance. It is structured functionally, with local tax offices directly under its control. The Ministry of Finance retains responsibility for tax policy, allowing the new entity to focus on tax administration. Additionally, it is recommended that a large taxpayer unit be set up by the Revenue Administration, with the aim also of assuming increasing responsibility for collection of social security contributions.

5.32 ***Implementation of an automated tax management system (VEDOP).*** VEDOP integrates all tax offices with the Turkish communications network and allows taxpayers to transfer their tax returns and check balances. It includes both the assessment and the collection of taxes. Automation has had several benefits: quicker collection of tax returns and declaration forms; better utilization of back-office staff; valuable taxpayer information directly transferred to a database, where it is used for macroeconomic forecasting and monitoring; and better integration with the Tax Intelligence Department in detecting unreported income.

5.33 ***The PMFC Law replaced the outdated 1927 Law on Public Accounting.*** The new law introduced important features of a modern accounting framework, including an accrual-based accounting system and consolidated reporting requirements for the general government; and it established an official body for setting government accounting standards.

5.34 ***Turkey has a single accounting system, which is maintained by the General Directorate of Public Accounting (GDPA).*** Chart I institutions (comprising line ministries) do not maintain separate accounting systems. The detailed books and records for accounting are maintained in more than 1,500 GDPA offices in cities and towns throughout the country. This classic division of function thus enables strict control of accounting transactions.

5.35 ***Periodic financial statements are prepared regularly and on time. GDPA prepares aggregated financial reports for the central government, which are published as a monthly bulletin.*** Since late 1998, the monthly data have also been publicly available on the GDPA website (http://www.muhasebat.gov.tr/mbulten/indexE.asp).

5.36 ***Turkey has adopted a "dual" system for budgeting and accounting using a cash-based approach for the budget and an accrual-based approach for accounting.*** Turkey has consciously switched from cash-based to an accrual basis of accounting. Since the annual budgets are cash-based, the GDPA in the Ministry of Finance has devised an intricate method for accounting entries that keeps track of both the cash-based and accrual entries. Cash-based budget outturns are therefore easily distinguished from accrual-based expenditures. As a practical matter, the immediate replacement of a cash-based budget by an accrual-based budget would demand enormous resources from both the government and Parliament. These resources are not readily available. The solution—maintaining the current cash-based system for the budget while changing government accounting—is a progressive, realistic approach that is consistent with orderly development and implementation. Switchover to accrual-based budgeting must be viewed as a longer-term objective.

5.37 ***Commitment accounting has been introduced***. Say2000i can capture and set aside spending agency commitments against the budget appropriation and budget allocation, thus preventing budget commitments in excess of appropriations.

5.38 ***A uniform chart of accounts that is harmonized with budget classification has been implemented.*** The GDPA has issued a new framework for the accrual-based chart of accounts. It is harmonized with the economic classification of the newly adopted GFS budget classification system. A new chart of accounts enabled the GDPA to compile financial statements consistent with the 2001-GFS budget classification.[126]

5.39 ***Uniform accounting standards have been introduced and a single authority to set standards has been established.*** Article 49 of the PFMC law mandates that accounting be harmonized with the international standards and standards be issued by a Government Accounting Standards Board (GASB), which was established as the general government's sole standard-setting authority, and has been operating since June 2006. The GASB is under the Ministry of Finance, comprised of representatives from the TCA, State Planning Organization (SPO), Ministry of Finance, Treasury, and other agencies.

5.40 ***An automated online accounting system has been implemented.*** Using a state-of-the-art Oracle database, the Ministry of Finance developed in-house an automated online accounting system, Say2000i.[127] Up and running since 2002, the system networks and captures receipts and payments from more than 1,500 national nodes as they are made.[128] Because the database is linked through a central server, all transactions are immediately available. The system can produce periodic financial statements without the typical delays of decentralized accounting systems. The system covers all general budgetary institutions except the Office of the President and accounting office for the State Debt within the Treasury. It includes the majority of special budget institutions (Chart II) and the regulatory supervisory agencies (Chart III).[129] The Say2000i system does not extend to social security institutions as well as local governments such as special provincial administrations and municipalities.

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[126] The GDPA will only be compiling the financial statements for the general government. The Department of Statistics is responsible for compiling GFS-compliant financial statistics.

[127] The total hardware and software investment was about US$8 million. See the General Directorate of Public Accounting (GDPA) web site, http://www.muhasebat.gov.tr/say2000/indexE.asp for a presentation of the technological architecture of the system.

[128] Serving more than 6,000 users, the system is comprised of 7,700 computers, 3,300 printers, 400 routers, 400 modems, two database servers, and seven application servers.

[129] There are only 7 institutions not covered by the *Say2000i* because of technical difficulties : The Turkish Standards Institute, Turkish Patent Institute, Small and Medium Sized Industry Development Organization (KOSGEB), Telecommunication Agency, Banking Regulatory and Supervision Agency (BRSA), Tobacco Agency, and Punishment and Prison Institutions.

(ii) The Unfinished Agenda and Remaining Challenges

5.41 ***The scope of tax audit activities needs to be improved.*** Over the medium term, the government has committed itself to increasing the number of auditors from 5 percent of the Revenue Administration staff to the international standard of 20 percent or more.

5.42 ***Implementing a Say2000i-compatible system in the social security institutions and local administrations.*** The government is in the process of implementing Say2000i-compatible accounting systems in the social security institutions and local administrations. However, the large number of local administrations (more than 3,200) poses an implementation challenge in the short term.

5.43 ***Properly phasing-in and completing the implementation of the accrual accounting system.*** The government intends to move to a full accrual accounting. Since 2004, the Say2000i system has been able to capture the acquisition of new assets. However, valuation of existing assets (including heritage assets) and depreciation policies are still to be worked out. Full transition to accrual accounting represents a major undertaking for any government. Like any large-scale project, the shift requires careful planning and management. Governments have adopted accrual accounting over a wide range of timeframes, often in stages. For example, the United Kingdom produced its first accrual accounts for individual departments in 1999–2000. It consolidated central government accounts using generally accepted accounting principles in 2003–04, and it will prepare whole-of-government accounts for 2005–06.

5.44 ***The implementation of full accrual accounting requires taking on complex issues.*** Key issues include valuation of assets and inventories, depreciation rates, and gains and losses from foreign exchange. As shown by the experience of countries that have switched to accrual accounting, implementation generally works best when done in phases.[130] Even where countries have successfully produced accrual-based financial statements, auditors have issued disclaimers of opinion on the accrual-based financial statements for a number of years. For example, the U.S. Government Accountability Office (GAO) has issued disclaimers on the consolidated financial statements of the United States government since 1997, the first year in which accrual-based consolidated financial statements were prepared.

5.45 ***Training users of accrual-based financial statements.*** The Ministry of Finance has made significant efforts in training a large body of public accountants across the country. Accrual-based financial reporting is not an end in itself but provides information useful for multiple purposes. Accrual-based accounting statements are difficult to understand, especially for non-accountants. For accrual-based financial statements to be fully useful as management decision-making tools, it is therefore important that users,

[130] For more information refer to IFAC publication "Transition to the Accrual Basis of Accounting" dated December 2003 (http://www.ifac.org/Store/Details.tmpl?SID=102026702640546)

including heads of departments and program managers, be extensively trained in how to use and interpret accrual accounting statements.

5.46 ***Implementing Say2000i interfaces with other applications.*** The Say2000i system needs an interface with the treasury system for accessing data on public debt, with the budget management and information system (BYES) for obtaining budget appropriation and cash allocations and transmitting actual expenditure data), and VEDOP revenue system (for obtaining accrual-based tax data). Interface to the VEDOP revenue system is fully operational. The interface to BYES and the treasury system is currently operational as well. Once all interfaces are fully operational, the need for manual intervention will be eliminated; and automatic transfer and the integrity of data would be ensured.

5.47 ***Issuing and implementing secondary legislation as required under the PFMC Law.*** The PFMC Law envisages secondary legislation to facilitate implementation of the law and provide detailed guidance to officials. For example, secondary legislation includes procedures for preliminary payment, transfer and set-off transactions, working principles for the GASB, and accounting and reporting standards.

5.48 ***Establishing GASB and issuing accounting standards***. Public accountability of government is demonstrated in part by accounting standards that require fair presentation and full disclosure. The accounting regulation issued by GDPA in November 2003 was revised in June 2005. However, GASB— not GDPA—is the authority to issue accounting standards for the general government.

5.49 ***Providing access to the Say2000i system for line ministries.*** Line ministries do not maintain separate accounting records although the PFMC Law provides them with an enhanced role in financial management; so it is particularly important that line ministries have unhindered read-only access to the Say2000i system. This will enable them to monitor the financial performance of their respective units. Currently, GDPA policy provides line ministry staff with access upon request, but access needs to be expanded and made more widely available.

5.50 ***Implementing full commitment accounting. Liabilities are fully captured in the Say2000i system***.[131] However, until recently only commitments for large multiyear capital expenditure projects were fully captured. The revised accounting regulation issued in June 2005 requires recording of all commitments to ensure budget discipline and avoid accumulation of arrears.

5.51 ***Establishing and implementing formal procedures for system controls audit.*** An online system with a database of the magnitude of Say2000i system requires formal

[131] The terms *commitments*, *expenditures*, and *payments* are often confused. Simply stated, *commitments* are the value of the purchase orders and contracts that bin an agency to buy certain goods or services to an amount specified. *Expenditures* are the actual amounts of goods and services for which full payment may or may not have been made. *Payment* is the amount transferred from the treasury bank account to the credit of the supplier's account.

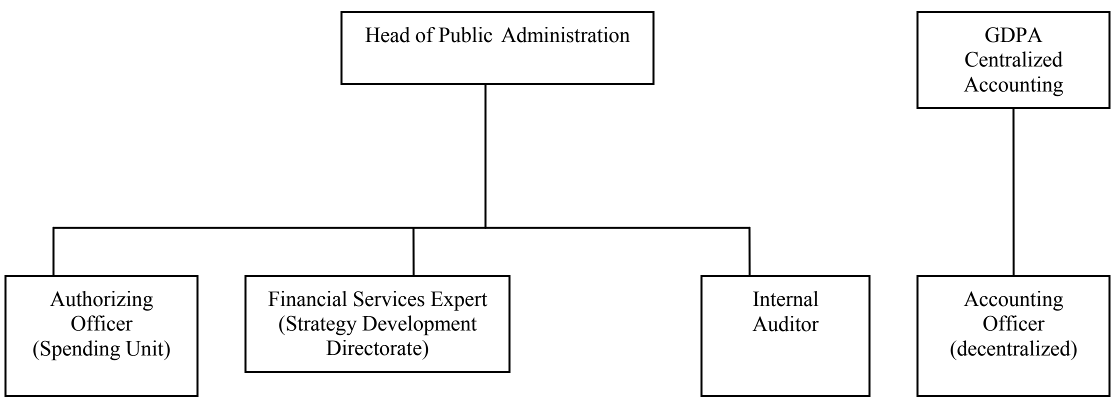
policies and procedures to audit system controls on a regular basis, including mechanisms for monitoring the implementation of audit recommendations.

C. INTERNAL CONTROL AND INTERNAL AUDIT

(i) Developments and Reforms since 2001

5.52 ***The PFMC Law has defined a modern financial management control framework for the public sector in Turkey***.[132] It has introduced major policy changes in internal financial controls and internal audit arrangements. The spending agencies will have increased authority and concomitant accountability for executing the budget. As shown in Figure 5.1, the law envisages a financial control framework. Each spending agency will have an authorizing officer and a financial services expert who belongs to the spending unit's administration.

Figure 5.1. Schematic Diagram of the Internal Financial Control Framework for the General Budget Institutions as Defined by the 2003 PFMC Law



Payment processing controls:
* Strategy Development Directorate. Financial services unit responsible for ex-ante controls.
* Authorizing Officer. Approves and is held accountable for payments.
* Accounting Officer. Verifies, makes payment, and maintains accounts.

5.53 ***There are positive aspects of the internal control system.*** The most important positive feature is the separation of duties and responsibilities between those who incur expenditures and those who make payments. The GDPA accounting offices exercise controls with respect to payments by verifying the documentation supporting the payment and authority to make the expenditure. Under the framework newly specified by the

[132] The original provision in the PFMC Law required establishment of a new position of financial control officer with full responsibility for ex-ante controls within each budget spending unit. This provision was deleted by the 2005 amendment and responsibility for ex-ante controls has now been assigned to the financial services unit within in each budget spending unit, thus eliminating new positions but at the same time clearly articulating the role of the financial services unit.

PFMC Law, these controls and compliance with rules and regulations would be exercised by the Strategy Development Directorate before payment. The GDPA accounting office would restrict itself to verifying the completeness of documentation and to ensuring that no material errors exist. Another positive feature of the internal controls is that Say2000i system does not allow deletion of transactions, so any corrections must be entered as new transactions.

5.54 ***The PFMC Law has introduced a modern internal audit framework.*** With devolution of authority and responsibility to spending agencies, the need has increased for a modern internal audit organization that can assure the head of the spending agency on the soundness of the internal control system. The PFMC Law requires each public administration to establish an internal audit unit within its administration. The law envisions a decentralized internal audit model in which internal auditors report to the head of the administration. This is similar to the current model of inspection boards in each line ministry, except that inspection boards report directly to the minister. To provide a centralized oversight mechanism over the dispersed internal audit function, the law requires a central Internal Audit Coordination Board (IACB) to be attached to the Ministry of Finance. This board would set internal audit standards, organize training for internal auditors, and provide quality assurance for internal audit work carried out by the line ministry internal audit units.

5.55 ***The law clearly articulates the accountability of ministers and other high-level civil servants.*** In the old accountability model, accountants and accrual officers were responsible to TCA for financial misdemeanors. This has been replaced with broad accountability for government officials. Articles 10 and 11 of the PFMC Law deal exclusively with ministers and heads of public administrations. The new provisions contrast sharply with the previous law, which carefully defined the accountability of the accountant but generally glossed over the accountability of the higher-level officials.

5.56 ***The "visa" power of the Turkish Court of Accounts and the Ministry of Finance has been revoked***. Under the previous system, the Turkish Court of Accounts and the Ministry of Finance were required to issue "visas"—that is, authority to incur expenditures and provide other approvals for expenditures above predetermined thresholds, which were in the form of controls normally exercised by an executive authority. TCA thus played an indirect role in the budget execution process. This created apparent conflict of interests, because TCA also audited budget execution reports. The PFMC Law has transferred this power to the Strategy Development Directorates to be established within each budget spending unit, which would exercise ex-ante control over budget expenditures.

5.57 ***Introduction of accountability reports.*** The PFMC Law (Article 41) requires every line ministry to prepare an annual accountability report. In addition to providing financial data, the report would include performance data and details of activities in implementing the strategic plan and budget. These reports would be audited by the TCA and submitted to Parliament. The introduction of accountability reports breaks with a long tradition of providing Parliament with financial reports only. It thus strengthens the accountability of line ministries. It should, however, be noted that recent studies have questioned the assumption that performance information necessarily serves the legislature. While this measure is laudable and at least sends a signal in the right direction, it is too early to evaluate its actual effectiveness in Turkey.

5.58 ***The Ministry of Finance has created three new departments to prepare secondary legislation and to implement the PFMC Law.*** These are the Financial Control Department, which prepares secondary legislation in the area of financial controls; the Internal Audit Department, which develops secondary legislation in the area of internal audit and also serves as a secretariat for the IACB; and the Financial Management Department, which is responsible for work in the area of performance budgeting.

5.59 ***The accrual accounting system would enable tracking of both movable and immovable assets.*** The Say2000i accounting system has captured purchase and construction of new assets since January 1, 2004. This will enable regular reconciliation between the fixed asset register and accounting data, and it will strengthen control over fixed assets.

(ii) Unfinished Agenda and Remaining Challenges

5.60 ***Implementation of the PFMC Law itself poses a major challenge***. Beyond serving as a more transparent and accountable approach to public resource management, the PFMC Law envisions a substantial change in the public internal financial control framework; and it devolves financial management authority and responsibility to line agencies. However, with the continuing uncertainty regarding the enactment of the Public Administration Framework Law—which envisages abolition of inspection boards in line agencies—the mapping of inspectors to internal audit positions has become less certain.

5.61 ***Phased implementation of the PFMC Law across the general government***. The PFMC Law is applicable to the central government as well as to social security institutions and local governments, consisting of 81 Special Provincial Administrations (SPAs) and more than 3,200 municipalities. Some of the SPAs and several smaller municipalities lack adequate resources for creating new institutional structures for internal audits. The law envisages a uniform implementation schedule across the general government, irrespective of the size or capacity of the agencies to implement the law. This poses an enormous implementation risk: smaller municipalities may either ignore the provisions that they consider too expensive, or they may implement the provisions by focusing on form rather than substance.

5.62 ***Involve spending agencies in the implementation of the PFMC Law***. The implementation of the PFMC Law had been orchestrated by the Ministry of Finance. Spending agencies had generally been aloof distant observers. If PFMC implementation is to proceed smoothly and if the spending agencies are now to support the reforms wholeheartedly, they must become actively involved in the process. This would require further efforts in dissemination and training. The government has taken the first step by creating a high-level Change Management Committee. Working Change Management Teams have been created to guide the implementation process and to enlist active involvement among spending agencies. These are steps in the right direction. Efforts must now turn toward making them functional.

5.63 ***The Public Administration Framework (PAF) Law adopted by the parliament and vetoed by the president has generated uncertainty regarding the role of inspection boards and internal audit units***. The PAF Law envisioned abolition of inspection boards in line ministries that carried out inspections, investigations, and minimal internal audit in their respective ministries. Since the veto, however, uncertainty has reigned with regard to respective roles of inspection boards and internal audit units. Previously, the inspection boards focused on identifying violators of laws and regulations. In general, they paid little attention to internal control systems. The creation of internal audit units to focus on internal control systems would be a step forward. Nevertheless, every environment needs investigative capacity to uncover abuse of power and misuse of public resources. It will therefore be important to retain inspection and investigation functions, albeit with fewer personnel. Also, the scenario needs to be considered of inspection boards being abolished before internal audit units become fully operational. This could weaken the control framework and increase the risk of misuse of funds. A detailed transition strategy urgently needs to be devised, outlining interim measures while the new institutional structures become fully operational.

5.64 ***Implement a payroll module—that is, a centralized payroll database—within the Say2000i system***. Payroll for the approximately 1.8 million general government staff is not yet centralized, exposing payroll to the inherent risks of misuse and malpractice. A personnel module is ready in the Say2000i system. When implemented, all employees will be tracked in the central database. Payments could be made electronically to an employee's bank account, thereby improving the control framework.

D. EXTERNAL AUDIT

(i) Key Features of the External Audit Arrangements

5.65 ***There are three external audit agencies in the public sector in Turkey***. These are: Turkish Court of Accounts (TCA); the High Audit Board under the Prime Minister's Department (YDK); and the State Audit Board under the Presidency (DDK). YDK was established in 1938 to audit state-owned enterprises on behalf of the parliament. DDK has a broad mandate, covering all public sector bodies except the military and the courts. Because it undertakes research studies, investigations, and audits only at the request of the president, it therefore does not function as a regular external audit agency.

5.66 ***TCA is independent of the legislature and the executive***. TCA is a constitutional establishment and is entrusted with the task of auditing on behalf of the Turkish Grand National Assembly. TCA carries out its work on behalf of the parliament but remains independent of both the legislative and executive branches of government. The parliament elects its president by secret ballot from two candidates, who are put forth by an ad hoc committee of 15 members drawn from the parliament's Plan and Budget Commission. The president of the TCA is elected for a seven-year term and is eligible for reelection. TCA has complete discretion in deciding what accounts and subjects to look at, including how and when to examine them.

5.67 ***TCA and YDK are financially independent***. The TCA enjoys financial independence by preparing its own budget, which it submits to parliament without intervention. The president of TCA is the sole authority who can authorize expenditures from the budget, leaving no room for either the legislative or the executive bodies to interfere with its budgetary spending. Similarly, YDK enjoys financial independence as it does not receive any budgetary support. The entire budget of YDK is funded out of audit fees collected from SOEs.

5.68 ***As an institution, TCA also exercises judicial power***. The TCA is a collegiate body which includes an elected president and elected members as well as appointed audit staff. While the auditors carry out audit function, the colleges—namely chambers and board of appeals—perform the judicial function.

5.69 ***TCA and YDK report to the parliament***. TCA reports on the general and annexed budgets. YDK reports on state-owned enterprises and on several funds. By contrast, DDK reports to the president. Under the new PFMC Law, TCA will be required to submit an opinion to the parliament on the annual accountability reports prepared by public administrations; an annual general conformity statement on the final accounts; and a report on evaluation of financial statistics in terms of accuracy, reliability, and conformity with set standards. In addition to these mandatory reports, TCA would submit ad hoc reports on performance audits and other special audits. An audit report for each SOE audited by YDK is submitted to the parliament. In addition, YDK submits a consolidated report on all SOEs audited during the year.

(ii) Developments and Reforms since 2001

5.70 ***The Constitution was amended in 2005 explicitly mandating TCA to audit social security institutions and local administrations***. Ambiguity regarding the mandate of the TCA to audit social security institutions and local administrations has been removed by the 2005 amendments to the Constitution.

5.71 ***The new draft TCA Law (January 2004) along with the PFMC Law (2003) addresses several key issues.*** These include:

- The PFMC Law extended TCA's audit mandate to cover all administrations forming part of general government. The earlier anomalies have been addressed by granting TCA the authority to audit the presidency. However, the December 2005 amendment to the PFMC Law has once again restricted TCA's mandate to audit the parliament.

- Audit of TCA by an independent commission comprising professional audit staff is included in the PFMC Law (Article 69).
- The draft law defines audit as a planned activity to be carried out in accordance with international standards.
- The draft law specifically provides for financial audit by TCA, thereby putting financial audit to the forefront along with the regularity audit.
- The PFMC Law has effectively removed the role for TCA in the visa approval process. The draft law similarly contains no provisions dealing with erstwhile powers of TCA regarding visa approval.
- The draft law contains an article explicitly requiring TCA to make its reports public within 15 days of their submission to Parliament.
- The draft law recognizes the need to carry out interim audits at any time during the financial year.
- The draft law permits the audit of accounts and transactions of public administrations by independent private auditors. However, such audits must be carried out under supervision of TCA auditors in compliance with its audit principles.

(iii) Unfinished Agenda and Remaining Challenges

5.72 ***TCA's draft law creates a sound basis for the development of government audit in Turkey that is in line with modern government audit concepts and accepted international auditing standards.*** It is important that the draft law be enacted quickly. This will enable TCA to concretely begin the implementation of reforms. The following additional measures would facilitate the transformation of TCA into a modern supreme audit institution.

5.73 ***Strengthening the audit function within TCA. The audit side of TCA is not yet fully developed***. The draft law is still insufficient in terms of structures and responsibilities. Even after enactment of the law, TCA will still be dominated by its judicial side. Its audit reports and the audit planning and coordination activities will largely remain in the hands of those primarily employed on non-audit issues. TCA will still lack an authoritative internal voice representing audit interests. And those aiming for senior positions will still find only one way forward: leaving audit to join the chambers as members of the court.

5.74 ***Developing capacity for financial statement audits. In the future, TCA intends to carry out financial audits***. This type of audit includes technical opinion on the reliability and accuracy of the financial statements. TCA is therefore committed to issuing short-form audit opinion for the more than 5,000 entities currently subject to its audit. This fundamental change of approach would require sustained training for TCA auditors to undertake financial statement audits and to issue audit opinions. Since the government has adopted accrual basis of accounting and would be producing accrual-based financial statements in addition to cash-based budget execution reports, this development requires capacity building within TCA on the skills to audit accrual-based financial statements.

5.75 ***Adopting a strategy for risk-based audit***. Until 2006, audits carried out by the TCA were based on the 100 percent transaction examination instead of risk assessment. T TCA has been maintaining the fiction of 100 percent audit based on the related articles of abolished Public Accounting Law no: 1050. With the effectiveness of the PFMC, the Parliament plans to adopt a new TCA Law which will make the external audit consistent with the application of internationally recognized audit standards.

5.76 ***Designing the role and structure of the YDK:*** The Public Administration Framework Law enacted by the parliament but vetoed by the president envisioned merger of YDK with TCA. This welcome proposal was consolidating the mandate of the country's Supreme Audit Institution and reduces the number of external audit agencies. However, with the presidential veto to the PAFL, the legal basis for the merger was abolished. Therefore a relevant article needs to be integrated to the TCA draft legislation. Moreover, issues posed by the merger must be carefully considered, including questions of personnel, grades, and levels of staff.

5.77 ***Devising a strategy for audit of local governments***. Local governments are part of TCA's audit mandate. There are more than 3,200 local administrations in Turkey, about 15 percent of which are audited by TCA. Since those selected are generally the largest, TCA estimates that about 80 percent of local government expenditures are thus subject to audit. However, this still implies a widespread lack of audit in this sector. Moreover, with the increased role for local administration envisioned under the decentralization agenda, the complexity and size of activities carried out by local administrations will doubtlessly increase significantly. This prompts the need for reconsideration of audit policies for this sector. Depending on the choice of a strategy, TCA's role might be redefined in several ways—for example, dividing local administrations into categories based on population size, with different strategies for local administrations of differing sizes; creating a new local government audit service; using private sector auditors to audit local administrations.

5.78 ***Developing secondary legislation, manuals, and guidelines***. The draft law provides a framework of principles. Secondary legislation, manuals, guidelines, and extensive training will be needed to achieve the aims. In particular, TCA must change from an institution dominated by its judicial functions to one that is adapted to carrying out modern audits and reporting its audit findings to the parliament.

5.79 ***Adopting international audit standards.*** In the future, TCA intends to carry out audits in line with accepted international audit standards. Article 35 of the draft law defines audit as a planned activity carried out in accordance with these standards. It is important that TCA adopts (without any changes) the audit standards of either INTOSAI or the International Federation of Accountants (IFAC). In addition, TCA should develop and issue ethical guideline for auditors.

E. LEGISLATIVE OVERSIGHT

5.80 ***The Plan and Budget (P&B) Commission of the parliament oversees the budgetary process.*** The commission is chaired by a member of the ruling party and is comprised of 40 parliamentarians. Parliamentarians are entitled to recruit advisers paid from the parliamentary budget. They provide expert advice on various issues. Advisors can come from the civil service or the private sector. Advisors from the civil service retain their previous job.

5.81 ***However, the P&B Commission holds little influence over the overall budget, because budgets must be prepared annually within the broader economic program agreed upon with the IMF.*** The parliament also exerts little influence over intersectoral allocations. Although the parliament and the P&B Commission have limited influence over overall budget size, it is not unusual for informal discussion to take place earlier in the budget process among members of the parliament, the commission, and the government. Considerable discussion occurs annually while the budget is being drafted, though the parliament has limited capacity to make actual changes. The three-year timeframe envisaged in the PFMC may facilitate better interactions and greater dialogue on budget between the parliament and the government.

5.82 ***Neither the parliament nor the commission reviews interim budget execution reports.*** The final accounts to parliament include an enormous quantity of numeric data but scant detail or discussion on program implementation, outcomes, or outputs. The reports are not conducive to discussion. The PFMC Law of 2003 envisioned annual accountability reports with details on costs and program achievements, thereby enabling meaningful debate in the parliament.

5.83 ***Little discussion takes place on in the parliament on TCA audit reports because the reports contain little information on financial management or accountability issues.*** Like the annual final account, the TCA audit report is primarily quantitative and contains little on financial management or accountability issues that emerged during the audit. To date, as described, the TCA has primarily discharged judicial functions and carried out compliance checks rather than financial audits. The new draft TCA law would change this by requiring TCA to carry out financial audits with opinions on findings, thereby strengthening parliamentary oversight over the executive branch.

5.84 ***Effective implementation of the PFMC Law would facilitate better parliamentary oversight over the executive branch.*** The law improves the framework for parliamentary oversight by requiring three-year budget estimates, a medium-term fiscal strategy, and annual accountability reports to the parliament. Furthermore, the draft law requires the TCA to render opinions on financial accounts, including any issues that emerged during the course of the audit process.

F. PUBLIC PROCUREMENT MANAGEMENT

5.85 ***Between 2001 and February 2006, the public procurement system made significant progress, yet significant issues and challenges remain.*** Inefficient procurement procedures in the past contributed to waste and opportunities for corruption in the award of public sector contracts. The 2001 PEIR and the Country Procurement Assessment Report (June 2001) highlighted procurement practices that encourage unrealistic bids and nontransparent decision making. This has led to many public investments remaining incomplete, with huge economic costs attached to these inefficiencies. Reforms implemented since 2001 have taken on a new dimension with the deepening dialogue related to EU Accession, specifically the "Procurement Screening Process", Baseline Indicator System (BIS) to assess public procurement system, the Consultants Assessment Study to assess the current status and problems of the consultants' sector in cooperation with the World Bank, and the e-GP initiatives.

(i) Developments and Reforms since 2001

5.86 ***A satisfactory new Public Procurement Law and secondary legislation was prepared, including procedural guidelines and instructions to provide guidance to procuring entities.*** Three national and one international consultant were hired to assist the Public Procurement Authority (PPA) in preparing the corresponding documentation, and all documents were finalized in 2002 before the Public Procurement Law came into effect in January 2003. All documents were published in the Official Gazette and are available through the PPA website.

5.87 ***Standard bidding documents (SBDs) for use by procuring entities were prepared***. The consultants also assisted PPA to prepare SBDs for procurement of goods, works, technical services, and consultant services. Here too all documents were completed before the Public Procurement Law came into effect in January 2003, and all documents were published in the Official Gazette and are available through the PPA website.

5.88 ***Documents to standardize public procurement operations were printed and disseminated for all procuring entities***. They are all made available through the PPA website, providing much easier and wider accessibility among public and private entities. Although reproduction and dissemination of standard documents was foreseen within the scope of grant-financed activities, the PPA published all documents on its website, an activity fully financed by its own resources rather than through grant funds.

5.89 ***Trainers were trained on the new Public Procurement Law.*** PPA's own staff provided advance training on the PPL upon request of procuring agencies, which also was financed from its own resources. As of May 2005, 9,634 staff from 278 procuring entities were trained by PPA trainers. In addition to three days of classroom training, a more comprehensive and systematic training module was developed using a web-based distance learning module. A consulting firm was hired to develop an interactive learning program for procuring entities and the private sector. This activity was completed in January 2004, and the learning tool was made available through PPA's website. Five thousand copies of interactive learning CDs were reproduced and distributed to public and private entities as well as subscribers of the Public Procurement Bulletin using PPA financial resources.

5.90 ***A Public Procurement Law for Utilities was prepared***. An international and a national consultant were hired to assist the PPA in preparing a new public procurement law for state owned economic enterprises for water, transport, energy, and the telecommunication sectors. This was done in line with the EU Utilities Directive. This activity was not explicitly defined under the scope of this project. However, in response to difficulties and urgent needs faced by the state owned enterprises, the Bank and PPA agreed to use grant funds for technical assistance. Two consultants were hired in January 2004. They submitted a draft law to the PPA in May 2004. The draft law was submitted by the PPA to the government, circulated amongst stakeholders for comments and inputs, and returned to the Ministry of Finance for further action. Currently the draft law is considered within the "Screening Process of Procurement with EU" - whether to incorporate it within the PPL or issue it as a single bill.

(ii) Unfinished Agenda and Remaining Challenges

5.91 ***Use of country procurement systems***. To some extent, all projects in Turkey rely on the existing country procurement systems with national competitive bidding (NCB). Thresholds are being raised, enabling use of NCB or other procurement methods for a larger portion of project procurement. Subject to certain conditions, exceptions, and waivers, the World Bank permits the use of country public procurement system for NCB contracts.

5.92 ***Procurement legislation.*** There have been two amendments to the PPL in June 2002 and July 2003. However, other laws have also made many other amendments to the PPL, mainly to provide exemptions to various agencies and to exclude procurement of certain services from the scope of the law. Later, a decision was made to hold all amendments on the PPL until after the Procurement Screening Process with EU is complete. It is recommended that the government should ensure internal consistency and integrity of the original law, considering a systematic and well thought out approach before making amendments. Since the PPA was established as a regulatory agency to prepare required legislation in public procurement, it is suggested that all draft laws amending the PPL be prepared and finalized in close consultation with the PPA.

5.93 ***e-Government Procurement Strategy***. There is presently no e-Government Procurement Strategy. However, the PPA has initiated a process on its own initiative to identify actions to be taken and the necessary legislation to be prepared by the government. Currently, procurement notices are published electronically; and e-bulletin and tender documents can be obtained in CD format. Most public procuring agencies maintain their own websites. Notices are published on the web in addition to obligatory issuance in the Public Procurement Bulletin, which is available in hard copy and electronic format. There is strategic integration within the context of e-government planning. PPA has agreed to establish a specific portal to serve public and private agencies such as the Social Security Agency and the Chamber of Commerce and Industry. (Such portals will simplify the collection of authenticating documents and certificates required in the bidding documents, for example, document authenticating membership in the chamber of commerce.) Within the context of the EU accession process some funds are allocated to PPA for electronic infrastructure and staff development.

5.94 ***Implementation of baseline indicators to assess the public procurement system***. As part of the ongoing dialogue supported by an IDF grant for institutional strengthening of Public Procurement Authority, it was agreed to conduct a joint assessment of public procurement system through the Baseline Indicators System (BIS). The BIS provides a structured approach to analyze the health of the existing system. A rating system was finalized in February 2006, with the participation of Public Procurement Agency (see Annex VIII for details). The report provides a comprehensive picture of the current public procurement system, which would become a valuable tool for identifying, tracking and prioritizing key areas for further strengthening. This study may require further refinements based on the latest OECD-DAC-World Bank rating BIS system and as necessitated by expected changes in laws and regulations. However major issues and concerns are summarized below:

Indicator	**Summary of Self assessment by PPA**	**World Bank's comments/concerns**
Indicator No. 1- Public procurement legislative and regulatory framework achieves the agreed standards and complies with applicable obligations	All the 26 sub-indicators rated as "fully achieved"	(i)New utility law to be enacted;(ii)PPA to maitain its oversight on all amendments and new law which affects public procurement;(iii) Bank remain concerned about exemptions provided to certain types of entities or services through other laws;(iv) open competitive bidding to be a preferred method in the law ;(v)all procurement above or below the threshold should be open to international competitors;(vi) data on direct procurement to be kept; (vii)threshold for mandatory publication of contract award to be increased and monitored by PPA; (viii) time limits for submission of tenders to be aligned with EU Directives; (ix) data on debarment process to be monitored; (x) unfair competitive advantage to state-owned enterprises to be removed and equal treatment to all bidders considered; (xi) PPA to prepare and issue a Good practice Guidance Note on how to prepare neutral technical specification; and (xii)electronic system to be put in place to monitor current status of complaint review process
Indicator No. 2 Existence of Implementing Regulations and Documentation	"fully achieved" on all the 6 sub-indicators	(i) PPA to ensure consistency within all implementing regulation; (ii) implementing regulation to be updated regularly; and (iii) User's Guide manual for contracting entities to be updated regularly
Indicator No.3 Mainstreaming Procedures into Public Financial Management	Out of 6 sub-indicators PPA has rated 1 as fully achieved, 4 as substantially achieved and 1 as not achieved	Further studies required to provide data on budget formulation.
Indicator No.4 Functional Management /Normative Body	Out of 4 sub-indicators, 3 "fully achieved' and I substantially achieved	Administrative capacity of PPA to be strenghthened and responsibilities within the organization clearly defined

Indicator No.5 Existence of Institutional Development Capacity	Out of 4 sub-indicators 2 “fully achieved”, 1 “substantially achieved” and 1 “not achieved”	(i)PPA to develop a more proactive strategy for capacity development through twinning arrangement(such as mandatory training,minimum qualification standards to professionalize procurement staff, on-line cerification of staff, awareness compaign etc); and (ii) collection and monitoring of national procurement statistics to be enforced in line with Article 53(b) 9
Indicator No 6: Efficient Procurement Operations Capacity and Practices	Out of 6 sub-indicators 1 is fully achieved and 5 are substantially achieved	(i) Need to improve procurement performance through availabilty, analysis and application of data
Indicator No 7 Functionality of Public Procurement Market	Out of three applicable sub-indicators, 2 “fully achieved” and 1 “substantially achieved”	There are certain systemic constraint in access to credit market. This needs to be addressed.
Indicator No 8 Existence of Contract administration and Dispute Resolution Provisions	Out of 2 sub-indicators 1 “fully achieved” and 1 “substantially achieved”	There are implementation issues. More study is required to determine coverage of existing procedure to facilitate efficient dispute resolution process
Indicator No 9 Effective Control and Audit System	Out of 5 sub-indicators, 2 are “fully achieved”, 1 “substantially achieved” and 1 “not achieved”	Implemenatation of PFMC law to be monitored
Indicator No 10 Efficiency of Appeal Mechanism	All 6 sub-indicators “fully achieved”	Complaints are not resolved at the initial stage(at the contractingentities) and generally referred to PPA, which delays the contract award for one month and increases the workload of PPA. PPA should develop and provide guidance to the contracting entities to address the complaints from participants
Indicator No 11 Degree of Access to Information	All 4 sub-indicators “fully achieved”	No Issue identified by the BIS team.
Indicator No 12 Ethics and Anti-corruption measures	Out of 7 sub-indicators all “fully Achieved”	Implementation issues remain in this area. Signature of ethical contract is required for all public employees. Disclosure of financial assests by the public staff is required every 5 years. But this issue requires more study.

5.95 ***Status of Dialog between EC and Turkey on Procurement***. As part of Turkey's accession to the EU, process screening meetings between EU and Turkey are being held. Public Procurement is one these topics and discussions of this topic took place in November 2005. Draft screening report prepared by EC notes improvements required in the following areas (i) public contracts(15% national preference above the threshold is incompatible with the acquis); (ii)Lack of sector (utilities) legislation; (iii)Concessions - lack of horizontal legal framework; (iv)Strengthening the Administrative capacity of the PPA; and (v) .Electronic Procurement - such as need for electronic auction on a pilot basis

5.96 ***Need for an Action Plan***. The action plan on CPAR 2001 recommendations summarizing responsibilities and achievements to date are given in Table 5.4. The table also benchmarks progress made on the action points identified in the 2001 CPAR.

Table 5.4. Action Plan as Provided in CPAR 2001

Actions	Responsibility	Achievement
Establish an interministerial committee to draft a new public procurement law. Consult interested stakeholders. Hire international legal experts to assist the Drafting Committee. Present a new public procurement law to the TGNA by October 2001.	GOT	Done
Apply public procurement law to all agencies at central and local levels, using budgetary or extrabudgetary public funds, and to SEEs.	GOT	Partially done
Draft and enact implementing regulations.	GOT	Done
Prepare and enact a medium-term plan for progressive reform of the public procurement legislation to achieve full alignment with EU Procurement Directives.	GOT	Pending EU procurement screening process
Undertake a review of public investment programming, budget planning, and procurement planning. (Coordinate with the PEIR.)	GOT MOF	Partially done
Introduce a prequalification procedure for large or complex contracts. (Include pre-qualification provisions in new public procurement law.)	GOT	Done
Reform the Contractor Certificate system.	GOT, MPWS	*DONE*
Improve market access by graduated reform and relaxation of legal and administrative obstacles to participation by foreign bidders.	GOT	Partially done
Revise the range of procurement methods: reinforce open bidding as the main procurement method; introduce methods for small-value purchases, direct contracting and consultants' services. (Include methods and their conditions for use in new public procurement law.)	GOT	Done
Increase transparency and fairness: lengthen bidding periods, reform bid opening procedures, use objective bid evaluation criteria; introduce more rigorous requirements for advertising tenders and announcing contract awards; abolish verbal bidding, bracketing and expression of bids as percentage discounts off unit prices. (Include in new public procurement law.)	GOT	Done
Introduce standard prequalification and bidding documents for civil works, goods, and services.	GOT	Done
Improve the bid protest mechanism; provide a legal basis and institutional arrangements for administrative review. (Link to the establishment of a central public procurement office.)	GOT	Done
Establish a new central public procurement office. (Establish and define its function in new public procurement law.)	GOT	Done
Draw up a national training strategy for public procurement.	GOT	Not yet
Develop a national training program for public procurement and deliver it through identified training institutions.	GOT Training institutions	Not yet
Establish procurement as a profession within the civil service.	GOT	Not yet
Establish a professional accreditation scheme for government procurement officers.	GOT	Not yet
Develop a more constructive relationship with the business sector through outreach programs	GOT	Partially done

Increase resources and investigative powers of TCA.	TGNA	Draft bill submitted to TGNA
Train TCA auditors in the application of the public procurement law	GOT	TCA
Publish results of procurement audits.	TCA	Not yet
Strengthen internal audit functions of procuring entities to audit procurement.	GOT Procuring entities	Partially done
Strengthen provisions in the criminal law on procurement-related corruption and enforce them more rigorously. (Include reference to criminal law provisions in new public procurement law.)	GOT	Done
Insert specific prohibitions against fraudulent and corrupt activities by bidders in bidding and contract documents. (Coordinate with development of standard bidding documents.)	GOT Procuring entities	Done
Put in place facilities for reporting allegations of fraud and corruption.	GOT	Done
Introduce clear conflict of interest rules. (Include in new public procurement law and standard bidding documents.)	GOT	Done

Source: World Bank Staff

G. COMMON REFORM DIRECTIONS

5.97 ***Implementation of the newly enacted laws represents a major challenge***. Never in Turkey's history have so many new laws been enacted altogether affecting public financial management. If successfully implemented, they could dramatically alter longstanding attitudes and practice. A bureaucratic culture that has traditionally been closed, conservative, centralized, control-oriented, and hierarchical could be transformed toward transparency and public service, opening itself to participation by civil society and enhancing accountability to citizens. Yet to succeed, the reform agenda must be fully planned and effectively executed. Although some aspects of the new legal framework are being piloted intermittently, most of the secondary regulations (that is, those related to practical implementation) are yet to be issued. None of the reforms have yet been fully implemented. The government's decision to undertake fundamental changes in the responsibilities of provincial and municipal governments also injects new complexity and considerable uncertainty into the PFMC implementation schedule. This, in part, has contributed to the delay in PFMC implementation.

5.98 ***Implementation of major public reforms needs strong coordination and monitoring.*** By the nature of the issues that they address, public sector reforms tend to be cross-cutting, and they require time for implementation. Strong high-level leadership must articulate a clear vision of the objectives. Pragmatic midstream adjustments must adapt to changing circumstances, and coordination must be effective across units of government. In part, the PFMC and the Public Finance and Debt Management (PFMD) laws spearheaded the public sector reforms to address concerns about recurring fiscal crises. Weak interagency coordination would pose the inherent risk of provisions being enacted that are inconsistent with or contradict the previous reforms. Enactment of the Omnibus Law has created concern that its provisions run counter to the intention of the PFMD and PFMC Law as approved by the Parliament—a measure to improve fiscal transparency and to ensure that policy decisions are subject to consideration in the context of a medium-term fiscal strategy that restrains expenditure commitments. It is crucial that Turkey maintains the credibility of its major public financial management reforms; so the need for strong, effective coordination to reconcile such conflicts cannot be overstated. Without arrangements to ensure effective leadership, implementation of the reform agenda will remain at high-risk.