United Nations TD/B/COM.2/ISAR/40

United Nations Conference on Trade and Development

Distr.: General
23 August 2007

Original: English

Trade and Development Board
Commission on Investment, Technology and Related Financial Issues
Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting
Twenty-fourth session
Geneva, 30 October–1 November 2007
Item 3 of the provisional agenda

Review of practical implementation issues of International Financial Reporting Standards

Case study of Turkey*

Note by the UNCTAD secretariat**

Executive summary

In concluding its twenty-third session, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) agreed to conduct additional studies and reviews of practical implementation issues of International Financial Reporting Standards (IFRS) with a view to developing guidance on good practices on IFRS implementation. Accordingly, country case studies of Pakistan, South Africa and Turkey have been prepared for consideration by the twenty-fourth session of ISAR.

This document presents findings of the case study conducted in Turkey. As of 1 January 2005, publicly-owned companies whose shares are traded in the Istanbul Stock Exchange are required to prepare their financial statements in accordance with Turkish accounting standards that are based on International Financial Reporting Standards (IFRS). In this case study, practical implementation issues pertaining to the regulatory framework, enforcement and technical capacity-building are discussed in the context of implementing IFRS.

The main objective of this case study is to draw lessons learned from the experience of Turkey in converging national standards with IFRS, and to discuss the findings with member States, with a view to facilitating sharing of experience among countries that are either implementing IFRS or that intend to do so in the future.

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** This document was submitted on the above-mentioned date as a result of processing delays.

Contents

I. Introduction

1. As a developing country with an emerging capital market, Turkey closely follows developments in international financial reporting and auditing. This report presents the historical development of accounting and financial reporting in the country and discusses the recent regulatory developments following the attempts at convergence with the global set of financial reporting standards that are referred to as the International Financial Reporting Standards (IFRS). In doing so, this report conveys the Turkish experience in adapting to IFRS as well as lessons learned in the implementation process.

2. Turkey has been attracting foreign direct investment (FDI) at various levels since the establishment of the Turkish Republic in 1923. Turkish companies started to invest in other countries in the late 1990s. The amount of FDI flowing into Turkey between 2002 and 2005 was $15.4 billion, whereas FDI flowing out of Turkey during the same period was $2.6 billion.[1] As of 31 December 2006, there were 14,932 companies in Turkey with foreign capital. Five percent of these companies received investments from the United States, and 56 per cent received investments from European Union-based companies.[2] Turkish companies, on the other hand, had most of their investments in the European Union and in the Commonwealth of the Independent States.

3. Turkey was hit by a severe economic crisis in November 2000 that continued through February 2001. There was a 7.5 per cent contraction in gross domestic product (GDP) and inflation jumped, with an annual increase in the consumer price index of 68.5 per cent. Economic growth recovered in the following years and inflation fell below 10 per cent starting in 2004. The GDP growth rate for 2006 was 6.1 per cent, reaching $400 billion.[3]

4. Turkey applied for membership in the European Union in 1999, and currently is a candidate country. With the resolution adopted by the European Parliament on 15 December 2004, negotiations for full membership started on 3 October 2005. Among many other legislative issues, the relations with the European Union require Turkey to adapt its financial reporting system to European Union legislation.

A brief history of accounting in Turkey[4]

5. The development of accounting practices in Turkey is heavily influenced by the practices of a number of Western countries as a result of the economic and political ties in a specific period. The first Commercial Code of 1850 was a translation of the French Commercial Code and reflected the French influence of the era. The end of the 19th century and the beginning of the 20th century mark the increased trade relations between Turkey and Europe, especially Germany.

6. These historical and political developments – and the fact that most foreign manufacturing businesses had been operated by Germans at the start of the Turkish Republic – led to strong German influence on the economic development of the emerging State. Following the establishment of the Turkish Republic in 1923, a second Commercial Code was enacted in 1926 (Law

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1 http://www.unctad.org/sections/dite_dir/docs/wir06_fs_tr_en.pdf. 12 April 12, 2007

2 http://www.hazine.gov.tr/ybs,_firmalar listesi.xls.

3 http://siteresources.worldbank.org/INTTURKEY/Resources/361616-1121189119378/turkey,_cem_report_chapter1.pdf, http://www.turkstat.gov.tr/PreHaberBultenleri.do?id=473, http://www.turkisheconomy.org.uk/economy/output.htm.

4 This section is heavily adapted from the article: Simga-Mugan C and Hosal-Akman N (2005). Convergence to international financial reporting standards: The case of Turkey. *International Journal of Accounting, Auditing and Performance Evaluation*. Vol. 2, No. 1/2: 12–139.

Number 826). This code was based on the German commerce and company laws that controlled the accounting rules.

7. Due to the lack of private enterprises and private capital at the beginning of the republic, the State took the responsibility to set up heavy industry and several manufacturing companies. These state-founded and operated companies are called State Economic Enterprises (SEEs), and Sümerbank (mine and textile products) was founded as the first SEE in 1933. It was originally entrusted with the operation of principal mines that were acquired through nationalization from German companies. Therefore, it is not surprising to see that Sümerbank's and other SEEs' accounting systems were developed by experts from Germany. Hence, through these enterprises the German influence was carried to the private sector as well. Furthermore, in the late 1930s, Turkey welcomed German academics of various fields in Turkish universities.

8. The decade of 1950–1960 marks the first attempts towards a more liberal economy. The current Commercial Code of 1956 came into effect on 1 January 1957, following contemporary economic developments.

9. After the Second World War, developments in the world economy such as the Bretton Woods economic conference affected the Turkish economy. In 1950, the Turkish Industrial Development Bank was founded with support from the World Bank to foster and finance private industrial investments. In the early 1950s, the country enjoyed unprecedented economic growth. The economic boom ended in the mid-1950s, and was followed by a period of economic crisis. A major outcome of the crisis was the need for foreign loans that eventually led to an International Monetary Fund (IMF)-led stabilization program in 1958[5].

10. During the 1950s, incentives were provided for the private sector and foreign investments. Since the second half of that decade, American expertise has been utilized, and the Turkish economic system has thus been heavily influenced by the American system. Successful individuals in various fields have been trained, and have pursued graduate degrees in foreign countries, especially in the United States, starting in the late 1950s. Since the return of the first of these graduates in the early 1960s, the accounting system has been heavily influenced by the American system. Furthermore, the American influence was also felt in the curriculum of business schools, especially in the fields of management and accounting.

11. The decade of 1970–1980 was an era of political instability which, together with the oil crises in 1973 and 1974, had adverse effects on the Turkish economy. From 1977 onwards, Turkey faced great difficulties in meeting foreign debt payments and encountered import bottlenecks. The increase in the wholesale price index reached 63.9 per cent per annum in 1979 and 107.2 per cent per annum in 1980[6].

12. In January 1980, a series of economic decisions following the IMF's recommendations were taken to reduce the inflation rate, increase production, and support importing activities. In the reconstruction period starting in the early 1980s, Law Number 2499 was put into effect in 1981 by the parliament to prepare the grounds for establishing the Capital Markets Board (CMB) and was amended in 2002. The Istanbul Stock Exchange (ISE) law was adopted in 1984, but full operations did not start until 1986. It is still the only stock exchange in Turkey. FDI rules were eased in 1988 and 1989.

[5] Ceyhun F (1992). Turkey's debt crises in historical perspective: A critical analysis. *METU Studies in Development*, vol.19, no.1: 9–49.

[6] Simga-Mugan C (1995). Accounting in Turkey. *The European Accounting Review*, Vol.4, No.2: 351–371.

13. Foundation of the CMB, ISE and the increase in foreign investments promoted the development of accounting and auditing standards. Increases in joint ventures and foreign trade led to the establishment of offices by the then "Big Eight" accounting firms in Turkey. As a result of these developments, large private enterprises started to report their financial statements in accordance with the International Accounting Standards (IASs) in addition to national reporting requirements. During this decade, Turkey enjoyed economic growth.

14. Turkey started the 1990s on a sound economic footing. However, altogether it was an economically unstable decade. The first major crisis was in 1994. This was followed by further crises in 1997, 1998 and 1999. During this decade, the inflation rate surpassed 100 per cent. As a result of the instability and high inflation rates, historical financial statements lost their information value. Although the IASs were translated into Turkish since the beginning of 1980s by the Turkish Expert Accountants' Association, they were not enforced by any authority.[7] Companies did not use inflation accounting. The subsidiaries of multinational companies and joint venture companies were applying inflation accounting either voluntarily or when it was required by the headquarters of the parent company.

15. In line with European Union requirements, CMB issued the IFRS-based standard Communiqué Serial: XI, No. 25, entitled "Accounting Standards in Capital Markets" on 15 November 2003 (from then on the new CMB rules) and required publicly-owned and traded companies to use the new rules starting January 2005 while encouraging early adoption. Currently, there are 333 companies traded on the Istanbul Stock Exchange (ISE), while 65 companies are traded on foreign stock exchanges, including Frankfurt, London, and New York.[8] For companies traded on European Union stock exchanges, IFRS-based statements are required, which is also allowed by the CMB. However, at present, there are no foreign companies listed on the Istanbul Stock Exchange.

II. Regulatory framework

A. Non-bank private entities

16. Until the establishment of the CMB and the Istanbul Stock Exchange, legal requirements were the main influence on the financial accounting system. Consequently, the Procedural Tax Code heavily influenced the accounting practice in Turkey.

17. The first set of financial accounting standards was developed in January 1989 by the CMB to be in effect for the fiscal years that started on or after 1 January 1989 (Serial X, No:11).[9]

18. As mentioned above, the environment surrounding the accounting practice in Turkey went through several transformations. However, accounting principles did not show such a development, and accounting was, and to some extent still is, treated as identical to tax accounting. Moreover, although there have been several attempts to form an accounting body since the 1940s, until recently there was no effort to pursue the establishment of standards. The main reason for this delay is the lack of pressure on Turkish companies to make publicly available comparable financial statements, because most of the businesses are family owned. The accountants in such companies are responsible for (a) bookkeeping

[7] http://www.tmud.org.tr/default.asp.
[8] www.reuters.com (found under TRSTOKS).
[9] www.spk.gov.tr.

for tax purposes (i.e. following procedural tax code); (b) cash management; (c) budgeting; (d) preparation of tax returns and financial statements required by the tax codes; and (e) very limited internal auditing.

19. In 1992, the Ministry of Finance organized a committee to establish accounting principles and a uniform chart of accounts that would be used by all companies. The ministry published the committee's report in a communiqué on 26 December 1992 establishing the principles and the Turkish Uniform Chart of Accounts (TUCA) to take effect 1 January 1994. All companies except banks, brokerage firms and insurance companies are required to conform to the guidelines stated in the communiqué.

20. According to the requirements of the 1992 communiqué, financial statements prepared in Turkey include a balance sheet, an income statement, a statement of cost of goods sold, a funds flow statement, a cash flow statement, a profit distribution statement and a statement of owners' equity, as well as notes to these statements. The balance sheet, income statement and notes to these statements constitute the fundamental statements, and the others are supplementary statements. The Ministry of Finance communiqué of September 1994 states that small companies are required to submit the fundamental statements only. Tax rules, on the other hand, require a balance sheet and an income statement from all first-class merchants. Financial statements have to be prepared within the three months following the end of an accounting period, which is usually the year end.

21. The Code of Obligations and the Commercial Code regulate the formation and activities of the businesses. The Code of Obligations controls ordinary partnerships which lack the status of legal entity. The Commercial Code, on the other hand, specifies the following types of legal entities:

(a) General and special partnerships;

(b) Limited partnerships;

(c) Partnerships limited by shares; and

(d) Corporations.

22. As mentioned above, the CMB issued the first financial accounting standards for publicly-owned companies in 1989, following the inauguration of ISE in 1986. This set of CMB standards was comparable to IASs, including the assumptions of going concern, consistency, time period, unit of measure and the basic principles such as, cost, matching, conservatism, materiality, objectivity and full disclosure. However, there were very significant differences in measurement and disclosure issues. The significant differences, among others, were accounting for the effects of inflation under hyperinflationary economies, and also accounting for long-term investments. Although Turkey had been experiencing considerable rates of inflation since 1984, financial statements were prepared at historical cost except for the revaluation of property, plant and equipment. Furthermore, long-term investments including subsidiaries and equity participations were carried at cost.

23. If the number of shareholders of a corporation exceeds 250, then that corporation is categorized as a publicly-owned company and is subject to CMB regulations. Currently, there are 274 publicly-owned companies whose securities are not publicly traded. Serial X, No: 11 standards (old CMB rules) are still in effect to regulate financial reporting of such entities. Publicly-owned companies whose shares are traded in the stock exchange are subject to the new CMB rules (Serial X, No: 25) that are based on IFRS.

24. There are some major issues that are covered in IFRS/IAS but not in the old CMB rules. These can be summarized as follows:

(a) Impairment of assets (IAS 36);

(b) The de-recognition of financial assets (IAS 39);

(c) Provision for employee benefits other than lump-sum termination indemnities (IAS 19);

(d) Segment reporting (IAS 14);

(e) Provisions, contingent liabilities and contingent assets (IAS 37);

(f) Deferred taxes (IAS 12);

(g) Treasury shares (IAS 32); and

(h) Hedge accounting (IAS 39).

25. Furthermore, there are certain differences between the old CMB rules and IFRS/IAS that could lead to reporting of different financial results and financial position. Major differences include:

(a) Measurement issues:

(i) According to CMB rules, foreign exchange losses that arise from acquisition of property, plant and equipment can be capitalized after related assets are put into use. IFRS and IAS, on the other hand, require recording of such foreign exchange losses as period expenses.

(ii) CMB rules require that construction contracts should be accounted for using the completed contract method, whereas IFRS and IAS require the use of percentage of completion or cost recovery methods.

(iii) Although IFRS and IAS treat organization and research costs as period expenses while permitting capitalization of development costs under special circumstances, CMB rules allow for capitalization of organization, research and development costs.

(iv) The amortization period of goodwill is different between the two sets of standards.

(v) While IFRS and IAS require discounting of the pension obligations to present value, CMB rules do not impose such a requirement.

(vi) All types of leases are accounted for as operating leases according to CMB rules.

(b) Disclosure issues:

(i) According to the CMB rules the applicability of related parties is limited to shareholders, subsidiary and equity investments whereas related parties are more broadly defined in IFRS/IAS.

(ii) There are no specific disclosure requirements relating to the fair value of financial assets and liabilities except for marketable securities under the CMB rules.

(iii) Statement of Changes in Shareholders' Equity is not required by the CMB rules.

(iv) CMB rules on format of the statement of cash flows do not require a breakdown of cash flows by type of activity.

26. In November 2003, CMB issued a communiqué to adapt the financial reporting standards of traded companies in ISE to IAS and IFRS (Series XI,

No: 25). The standards were mandatory for all publicly-traded companies and intermediary institutions (brokerage firms) from the beginning of 2005. The new standards in the communiqué are essentially the same with IAS/IFRS except for the amendments by IASB after 2004. One of the differences between the new CMB rules and IFRS lies in the treatment of goodwill. According to CMB rules, goodwill is still amortized.

27. According to tax rules, on the other hand, in principle, accrual accounting is required, but the treatment of certain items is closer to cash accounting. At the same time, with CMB, the Ministry of Finance required a one-time application of inflation accounting to restate the balance sheet ending 31 December 2003 or at the end of the then current fiscal year.[10]

28. Through Law No: 4487 dated December 1999, an addendum was made to the Capital Markets Law for the establishment of the Turkish Accounting Standards Board (TASB) to issue Turkish Accounting Standards (TAS) that would facilitate fair disclosure of the financial position. The board has both administrative and financial autonomy. It held its first meeting in March 2002, and has nine representatives from the Ministry of Finance, Higher Education Council, CMB, the Undersecretariat of Treasury, Ministry of Industry and Commerce, the Banking Regulation and Supervision Agency (BRSA), the Union of Chambers and Commodity Exchanges in Turkey (TOBB), a self-employed accountant and a certified financial consultant from Union of Certified Public Accountants and Sworn-in Certified Public Accountants in Turkey (TURMOB).[11]

29. TASB has an agreement with the IASB to officially translate and publish IFRS/IAS and the related interpretations. As of mid-2007, TASB had issued 31 TAS and seven Turkish Financial Reporting Standards (TFRS). All of these issued standards correspond to the respective IAS and IFRS.

30. Currently, TASB has no enforcement authority to require any Turkish company to prepare financial statements in accordance with TAS or TFRS (hereafter referred to as TAS).

31. Consolidation rules are not required under the present Commercial Code and tax legislation. However, CMB issued a communiqué in 2003 (Serial XI, No:21) that stipulates consolidation of financial position of companies that meet the criteria which are the same as IFRS rules for publicly-owned companies whose shares are traded. Since adoption of new IFRS-based CMB rules, companies are required to comply with the new regulation. TASB also published TAS 27 – Consolidated and Separate Financial Statement, which is fully compatible with IAS 27.

32. Another major discrepancy between the tax rules and the accounting rules concerns fixed assets. According to the accounting rules, the cost of fixed assets includes – in addition to the acquisition cost – items such as interest expense on self-constructed assets (capitalized until the asset is ready for use), foreign exchange losses on the purchase price of the assets, the debts incurred for such assets, and long-term investments (capitalized until the debt for the asset or investment is paid in full). According to tax rules, however, companies may continue to capitalize the interest expense related to loans used to finance such assets after the asset is in use.

[10] Simga-Mugan C and Akman N (2002). Turkey. Revised chapter in World Accounting, Release 24. Orsini LL, Gould JD, McAllister JP, Parikh RN and Schultzke K (eds). Lexis–Nexis/Matthew–Bender, November.

[11] www.turmob.org.tr.

33. According to both the old CMB regulations and the Ministry of Finance requirements between 1983 and 2003, companies revalued their fixed assets (except land) and the related accumulated depreciation if they wished, provided that they have been using those fixed assets for more than one year. The revaluation rate was based on an index published by the Ministry of Finance every December that approximated the country's annual inflation rate. The difference between the net revalued fixed assets of the current period (revalued cost minus revalued accumulated depreciation) and the previous period was accumulated under the owners' equity section of the balance sheet under the name "revaluation fund". This revaluation surplus was non-taxable unless distributed, and may have been added to capital via issuance of bonus (free) shares. With the inception of inflation accounting in 2003, this practice was abandoned.

B. Banks and financial institutions

34. Financial reporting of financial institutions is regulated by BRSA. Until recently, BRSA issued its own set of accounting standards that financial institutions had to comply with. However, since November 2006, these institutions have been required to apply TAS to prepare their financial statements, except for certain differences such as loan loss provisions.

35. In summary, financial reporting in Turkey has a multi-institutional structure. Turkish companies prepare their financial reports according to different sets of accounting standards, depending on the nature of their business and their shareholding structure. Table 1 summarizes the reporting requirements of different companies.

Table 1. Reporting requirements of different companies

Publicly owned but not traded in the stock exchange	Old CMB standards (Series XI, No. 1 and its amendments)
Publicly owned and traded in the stock exchange	New CMB standards (Series XI No. 25 and its amendments)
Brokerage companies	New CMB standards (Series XI No. 25 and its amendments)
Banks and financial institutions	TAS
Insurance companies	Communiqué of undersecretariat of treasury

36. As illustrated in the table above, presently companies that are not publicly owned are not required to apply any accounting standards other than Ministry of Finance's communiqué of 1992 and the tax legislation.

C. The accounting profession and auditing

37. The accounting profession was formally defined by Law No: 3968, enacted in 1989. The three categories of accountants according to the law are as follows:

(a) Independent Accountant (IA): The IA is a practicing accountant who may keep the accounting records of companies, and develop accounting systems within the companies.

(b) Certified Public Accountant (CPA): Apart from the responsibilities of IAs, CPAs may conduct audits and perform consulting services; and

(c) Sworn-in Certified Public Accountant (sworn-in CPA): Sworn-in CPAs may not keep accounting records for their clients. They have the responsibility of certifying the financial statements as defined by the law.

38. The law also defines the competencies that are required (education, certificates and diplomas) to become an IA, CPA and sworn-in CPA. The professionals are recognized by the Turkish Union of Chambers of CPAs and are sworn in as CPAs.

39. The chambers of CPAs and sworn-in CPA's are separate. Chambers are professional organizations regarded as legal entities carrying qualities of public institutions. They are established for the objectives of meeting the needs of members of the profession, facilitating their professional activities, providing the development of the profession in compliance with common requirements, maintaining professional discipline and ethics, and providing the prevalence of honesty and mutual confidence in the work of the members of the profession and in their relations with their clients.

40. Auditing activities and audit firms in capital markets are regulated by CMB (Communiqué Serial: X, No: 22). Existing CMB regulations have been revised following regulatory reforms that were passed in the United States and the European Union. These include:

(a) Separation of audit and consultancy;

(b) Establishment of audit committees for companies whose securities are publicly traded and for brokerage firms;

(c) Audit firm rotation; and

(d) Determination of responsibility for the preparation, presentation and accuracy of financial statements and annual reports.

41. The maximum number of years that an audit firm can audit a company whose securities are publicly traded is seven years. At the end of seven years of service, the audit of that company should be contracted to another audit firm. In order for the first auditing firm to resume the auditing services of the same company, at least two accounting periods should elapse.

42. Per CMB rules, in order to conduct auditing activities, an auditing firm should meet the following requirements:

(a) An audit firm should be incorporated as a corporation with shares written to the name.

(b) The major partner should own 51 per cent of the shares;

(c) Auditors should be university graduates in the fields of economics and business administration.

(d) The firm should only be engaged in auditing activities.

(e) The firm should be insured (new amendment in 2007).

43. As noted above, banks and financial institutions are regulated by BRSA, and thus this agency oversees independent audit processes of such institutions. BRSA authorizes and terminates the activities of the audit companies. It carries out these activities through two by-laws: the law on independent audit of banks and authorization of independent audit firms.

44. The information Technologies Auditing Project started in 2004 with a change in the by-laws of BRSA which resulted in a partial reorganization of the agency. A working group was established that studied the relevant standards and literature. In addition, a survey on the technical capacity of the banks was carried out around the same time. Finally, in May 2006, BRSA issued a communiqué on auditing of information technologies of banks (IT audit). It

adopted the Control Objectives for Information and Related Technology (COBIT).[12]

III. Capacity-building

45. In code law countries, of which Turkey can be classified as one, standard setting and enforcement are primarily functions of governmental institutions. In such countries, there is a lower demand for high-quality financial reporting and disclosure, as the reporting model is oriented towards tax offices and financial institutions. In common law countries, on the other hand, the enforcement of high-quality financial reporting standards is needed for shareholder protection.

46. Therefore, in Turkey, issuing accounting standards is not enough for enforcement of those standards. Legally, companies should be required to use TAS for those IFRS-compatible standards to be fully enforced.

47. A new draft commercial code that will introduce new financial reporting requirements per TAS has been discussed in related commissions of the parliament since the beginning of 2007. However, it is not expected to be enacted before 2008. Article 64 of the draft code requires all companies excluding small and medium-sized enterprises (SMEs) to prepare financial statements in accordance with TAS. Developing accounting standards for SMEs is an ongoing project of TASB. These standards are expected to be a simplified version of TAS which would be in line with the IASB's SME project.

48. The dilemma of preparing financial statements per tax requirements or according to accounting standards was also apparent in the responses of the executives who participated in a survey that assessed the perceptions of the preparers regarding IFRS.[13] Eighteen per cent of the respondents see the differences between the IFRS-based standards and tax regulations as a major obstacle in applying the standards.

49. Therefore, in Turkey, standards alone do not guarantee the quality of financial information disclosed, rather the institutional factors such as the incentive of preparers should be considered.

50. The accounting managers of publicly-owned companies are already familiar with IAS-based accounting standards. However, most of the accounting managers of family-owned businesses are not exposed to such standards and are not familiar with the content of TAS. Once the draft commercial code is enacted and companies start to apply TAS, these managers will be in significantly difficult positions with respect to preparing financial statements. Family-owned companies comprise more than 85 per cent of businesses in Turkey.

51. Training and education on IFRS are mostly provided by universities and academic organizations. Universities already incorporated IFRS courses in their graduate and undergraduate curriculums as elective courses. In some universities, principles of accounting courses are covered using IFRS. Accounting textbooks are revised to reflect the changes that are brought about by the implementation of IFRS.

52. One of the academic organizations, AACF (Accounting Academician's Collaboration Foundation), organizes international and national seminars and workshops open to practitioners and academicians on various issues of

[12] http://www.bddk.org.tr/turkce/raporlar/sunumlar/332it_audit_bddk_yaklasimi_20_4_2006.

[13] Akman N, Simga-Mugan C, Arikboga D (2005). Awaiting IFRS: Perceptions and Demands Of Executives In An Emerging Market. AACF, 2nd Annual Accounting Conference. 10–12 November. Istanbul, Turkey.

IFRS/TAS (such as implementation of IAS 39).[14] Similarly, the Turkish Expert Accountants' Association holds seminars on IFRS in general, and on some specific standards.[15]

53. In order to align auditing standards with international developments, CMB published revised auditing rules and regulations by Communiqué Serial X, No: 22 in 2006 and later amended it with No: 23 in 2007. This communiqué states that:

> "Independent auditing firms, their auditors and other staff shall not provide any issuer or intermediary, contemporaneously with the audit, any non-audit service, with or without fee, including:
>
> (a) Bookkeeping and other related services;
>
> (b) Financial information systems design and implementation;
>
> (c) Services on management, accounting and finance;
>
> (d) Appraisal or valuation services and actuarial services;
>
> (e) Internal audit outsourcing services;
>
> (f) Legal services and expert services;
>
> (g) Any other consultation services."

54. As mentioned in the Report on the Observance of Standards and Codes of the World Bank, TUDESK (Turkish Auditing Standards Board) was formed in 2003.[16] It issues national auditing standards which in essence are translations of IASs issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. However, before the new commercial code is enacted, there is no requirement for companies other than entities whose shares are publicly traded to have their financial statements audited.

55. In addition to accounting and auditing standards, CMB initiated the Corporate Governance Code. This code is based on Organization for Economic Cooperation and Development (OECD) principles, and requires publicly-traded companies to publish their corporate governance ratings. Rating agencies can rate the level of compliance of companies with "Corporate Governance Practices" recommended by the Capital Markets Board of Turkey.

IV. Lessons learned

56. Turkey is one of the proactive countries that took steps to improve its financial reporting and auditing system to align the requirements with the commencement of IFRS in 2005 in Europe.

57. In essence, the adoption of IFRS-based standards turned out to be a three-step process where the first step was the early adoption of IFRS between 2003 and 2005 by companies whose shares are publicly traded. The second step was the compulsory adoption of IFRS starting in 2005, again by the traded companies. The third step was the mandatory adoption by all publicly-owned companies upon the enactment of the draft commercial code.

58. Encouraging the traded companies to adopt IFRS or IFRS-based CMB standards before 2005 led to two benefits:

[14] http://www.modav.org.tr – 16 July 2007.

[15] http://www.tmud.org.tr/dokumanlar/2007_s.doc - 16 July 2007.

[16] www.imf.org/external/pubs/ft/scr/2006/cr06126.pdf - 16 July 2007.

(a) More transparent financial statements were introduced; and

(b) The experience of the early adopters during the transition period helped the other publicly-traded companies.

59. The adoption of IFRS-based rules by the traded companies before the other private companies will ease the way for the latter companies. Non-publicly-owned private companies will benefit from their publicly-traded counterparts' experience during the implementation.

60. TAS will affect many parties covering both the internal and external users of financial statements. For external users such as foreign and domestic stock investors, TAS will bring transparency and comparability. These users will find themselves at ease while making investment decisions with the help of comparable and consistent financial data.

61. A study[17] examining the market reaction to inflation accounting-based financial reports indicated that accounting earnings announcements have an effect on market prices at a 0.10 significance level. It also found that inflation-adjusted financial reports had an impact on abnormal returns during the event window surrounding the annual earnings announcements. The paired samples T-test performed included 36 pairs of cumulative standardized abnormal return data for 2002 and 2004. The test results showed that, at a 95 per cent confidence level, the hypothesis that these two samples have equal means was rejected. This implies that the market reacted to inflation-adjusted data.

62. One of the urgent issues in Turkey is to solve the multi-institutional structure of the accounting environment. There should be one accounting standard-setting body for all entities.

63. A related issue is the enforcement of TAS. Until the draft commercial code is enacted, TASB does not have any power to enforce the adoption of TAS by all companies. As stated above, BRSA is the only authority that requires the use of TAS. It could be beneficial for CMB and Undersecretariat of Treasury to follow the BRSA example and entrust their standard-setting authority to TASB.

64. Significant amounts of training and education for financial statement preparers and small and local auditing companies are needed. A lesson learned from the initial implementation is the insufficient understanding of accounting standards by these groups.

65. Generally, accounting standards do not address the full details of application that requires judgment from the management of entities. TAS involve a great deal of management judgment. As significant judgment is exercised in applying the accounting standards, incomplete comprehension of standards would lead to lower-quality financial information.

66. The results obtained through the survey discussed above brought to light the inadequate level of understanding of the accounting standards by financial statement preparers. As the demand for independent auditors will increase upon the enactment of the draft commercial code, there should be enough training for the professional accountants and auditors with respect to both accounting and auditing standards.

67. Within this framework, the results of the Turkish survey with respect to the question of the sources of advisory services (or consulting services) for the implementation of the IFRS-based accounting standards points to a very important potential problem of infringement of independence of audit

[17] An ongoing study being carried by Professor F.N. Can Şımga-Muğan et al. – Middle East Technical University, Ankara.

companies. It should be noted that a majority of the respondents indicated that they intend to ask for consultancy from their current auditors, although such a practice is forbidden by CMB regulations.

68. The proposed changes in disclosure and particularly in measurement issues stated above will bring additional responsibilities to auditing firms, which are expected to be knowledgeable on the new set of accounting rules. There are indications that finance executives and accounting department staff will need extensive training on the application of TAS.

69. CMB and TASB should jointly establish a technical inquiry service for companies and auditors to answer very specific questions coming from the users of the accounting standards, and based on the common questions and complaints develop recommendations to TASB.

70. There are currently private training programmes that are available to the public. Especially in cases when these programmes are offered by spin-offs of the auditing firms, conflict of interest might be a problem which could result in ethical dilemmas. Thus, TASB should oversee and regulate the content of these programmes and closely monitor the auditor–client relationship.

71. TASB already translated IASB interpretations. However, these interpretations might not adequately address the concerns within the Turkish context. Therefore, the board should establish an interpretations committee to resolve national and when necessary sector-specific issues that may come up during the implementation of TAS. This committee should also publish books on the application of various standards.

72. One of the basic objectives of IASB is "to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions".[18] It might be beneficial if TASB communicates to IASB the concerns and questions of the Turkish practice, along with the solutions provided. Such an effort could assist Turkey as well as other developing countries in aligning their national standards with IFRS.

73. Currently, there is no supervision of auditing companies as a whole. CMB carries out inspections to determine whether auditing companies are performing their audit engagements in accordance with auditing standards. There should be a public oversight board to supervise the implementation of auditing standards and make sure that auditing companies are acting with due care. While the establishment of a public oversight board has been discussed since 2004, no legal or regulatory action has yet been taken.

V. Conclusion

74. Over the years, the Turkish accounting system has undergone considerable change. Financial accounting and reporting started as a record keeping for tax purposes. Although Turkey could still be classified as a code law country, since the 1960s there is a trend toward Anglo-Saxon style reporting. This movement accelerated after the establishment of the Istanbul Stock Exchange. The growth of global trade and investment also accelerated the change in accounting and auditing standards. As a result, Turkey accepted to adopt the IFRS by translating them into Turkish. Similarly, International Auditing Standards have also been translated and put into effect.

[18] http://www.iasb.org/About+Us/About+the+Foundation/Constitution.htm-16 July 2007.

75. In code law countries such as Turkey, laws need to be changed in order to enforce an accounting standard. The Turkish experience regarding the process of enacting the new commercial code is an excellent example. Well-known lawyers and accountants from the country have been working on the draft code for more than six years. Therefore, countries that intend to implement IFRS should have their transition plans ready well ahead of launching IFRS.

76. At present, Turkey faces two main obstacles. The first one relates to endowing TASB with enforcement authority; the second one to the training of the accountants and staff of the local auditing firms.

77. The Turkish experience on the way to converge with the international accounting and auditing standards could help other developing countries with respect to the following issues:

(a) It might be better to require the use of IFRS or IFRS-based national standards in the case of large companies that could already be familiar with the international accounting standards to some extent.

(b) It would be helpful to have a single authority that oversees the development and implementation of the standards.

(c) It would be advisable to train the trainers before launching the accounting and auditing standards.