

## Turkish Financial Reporting System and Capital Markets' Regulations

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**Abstract:** Accounting is a knowledge system which records, classifies and summarizes the economic activities of the companies. In this turn accounting has very close links with many social economic factors that shapes an accounting system in a country. The aim of this paper gives information about contemporary Turkish accounting system and its relation with capital markets' regulations. Also, this paper reviews current literature on accounting standard setting issues and the last developments in Turkey since 1923. It should be addressed that, there's no capital markets and bourses before 1980s in Turkey. After this date significant changes has lived both in economy and accounting system in axis of capital markets and candidacy process of European Union. Also this situation brought out theoretical debate on the change of current accounting system from continental Europe to Anglo-Saxon system.

### 1. Introduction

Accounting is referred as a language of business (Mueller et al. 1991). Accounting is not independent discipline. Accounting is shaped by the environment in which it operates. Just as nations different histories, values, and political and economic systems, they also have different patterns of financial accounting development. Accounting is not identical in all countries. This diversity is the result of business environment in the related country. It is interesting to note, too, that when countries' business environments are similar, their financial accounting systems also tend to be similar (Mueller et al. 1991).

In the phase of literature review, we saw that some external and internal factors affect the accounting development in a country. We can point out the factors under these titles which Mueller referred to them (Mueller et al.1991; Çürük, 2001).

- Relationship between business and the provider(s) of capital.
- Political and economic ties with other countries.
- Legal system.
- Levels of inflation.
- Size and complexity of business enterprises, sophistication of management and the financial community, and general levels of education.

Variables mentioned above bring about to develop a country's accounting system. After a certain time, some nation's accounting systems begin to resemble each others. And this process concludes the clusters. In accounting literature has got two main accounting clusters (Mueller et al., 2001; Volmer et.al. 2007). They are; British-American (Anglo-American) Model is cited investor-oriented and Continental (Continental European) Model is cited creditor- oriented.

The accounting in Turkey has been formed in the line with creditor-oriented,Continental European model. Nevertheless Join Stock companies have got peculiar regulations and we cannot say that only Continental European Accounting regime could have been influenced on preparing and putting forward these regulations (Çürük, 2001). Also it will be beneficial to remind that, in Turkey, official capital markets grew in 1980's. After the enactment of Capital Market Law (CML) in 1981(Sümer, 1999).

Despite the fact that Turkish companies have started to issue securities (mainly shares and bonds) in the 1970s, considerable developments in the securities market in Turkey have been experienced following the years that the CML was enacted. Increase in share issue, particularly following the years that the Istanbul Stock Exchange (ISE) started operation was notable. ISE started operation in 1986 with 40 registered companies and now there are 349 registered companies in ISE as the date of 2009/15.04 (imkb.gov.tr). From the legal system

perspective, all companies listed on the Istanbul Stock Exchange (ISE) are registered with the Capital Market Board (CMB). Capital Market Board is an institution which entitled by the Capital Market Law. Capital Market Board fulfill the duties and exercise authority which given by the CML (Capital Market Law, Act,17,22).

After the introduction, the paper is organized as; following chapter two gives information about regulations in accounting. In the third chapter the new accounting standard setters and their standards will be place after 1980s. Turkey's prospective European Union (EU) membership and its influence on the accounting is in chapter four. The paper will conclude with chapter five.

## 2. Accounting Regulations In Turkey

In Turkey, all joint stock companies with more than 250 shareholders or which offer their securities to public including all companies listed on the ISE have been required to be registered with CMB. As far as financial reporting is concerned, there is no specific regulation that addresses the listed companies only. Companies listed on ISE, like those companies unlisted but registered with the CMB, are required to their financial reports in accordance with CMB's regulations (CML,Act;11 and Çürük, 2001).

There was no specific regulation or accounting standards that addresses merely the accounting of the private-sector in Turkey until early 1980's. Turkey, however, has experienced a major breakthrough in the area of accounting and financial reporting since then. The main recent developments that have had direct impact on disclosure practices of Turkish companies have been the financial reporting regulations that were introduced by the Capital Market Board (CMB) in the 1980s and the Ministry of Finance (MF) in the 1990s.

In this point, one can say that, before the 1980-1990 period, there is not a differentiation like that listed and unlisted companies in Turkey. Therefore all companies' accounting practises were carrying out with the same regulations in Turkey until 1980's. What were these same regulations? These are; Turkish Commercial Code and Turkish Tax Laws.

Republic of Turkey's first Commercial Code is date 1926 and no: 865 code. This code is referred to German resources and brought two important renewals. First renewal was about the joint stock companies' regulations in the code and second renewal was concerning about obligatory keeping books by companies. This code could not develop accounting practices as expected from business environments. Because, state owned joint stock companies's accounting regulations preserved code's influence (Turmob, 1998). New Turkish Commercial Code was enacted in 1956. The Commercial Code (TCC) No. 6762 of 1956, which is still in force, was prepared by a committee headed by German Professor Hirsch. TCC No. 6762, is broadly divided into two books. The first books address general principles of commercial trading, including requirements for bookkeeping and the second book addresses commercial partnerships and companies, including limited liability and joint stock companies (Çürük, 2001).

Essentially, TCC has shortcomings on the accounting regulations. For instance, it does not take in to consideration "depreciation". TCC also leave all companies free to choose their amortization methods (Bektöre et.al,2008). On the other side, taxation plays very important role in the formulation and application of accounting in Turkey. Therefore tax laws which issued 1950's should be noted here. These are: The Income Tax Law (No: 193), the Corporate Tax Law (No: 5422 It's superseded in 2006also new Corporate Tax Law Enacted in June 2006) and the Tax Procedure Law (Law No: 213). Still listed companies in Turkey prepares two different financial reports first is the in the compliance with CML and Capital Market Board's regulations and second is that compliant with Tax laws and Ministry of Finance's regulations.

## 3. New Accounting Standard Setters And Their Standards

In this part, we will try to examine formation and development of accounting standards and their functions for the listed companies after the 1980s up to now. As we specified that the prior parts of this paper, 1980s were very important years for the both listed companies and the development of accounting in Turkey. Two major events occurred in those years. Firstly In 1981 the Capital Market Law (CML) was issued and with respect to this law Capital Market Board (CMB) established. Another major event was, establishing of Istanbul Stock Exchange (ISE) in 1986.

Approximately after two years of its establishment, Capital Market Board, issued its first regulation about accounting and financial reporting. The name of this communiqué is "Standard Financial Statements and Reports" which was introduced in 1983. Also CMB issued a "General Standard Accounts Chart" as a supplement for the companies in 1987. In CMB's first communiqué involved in; uniformity in the accounting, general accepted accounting principles, financial statements formats and footnotes. (Gökdeniz, 1996:42).

The CMB's first regulation in accounting and financial reporting; Communiqué No. VIII/2 remained in force till 1989. Capital Market Board amended and developed its previous communiqués. As a result, CMB enacted Communiqué No. XI/1. With the respect to enactment of Communiqué No.XI/1, CMB's previous

communiqués concerned with accounting and financial reporting were superseded. Also this communiqué shows the compliance with European Fourth Directive (Gökdeniz, 1996).

The aim of the Communiqué XI/1 summarized in the Article 1, is to establish principles and rules for the preparation, presentation and publication of financial statements and reports that apply companies controlled by Capital Market Board. "Principles and rules" refer to fundamental accounting concepts, valuation and measurement rules to be used in the preparation of the financial statements and reports. The financial statements stated in Art.1, on the other hand, include a balance sheet, and income statement, cash and fund flow statements, a statement of costs of goods sold and profit distribution statements and reports comprising the annual report and the audit board's report, as specified in Arts. 2 and 53 of the Communiqué (Çürük, 2001).

In the present day, for the listed companies one can say that the most important regulation of Capital Market Board is "Communiqué XI/25". The exact name of communiqué is "The Communiqué about Accounting Standards in the Capital Market". This Communiqué is consist of 727 articles and it encompasses each of 33 International Financial Reporting Standards (IFRS). IFRS take places in the communiqué were showed by a table as a appendix that enclosed this paper. Communiqué XI/25 was introduced by CMB in 2003. But the Communiqué enacted compulsory in 01/01/2005, however, companies willing to carrying out the Communiqué has released free since 31/12/2003.

The aim of the Communiqué specifies on Art.1 is to indicate that, accounting principles and rules for the preparation and presentation of financial statements which will be drawn up by the companies. This additional official aim which indicated in the Communiqué, As the President of Capital Market Board Dr. Cansızlar specified that, with the globalization of the capital markets and especially European Union (EU) begin to come to force to the listed companies to prepare their consolidated financial statements as IFRS, that has accelerated of preparation and enactment of Communiqué XI/25 (Ankara SMMM Odası, 2004).

In the other hand, after 1990s two accounting standard setters were established in Turkey. First established standard setter was Turkey Accounting and Auditing Standards Board (TМУDESK). TМУDESK has been established with the supporting of Union of Chambers of Certified Public Accountants of Turkey (TURMOB) in 1994. TМУDESK has brought together 60 members who are accounting experts for each related sector in the country. The purpose of TМУDESK is; to indicate the essences of preparation of the financial statements and to fulfill the uniformity in accounting principles for all business enterprises in Turkey. Also the Board worked about determining the Audittance standards.

Board paid attention on issuing standard, in compliance with international accounting standards. Therefore the Board were sending reports to International Accounting Standards Board (IASB) concerning with its works in the end of year. In 2001, Board issued 19 accounting standards (Türmob and Tmudesk, 2001). The standards of TМУDESK only had recommendation feature so it caused lacking of support of law and it was resulted with the weakening the influence of TМУDESK (Turmob, 1998:54).

In Turkey the real breakthrough in the subject of standard setter is that the establishment of Turkish Accounting Standards Board (TASB). TASB was established with a amendement into Capital Market Law in 2002. TASB is consist of 9 members who are experts in the field of accounting and finance. TASB has got autonomous budget and self-administration. The main mission of TASB is; to determine and publish national accounting standards which will provide adoption and development of national accounting principles and will be applied for public interest for the financial statements have to be, adequate of need, true, reliable, balanced, comparable, understandable in the presentation of audited financial statements.

In 2005, TASB and International Accounting Standards Committee Foundation (IASCF) signed a copyright agreement. As the provisions of this agreement, TASB accepts IASCF's official translation procedure in the process of preparing the standard. Therefore TASB aimed to general acceptance and validity of its standards all over the world (tmsk annual report 2005). The standards were introduced by TASB was named as Turkey Financial Reporting Standard (TFRS) or Turkey Accounting Standard (TAS). The TFRS and/or TAS determined by TASB are classified with the principles of related IFRS or IAS. TASB issued 7 TFRS and 29 TAS up to now.

#### **4. The Relationship Between Prospective Turkey's EU Membership And Accounting Applications**

Primary relations between Turkey and EU began with the Ankara Agreement in 1963. It established an association between European Economic Community (EEC) and Turkey. The basic objectives of this association includes the continuous and balanced strengthening of trade and economic relations and the establishment of a customs union in three phases as well as the free movement of workers between parties.

The real breakthrough in the relationships between Turkey and the EU came with the decision taken by the Helsinki European Council on 10-11 December 1999. It declared Turkey as the thirteenth candidate states. Compliance with the Copenhagen political criteria was similarly emphasized as a prerequisite for the opening of accession negotiations. From the early 2000s Turkey has made noticeable progress towards the meeting

Copenhagen political criteria owing to reforms like that the New Civil Code. The convergence in many fields with EU was sustained in Turkey (Fişne, 2003).

In the side of accounting and finance of this convergence, we can look at Dr.Çürük's research as a sample. A part of his research is interested in the relationship between Turkish listed companies' accounting requirements with practices and European Union Fourth Directive (EUFD). In the research, he used the CMB Communiqué and financial statements of the listed companies over the period 1986-1995. He aimed to test the impacts of the EUFD on disclosure requirements and practices in Turkey.

Findings of this research indicates that; there is a strong association between the level of emphasis placed on the main disclosure issues in the text of the CMB Communiqué and that in the text of the EUFD and a high level of conformity between the disclosure required by the CMB Communiqué and the EUFD. Even he specified that CMB's Communiqué is the direct translation of the EUFD. Also he specified that Turkish companies paid increasingly more attention to the disclosure of information required by the EUFD than to the disclosure information not required by the EUFD, particularly following the enactment of CMB Communiqué (Çürük, 2001).

As we mentioned in part 3, for the listed companies in Turkey, the most important regulation is "Communiqué XI/25" which issued by CMB. Also this Communiqué is almost direct translation of IFRS. European Parliament and Commission's requirement (2002) about to adopt International Accounting Standards (IAS) for the listed companies which prepare consolidated financial statements and Communiqué XI/25 in Turkey, point out International Accounting Standards. In this point as far as Turkey adopt the IAS will converge with EU's requirements on accounting and financial reporting in a certain degree.

Also there is a project for convergence of regulation' institutions in candidate countries with the institutions of member countries. The name of this project is "twinning project". This project's framework is to match a candidate country's regulation institution with a member's one. In this point Capital Market Board has been matched with German regulation institution BaFin (spk.gov.tr).

## 5. Conclusion

This paper reviews current literature on accounting standard setting and the last developments focused with capital market's regulations in Turkey. We should address that, there's no capital markets and bourses before 1980s in Turkey. In those years only accounting standards are commercial code and tax laws. Turkey's accounting and financial reporting requirements and practices were closed and limited as well as economic activities in the country. In all its aspects, accounting and financial reporting were under the influence of Continental European accounting regime.

With the rapid change in economy in 1980s, capital markets gained legality. With the regulations of Capital Market Board, listed companies began to give account of their investors. Now the process of change in accounting and financial reporting began to tend to Anglo-Saxon accounting regime. Especially in lately 1990s and early 2000s first of all institutions established that are only deal with accounting standards. These institutions mainly referred International Accounting Standards (IFRS). While authorities issue standards, also they think to achieve convergence with European Union's accounting regulations.

Especially Turkey Accounting Standard Board (TASB) will has full legal enforcement over the both listed and unlisted companies. Because Turkish Commercial Code draft that is expected to come to force in 2009 or 2010, point out that all companies will comply with TASB's standards. In this point, recent developments in the accounting and financial reporting indicates that; Turkey adopted IFRS and current constituents of accounting are being tested with IFRS. The accounting constituents which don't comply with IFRS will be left.

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#### Internet Resources

www.spk.gov.tr

www.tmsk.org.tr (for annual report) 3-12

#### Laws

Capital Market Law, No:2499 with The Amendment Law No: 3794.

## Appendix

The International Financial Reporting Standards which take place in Communiqué XI/25 (In the Order to the Communiqué)

IFRS NO	TITLE OF IFRS
IFRS 1	Presentation of Financial Statements
IFRS 34	Interim financial Reporting
IFRS 7	Cash Flow Statement
IFRS 18	Revenue
IFRS 2	Inventories
IFRS 16	Property, Plant and Equipment
IFRS 38	Intangible Assets
IFRS 36	Impairment of Assets
IFRS 32	Financial Instruments: Disclosure and Presentation
IFRS 39	Financial Instruments: Recognition and Measurement
IFRS 22	Business Combinations
IFRS 27	Consolidated Financial Statements and Accounting for Investment in Subsidiaries
IFRS 28	Accounting for Investments in Associates
IFRS 31	Financial Reporting of Interests in Joint Ventures
IFRS 21	The Effects of Changes in Foreign exchange Rates
IFRS 29	Financial Reporting in Hyperinflationary Economies
IFRS 33	Earnings Per Share
IFRS 10	Events After The Balance Sheet Date
IFRS 37	Provisions, Contingent Liabilities and Contingent Assets
IFRS 8	Net Profit or Loss for the Period Fundamental Errors and Changes in Accounting Policies
IFRS 17	Leases
IFRS 24	Related Party Disclosures
IFRS 14	Segment Reporting
IFRS 30	Disclosure in the Financial Statements of Banks and Similar Financial Institutions
IFRS 11	Construction Contracts
IFRS 35	Discontinuing Operations
IFRS 20	Accounting for Government Grants and Disclosure of Government Assistance
IFRS 40	Investment Property
IFRS 12	Income Taxes
IFRS 19	Employee Benefits
IFRS 26	Accounting and Reporting by Retirement Benefit Plans
IFRS 41	Agriculture

Source: Ankara SMMM Odası (2004) p: 350.