THE ROLE OF STATUTORY AUDITORS
IN JOINT STOCK CORPORATIONS
A Comparative Study between Turkey and Germany

A thesis submitted to the Bucerius/WHU Master of Law and Business Program in partial fulfillment of the requirements for the award of the Master of Law and Business (“MLB”) Degree

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July 15, 2010

12,225 words (excluding footnotes)
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<td>AktG</td>
<td>Aktiengesetz</td>
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<td>CGP</td>
<td>Corporate Governance Principles of the Capital Markets Board of Turkey</td>
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<td>Capital Markets Board of Turkey</td>
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<td>Draft TCC</td>
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<td>exempli gratia (for example)</td>
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<td>EC</td>
<td>European Council</td>
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<td>EU</td>
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A. INTRODUCTION

Statutory auditors play a fundamental role in corporate governance. Particularly, subsequent to the collapse of Enron and other companies many debates have flared up over the role as well as the functions of auditors within and outside the corporate structure.¹

There exist differences among legal systems of different countries in respect of the meaning of statutory auditor. In many countries, independent external auditors or audit firms, primary role of which are the examination of financial statements as well as reporting on a corporation’s financial status, is understood under the term of statutory auditor.

Turkish legal system has a different understanding with respect to the role of statutory auditors in JSCs. The TCC recognizes statutory auditors, besides the shareholders’ general meeting and the board of directors, as one of a JSC’s mandatory organs and anticipates a hybrid system with regard to the functions of statutory auditors.

As the result of this hybrid system, in addition to the duty of examination of financial statements as well as management reports of JSCs and accordingly reporting on the results of such examination in an annual audit report addressed to the shareholders’ general meeting, statutory auditors also have a fundamental duty to supervise and monitor the transactions undertaken by the board of directors of JSCs. Moreover, they also fulfill other administrative and representative functions such as calling of a shareholders’ general meeting or initiating court actions against the members of the board of directors. Except for some JSCs subject to capital market legislation, the TCC requires no independent external auditors for the purpose of examination of the financial statements and management reports.

On the other hand, in contrast to the abovementioned Turkish system in which statutory auditors are among the mandatory organs of a JSC and fulfill several other supervisory, administrative as well as representative functions in addition to their

¹ Monks and Minow, p. 498; Hahn and Taylor, p. 504 – 505.
auditing function, statutory auditors (*Abschlussprüfer*) in Germany are entrusted only with the auditing function of the financial statements of the JSC. Furthermore, they are not recognized as a mandatory organ of German JSCs. The supervisory as well as other functions entrusted to the statutory auditors in Turkey are fulfilled by the supervisory board (*Aufsichtsrat*) of the German JSC as the result of the two-tier board structure of German JSCs the focal principle of which is the strict separation of the roles of management and control.

In the German corporate governance system the statutory auditors, who may be certified public accountants or audit firms, conduct audits pertaining only to annual financial statements as well as management reports\(^2\). Such auditors are obliged to examine whether such statements have been prepared in compliance with the legal regulations and the relevant provisions of the articles of association and whether the financial statements and reports represent an accurate picture of the corporation’s financial status. In addition to take an important part in the external corporate governance as a result of their guarantee or attestation function\(^3\), they are also considered playing an important role in internal corporate governance since they fulfill a supporting function to the supervisory board.

Taking into consideration this hybrid system of the current TCC concerning the functions of Turkish statutory auditors, the functions of Turkish statutory auditors may be regarded as a combination of functions of the supervisory board and the statutory auditors of German JSCs.

At present, the TCC, which was enacted in 1956 and which, apart from minor amendments, has not been amended in a fundamental way since its enactment, is undergoing a fundamental amendment in order to bring the commercial law system of Turkey more into line with European legislation.\(^4\) The Draft TCC\(^5\), which was

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\(^2\) Small-sized JSCs within the meaning of § 267 sec. 1 HGB are exempt from preparing management reports.

\(^3\) Jungmann, Legal Aspects of Corporate Governance, p. 40 (Hand-Out VIII: The Role of Auditors in Corporate Governance).

\(^4\) Ararat and Ugur, p. 197.

\(^5\) The text as well as the legislative argumentations are available on the website of the Turkish Grand National Assembly, [http://www2.tbmm.gov.tr/d23/1/1-0324.pdf](http://www2.tbmm.gov.tr/d23/1/1-0324.pdf) (last visited July 14\(^7\) 2010).
adopted by the Justice Commission of the Turkish Grand National Assembly, is being discussed in the Grand Assembly and the said draft is expected to be approved by the Grand Assembly very soon.

The Draft TCC intends to abolish the hybrid system created by the current TCC without suggesting an alternative mechanism to fulfill the supervisory, administrative as well as representative functions of statutory auditors as provided for in the TCC. It also aims to abolish the requirement to have statutory auditors as one of the mandatory organs of JSCs.

The Draft TCC introduces the same concept of statutory auditors as provided for in the HGB and foresees that the statutory auditors are entrusted only with the auditing function of the financial statements as well as the management reports prepared by the board of directors of JSCs. Moreover, it provides that the audits of such statements and reports are to be conducted by independent auditing firms, or alternatively, in small-sized companies, by at least two sworn-in certified public accountants or public accountants.\(^6\)

The main reason behind writing a thesis about the role of statutory auditors in JSCs and attempting to make a comparative study of the German and the Turkish system is to analyze the new concept of statutory auditors in depth and draw attention to the implications of the radical approach taken by the Draft TCC in connection with the role of statutory auditors in Turkish JSCs.

This thesis is composed of four chapters. The next chapter comprises of two subchapters. A short introduction concerning the differences between the internal and external monitoring mechanisms in Turkey is given since statutory auditors are considered an internal monitoring mechanism. Following the introduction, the subchapter on the TCC focuses on the essential characteristics and functions of statutory auditors and such characteristics as well as functions are explained in great detail for the purpose of highlighting the importance of the hybrid system. It then points out the current practice and problems in connection with statutory auditors. Second subchapter begins with an introductory part presenting the main reasons behind the amendment of the TCC. The remaining part of this subchapter is devoted

\(^6\) Art. 400 sec. 1 Draft TCC.
to the explanation of the characteristics and functions of statutory auditors as envisaged in the Draft TCC by also taking into account the corresponding provisions in the HGB. Given that the section of the Draft TCC on statutory auditors is based on the relevant section of the HGB on statutory auditors, the corresponding provisions of the HGB as well as the differences between two systems are also explained in the related parts of this subchapter.

The third chapter examines the current situation in Germany with regard to statutory auditors. It begins with a short introduction to the two-tier board structure as well as to the role of supervisory board in German JSCs since, as already explained, the functions of Turkish statutory auditors may be regarded as a combination of the functions of both the supervisory board and the statutory auditors in German JSCs. The remaining part of this chapter is dedicated to the role of statutory auditors in German JSCs and their functions in German corporate governance. However, since the relevant provisions of the HGB in respect of statutory auditors are already discussed in the second chapter for the purpose of making a comparative analysis of similarities and differences between the Turkish and the German system, this chapter rather gives a summary of important characteristics of German statutory auditors and accordingly contains no detailed explanation of each provision for the sake of avoiding repetition.

The last chapter tries to assess whether and how the reform envisaged by the Draft TCC may reshape the current system in the TCC and whether the radical approach chosen by the Draft TCC will work despite the abolishment of the mandatory organ of statutory auditors without suggesting an alternative mechanism to be entrusted with the supervision as well as other functions of the statutory auditors. In this regard, it also aims to offer recommendations as to improve the mechanism of statutory auditors in general.

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7 §§ 316 – 324a HGB.
B. STATUTORY AUDITORS IN TURKEY

Audits in Turkish JSCs are conducted in several ways from different angles and for the purpose of protection of interests of different benefit groups. The main goal is to protect the economic interests of shareholders and creditors as well as to maintain a successful operation of the company. It also is of importance to protect the future interests of the potential shareholders. Within the context of such protection of interests, priority is given to the monitoring of transactions undertaken by the board of directors of JSCs. In view of the fact that the directors, in collaboration with the shareholders, could act in a way detrimental to the interests of all or some benefit groups, the Turkish legal system developed two monitoring mechanisms: internal monitoring and external monitoring.\(^8\)

Internal monitoring may be conducted by several different persons depending on the circumstances and thus, a distinction can be made between internal monitoring performed in a broad sense and the one performed in a narrow sense.\(^9\)

Similar to shareholder control mechanisms in Germany\(^10\), shareholders of Turkish JSCs may also control the JSC by exercising their control rights during and/or prior to shareholders’ general meetings; through appointment of special auditors; and by way of initiating lawsuits under certain circumstances. In addition to the voting rights of shareholders, the rights set forth in the below paragraph are available to the shareholders for the purpose of monitoring and influencing the corporation in a broad sense.

Several rights of the individual shareholders (e.g. the right to file lawsuits against the members of the board of directors as well as statutory auditors\(^11\), submission of complaints to statutory auditors with regard to acts of members of board of directors

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\(^8\) Poroy, p. 365.

\(^9\) Cevik, p. 538.

\(^10\) Jungmann, The Effectiveness of Corporate Governance, p. 433.

\(^11\) Art. 336, 346 TCC.
and executives\textsuperscript{12}, right to information\textsuperscript{13}, filing of rescission suits\textsuperscript{14}); the minority shareholders (e.g. granting or denial of discharge to the members of the board of directors and the statutory auditors from their relevant acts\textsuperscript{15}, requiring the statutory auditors to file lawsuits against the members of the board of directors\textsuperscript{16}, appointment of special auditors\textsuperscript{17}, right to information\textsuperscript{18}, reporting of complaints/censurable facts to statutory auditors for investigation\textsuperscript{19}, calling of shareholders’ general meeting\textsuperscript{20}); the majority shareholders (e.g. appointment of the members of the board of directors and statutory auditors\textsuperscript{21} and dismissal thereof\textsuperscript{22}) as well as creditors (e.g. filing lawsuits on behalf of the company with respect to assertion of damage claims\textsuperscript{23}) may be deemed as internal monitoring in a broad sense.

However, it has to be mentioned that although it is easier to exercise such control mechanisms in small-sized JSCs the major shareholding of which is owned mostly by a family, in JSCs having many shareholders with tiny portions of shares, it is much harder to exercise the said control mechanisms and accordingly influence the corporation. Moreover, it is also very common that most of the shareholders without significant amounts of shares do not have any interest in exercising their control over JSCs.

\textsuperscript{12} Art. 356 TCC.
\textsuperscript{13} Art. 360-362 TCC.
\textsuperscript{14} Art. 381 TCC.
\textsuperscript{15} Art. 310 TCC.
\textsuperscript{16} Art. 341 TCC.
\textsuperscript{17} Art. 348 TCC.
\textsuperscript{18} Art. 362-363 TCC.
\textsuperscript{19} Art. 356 TCC.
\textsuperscript{20} Art. 366-367 TCC.
\textsuperscript{21} Art. 312, 347 TCC.
\textsuperscript{22} Art. 316, 350 TCC.
\textsuperscript{23} Art. 309, 336, 342, 359 TCC.
In contrast to internal monitoring in a broad sense, internal monitoring in a narrow sense needs to be performed by statutory auditors elected by the shareholders’ general meeting. They are under the duty to conduct audits of the annual financial statements and the management reports of the company as well as to supervise the members of the board of directors with the intention of ensuring that their activities comply with respective laws and the articles of association of the JSC.\(^{24}\) Moreover, they also fulfill administrative and representative functions.

Within the meaning of external monitoring, a distinction can be made between the monitoring conducted by the state and the monitoring conducted by the independent external auditors. State can conduct external audits during the incorporation as well as the operation of a JSC. Officers of commercial registries are also entitled to carry out external audits. Attendance of the inspectors of the Ministry of Industry and Commerce at the shareholders’ general meetings and the submission requirement of the documents regarding such meetings are clear indications of a continuous external monitoring mechanism.\(^{25}\)

Furthermore, another external monitoring function is carried out by the CMB. The subject of the CML\(^ {26}\) is to regulate and control the secure, transparent and stable functioning of the capital market and to protect the rights and benefits of investors with the purpose of ensuring an efficient and widespread participation of the public in the development of the economy through investing savings in the securities market.\(^ {27}\) Such external monitoring function is conducted by the CMB on JSCs subject to capital market legislation. Issuers and capital market institutions should have the financial statements, which are identified by the CMB, audited by independent auditing firms previously established and to be established according to the provisions of the CML, with respect to the compliance with the principle of fair reflection of the accuracy and reality of information.\(^ {28}\)

\(^{24}\) Bolzoni, p.480.

\(^{25}\) Poroy, p. 367.

\(^{26}\) Capital Market Law No. 2499 was published in the Official Gazette number 17416 on 30.07.1981.

\(^{27}\) Art. 1 CML.

\(^{28}\) Art. 16 sec. 2 CML.
External auditing of -only- the annual financial statements may also be conducted by independent external auditors. Although the appointment of such external auditors by the JSC itself brings the external auditing closer to internal auditing, the qualifications of auditors, their particular experience and knowledge in the fields of accounting and auditing as well as their independence from the JSC puts this type of monitoring under the umbrella of external monitoring. The distinct characteristic of this type of monitoring is the independence thereof.

Essentially, under the current system of TCC, as also mentioned in the above paragraphs, in addition to their several other functions, the examination of the annual financial statements as well as the management reports of the JSC is conducted by the mandatory organ of JSCs, the statutory auditors.

In practice, since an “organic link” exists between the statutory auditors and the JSC as a result of the election of statutory auditors by the shareholders’ general meeting which also elected the members of the board of directors and no personal qualification requirements in respect of their knowledge and experience are mandatory for such statutory auditors, there are huge discussions about the trustworthiness, impartiality as well as independence of such audits conducted by the statutory auditors.

Nevertheless, the legislators tried to correct such deficiency of the system by means of appointment of special auditors. As per TCC, which system is similar to the German system of appointment of special auditors, the shareholders’ general meeting may appoint special auditors for the examination of the accurateness of the balance sheet as well as of the improprieties or gross breaches within the last two years relating to the formation of the JSC or the management of the JSC. In case of

29 Pasli, p. 189.

30 Art. 10 of the Communiqué of the CMB Serial: X, No: 16 regarding Independent Auditing in Capital Markets as well as sec. 4.1 of the Corporate Governance Principles of the CMB state that independence principle indicates that the independent audit activities should be conducted without being influenced by any relationship, benefit or other factors that may impede the auditor’s professional discretion and impartiality.

31 Pasli, p. 191.

32 Helvaci, p. 125.
rejection of the petition with regard to the appointment of special auditors by the shareholders’ general meeting, upon petition of shareholders holding at least one-tenth of the share capital of the JSC for the last six months prior to submission of petition, the competent commercial court is entitled to appoint special auditors, provided that facts exist which give reason to suspect that improprieties or gross breaches of the law or the articles of association have occurred in connection with the abovementioned matters.\textsuperscript{33}

German law provides that for the examination of matters relating to the formation of JSC or the management of the JSC’s business, in particular, measures taken in connection with capital increases or capital reductions, the shareholders’ general meeting is entitled to appoint special auditors (\textit{Sonderprüfer}). In case of rejection of a motion to appoint special auditors by shareholders, whose aggregate holdings amount to at least one-tenth of the share capital or one million EUR, the court may elect a special auditor at the request of such shareholders.\textsuperscript{34}

However, the Draft TCC envisages a new concept of special auditors. Special auditors may only be appointed provided that the statutory auditors submit a limited positive opinion letter or a disclaimer in connection with the relationship of the JSC to the controlling company or group companies; or the board of directors informs the JSC on incurred damages with regard to certain legal transactions or precautions by the group. The competent commercial court is entitled to appoint special auditors upon request of any shareholder.\textsuperscript{35}

Upon this short introduction on the internal and external monitoring mechanisms in Turkey, the statutory auditors fulfilling an internal monitoring function in a narrow sense are discussed in further detail in the below paragraphs.

\textsuperscript{33} Art. 348 TCC.

\textsuperscript{34} § 142 sec. 1 and sec. 2 AktG.

\textsuperscript{35} Art. 406 Draft TCC.
I. **Turkish Commercial Code**

As per TCC, apart from the board of directors and the shareholders’ general meeting, statutory auditors are one of the mandatory organs of Turkish JSCs and thus, the non-existence of statutory auditors is one of the grounds for the dissolution of a JSC.³⁶

The Turkish JSC, being a merchant pursuant to TCC, is under the obligation to keep, depending on its size, all necessary books and records in order to clearly show its economical and financial position, commercial transactions as well as asset position.³⁸ The board of directors of the JSC has the duty to keep the required books and records as well as, based on such books and records, to prepare the balance sheet in connection with the previous fiscal year.³⁹ Moreover, apart from the preparation duty of the balance sheet, they also have to set up an annual management report clarifying the commercial, economical and financial position as well as the undertaken commercial transactions by the JSC together with a proposal on the appropriation of profits.⁴⁰

The statutory auditors are under the duty to audit the mentioned annual financial statements as well as the management reports prepared by the board of directors. Moreover, they also fulfill other supervisory, administrative as well as representative functions in JSCs. Therefore, the system of statutory auditors is considered a hybrid system due to the combination of auditing and other functions entrusted to them.

The provisions set forth in Art. 347 to 359 TCC govern the characteristics and functions of statutory auditors.

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³⁶ Art. 435 TCC.
³⁷ Art. 11 TCC.
³⁸ Art. 66 TCC.
³⁹ Art. 325 TCC.
⁴⁰ Art. 327 TCC.
1. Legal Nature of the Relationship between Statutory Auditors and Joint Stock Corporation

The legal nature of the relationship between statutory auditors and JSC is characterized as a representation (Vekalet) relationship.\(^{41}\) The Supreme Court of the Republic of Turkey held that the shareholders’ general meeting may be assumed to have made a firm offer and the statutory auditors may likewise be taken to have accepted that offer.\(^{42}\) It expressed the view that there is a private law agreement between the statutory auditors and the JSC. However, it was also emphasized that the legal relationship between the parties should be characterized as a service agreement, provided that the shareholders’ general meeting grants remuneration to the statutory auditors.\(^{43}\) Nevertheless, the Civil General Council of the Supreme Court stated that the legal relationship between the parties cannot be considered as a service agreement.\(^{44}\)

2. Composition of Statutory Auditors

   a. Number of Statutory Auditors

In every JSC there must be at least one or more statutory auditors, provided that the maximum number of the statutory auditors is five. In case of more than one statutory auditor the statutory auditors compose a board.\(^{45}\)

\(^{41}\) Poroy, p. 373.

\(^{42}\) Furmston, p. 33.


\(^{45}\) Art. 347 sec. 1 TCC.
b. Appointment and Term of Office of Statutory Auditors

The first statutory auditors are appointed by the incorporators of the JSC for a term of one year and their names are enlisted in the articles of association. Subsequently, the statutory auditors are elected by the shareholders’ general meeting for a term not exceeding three years. The statutory auditor may be appointed for another term of office.

In the event one of the regular statutory auditors ceases to hold office prior to the expiration of his respective term of office, the remaining statutory auditors appoint a new auditor to hold office until the next shareholders’ general meeting. In cases the JSC has only one statutory auditor, the competent commercial court appoints the new statutory auditor upon the request of an individual shareholder or a member of the board of directors.

c. Expiration of Term of Office of Statutory Auditors

The term of office of statutory auditors expire for reasons such as (i) the non-election of the statutory auditor upon the expiration of the term of respective office; (ii) the resignation of the statutory auditor; (iii) the removal of the statutory auditor by the shareholders’ general meeting; and (iv) the occurrence of circumstances envisaged by law as the expiration of the qualities attributable to statutory auditors or as not compatible with the qualifications for statutory auditors. These circumstances include the election of the statutory auditors to the board of directors or employment as an officer of the JSC, marriage to a member of the board of directors or to a relative.

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46 Art. 347 sec. 2 TCC.

47 Art. 351 TCC.

48 The shareholders’ general meeting is granted with the exclusive authority to remove the statutory auditors any time without cause. However, as per Article 350 TCC the statutory auditors who are not shareholders of the JSC are entitled to indemnification provided that they prove the unfairness of such removal.
thereof, death of the statutory auditor, bankruptcy, and being charged with serious misconduct.\textsuperscript{49}

3. Personal Qualifications for Statutory Auditors

As per Turkish statute law, only natural persons with full legal capacity\textsuperscript{50} may be appointed as statutory auditors of JSCs. In case of a single statutory auditor, such statutory auditor needs to be a Turkish citizen. Moreover, in case of a board of statutory auditors, more than half of the members need to be Turkish citizens. As per TCC statutory auditors need not to be shareholders of the JSC unless the articles of association of the JSC so prescribe.

A person, who is (i) a member of the board of directors, (ii) an officer of the JSC, (iii) an ascendant, a descendant, a spouse or a relative to the third kin of a member of the board of directors, may not be elected as a statutory auditor.

As already mentioned in the above paragraphs, a person charged with serious misconduct cannot be appointed as a statutory auditor.\textsuperscript{51}

The par. 4 of Article 347 of the Draft Turkish Commercial Code of 1951 provided for financial literacy as a personal qualification requirement so as to be appointed as statutory auditors. The mentioned draft required qualifications such as having a chartered accountant certificate, graduation from faculties of economics or directorship or accountancy experience in a commercial enterprise for at least five years. However, the government commission reviewing the said draft in 1956 excluded this financial literacy requirement with the view that such requirement could not be complied with under the then-existing circumstances of the country.\textsuperscript{52}

\textsuperscript{49} Art. 349 TCC.

\textsuperscript{50} The requirement of having full legal capacity is set forth in the Regulation on Shareholders’ General Meetings and Inspectors of the Ministry of Industry and Commerce.

\textsuperscript{51} Art. 15 (e) Regulation on Shareholders’ General Meetings and Inspectors of the Ministry of Industry and Commerce.

\textsuperscript{52} Poroy, p. 371.
It should be emphasized that it is of major importance that statutory auditors need to have the necessary knowledge, experience and skills in accounting, auditing as well as management of companies in order to properly conduct financial audits on the financial documents of a JSC and to fulfill other supervisory, administrative as well as representative functions entrusted to them by the TCC. Although the possibility always exists to include a relevant provision in the articles of association of the JSC in connection with the personal qualifications of the respective statutory auditors$^{53}$, there are no mandatory requirements set forth in the current TCC in this respect.

As will be discussed in great detail under the chapter regarding the Draft TCC, the Draft TCC requires the statutory auditors to be independent audit firms, or alternatively, sworn-in certified public accountants or public accountants and to possess adequate qualifications so as to conduct financial audits of JSCs.

4. Duties of Statutory Auditors

Taken into consideration the general duties of statutory auditors enlisted in Article 353 TCC as well as the special duties and functions enlisted in Articles 341 and 354 to 357 TCC, the Turkish law system entrusted statutory auditors, in addition to their auditing function with regard to the annual financial statements and the management reports of JSCs, with supervisory, administrative and representative functions and thus, put this mandatory organ in a superior position to that of the board of directors. This mandatory organ with its hybrid system arising out of the authority to supervise the management as well as to audit the financial statements and the management reports of the JSC may be considered as a kind of combination of the supervisory board and the statutory auditors in German JSCs.$^{54}$ As provided for in the TCC, statutory auditors’ main duties include:

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$^{53}$ Cevik, p. 545.

$^{54}$ Poroy, p. 371.
a. General Duties

aa. Determination of the preparation style of the balance sheet in collaboration with the members of the board of directors

bb. Making inquiries about the business transactions of the JSC and inspection as well as examination of company books at least once every six months

cc. Inspection of the JSC’s assets, especially, cash at least once every three months

dd. Examination as well as confirmation of the existence of commercial papers at least once every month

ee. Examination as well as confirmation of the prerequisites set forth in the articles of association of the JSC with regard to the shareholders’ attendance in the shareholders’ general meetings

ff. Auditing of the annual financial statements, budget, balance sheet and books of the JSC

gg. Supervision of the liquidation transactions

hh. Calling of the shareholders’ general meeting in extraordinary circumstances in case of negligence on the part of the board of directors\(^{55}\)

ii. Attendance at the shareholders’ general meeting\(^{56}\)

jj. Supervision of the members of the board of directors with regard to the compliance with the relevant provisions of laws as well as the provisions of the articles of association of the JSC

\(^{55}\) 11\(^{th}\) Civil Chamber of the Supreme Court held with its decision of E. 1982/3858, K. 1982/4511, 08.11.1982 that also in cases the members of the board of directors cease to hold office due to resignation and/or similar reasons and thus in the event the JSC lacks one of its mandatory organs, statutory auditors are entitled to call the shareholders’ general meeting (11\(^{th}\) Civil Chamber of the Supreme Court, E. 1982/3858, K. 1982/4511, 08.11.1982, www.kazanci.com (last visited July 5\(^{th}\) 2010)).

\(^{56}\) As per Article 20 sec. 2 of the Regulation on Shareholders’ General Meetings and Inspectors of the Ministry of Industry and Commerce, ordinary shareholders’ general meetings cannot be held without the presence of at least one statutory auditor.
As the result of the examination and audit conducted by the statutory auditors, they are under the duty to prepare an audit report encompassing their opinions on the management report prepared by the board of directors as well as other relevant documents. Such audit report needs to be addressed to the shareholders’ general meeting. The shareholders’ general meeting cannot resolve upon the balance sheet without reviewing the audit report.\textsuperscript{57}

In current practice, however, the statutory auditors do not make enough efforts to fulfill their mentioned functions in a proper way and thus, the audit reports presented to the shareholders’ general meeting are mostly considered as purely formalistic documents.

b. Special Duties

As mentioned above, the special duties and functions of statutory auditors are enlisted in Articles 341 and 354 to 357 TCC. As per these special provisions, in addition to the preparation of the audit report, statutory auditors are entrusted with duties such as notification of the fraudulent transactions, irregularities in business transactions and violations of laws or articles of association to the superior of the person in violation and to the chairman of the board of directors, and to the shareholders’ general meeting in necessary cases\textsuperscript{58}, calling of the extraordinary shareholders’ general meetings whenever it is necessary to protect the interests of the JSC\textsuperscript{59}, investigation of the complaints submitted by individual or minority shareholders\textsuperscript{60}, attendance at the meetings of the board of directors and – when necessary- addition of items to the agendas of the meetings of the board of directors as well as the extraordinary shareholders’ general meetings.\textsuperscript{61} Furthermore, statutory

\textsuperscript{57} Art. 354 TCC.

\textsuperscript{58} Art. 354 TCC.

\textsuperscript{59} Art. 355 TCC.

\textsuperscript{60} Art. 356 TCC.

\textsuperscript{61} Art. 357 TCC.
The Role of Statutory Auditors in Joint Stock Corporations

Auditors are also under the duty to represent the JSC in court against the members of the board of directors.\textsuperscript{62}

5. Rights, Obligations and Liabilities of Statutory Auditors

a. Rights of Statutory Auditors

The provision with respect to the mandatory content of the agenda of the shareholders' general meeting provides that in the event that no remuneration is assigned to statutory auditors in the articles of association of the JSC, the shareholders' general meeting may grant remuneration to statutory auditors.\textsuperscript{63} Although it is customary practice to grant remuneration to statutory auditors, such remuneration is not mandatory.\textsuperscript{64}

b. Obligations of Statutory Auditors

The statutory auditors are under the obligation not to disclose any trade secret of the JSC, which became known to them as the result of holding office as a statutory auditor, neither to shareholders nor to any other third party.\textsuperscript{65} Moreover, the statutory auditors, when performing in their capacity in compliance with the provisions of law as well as the articles of association, are obliged to carry out their performance with the proper and due care.\textsuperscript{66}

c. Liabilities of Statutory Auditors

The statutory auditors, who do not perform their tasks with the proper and due care, are jointly and severally held liable to the JSC for any damages arising out of or in

\textsuperscript{62} Art. 341 TCC.

\textsuperscript{63} Art. 369 sec. 3 TCC.

\textsuperscript{64} Poroy, p. 373.

\textsuperscript{65} Art. 358 TCC.

\textsuperscript{66} Art. 359 TCC.
connection with their performances. The burden of proof is carried by the statutory auditors.\footnote{Art. 359 TCC.}


As also stated in the Introduction chapter of this thesis, statutory auditors play a fundamental role in corporate governance. One of the most important functions of statutory audits are to give assurance to stakeholders whether the financial statements and other relevant documents such as the management reports are prepared by the board of directors of JSCs in compliance with the legal regulations as well as the articles of association and whether such statements can be relied upon so as to assess the current situation of the JSC. Hence, audited financial statements are a key information resource for stakeholders.\footnote{Moizer, Governance and Auditing, p. xi.} Another important function of the statutory auditors in the TCC is that they are also under the duty to supervise the management of the JSC. However, according to most legal academics and professionals, statutory auditors in Turkey cannot fulfill their functions anticipated in the TCC and therefore, the said mandatory organ is considered a bad-functioning and outdated organ\footnote{Helvaci, p.125, Poroy, p. 373.}. The duties as well as the high responsibilities of the statutory auditors do not have any relevance to real life since they do not make any efforts to fulfill their functions. The statutory auditors are only elected to be in compliance with the TCC so as to ensure to have the necessary mandatory organ of statutory auditors in the JSC for the sake of avoiding the danger of dissolution. They do not fulfill most of their functions with which they are entrusted by the TCC.

As explained in the above paragraphs, the statutory auditors in Turkish JSCs are elected by the shareholders’ general meeting and their remuneration is also granted by the shareholders’ general meeting unless there is a relevant provision in the articles of association. Furthermore, they can be removed anytime without a cause by the shareholders’ general meeting. Since there is no additional requirement or weighted quorums are necessary for such transactions, the shareholder(s) holding
the majority portion of the share capital of the JSC is/are able to manipulate the
election of the statutory auditors as they see fit.\textsuperscript{70} Same majority is also able to
manipulate the election of the members of the board of directors. As a result of such
unity of interest\textsuperscript{71} between the statutory auditors and the board of directors, they end
up acting together and thus, the mandatory supervision as well as other
administrative and representative functions of statutory auditors required by the TCC
cannot be performed by the said statutory auditors.

Consequently, the reliability as well as independence of such statutory auditors are in
fact problematical since these statutory auditors, for the election of which no personal
qualification requirements with regard to their experience and knowledge for
performing their functions are needed, cannot be considered independent from the
JSC and its board of directors upon whom they are reporting.\textsuperscript{72}

Another major problem is that no personal qualifications are required by the TCC in
respect of the experience, knowledge and skills of the statutory auditors. The
statutory auditors are overcharged with so many important tasks and responsibilities
which they cannot handle in a proper way without having the necessary knowledge
and experience. Therefore, the importance given by the TCC to the statutory auditors
is highly understated by the practice.\textsuperscript{73}

Furthermore, customarily, they are granted a very symbolic remuneration and thus, it
is not logical to expect from these statutory auditors to conduct a thorough audit of
the financial statements and management reports as well as to fulfill other functions
and especially the function to supervise the board of directors of the JSC.
Consequently, the internal audit of JSCs is not fulfilled with due and proper care and
the audit reports prepared by incompetent statutory auditors cannot be considered as
satisfactory as they ought to be. It is also very common to come across audit reports

\textsuperscript{70} Poroy, p. 371.
\textsuperscript{71} Helvaci, p. 125.
\textsuperscript{72} Pasli, p. .191.
\textsuperscript{73} Erüreten, p. 392.
the content of which do not include more than several sentences with regard to the financial statements of the JSC.

Moreover, the upper limit in connection with the composition of statutory auditors is also criticized among scholars \textsuperscript{74} since it is considered as highly difficult to conduct audits of the financial statements and management reports as well as to supervise the management of the JSC with a maximum number of five statutory auditors. Taking into consideration the size of JSCs it is not possible to conduct due and proper audits and fulfill other functions at the same time.\textsuperscript{75}

\textbf{II. Draft Turkish Commercial Code}

The Draft TCC, which was submitted to the Turkish Grand National Assembly by the Council of Ministers on November 9\textsuperscript{th} 2005 and adopted by the Justice Commission of the Turkish Grand National Assembly, is expected to be approved in the near future by the Grand Assembly.

The Draft TCC introduces major amendments to the TCC and the reasons behind the introduction of the Draft TCC have been explained by the legislators in great detail in the legislative argumentation section of the Draft TCC. Such reasons include, inter alia, the developments directly affecting the TCC, the relationship of Turkey with the EU, placement of Turkey as an important player in international markets.\textsuperscript{76}

Although the legislation of the member countries of the EU have been subject to constant improvements and amendments during the second half of the 20\textsuperscript{th} century as a result of the developments in this period such as the creation of the European Economic Community, the EU, the North American Free Trade Agreement (NAFTA) or the World Trade Organization, the TCC has not been amended in a fundamental way since its enactment on July 9\textsuperscript{th} 1956.

\textsuperscript{74} Eris, p. 1940.

\textsuperscript{75} İmregün, p. 257.

\textsuperscript{76} The Draft TCC, p. 2.
Subsequent to the application of Turkey dated April 14th 1987 to accede to the EU, the EU established a Customs Union with Turkey on December 11th 1995. Turkey was officially recognized as a candidate for full membership at the Helsinki Summit of the EC on December 10th – 11th 1999 and, the EC adopted the Accession Partnership for Turkey on March 2001. As a result of the candidacy for full membership and with a view to access to the EU, Turkey must complete negotiations with the EU with regard to 35 chapters of the acquis communautaire, the total body of EU law. In this respect, the legislators drafted the Draft TCC so as to bring the commercial law of Turkey in line with the EU law and to make it more dynamic as other commercial codes of the member countries of the EU.

Another important reason mentioned by the legislators is the intention to place Turkey as an important player in international markets. They emphasized the importance of having a commercial code that takes into account the institutions, committees as well as rules of international markets.

Upon making references to the Sarbanes-Oxley Act of July 30th 2002, which mandated enhanced director independence from management, and to the EC Recommendation of May 16th 2002 on Statutory Auditors’ Independence in the EU, the legislators put a lot of emphasis on the importance of the independence of statutory auditors. They regarded the independence as the most important qualification of financial audits and statutory auditors and thus, highlighted that an employment relationship in connection with the audit of the financial statements as well as the management reports of the JSC cannot exist between the statutory auditors and the JSC.


78 The Draft TCC, p. 3.

79 The Draft TCC, p. 4.

80 Bainbridge, p. 1.

Moreover, the Draft TCC takes a radical approach by introducing a new concept with regard to statutory auditors and accordingly intends to abolish one of the mandatory organs of JSCs. As per the Draft TCC statutory auditors are not to any further extent considered as a mandatory organ of JSCs. They are only entrusted with the function to audit the financial statements as well as the management reports of JSCs. Consequently, the hybrid system created by the TCC has been brought to an end without any constructive suggestion of an alternative mechanism as to whether and by whom the supervisory, administrative as well as representative functions of statutory auditors granted to them by the TCC will be performed.

Furthermore, it is also possible to see the relevant references\(^\text{82}\) to the HGB in the relevant legislative argumentation sections of the provisions in connection with the statutory auditors since the legislators adopted the same concept of statutory auditors in Germany. Apart from minor differences, the functions of the statutory auditors under the Draft TCC are comparatively similar to the functions of the statutory auditors under the HGB. The Draft TCC also follows the same logic with respect to the order of the provisions.

Another distinction of the Draft TCC from the TCC is that the Draft TCC introduces an additional type of auditors (İslem Denetcileri) who are entrusted with the auditing duty of particular transactions of JSCs such as, inter alia, incorporation, capital increase and decrease, merger, split and, issuance of securities.\(^\text{83}\)

Following this short explanation of the reasons behind the amendment of the TCC as well as the approach taken by the Draft TCC, the characteristics as well as functions of statutory auditors envisaged in the Draft TCC are discussed in further detail by also taking into consideration the corresponding provisions in the HGB.

The provisions set forth in Art. 397 to 406 Draft TCC govern the new concept introduced by the Draft TCC.

\(^{82}\) The Draft TCC, p.131, Akugur, p. 278.

\(^{83}\) The Draft TCC, p. 42.
1. Legal Nature of the Relationship between Statutory Auditors and Joint Stock Corporation

The auditing function is performed by independent auditors and/or independent auditing firms in accordance with a private law agreement between them and the JSC. The legal nature of the relationship between statutory auditors and JSC may be characterized as a service agreement. As the legislators highlight in the legislative argumentation section of the Draft TCC\(^84\) that it is not possible to regard the relationship between the statutory auditors and the JSC as an employment relationship since the statutory auditors need to be independent from the JSC and its board of directors upon whom they will be reporting. The legislators emphasize that the debatable legal nature of the relationship between the said parties is mainly designated by countries’ doctrine or court decisions. Although they underline several problems whether the agreement between the statutory auditors and the JSCs could be deemed as a public law agreement and whether the statutory auditors could be considered as one of the mandatory organs of the JSCs\(^85\), they do not make any suggestion with regard to the legal nature of the relationship between the parties.

2. Composition of Statutory Auditors

a. Number of Statutory Auditors

As per Draft TCC the financial statements and the annual management report of a JSC have to be examined by an independent auditing firm the partners of which need to be certified public accountants or sworn-in certified public accountants. However, the Draft TCC provides a more advantageous provision with regard to the statutory auditors of small and medium-sized JSCs and thus permits the statements and reports of such JSCs to be audited by one or more certified public accountant or sworn-in certified public accountant.\(^86\)

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\(^{84}\) The Draft TCC, p. 26.

\(^{85}\) The Draft TCC, p. 134.

\(^{86}\) Art. 400 sec. 1 Draft TCC.
The HGB provides for qualified auditors and qualified auditing firms to conduct audits. It also stipulates that audits of the annual financial statements and management reports of medium-sized limited liability companies or of medium-sized business partnerships within the context of § 264 (1) HGB may be conducted by certified public accountants or certified accounting firms.87

b. Appointment and Term of Office of Statutory Auditors

The statutory auditor is elected by the shareholders’ general meeting every year prior to the end of the fiscal year in which he performs his examination functions.88 In case a statutory auditor has not been selected by the end of the fourth month of the fiscal year, the competent commercial court appoints the statutory auditor upon the petition of the board of directors, a member of the board of directors or any shareholder.

Same as in the Turkish system, the statutory auditors in Germany also are appointed by the shareholders’ general meeting.89 However, such statutory auditors are generally pre-approved by the supervisory board or its audit committee prior to their appointment by the shareholders’ general meeting.90

c. Expiration of Term of Office of Statutory Auditors

The audit mandate can only be revoked in case another statutory auditor is appointed and provided that, upon the petition of the board of directors or the shareholders whose aggregate shareholding amounts to one-tenth of the share capital of the JSC (one-fifth of the share capital in case of public JSCs), the competent commercial court decides that concerns exist in relation to the personality

87 § 319 (1) HGB.
88 Art. 399 sec. 1 Draft TCC.
89 § 318 (1) HGB.
90 Jungmann, Legal Aspects of Corporate Governance, p. 42 (Hand-Out VIII:The Role of Auditors in Corporate Governance).
as well as prejudice of such auditor. The commercial court has to hear the interested parties and the statutory auditor prior to its decision.\footnote{Art. 399 sec. 4 Draft TCC.}

An audit mandate may be terminated by the statutory auditor only due to just cause. Nevertheless, differences of opinions, reservations or disclaimers with respect to the opinion letter to be prepared by the statutory auditor cannot be held as a just cause.\footnote{Art. 399 sec. 8 Draft TCC.}

This provision of the Draft TCC corresponds to § 318 HGB. The only difference between these provisions is that the HGB stipulates that the shareholders have to own one-twentieth of the share capital or a shareholding amounting to at least EUR 500,000,- in order to submit a petition.

3. Personal Qualifications for Statutory Auditors

As already explained, the Draft TCC entrusts independent audit firms, or alternatively, in small-sized companies, sworn-in certified public accountants or public accountants with auditing function.

The incorporation and operation requirements for independent auditing firms and the personal qualification requirements for statutory auditors are to be regulated by a regulation of the Ministry of Industry and Commerce.

Moreover, the Draft TCC sets forth grounds for disqualification of statutory auditors. A sworn-in certified public accountant, a certified public accountant, an independent auditing firm and its partners or persons with whom they perform their profession jointly, are not allowed to be appointed as statutory auditors provided that he, she or the firm, inter alia, (i) is a shareholder in the JSC to be audited, (ii) is, or within the last three years prior to its appointment as statutory auditor was, a director or an officer of the JSC to be audited, (iii) is a legal representative, a member of the board of directors or owner of a company, which is affiliated with the JSC to be audited or owns more than 20% of such affiliated company, (iv) renders additional services
other than the auditing function such as bookkeeping or involvement in the preparation of financial statements of the JSC to be audited, (v) received more than 30 percent of its income within the last five years and is also expected to receive more than thirty percent in the current fiscal year as a result of rendering audits to the JSC to be audited or to other companies the shareholdings of which in the JSC to be audited amounts to more than twenty percent.\footnote{Art. 400 sec. 1 Draft TCC.}

In addition to the election of statutory auditors by the shareholders’ general meeting to ensure the existence of an unbiased audit, the legislators’ reasoning behind drafting the abovementioned criteria for the disqualification of statutory auditors is to ensure the independence of statutory auditors from the JSC and its board of directors upon whose transactions they will be reporting.

This provision is also based on § 319 HGB. However, additionally, § 319 sec. 2 provides that a statutory auditor is not allowed to conduct audits in case any business, financial, or personal relationship exists, which may bias the auditor’s judgment.\footnote{§ 319 sec. 2 HGB.} This requirement was issued to cover anything not directly regulated in a situation where statutory auditor’s independence might be compromised.\footnote{Strohm, p. 69.}

Furthermore, the GCGC requires the supervisory board, or alternatively, the audit committee, prior to the submission of a proposal with regard to the election of auditors, to obtain a statement from the proposed auditors so as to ensure their independence from the JSC as well as the members of the management board.\footnote{Sec. 7.2.1 GCGC.}

CGP issued by the CMB\footnote{Corporate Governance Principles have been issued on 2003 and amended on 2005. Such principles may be seen through the CMB’s website: \url{http://www.cmb.gov.tr/regulations/regulations_index.html} (last visited July 11\textsuperscript{th} 2010).} stipulates that the audit needs to be conducted “without being influenced by any relationship, benefit or other factors that may impede the
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auditor’s professional discretion and impartiality”. Although the CGP mainly addresses publicly held JSC, it is recommended that other JSCs and institutions implement such principles as well.

4. Duties of Statutory Auditors

a. Subject and Scope of Audit

As per Draft TCC the financial statements as well as the annual management reports of JSCs should be examined by statutory auditors. In the event that the financial statements and the annual management reports are not audited by statutory auditors, such statements and reports cannot be adopted by the shareholders’ general meeting.98

The Draft TCC requires all types and sizes of JSCs to be audited by the statutory auditors. Article 397 Draft TCC is based on § 316 HGB. The only difference between these provisions is that § 316 HGB provides that the annual financial statements and the management report of companies, with the exception of small-sized companies in terms of § 267 sec.1 HGB99, as well as group companies must be audited by statutory auditors. Even though such an exception for small-sized JSCs has not been provided by the Draft TCC, there exist additional provisions more advantageous to the small and medium-sized JSCs.100

The statutory audit of the financial statements and the annual management reports comprises of the auditing of the accounting records with the inclusion of the

98 Art. 397 sec. 1 and 2 Draft TCC.

99 Small-sized corporations are those that do not exceed at least two of the following three requirements:

1. Balance sheet in the amount of EUR 4,840,000,– after deducting any deficit presented on the asset side.

2. EUR 9,680,000,– in turnover proceeds within twelve months prior to the close of the fiscal year.

3. An average of 50 employees during the year.

100 The Draft TCC, p. 131.
inventory. The statutory auditors are obligated to examine the conformity of the financial statements and the annual management reports with the Accounting Standards of Turkey, the legal regulations as well as the relevant provisions of the articles of association of the JSC.\(^{101}\) The annual management reports prepared by the board of directors must be examined as to whether such reports are in compliance with the financial statements as well as with the findings of the statutory auditors as the result of the audit. Moreover, the statutory auditors also have to scrutinize whether the reports present a valid representation of the commercial situation of the JSC.

It also is of great importance that the statutory audit should be conducted in a way to ensure that the state of the JSC\(^{102}\) and the risks of future developments\(^{103}\) which could threaten the continuity of the JSC are validly presented and that any violation as well as inaccuracy may be recognized in that respect.

Moreover, it has been emphasized that the audits are to be conducted with the due care and in accordance with the requirements of audit profession, business ethics and international standards and thus, the legislators stress the importance of professionalism for the purpose of the examination of the financial statements as well the annual management reports of JSCs so as to justify their reformist approach taken with regard to the section of statutory auditors in the Draft TCC.\(^{104}\)

The provision of the Draft TCC with respect to the subject and the extent of statutory audit corresponds to § 317 HGB. The statutory auditor stipulated in the HGB fulfills a controlling function by means of ensuring the truth and fairness of the financial statements prepared by the management board.

In contrast to the relevant German provision, the legislators underlined in the legislative argumentation section of the Draft TCC that the statutory audits comprise

\(^{101}\) Art. 397 sec. 1 Draft TCC.

\(^{102}\) Art. 397 sec. 1 Draft TCC.

\(^{103}\) Art. 397 sec. 2 (c) Draft TCC.

\(^{104}\) The Draft TCC, p. 133.
not only of the annual financial statements but also the interim financial statements as provided for in national as well as international auditing standards.\textsuperscript{105}

b. Audit Report

As the result of the financial audit, statutory auditors must prepare an audit report in writing and with due clarity on the type, nature, scope as well as the result of the audit which also includes a comparison with the previous year’s results.\textsuperscript{106} The audit report to be submitted to the board of directors is based on the financial statements of the JSC and includes, within the meaning of the accounting standards envisaged in the Turkish Accounting Standards, an assessment of the opinions of the board of directors on the position, the continuity as well as the future developments of the JSC, to the extent the audited documents permits such assessment.\textsuperscript{107} The audit report also has to encompass the irregularities with respect to the application of the Turkish Accounting Standards, the ambiguities regarding the continuity of the JSC as well as the facts that could jeopardize such continuity.\textsuperscript{108}

Furthermore, in the main part of the audit report it has to be determined whether (i) the bookkeeping records and the financial statements of the JSC are in compliance with the law as well as the provision of the articles of association with reference to financial reporting, and (ii) the board of directors has provided explanations and documents requested by the statutory auditors when carrying out the audit. The audit report also has to explain whether the financial statements based on the company books, within the meaning of the Turkish Accounting Standards, present an accurate picture of the assets, the financing and profitability of the JSC.\textsuperscript{109}

\textsuperscript{105} The Draft TCC, p. 132.

\textsuperscript{106} Art. 402 sec. 1 Draft TCC.

\textsuperscript{107} Art. 402 sec. 3 Draft TCC.

\textsuperscript{108} Art. 402 sec. 3 (a) and (b) Draft TCC.

\textsuperscript{109} Art. 402 sec. 5 Draft TCC.
The source of this provision regarding the audit report is § 321 HGB. As also provided in the German system, the financial statements and the management report must be thoroughly analyzed and, particularly, the facts which could endanger the existence of the JSC or could materially hinder its development and which indicate serious violations by the legal representatives against the law or the articles of association must be reported by the statutory auditors.\textsuperscript{110} In comparison to the German audit report (\textit{Prüfungsbericht}), the audit report envisaged in the Draft TCC has to include a comparison of the current results with the previous year’s results.

Similar to § 321 sec. 4 HGB, the previous version of the provision in the Draft TCC required the inclusion of an assessment in the audit report whether measures are necessary to improve the internal control system of the JSC. Nevertheless, the current version of the Draft TCC does not any longer contain this requirement of assessment even though the legislators put enormous emphasis on the importance of early diagnosis of the risks that could jeopardize the JSC, the notification of such risks to the relevant authorities in charge and taking of precautions for the purpose of maintaining the security of corporate governance authorities as well as the markets.

Another difference between the Draft TCC and the HGB with regard to the audit report is that the Draft TCC provides for the audit report to be submitted to the board of directors whereas the audit report prepared by German statutory auditors is addressed to the supervisory board.\textsuperscript{111}

The Draft TCC does not provide an equivalent provision with respect to the disclosure of the audit report as a result of special circumstances as provided by § 321a HGB.

c. Opinion Letter

The other instrument for the purpose of reporting the results of the statutory audit conducted by statutory auditors is the opinion letters. As opposed to the detailed

\begin{footnotes}
\item[110] § 321 sec. 1 HGB.
\item[111] Schmidt, p. 744.
\end{footnotes}
audit report containing comprehensive information about the financial statements and the management reports, the opinion letter is prepared, in addition to the explanation of the type, nature as well as the scope of the audit, to summarize the results of such audit. Moreover, the opinion letter also encompasses the qualification of the personal opinion of the statutory auditors in accordance with the results of the audit. The statutory auditor has to explain the reasons for the qualification.

In the event statutory auditor expresses his positive opinion, he has to explain that, as the result of the assessment made in line with the Turkish Accounting Standards, the audit of the financial statements and the annual management report reveal no reasons for objection and that the financial statements as well as the annual management reports of the JSC present a factually accurate picture of the assets, the financials and the profitability of the JSC. The difference between the audit report and the opinion letter is that the opinion letter fulfill a certification function rather than to give an accurate picture of the JSC with regard to the situation of the JSC.

In case of an objection, statutory auditors may limit their positive opinion or may submit a negative opinion letter. The scope of such limitation has to be included in the opinion letter. The statutory auditors have to disclaim their opinion provided that ambiguities exist to such extent that audits cannot be conducted and the board of directors tries to prevent the audit in a significant way. The reasons for the disclaimer have to be explained without being under the obligation to present the relevant proofs. As per the equivalent subsection of the HGB the German statutory auditors must disclaim their opinion provided that important findings occur which would concern the reliability of the financial statements.

In cases of limited positive opinion letter, negative opinion letter or denial of submission of an opinion letter, the shareholders’ general meeting cannot adopt a

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112 Art. 403 sec. 1 Draft TCC.
113 Art. 403 sec. 4 Draft TCC.
114 § 322 sec. 5 HGB.
resolution based on the financial statements that are audited by the statutory auditors. Hence, within two business days upon the submission of the opinion letter, the board of directors has to convene the shareholders’ general meeting and has to resign as effective as of the day of the shareholders’ general meeting. The new board of directors elected by the shareholders’ general meeting is under the obligation to have the financial statements prepared within six months in line with the relevant laws, the articles of association as well as the accounting standards and accordingly to submit such statements to the shareholders’ general meeting together with the audit report to be prepared as a result of the examination of the new financial statements.115

This provision on the opinion letters of statutory auditors is based on § 322 HGB. The heading of the provision in the Draft TCC is “Opinion Letter” whereas the heading of the corresponding German provision is “Annotation of Certification” (Bestätigungsvermerk). Although the provisions have almost the same content, the German provision has a more structural and systematic approach in contrast to the matching Turkish provision. Prior to the explanation of the functions of the types of certification letters, § 322 sec. 2 HGB clearly provides that the assessment of the result of the audit must clarify the type of the certification.

The fifth subsection116 of the provision regarding the election of the new board of directors by the shareholders’ general meeting for the purpose of the preparation of new financial statements is not based on the HGB. Even though this subsection was not included in the older version of the Draft TCC and the legislators highlighted in the legislative argumentation section of the Draft TCC117 that the shareholders’ general meeting must decide on a case-by-case basis to determine whether the members of the board of directors must be removed and new financial statements must be prepared, the new version of the Draft TCC includes this subsection.

115 Art. 403 sec. 5 Draft TCC.
116 Art. 403 sec. 5 Draft TCC.
117 The Draft TCC, p. 138.
d. Differences of Opinions

The Draft TCC provides that in cases of differences of opinions between the statutory auditors and the JSC arising out of interpretation and application of the relevant laws and/or the relevant provisions of the articles of association with regard to the financial statements and the management reports of the JSC, the competent commercial court, upon petition of either the board of directors or the statutory auditors, has to decide on such differences of opinions.\(^\text{118}\)

Although the HGB also used to contain a provision with respect to differences of opinions between statutory auditors and JSCs\(^\text{119}\), the latest version of the HGB does not provide a provision in this respect. Moreover, the inclusion of this provision into the Draft TCC was also criticized by legal academics\(^\text{120}\) since a dispute arising in connection with the company accounts, financial statements as well as management reports between the board of directors and the statutory auditors was considered as highly unthinkable.

5. Rights, Obligations and Liabilities of Statutory Auditors

a. Rights of Statutory Auditors

The board of directors, upon preparation and approval of the financial statements as well as the annual management report, is under the obligation to provide all the necessary conditions to the statutory auditor for the purpose of examination of the books, correspondence, documents, assets, debt, and inventory.\(^\text{121}\) The statutory auditors have the right to request any and all information and documents from the members of the board of directors as the auditors deem necessary so as to conduct a proper audit in compliance with the relevant laws. The statutory auditors are entitled to use such information rights also prior to the preparation of the financial

\(^{118}\) Art. 405 sec. 1 Draft TCC.

\(^{119}\) Peltzer and Voight, p. 242 – 243.

\(^{120}\) Moroglu, p. 194.

\(^{121}\) Art. 401 sec. 1 Draft TCC.
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statements provided that the information and/or the documents are necessary for preparing for the audit to be conducted.\textsuperscript{122}

This provision is based entirely on § 320 HGB which also expresses the duty of the legal representatives to present the necessary documentation as well as the information to the statutory auditors and the right to information of the statutory auditors.

The statutory auditors are also entitled to receive an audit fee as the result of the independent external audit conducted by them due to the service agreement executed between them and the JSC.

\hspace{1cm} b. Obligations of Statutory Auditors

The statutory auditors are under the obligation to carry out the audit mandate in an honest and impartial way and, without obtaining prior approval, they cannot disclose or use any trade secret of the JSC, which became known to them as a result of holding office as a statutory auditor.

The legislators explained in the legislative argumentation section of the Draft TCC\textsuperscript{123} that the above mentioned provision with respect to the obligation to maintain confidentiality is based on § 323 HGB in its entirety.

\hspace{1cm} c. Liabilities of Statutory Auditors

In the event that the statutory auditor intentionally or negligently violates its duties, the JSC and/or subsidiaries thereof have to be compensated due to the damages incurred.\textsuperscript{124} Furthermore, in addition to the description of the limits on the liability of damages of persons who have acted negligently and thus caused the disclosure or

\textsuperscript{122} Art. 401 sec. 2 Draft TCC.

\textsuperscript{123} The Draft TCC, p. 139.

\textsuperscript{124} Art. 404 sec. 1 Draft TCC.
usage of any trade and/or business secrets of the JSC\textsuperscript{125}, the liability of the board of directors, the members of the board of directors as well as its employees, provided that the statutory auditor is an independent auditing firm, have also been highlighted.\textsuperscript{126}

Moreover, the statutory auditors may be held liable against the JSC, its shareholders as well as its creditors provided that they act negligently in fulfilling their functions. However, the Draft TCC stipulates that the burden of proof is carried by the claimants.\textsuperscript{127}

This provision governing the liabilities of statutory auditors is taken from § 323 HGB.

\textsuperscript{125} Art. 404 sec. 2 Draft TCC.

\textsuperscript{126} Art. 404 sec. 3 Draft TCC.

\textsuperscript{127} § 554 (1) Draft TCC.
C. STATUTORY AUDITORS IN GERMANY

Even though the main part of this chapter will be devoted to the role of the statutory auditors in German JSCs, a short explanation of the two-tier board structure as well as the role of the supervisory boards in JSCs is of major importance for the purpose of this comparative study since the current hybrid system with regard to the functions of statutory auditors in the TCC is considered as a combination of functions of the statutory auditors and the supervisory board of German JSCs. Following such explanation, the role of statutory auditors in Germany will be discussed in detail. However, as already mentioned, since the provisions of the Draft TCC with regard to the statutory auditors are based on the relevant provisions of the HGB and such provisions were discussed in the previous chapter, no further explanation of each provision will be given for the sake of avoiding repetition.

I. The Two-Tier Board Structure and the Role of Supervisory Board in German JSC

The German JSC can only act through its mandatory organs of corporate structure. Besides the mandatory organ of shareholders’ general meeting, the German JSC provides for a two-tier board structure consisting of the management board and the supervisory board. This two-tier board structure safeguards the characteristic of separating both functions, which are transferred to two different corporate organs \(^{128}\) the functions of which are clearly determined. \(^{129}\) As described in the previous chapters, the Turkish JSC also acts through its mandatory organs, namely the shareholders’ general meeting, the board of directors and the statutory auditors. The Turkish JSC, however, does not provide for a two-tier board structure as opposed to the German JSC.

\(^{128}\) Theisen, p. 259.

\(^{129}\) Dornseifer, p. 219.
Furthermore, the importance of strictly separating the management and supervision functions of companies and groups of companies has been also emphasized from an economic point of view by legal academics.  

Whereas the management board, the members of which are appointed by the supervisory board, is entrusted with the sole responsibility for the management and running the daily business of the JSC, the supervisory board appoints, supervises and advises the members of the management board and safeguards the interests of the corporation. As per sec. 5.1.1 of the German Corporate Governance Code the task of the supervisory board includes regularly advisory and supervision of the management board with regard to the management of the JSC and also involvement in decisions of fundamental importance. Furthermore, the management board and the supervisory board cannot have the same person as a member at the same time for the purpose of ensuring the independence of the members of the management board in directing the JSC.

The management board is under the obligation to ensure that the required commercial accounts as well as books are kept. It is responsible to draw up the annual financial statements (Jahresabschluss) as well as the consolidated financial statements (Konzernabschluss) in accordance with the legal requirements. The annual financial statements must give the legally required accurate picture of the JSC, that is, a statement of the previous business year's corporate governance.  

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130 Semler, p. 1.
131 §76 sec. 1 AktG.
132 Werder and Talaulicar, p. 31.
133 Dornseifer, p. 248.
134 Sec 5.1.1 GCGC.
135 Werder and Talaulicar, p. 31.
136 § 91 sec. 1 AktG.
137 §§ 264, 290, 315a HGB.
138 Luttermann, German Corporate Governance in International and European Context, p. 179.
The supervisory board, the members of which are elected by the shareholders’ general meeting and by the employees, if any of the codetermination statutes applies, fulfills the main supervision function in German JSCs as opposed to statutory auditors in Turkish JSCs who are entrusted with this function. It has been emphasized that this control function requires the cooperation of the supervisory board and the management board.\textsuperscript{139}

As the main monitoring organ of the JSC the most important duty of the supervisory board is to supervise the management of the JSC\textsuperscript{140}. It also may conduct inspections and examine the books and records of the JSC as well as the assets, in particular, cash, inventories of securities and merchandise.\textsuperscript{141} However, legal academics expressed that such right is hardly ever used in practice.\textsuperscript{142} Although statutory auditors in Turkey are entitled to the same right of examination and inspection, statutory auditors in the current Turkish practice also make no use of this right.

Other rights and duties of the supervisory board include, inter alia, convening of the shareholders’ general meeting whenever the interests of the JSC require\textsuperscript{143}, representation of the JSC in all affairs in relation to the management board, particularly by initiating court actions against the members of the management board\textsuperscript{144}. The supervisory board has the duty to mandate external auditors for the purpose of conducting audits on the annual financial statements of the JSC so as to ensure their supervision function in connection with the financial statements of the JSC.

\textsuperscript{139} Jungmann, The Effectiveness of Corporate Governance, p. 450.

\textsuperscript{140} §111 sec. 1 AktG.

\textsuperscript{141} §111 sec. 2 AktG.

\textsuperscript{142} Mäntysaari, Comparative Corporate Governance p. 345.

\textsuperscript{143} §111 sec. 3 AktG.

\textsuperscript{144} Jungmann, The Effectiveness of Corporate Governance, p. 432.
Taking into consideration the lack of a two-tier board structure in Turkish JSCs, the abovementioned supervisory, administrative and representative functions performed by the supervisory board are fulfilled by the statutory auditors in Turkish JSCs.

II. The Role of Statutory Auditor in German JSC

1. Applicable Provisions of Laws

The German JSC, being a merchant under the HGB\(^\text{145}\), is under the duty to keep books and records so as to show a clear picture of the commercial transactions as well as its asset position in accordance with generally accepted accounting principles.\(^\text{146}\) As explained above, the management board of the JSC is under the duty to ensure that the required commercial books are kept.\(^\text{147}\) Moreover, the JSC is also obligated to prepare the annual financial statements, which encompass (i) the balance sheet showing all assets and liabilities upon the establishment of the business and at the close of every fiscal year, (ii) the profit and loss statement showing the expenses as well as revenues with regard to the fiscal year, and (iii) notes which supplement the annual financial statements.\(^\text{148}\) Small-sized JSCs within the meaning of § 267 sec. 1 HGB are, however, exempt from preparing management reports.

The management board has to submit the annual financial statements as well as the management report promptly upon completion to the supervisory board\(^\text{149}\) together with the proposal for appropriation of any net retained profit.\(^\text{150}\) Subsequently, the supervisory board has the duty to examine such documentation as well as the proposal with regard to the appropriation of profit.\(^\text{151}\) The statutory auditors support

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\(^{145}\) § 1 (1) HGB.  
\(^{146}\) § 238 HGB.  
\(^{147}\) § 91 sec. 1 AktG.  
\(^{148}\) § 242 sec. 3 HGB.  
\(^{149}\) § 170 sec. 1 AktG.  
\(^{150}\) § 170 sec. 2 AktG.  
\(^{151}\) § 171 sec. 1 AktG.
the supervisory board since they are entrusted with the function to audit the mentioned annual financial statements. Apart from the small-sized corporations, all JSCs are subject to annual statutory audits to be conducted by the statutory auditors. Following the examination of the annual financial statements and the management reports, the statutory auditors must prepare an audit report on their findings and summarize the results of their examination, without giving many details, in a certification letter. The relevant provisions governing the characteristics as well as functions of statutory auditors are to be found in §§ 316 – 324a HGB.

2. Agency Theory and Functions of Statutory Auditors in German Corporate Governance System

As the result of the separation of ownership and control and accordingly information of asymmetry, the management of agency problems arising out of a potential divergence of interests between shareholders as the main principals and the management board as their main agent is regarded as one of the focal topics in corporate governance. The conflict of interests arising in connection with the management board’s potential usage of the resources of the company for their own benefit rather than the benefit of shareholders could be mitigated by the mechanism of statutory auditors acting as an intermediary between the shareholders and the management board. As the result of such intermediary position, the statutory auditors could reinforce the lacked trust of the principals against their agents.

The reporting mechanisms of statutory auditors, namely the audit report and the certification letter, stipulated in the HGB and also envisaged in the Draft TCC play an

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152 § 316 sec. 1 HGB.
153 § 321 HGB.
154 § 322 HGB.
155 Berle and Means, p. 112.
157 Bainbridge, p. 6.
important role so as to alleviate the conflict of interests between the shareholders and the management board.

Even though the statutory auditors are considered a part of external corporate governance as the result of acting as independent external auditors reporting on the financial position of the JSC, they also play a very important part in internal corporate governance due to their supporting role to the supervisory board of JSCs by means of conducting audits on the financial statements. Since the audit report prepared by the statutory auditors upon their examination is addressed to the supervisory board, they are deemed making a direct contribution\(^ {158}\) to align the interests of the shareholders and the management board and thus, also being an indispensable part of internal corporate governance. Moreover, the other reporting mechanism, the certification letter with its external effect due to the disclosure requirement of such letter together with the annual financial statements pursuant to HGB\(^ {159}\), is a key source for shareholders who require the assess the financial, economical as well as commercial position of the JSC. Hence, it is evident that this reporting mechanism also helps to mitigate the agency problem.\(^ {160}\)

Apart from their auditing function, they also fulfill another function of making appraisals with regard to statutory compensation of shareholders subsequent to the occurrence of certain circumstances such as squeeze out or merger.\(^ {161}\)

\(^{158}\) Jungmann, Legal Aspects of Corporate Governance, p. 38 (Hand-Out VIII: The Role of Auditors in Corporate Governance).

\(^{159}\) § 325 (1) HGB.

\(^{160}\) Jungmann, Legal Aspects of Corporate Governance, p. 38 (Hand-Out VIII: The Role of Auditors in Corporate Governance).

\(^{161}\) Jungmann, Legal Aspects of Corporate Governance, p. 43 (Hand-Out VIII: The Role of Auditors in Corporate Governance).
D. RECOMMENDATIONS & CONCLUSION

The Draft TCC envisages a new concept with regard to statutory auditors and their functions which are described in great detail in previous chapters of this thesis. It intends to abolish the requirement of having internal statutory auditors as one of the mandatory organs of a JSC and requires independent external auditors to conduct audits on the financial statements and management reports of JSCs. Hence, it aims to abolish the hybrid system created by the TCC with regard to the functions of statutory auditors without making any constructive suggestion of an alternative mechanism as to whether and by whom the supervisory, administrative as well as representative functions of internal statutory auditors stipulated under the current system will be fulfilled.

As can be clearly understood from the subchapter explaining the new model introduced by the Draft TCC, the section in the Draft TCC governing the characteristics of statutory auditors is adopted mostly in its entirety from the relevant provisions of the HGB governing statutory auditors. However, the legislators should have thought in a more precise way whether their suggested model is compatible with the conditions peculiar to Turkey since Turkish JSCs do not have a two-tier board structure with the strict separation principle of the roles of management and control as in German JSCs and accordingly a supervisory board fulfilling the supervisory as well as other functions.

The advantage for Turkey of adopting the new model concerning the statutory auditors would be to ensure the independence of auditors and having independent external auditors with the necessary knowledge and experience to conduct financial audits. Moreover, the goal of the harmonization of Turkish legislation with European legislation has also been reached. Hence, such new concept of having independent external auditors entrusted only with the auditing function must be maintained. Nevertheless, it is of major importance to have an additional mechanism regarding the other functions as explained above. In this respect, some recommendations would be useful for the legislators:
I. Protection of the Mandatory Organ of Internal Statutory Auditors

Even though the new concept of independent external auditors entrusted with the auditing function must be maintained as envisaged in the Draft TCC and since it is unlikely that Turkey would adhere to the two-tier board structure, the mandatory organ of internal statutory auditors needs also to be maintained so as to have an institution to fulfill the supervisory, administrative as well representative functions entrusted to the mandatory organ of the supervisory board in Germany, the core function of which is the supervision of the management board. Internal statutory auditors cannot be abolished without creating another body for the fulfillment of such important functions.

Additionally, another advantage of keeping the mandatory organ of internal statutory auditors within the corporate structure is that they can fulfill their important functions in a more effective way as the result of being involved in the operations of the JSC.

II. Personal Qualification Requirements for Internal Statutory Auditors

In addition to protect the mandatory organ of internal statutory auditors, the personal qualification as well as disqualification requirements of such internal statutory auditors must be regulated in parallel to the personal qualification and disqualification requirements for the independent external auditors as introduced by the Draft TCC. Even though the internal statutory auditors will not be to any further extent entrusted with the auditing function, they must have the necessary knowledge, experience and skills so as to fulfill their supervisory, administrative and representative functions.

Moreover, it also has to be emphasized that internal statutory auditors need to be compensated in a proper way. As described in the subchapter regarding the current practices and problems related to statutory auditors, at present, they are granted a very symbolic remuneration, if any, and thus, it cannot be expected from the auditors to fulfill their functions effectively.
III. Establishment of an Audit Committee & Appointment of Non-Executive Directors as Internal Statutory Auditors

Another recommendation would be the establishment of an audit committee consisting of non-executive directors in the event the mandatory organ of internal statutory auditors will not be maintained. Both the TCC\textsuperscript{162} and the Draft TCC\textsuperscript{163} permits the board of directors to establish audit committees consisting of several members of the board of directors depending on the size of the JSC.

Non-executive directors can make significant contributions through effective challenging of the executive members of the board of directors by means of performing their supervisory, administrative as well as representative functions as a result of their relative distance from daily operations of the JSC combined with their external experience.\textsuperscript{164}

In addition to the fulfillment of the supervision and other functions, the non-executive directors in the audit committee may also be responsible to oversee the business relationship between the independent external auditors and the JSC. Such committee could be responsible for hiring, supervision, retention, and compensation of the independent external auditors.\textsuperscript{165}

However, it has to be borne in mind that the non-executive directors have a difficult role since being independent and involved in the operation of the JSC and to challenge the board of directors and also sometimes having a supporting role at the same time could be very challenging.\textsuperscript{166}

\textsuperscript{162} Art. 318 par. 2 TCC.
\textsuperscript{163} Art. 366 (2) Draft TCC.
\textsuperscript{164} Steele, p. 52.
\textsuperscript{165} Coffee, Jr, p. 633.
\textsuperscript{166} Steele, p. 65.
IV. Establishment of a Supervisory Authority of Independent Accounting

Germany introduced an independent accounting supervisory authority (Prüfstelle für Rechnungslegung) which examines whether the financial statements of a public corporation and the management reports are in conformity with the laws as well as generally accepted accounting principles.\textsuperscript{167} In addition to the annual statutory audits conducted by the independent external auditors, introduction of a similar supervisory authority with respect to audits of public corporations in Turkey could be also suggested to enhance the independence of external auditors.

As a final conclusion, in view of the analysis of the provisions of the Draft TCC with regard to the statutory auditors taking also into consideration the corresponding provisions of the HGB, it has to be emphasized that even though the reform envisaged by the Draft TCC would reshape the current system of statutory auditors in the TCC in some ways, the radical approach chosen by the Draft TCC cannot work without making any constructive suggestions in connection with an additional body to be entrusted with the supervision as well as other functions of the internal statutory auditors under the current system.

\textsuperscript{167} §§ 342b et seq. HGB.
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