

# Contemporary Research in Accounting, Auditing and Finance



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Edited by

Ersin Kurnaz and Murat Serçemeli

Cambridge  
Scholars  
Publishing



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This book first published 2019

Cambridge Scholars Publishing

Lady Stephenson Library, Newcastle upon Tyne, NE6 2PA, UK

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

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ISBN (10): 1-5275-3182-1

ISBN (13): 978-1-5275-3182-6

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## PREFACE

The globalization of the world, technological advances and changing human needs have affected the business world as well as many other areas. While changes and developments have taken many years in the past, they happen very quickly today. It has also become necessary for businesses to adapt to these changes. Business management must follow developments in the areas of accounting, auditing and finance in order to be able to adapt to such developments.

The purpose of this book is to examine the current issues in accounting, auditing and finance from a scientific point of view and make various suggestions for them. In this context, the contents of the book have been created taking into account the latest developments in the field. It has also benefited from a very wide range of resources, since a comprehensive area has been selected. This feature will allow the persons concerned to benefit more from the book.

As a result of teamwork, this book is being prepared and the scientific researches on selected topics in accounting, auditing and finance are sought from expert writers in their fields. Each author has focused on issues related to their respective fields. The editors, on the other hand, have tried to form a common language and unity in order to provide integrity in the book. The responsibility for each chapter belongs to the author of that chapter. The book consists of thirteen units. This book, which includes contemporary studies in the fields of accounting, auditing and finance, will be useful for those concerned.

The Editor





# COMPARISON OF AMORTIZATION IMPLEMENTATION WITH TAS-16 AND VUK

YAKUP ASLAN

## Introduction

The concept of depreciation comes from the original Latin word for amortization, and includes the meaning of gradually killing, deformation, and a step-by-step approach to decay. Investment expenditures related to tangible fixed assets are recorded as expense by depreciation and are related to the results of the period. Therefore, depreciation calculated for property, plant and equipment affects the result of the period and plays an important role in determining profit or loss.

The ability to make different definitions for depreciation in tangible fixed assets arises from the emergence of different approaches for different purposes. These approaches can be summarized as follows (Sevilengül, 2011).

- In financial terms, it is the process of returning the capital invested in fixed assets.
- Economically, it is the process of ensuring the continuity and sustainability of the capacity.
- It is the process of incorporating cost losses into the costs in the sense of cost, the use of fixed assets used or other reasons.
- In terms of general accounting, it is the expense of depreciation of fixed assets during the time they are used.
- An activity is a process in which a registered value is destroyed within a certain period of time.
- A process distributes an appropriated expense to the relevant years.
- It is an accounting process that shows the depreciation of fixed assets in an enterprise as a result of usage-related depreciation and is the reason why the purpose of renewal is to be renewed.

Tangible assets have an important place in industry, especially in the business community. Parallel to this, depreciation of the assets in question is equally important. Because of this, depreciations should be calculated in

the most appropriate way and correctly in order to present the tangible assets in a proper way on the financial statements and to report profit or loss correctly (Uğur & Atasel, 2017). The depreciation of the tangible fixed assets is the calculation of depreciation (Gökçen, 2007).

### **Amortization in fixed assets by TAS-16**

Regardless of the general activity of the business, the tangible assets in the balance have a special precaution. Even if there is not much need to invest in tangible fixed assets in trade and service businesses, accounting transactions related to acquired fixed assets have an important place in accounting flow and reporting. The 16th Turkey Accounting Standard; the accounting of tangible assets, the determination of their book values and the depreciation amounts that should be reflected on the financial statements related to them, explain the application principles of depreciation and amortization.

According to the Standard, Tangible Fixed Assets are defined as "physical items that are held for the production or supply of goods or services, to be given to others or to be used for administrative purposes and foreseen to be used over a period of time" (TAS-16, md.6). In order for a property, plant and equipment to be activated as an asset, tangible assets must be able to measure the future economic benefits and costs of the operation reliably (TAS-16, md.7).

In the capitalization of tangible fixed assets, what constitutes a fixed asset item is not foreseen in TAS-16. Instead, it was emphasized that accounting principles should be judged in applying to operating-specific conditions. An entity accounts for all costs related to property, plant and equipment at the historical cost of those assets. These costs are incurred during the initial acquisition or construction phase of a property, plant and equipment; addition, partial renewal and maintenance. Spare parts and maintenance materials are generally monitored in stock. These are reflected in the income table when they are used. However, significant spare parts and materials that the operator expects to use over a period of time are considered as fixed assets (Gökçen, Ataman, & Çakıcı, 2011). The TAS No. 16 Standard has shown significant changes in the amortization amounts according to the legislation. The most striking change is that the scrap (residual) value of the economic asset subject to depreciation is deducted from the cost value if it is not an insignificant amount, and that all tangible assets are depreciated on a monthly basis to begin the use of the asset (Kıst Amortization Application). These and other differences can be categorized under five headings.

1. Differences in Amortization Separation Conditions;
2. Differences in Depreciation Subject to Amortization;
3. Differences in Depreciation Rate and Duration;
4. Differences in the Amortization Amount Calculation;
5. Differences in the Depreciation Method.

The concepts used in amortization applications stipulated by the standard are as follows;

- Amortization: Amortization of an asset is systematically distributed over its useful life.
- Useful Life: It refers to the expected period of use of an asset or the amount of production expected to be obtained from the related asset or a similar unit of production.
- Depreciation Amount: This represents the amount found by deducting the residual value from the cost of an asset or from other amounts that replace the cost.
- Book Value: The amount of an asset that is reflected on the financial statement after the accumulated depreciation and accumulated impairment losses are reduced.
- Residual Value of an Asset: When an asset reaches the end of its estimated useful life, it is the estimated amount that is expected to be recovered from its disposal, less the estimated costs of disposal.

According to the Standard, it is essential to deduct the residual value of the asset (residual value) from the cost while calculating the value subject to depreciation. However, if there is no residual value or if it is insignificant, it is necessary to take this value into account. Residual value must be paid regularly. Changes in the residual value are the changes in accounting estimates accounted for in accordance with TAS-8.

Various depreciation methods can be used to systematically distribute the amount of an asset subject to depreciation over its useful life. These methods are as per TAS-16:

- The Normal (Linear) Depreciation Method;
- The Amortization Method over Reduced Leaders;
- The Production Quantity Method.

The entity chooses the method that best reflects the expected consumption pattern of the future economic benefits of the entity. The selected method is applied consistently from the period unless there is a change in the expected consumption pattern of future economic benefits. The differences between the Tax Procedural Code and TAS-16 are shown in the following tables (Şen, 2011).

**Table 1-1. Differences between TAS-16 and VUK in Practice**

VUK	TAS-16
a) More than one year in operation.	a) A year in operation or excessive use from an activity period.
b) Exposure to wear, abrasion or degradation.	b) Exposure to wear, abrasion or degradation
c) The activity must be registered (inclusion of the inventory means that the economic asset is included in the inventory and is in fact registered and stored in the inventory).	c) The activity must be registered and ready for use.
d) A certain amount of the value is the economic value (900 TL for the year 2018).	d) There are no numerical limitations on the classification of an asset as a tangible asset.
e) Tangible assets held for sale may continue to be depreciated in non-current assets that are not expected to have economic benefits in the future.	e) Property, plant and equipment held for sale is depreciated in the case of assets that are not expected to have economic benefits in the future.
f) There are no arrangements for depreciation by separating or grouping items. However, valuations can be made together.	f) It is possible to separate depreciation by separating or grouping the pieces.
g) Depreciation is what you need. Taxpayers will be able to allocate depreciation if they want, but will not be able to separate the depreciation that they did not allocate in the following periods.	g) There is no such thing as depreciation. Because the standards are aimed at revealing the true situation of the intended enterprises in all aspects.

**Table 1-2. Differences in Amortization**

VUK	TAS-16
a) The value subject to depreciation is the cost of the asset.	a) Amortization is the amount after the residual value is deducted from the cost value of the asset. Exposure to wear, abrasion or degradation.
b) Depreciation is calculated over the total amount including the maturity difference since the maturity differences arising from the acquisition of the asset are included in the cost of the asset.	b) Maturity differences arising from the acquisition of assets are depreciated over non-maturity amounts because they are not included in the cost of the asset.
c) As the financing costs of the tangible fixed assets (later optional periods) have to be added to the financials, the value of depreciation includes the financing costs in each case.	c) Depreciation is charged over the cost of capital, which does not include financing costs (except for qualifying assets), since financing expenses related to obtaining an asset must not be presented as financial assets.

**Table 1-3. Depreciation Rates and Diversity**

VUK	TAS-16
<p>a) Although the amendment to the "useful life" depreciation in the VUK is the actual period, it is necessary to comply with the published economic lives.</p> <p>b) The useful life is only determined on the basis of a "year".</p> <p>c) The useful life is stable except in exceptional circumstances.</p> <p>d) The depreciation rate in the Decreased Funds Scheme is two (2) times the Normal Depreciation rate. However, this rate can never exceed 50%.</p>	<p>a) The depreciation period is determined by the useful life or production amount. The useful life of the economic asset is estimated by the business management. The choice of depreciation rates should be determined to reflect the utility of the entity in using the asset. The depreciation rates should also be changed when the asset changes its usage pattern (when the number of shifts increases, when the usage location changes).</p> <p>b) The useful life is determined on the basis of a "year" or "production unit".</p> <p>c) Estimates of the useful life and residual value must be made annually and the changes reflected.</p> <p>d) The depreciation rate in the Decreased Funds Scheme is two (2) times the Normal Depreciation rate. There are no restrictions on the application of the rate.</p>

**Table 1-4. Differences in Amortization Calculation**

VUK	TAS-16
<p>a) Steep depreciation applies only to passenger cars.</p> <p>b) Amortization will be started in the light of the receipt of the Auto Motorist and the month of receipt shall be counted.</p> <p>c) The amount of depreciation that is not allocated for the first period is added to the depreciation amount for the last year.</p>	<p>a) Depreciation applies to all tangible assets.</p> <p>b) Amortization should be started in the light of the receipt of the Passenger Car and the monthly fraction received shall be counted.</p> <p>c) The amortization amount that is not allocated for the first period is reflected by taking into account the relevant months following the period of the end of the asset's life.</p>

**Table 1-5. Differences in Depreciation Method**

VUK	TAS-16
<p>a) The methods that can be used are the Normal Depreciation Method, the Depreciation Method over Declining Leaders (Accelerated), and the Extraordinary Depreciation Method in</p>	<p>a) The methods that can be used are the Normal (Linear) Depreciation Method, the Decreasing Leader Method and the Production Amount Method.</p> <p>b) Unless there is a change in the</p>

<p>exceptional circumstances. The Production Quantity Method is not foreseen.</p> <p>b) According to the Normal Depreciation Method for a tangible fixed asset, it is not possible to switch to the Reduced Fundamentals Method after depreciation has started. However, the Normal Depreciation Method can be reversed if the Decreasing Leader Method is used.</p> <p>c) Only taxpayers who keep books according to the Balance Sheet Method can apply the Decreasing Fundamentals Method.</p>	<p>expected consumption pattern of future economic benefits, the selected depreciation method should be amended and applied consistently. If the expected consumption pattern changes, the depreciation method can also be changed.</p> <p>c) All businesses will maintain their books in accordance with TAS/TFRS and will apply the provisions stipulated by the standards when they begin to prepare their financial statements in accordance with TAS/TFRS.</p>
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## Conclusion

Amortization Practices for Businesses are very important in accordance with the notion of precaution, which is the basic concept of accountancy. In the same way, depreciation is seen as a very meaningful compensation method for the decline in the value of economic assets because the entities are working on a continuity basis.

The 16th Turkey Accounting Standard (TAS-16) discloses embodiments of tangible asset depreciation. There are differences in the application of the methods between the Standard and the existing applications, with the Amortization Amount specified, the Amortization Time and Rate, and the Amortization Methods. The most basic of these is to consider the Residual Value when the Standard Depreciation Value is determined, to adopt the Continuous Depreciation Application for all tangible assets and to use the Production Price Method in the Depreciation Calculation as a depreciation method.

On the basis of depreciation, businesses can write off more or less time depending on the method they choose, reduce/increase the cost of manufactured goods, and offset the amount of tax they will pay. The basis for doing this is to apply the most appropriate method in terms of operation. For this reason, the accounting practitioner must know all aspects of depreciation (Gökçen et al., 2011).

In the 2013 accounting period, it will be mandatory for Turkey's accounting practices to comply with Accounting Standards and Financial Reporting Standards (Law No. 6102, paragraphs 64-88). It is clear that the differences between the Standards and the Tax Legislation will cause

implementation difficulties. Harmonization of the regulations in tax legislation with the accounting standards will provide convenience both to the accounting practitioners and to the financial statement users. The basic rationale of the cost model is similar in Standard 16 and VUK. However, there are differences in the calculation of the cost. In particular, the valuation of property, plant and equipment with fair value, the recognition of impairment losses, the improvements introduced in the amortization separation and the calculation of the effects of income taxes on these situations pose some problems. These differences are because the accountants of the firms and the auditors working in the audit firms are foreign.

In general terms, some provisions in TAS-16 provide taxpayers with an advantage over the VUK. In addition to the advantage, the Standard presents an important situation for the users of the financial statement, especially in the determination of the value of the tangible fixed assets in manufacturing enterprises, the differences caused by the valuation of these assets and the fair value of the company value. From the perspective of information users, the fact that the values appearing in an enterprise's binary are not indicative of the real situation, is important in terms of decisions. The more values appearing on the balance, the more likely they are to be offset by the decisions they will make.

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# NEW BLOOD FOR PARTICIPATION BANKS: THE EVALUATION OF NEWLY ESTABLISHED STATE-BASED PARTICIPATION BANKS IN TURKEY

TUĞBA EYCEYURT BATIR

## Introduction

There is a group of people in Turkey who reject working with a bank which uses interest or performs its business with interest, as in the world. Therefore, following the establishment of the first Islamic bank “Nasser Social Bank” in 1971 in Egypt, the first Islamic bank of Turkey “Albaraka Turk” was established in 1984.

Islamic finance emerged, named as the Special Finance House (SFH) in Turkey. Soon after, Al Baraka Turk was established as the first SFH in 1984 and Kuveyt Turk followed in 1989 (Aysan, Dolgun, & Turhan, 2013; Eyceyurt Batir, Volkman, & Gungor, 2017). Following Kuveyt Turk, Bank Asya was established in 1996 and Türkiye Finans Katılım Bankası (TFKB) was established in 2005. During that time some other Islamic banks were established but they were shut down before 2005 for several reasons, so they are not included in this study.

The SFHs were all included by the Banking Regulation and Supervision Agency (BRSA), through the 5411 Banking Law in 2005. In this way they all acquired the same functions and privileges as the conventional banks and attained more importance and popularity in Turkey. Based upon the change from the 5411 Banking Law, the name “special finance house” was changed to “participation bank” (PB) in 2005 (Aysan et al., 2013).

However, participation banks have a small share in the total asset size of the banking system in Turkey, and their considerably higher growth rates indicate that they are developing and well-performing financial institutions (Eyceyurt Batir & Gungor, 2016). Participation banks increased their assets from USD 1.8 billion in 2002 to USD 28 billion in 2010, at a compound annual growth rate of 33% compared to the sector

average of 19% for the same period. They also increased their combined market share in assets from 2.1% in 2002 to 4.3% in 2010 (Bicer, 2011; Kartal & Demir, 2017).

In February 2015, the Saving Deposit Insurance Fund (SDIF) retained 63% of the management of one of the PBs, Bank Asya, then Bank Asya was completely transferred to the SDIF in May 2015 based upon some financial and political problems. The previous bad experiences in participation banking with Ihlas Finans and Bank Asya have confused the people who work or do not work with participation banks. So, the main idea of state-based banking and a state guarantee has occurred. Thus, especially the people who work with participation banks in Turkey started to think about state-based banks.

### **New blood for participation banks in Turkey**

Recently the government has continued the development of participation banks. Therefore, some regulations were done to advance the participation banking sector. Since one of the participation banks, Bank Asya, pulled out of the market in 2016, the number of PBs has decreased. Instead two new state-based participation banks got into the market. This market penetration had two favorable effects. Firstly, this penetration increased the number of participation banks. Secondly the government got involved in the participation banking system (Doğan, 2017).

The State banks of Turkey, Ziraat Bank, Vakıf Bank, and Halkbank, have applied to establish Islamic windows in their constitution and Ziraat Katılım was activated by May 2015. Then, Vakıf Katılım received an authorization approval from the BRSA in February 2016. But the establishment license of Halkbank Katılım was cancelled by the BRSA, based on Halkbank's declaration.

In addition, two banks in liquidation (Türkbank and Emlakbank) are expected to return to the stage as participation banks. The Saving Deposit Insurance Fund (SDIF) has already announced this conversion for Emlakbank (AK, 2015).

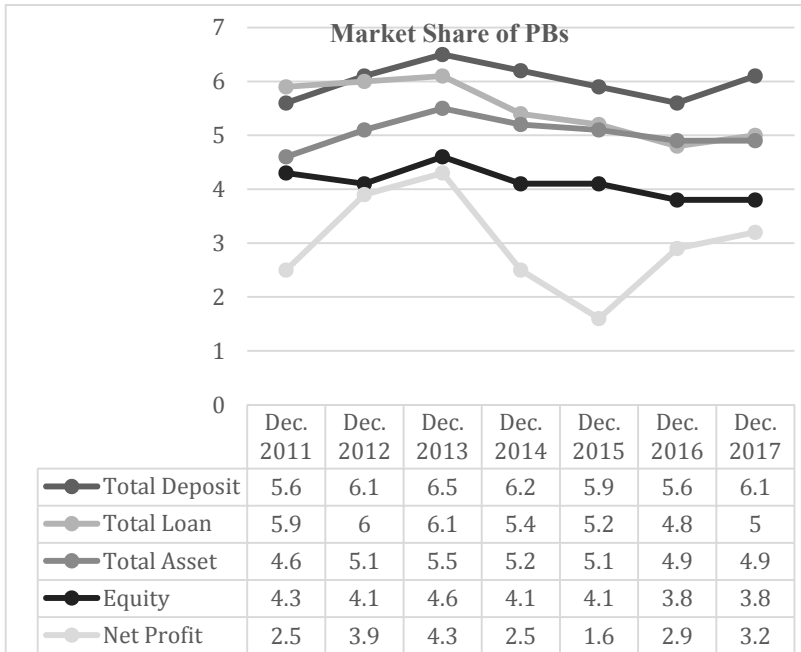
According to the chairman of the Participation Bank Association of Turkey (PBAT) and the general manager of Albaraka Turk, Meliksah UTKU, new state-owned participation banks initially got into the market in metropolitan regions but they will focus on the countryside soon, since there is big potential for participation banking in the countryside. Also, he states that the market share of PBs was stable although one of the PBs pulled out of the market, so this was already progress considering that PBs had lost an actor.

## Methodology

The banking sector is one of the most important industries since it directly effects the economy of a country. Therefore, whether or not the new attendance to the participation banking system has a positive influence on the sector is important.

The methodology used in this paper is qualitative, supported by quantitative data acquired from PBAT and the Bank Association of Turkey (BAT). Financial data and the growth rate of participation banks and the total banking sector are calculated. Considering these data, the situation of the participation banking sector is evaluated.

Currently there are three relatively older active participation banks, Albaraka Turk, Kuveyt Turk, and Turkiye Finans, and two newly launched state-based participation banks, Ziraat Katılım and Vakıf Katılım. The market share of participation banks in the total banking sector between the years 2011 and 2017 is given below.



\*Data are collected from the official PBAT website for all figures; figures are drawn by Microsoft Excel.

Figure 2-1. Market Share of PBs

Figure 2-1 shows that the total deposit, total loan, total asset, equity and net profit market share of PBs all increased until the end of 2013. Then the market share decreased in selected indicators until the end of 2016 and after that it started to increase again. It might show that after Bank Asya's termination, there was a negative effect on the market share between the years 2013 and 2016. On the other hand, the recovery of the sector and the new state-owned participation banks started to have a positive effect after 2016.

The growth rates of the selected indicators for the last five years for participation banks and total banks are given in Table 2-1. As for the participation banking sector and bank groups, it is seen in Table 2-1 that, the yearly growth rates of some selected indicators of PBs are not as high as the growth rates of the total banks' selected indicators. It might be caused by the termination of the activity of one of the PBs, Bank Asya. Following the start-up of the Ziraat Katılım Bank in 2015 and the Vakıf Katılım Bank in 2016, by the year 2017, the growth rates of PBs' selected indicators were higher than the growth rates of those of the TBs. This may be called the positive effect of newly established state-based participation banks.

**Table 2-1. Yearly Growth Rate of Participation Banks (PB) and Total Banks (TB) between 2014 and 2018**

Selected Indicators	Yearly Growth Rate (%)									
	2014 (December)		2015 (Dec)		2016 (Dec)		2017 (Dec)		2018 (April)	
	P.B.	T.B.	P.B.	T.B.	P.B.	T.B.	P.B.	T.B.	P.B.	T.B.
<b>Total deposits</b>	6,4	11,3	13,7	18,3	9,6	16,7	29,2	17,8	9	6,6
<b>Total loans</b>	3,5	17	13,7	18,3	7,2	17,2	25,7	21	8,1	7,1
<b>Total Assets</b>	8,4	15,1	15,4	18,2	10,5	15,8	20,5	19,3	7,3	5,5
<b>Equity</b>	8,6	19,7	10,7	13,1	8	14,5	18,7	19,6	8,8	6
<b>Net Profit</b>	-55,8	-24,4	-14,4	39,7	173,1	44	43,1	30,9	38,4	7,9
<b>Number of Employees</b>	-3,1	1,2	1,9	0,3	-12,6	-3	3,9	-1,2	1	0,3
<b>Number of Branches</b>	2,6	1,9	9,1	0,5	-11,2	-4,3	7,6	-1,4	0,9	-0,3

\*Data are collected from the official BRSA and PBAT websites. Growth rate is calculated according to 12 months of the previous year.

If the selected indicators are evaluated on the basis of participation banks between the years 2010 and 2017, Figure 2-5 arises.

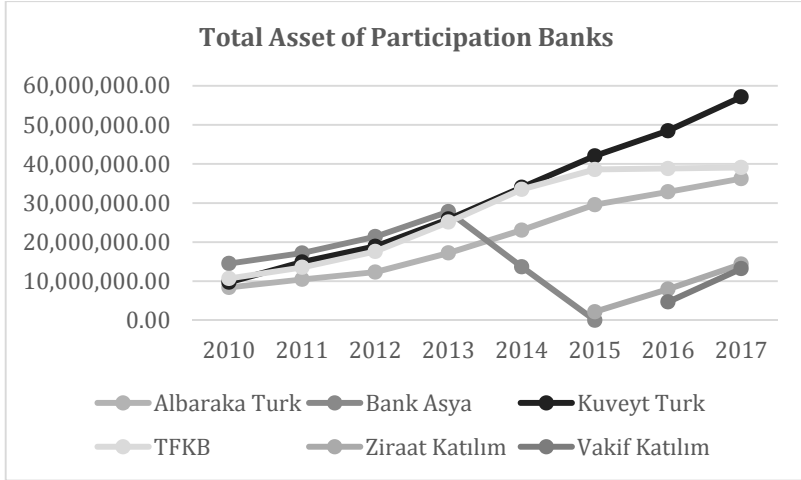


Figure 2-2. Total Assets of Participation Banks

Figure 2-2 shows that the total assets of each participation bank increased except Bank Asya. The total assets of Bank Asya went to zero point by the year 2015 after it terminated its activity. The comparatively total asset increase of state PBs seems higher than the increase of other PBs. Also, after Ziraat Katılım's establishment in 2015 and Vakıf Katılım's establishment in 2016, the increase in the total assets of other PBs shows a degressive rate in comparison with previous years. This might be caused by the two new competitors, Ziraat Katılım and Vakıf Katılım.

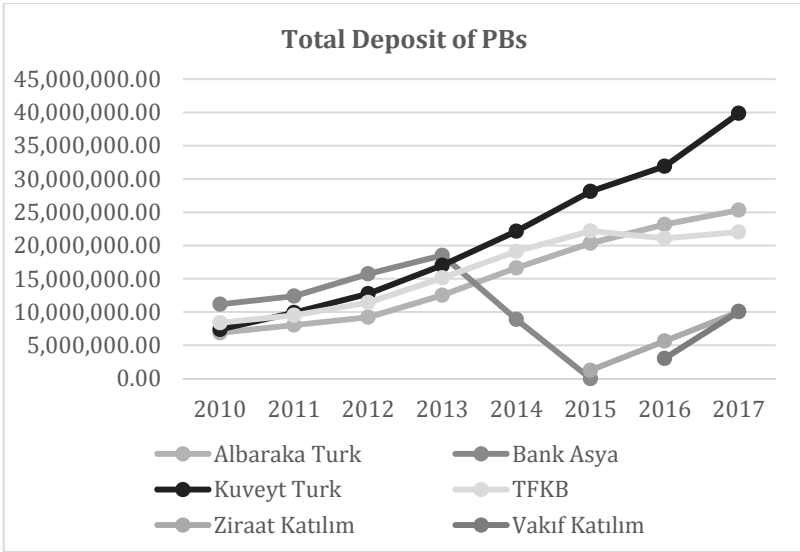


Figure 2-3. Total Deposits of Participation Banks

Figure 2-3 shows that the total deposits of PBs continually increase, except for Bank Asya since its termination. Especially Kuveyt Turk increased its deposits from about 7 million TL to almost 40 million TL in 7 years. When the new state-based PBs are examined, it is seen that the total deposits of each state-based PB reached approximately 10 million TL by the year 2017.

In parallel with the total deposits of PBs, Figure 2-4 shows that the total loans of PBs continually increase, except Bank Asya. When the total loans and total deposits are checked together, it is seen that TFKB and Ziraat Katılım make more loans available than their total deposits. In 2017, Ziraat Katılım has 11.747.000 TL in total loans while it has only 10 million TL in total deposits. Nevertheless, TFKB has 26 million TL in loans while it has 22 million in deposits. These banks may use sources other than deposits to provide loan facilities.

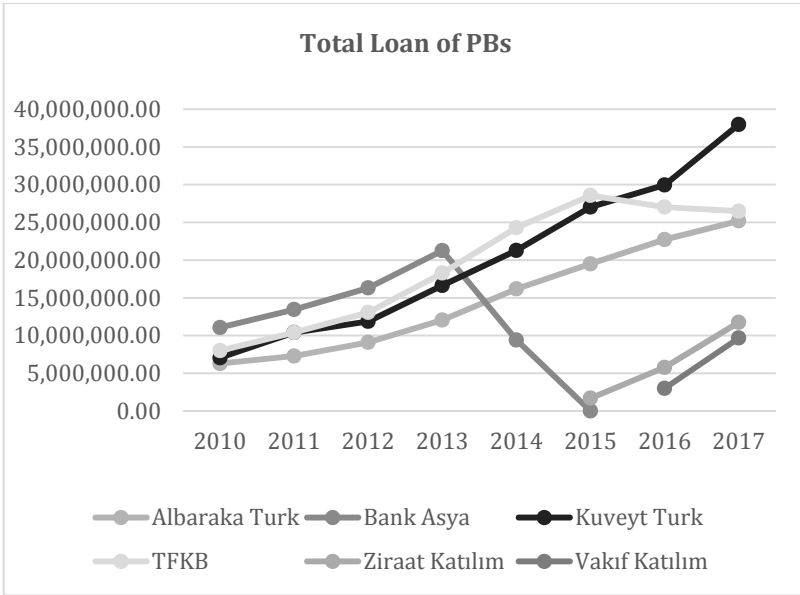


Figure 2-4. Total Loans of PBs

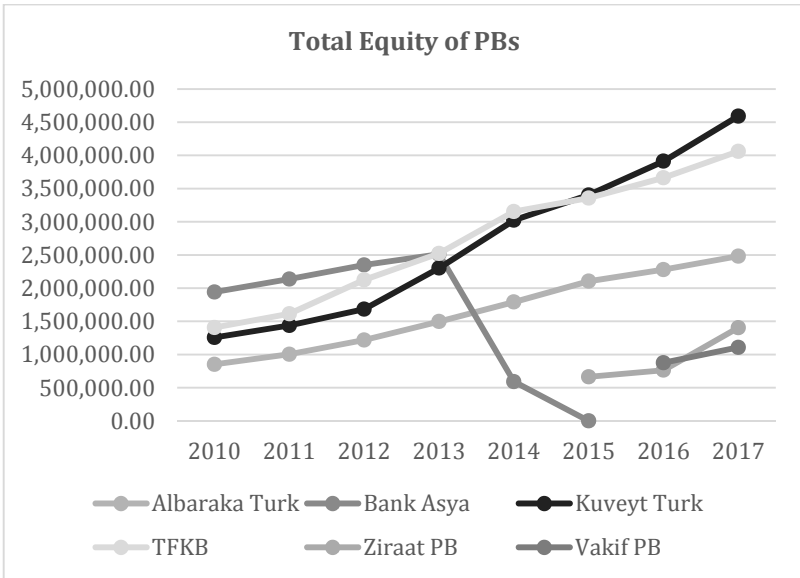


Figure 2-5. Total Equity of Participation Banks

When the total equity is evaluated there is a continuous increase in all PBs' total equity except for Bank Asya in Figure 2-5. For the last year Ziraat Katılım, Kuveyt Turk and TFKB have a high increase in total equity. Kuveyt Turk has the highest equity with approximately 4.5 million TL and TFKB follows with 4 million TL.

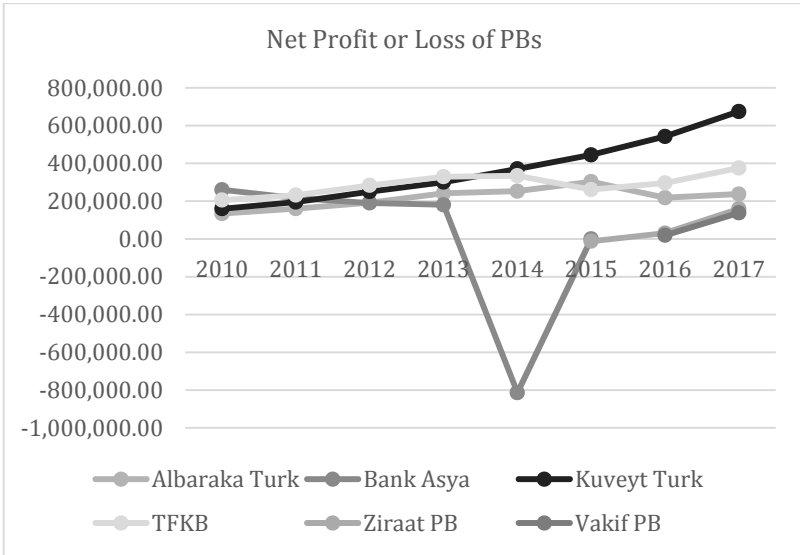


Figure 2-6. Net Profit or Loss of Participation Banks

Figure 2-6 shows that Bank Asya had a loss in 2013-2014 before being transferred to the SDIF. It is seen that, Kuveyt Turk had about 675.000 TL net profit, TFKB had about 375.000 TL net profit, and Albaraka Turk had about 237.000 TL net profit. When the profit or loss of state-based PBs are calculated, Ziraat Katılım had 158.000 TL net profit and Vakıf Katılım had 138.000 TL net profit.

## Conclusion

Although there are no precise data about the potential volume of participation banking in Turkey, it seems that participation banks will keep increasing their market share especially after the launch of new state-based participation banks. Because it is thought that there is big potential for at least relying on a more conservative depositor base and the share of the participation banking system could not reach the well-deserved status of



the total banking system. As stated by the chairman of PBAT, it is thought that if the newly launched state-based participation banks widen to rural areas, participation banks will serve more people who want to work with Sharia compliant banks.

When the selected financial indicators are examined, it is seen that especially until Bank Asya's transfer to the SDIF, financial indicators were better than the total banking sector. Besides, the market share of PBs continually increased until the transfer. After Bank Asya's termination there was a slight decrease in the market share as the PBs lost an actor. But the selected indicators of other PBs went on to increase. Especially after the recently launched state-based PBs the market share of PBs in selected indicators started to increase again. This might show the positive effect of new state-based PBs on the sector. Nevertheless, to make a brief and precise detection, we need a longer time to fully examine the financial and economic contribution of new state-based participation banks.

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# THE AUDIT RISK AND EARNINGS MANAGEMENT RELATIONSHIP

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## **Introduction**

Recent financial crises are important in that they highlight the current complicated nature of the global financial system and they have created new questions to be answered by researchers and new fields of interaction that need to be investigated. The increasing international activities of enterprises and international financial integration have increased the severity and impact areas of financial crises. The impacts of company scandals on capital markets have once again revealed the importance of the independent audit for the efficient operation of markets. The quality of financial integration is certainly one of the most important main inputs of financial information in terms of the global financial system. The earning quality of enterprises is a significant part of financial information in terms of domestic and foreign markets. Independent audit activities satisfy an important need of the financial system by ensuring the accurate conveyance of earning quality to financial statement users. Earning management activities are an important problem on which auditors must put excessive emphasis. The flexibility provided for users by the financial reporting framework makes the extent of fraudulent financial reporting controversial. It is important for auditors to clarify this gray zone so that the audit quality can be increased. Increasing the effect of audit activities is closely related to improving the quality of financial information. The interaction between the financial information quality, earnings quality, earnings management and audit risk in terms of improving the financial reporting culture is important for the operation of the financial system.

## **Financial information quality**

As an accounting function, financial information is quantitative related to the financial status of an enterprise produced by the accounting

information system regarding internal and external stakeholders and the qualitative output of activities that can be expressed in money performed with the aim of realizing the objectives of the enterprise. Financial information is a two-dimensional definition as an input of the audit process. Fundamental qualitative features constituting the first dimension point out that the most important characteristic of financial information is to help decision-making. In this sense, relevance – understandability, comparability – consistency and reliability – and faithful representation determine the quality of financial information (FASB 2, 1980: 13). These characteristics that must be possessed by financial information constitute a conceptual framework in order to minimize information asymmetry. Enhancing qualitative characteristics constituting the second dimension represent common limitations regarding faithful and reliable financial information. Financial information is shaped within the framework of accounting standards and presented to relevant people through financial statements and reports. Accounting standards are the body of rules based on generally accepted accounting principles (GAAP), determining accounting standards, recording values and procedures of transactions, classification and the reporting of such transactions with the aim of creating application integrity. Accounting standards can mislead users of financial statements as they have a flexible nature in terms of practicality aimed at adapting to the different natures of enterprises. This flexibility in accounting standards is mostly created in connection with realization time and accrual concepts. Financial information manipulations that are aimed at deliberately affecting the differences between enterprises that need to be emphasized in terms of the relevant stakeholders in order to increase the stock values of the enterprise and affect the income transfer between the enterprise and funders (Stolowy and Breton, 2000; Kirschenheiter and Melumat, 2002; Stolowy and Breton, 2004) are attempts to benefit from this flexibility mostly by deviating from the principle of substance over form. Financial information manipulations, which can be summarized as an attempt to manage the risk perceptions of stakeholders about the enterprise through various accounting procedures in order to show the financial status of the enterprise differently from the actual state, are a result of using the financial communication between the enterprise and its stakeholders as a perception management process. A review of the academic literature reveals that there is no commonly agreed definition of financial information manipulation and classifications have been made through various relationships such as objectives and achievements. Stolowy and Breton (2004: 7) state that financial information manipulations can be performed in favor of (in order to minimize costs

related to legal regulations and capital costs) and against (as executives want to maximize their wages) the enterprise. Mulford and Comiskey (2002: 4) point out that financial information manipulations have four objectives relating to stock values (high stock and option values, low volatility and equity capital costs), the cost of borrowing (improving credibility, increasing the level of debt, and making the enterprise more flexible with lower costs of borrowing), executive wages (executives want to increase their wages due to wage systems based on profit) and political costs (to avoid various legal regulations). Cox and Weisich (2002) state that 70 per cent of the financial information manipulation discovered during the audits performed in the USA involved premature revenue recognition, transition among fiscal periods and fictitious revenue recognition. The power to create income is the ability of an enterprise to make profit in the current and future periods based on its activities. The market value of the enterprise reflects all of the income creation powers of the enterprise's assets. The impression management of relevant stakeholders in connection with the enterprise's power to create income is possible with various methods of financial information manipulation such as earnings management, income smoothing, big bath accounting, creative accounting practices, aggressive accounting, fraudulent financial reporting and window dressing, etc. Earnings management is the manipulation of stakeholders by the enterprise management by announcing wrong or incomplete accounting data or not announcing data at all in order to affect the decisions of the relevant stakeholders about the earning projections of the enterprise.

### **Earnings quality**

Earnings quality is a factor that is free of accounting anomalies, aims to make higher profits with lower costs, reveals the actual earning power of the enterprise, represents the characteristics of the earning creation process and affects the efficiency of capital markets. Earnings quality is an important component of the financial reporting system as an indicator of the level at which an enterprise creates values. A lot of researchers have come up with different definitions taking different points of view towards earnings quality. Lev (1989) defines earnings quality as a decision related to stock price valuation decisions or practicality while Dodd and Graham (1934) explain it as a coefficient reflecting the characteristics of a firm as well as macro factors. Schipper and Vincent (2003: 98) see earnings quality as the consistency between a criterion or explanation and what it represents with reference to FASB (FASB Concepts Statement No. 2,

para. 63) while Balsam et al. (2003: 74) point out that earnings quality is a concept that cannot be observed but addressed with various criteria such as the earnings reaction coefficient. Richardson (2003) states that the key criterion in the measurement of earnings quality is deviation of the net income from cash flow while Bellovary et al. (2005) point out that it is the power of reported earnings that reflects the enterprise's earnings correctly and also makes it possible to predict the future earnings of the enterprise. FASB (1998) defined earnings quality as the usefulness and practicality of the current earnings of an enterprise while investors predict future earnings of the enterprise (SFAS No. 132, para. 26). Dechow and Schrand (2010: 168) listed the factors affecting earnings quality as financial reporting practices, characteristics of the governance-management board, the management property, size and performance of the enterprise, political processes, regulations, country-level institutional factors, audit companies, auditor characteristics, non-audit fees, and the public offering. Yel (2009) collected factors affecting earnings quality under seven titles. These are persistence, predictability, stability, relevance, reliability, accrual quality and earnings management. Persistence represents continuity of earnings of the enterprise in years. Schipper and Vincent (2003) state that persistent earnings and sustainable earnings are equal in this context. Predictability is the usefulness of earning components in a way that it increases the prediction abilities of financial statement users in matters in which they are interested (FASB, 1998). Stability is the fact that enterprise earnings do not perform with relatively high volatility in years. Giroux (2004) states that accrual practice supports stability while Bao and Bao (2004) suggest that earnings variability must be lower than sales variability. Earnings reliability means that earned amounts include a relatively large number of predictions and estimations, thus making them mostly free of fault and highly provable. Dechow and Dichev (2002) state that abnormal accruals and errors of estimation regarding accruals affect earnings reliability and therefore earnings quality negatively. Relevance means that earnings are reliable in terms of valuation. Accrual quality is the capability of accruals to transform into cash flow as an earning component (Francis et al., 2006). Earnings management is a deliberate intervention in the financial reporting system aimed at deriving benefits (Schipper, 1989).

### **Earnings management**

Earnings management practices certainly cause significant deformations in the earnings quality and financial reporting culture of an enterprise and it is mostly controversial whether such practices are fraudulent financial