THE ROLE OF MODERN INTERNAL AUDITING AND CORPORATE GOVERNANCE IN TURKEY:*

A SOUND COMPARISON WITH THE GLOBAL INTERNAL AUDITING STANDARDS AND A BENCHMARK ANALYSIS ON COMPANIES WITH CORPORATE GOVERNANCE RATING SCORES THAT LISTED IN ISTANBUL STOCK EXCHANGE CORPORATE GOVERNANCE INDEX (CGI) **

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ABSTRACT

Corporate governance index (CGI) is a quite new concept in Turkey. As a promising emerging country and a candidate for EU accession, Turkey needs both structural changes and an ongoing development and harmonization of its capital market legislation. Hence, the use of corporate governance (CG) framework and the modern internal auditing techniques could enable Turkey not only to manage its own risks better but also to increase the market's confidence in its commitment to sound fiscal and monetary policies.

In this paper, we analyze the listed companies' corporate governance and internal auditing performance metrics which

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* Bu çalışmanın verilerini paylaşmak istemiyorum.

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have gained the relevant rating scores based on the Corporate Governance Principals of Turkey. This rating reflects a good overall performance of the company regarding its current

corporate governance structures as measured against the Principles of the Turkish Capital Markets Board (CMB). In this way, we aim to increase the awareness on the importance of corporate governance framework, CG issues and the benefits of relying on modern internal auditing techniques to achieve strategic goals for Turkish companies in the future. We also intend to contribute the improvement in these fields of work.

Corporate governance index (CGI) is a quite new concept in Turkey and unfortunately the number of companies at GCI is surprisingly low as compared to the number of listed companies at Istanbul Stock Exchange (ISE), i.e. 319. There are only 18 listed companies accepted to this index. For this reason, we could not apply any econometric analysis with such a limited number of samples in our hands rather; we could only be able to use descriptive analysis.

But, to our knowledge, this is the first study using the data of the companies listed in Istanbul Stock Exchange Corporate Governance Index (CGI) in Turkey in connection with the related variables. Due to data constraints we prefer the non-financial companies which have corporate governance ratings to make a sound comparison with the Institute of Internal Auditors (IIA) standards and international benchmarking for Turkey.

We use the listed company data which is publicly available and make a benchmark analysis internationally as the methodology by comparing the results with the IIA Standards and Corporate Governance Principals. Based on the findings, we make some relevant policy recommendations for future developments in Turkey.

Key Words: Corporate Governance Index, Modern Internal Auditing, Audit Committee, Corporate Governance Committee, CGI

JEL Classification: G34. M42

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MODERN İÇ DENETİM VE KURUMSAL YÖNETİMİN TÜRKİYE'DEKİ ROLÜ: ULUSLARARASI İÇ DENETİM STANDARTLARIYLA KIYASLAMA IŞIĞINDA İMKB KURUMSAL YÖNETİM ENDEKSİNDEKİ KURUMSAL YÖNETİM DERECELENDİRME NOTU OLAN ŞİRKETLERE YÖNELİK BİR BENCHMARK ANALİZİ

ÖZET

Kurumsal yönetim endeksi (CGI) Türkiye için çok yeni bir kavramdır. Gelişmekte olan ve AB üyeliğine aday bir ülke konumundaki Türkiye, yapısal değişikliklerle birlikte sermaye piyasaları mevzuatını yeknesaklaştırma ve geliştirme ihtiyacı içerisindedir. Bu sebeple, kurumsal yönetim çerçevesi ile modern denetim tekniklerinin kullanılması, Türkiye'nin kendi durumuna ait risklerini yönetebilmesini mümkün kılmanın ötesinde, piyasaların mali ve parasal politikalara uyumluluğunu da artırıcı etkide bulunacaktır.

Bu çalışmada, İMKB kurumsal yönetim endeksine kote şirketlerin Türkiye Kurumsal Yönetim İlkeleri'ne uygunluk derecelerine göre elde edilen kurumsal yönetim ve iç denetim performans ölçümleri analiz edilmektedir. Bu derecelendirme, şirketlerin halihazır kurumsal yönetim yapısının Sermaye Piyasaları Kurulu (SPK) ilkelerine uyumluluk performansını göstermektedir. Ayrıca çalışmada, ülkemizdeki şirketlerin stratejik hedeflerine ulaşmasını mümkün kılacak kurumsal yönetim çerçevesinin önemine ve modern iç denetim teknikleri uygulamanın yararlarına dikkat çekilmesi de amaçlanmıştır.

Kurumsal yönetim endeksi'nin (CGI) Türkiye için çok yeni bir kavram olması dolayısıyla, bu endekse dahil şirket sayısı İMKB'de işlem gören şirket sayısına oranla çok düşük kalmaktadır (319 şirketten 18'i bu endekse kabul edilmiştir.). Şirket sayısındaki azlığın örneklemi kısıtlamasından ötürü ekonometrik analiz

uygulanamamış, bu nedenle deskriptif bir analiz yöntemi tercih edilmiştir.

Ancak çalışma, bilebildiğimiz kadarıyla, bütünsel ve içerik açısından ülkemizde mevcut ilgili veriler ve değişkenler üzerinden İstanbul Menkul Kıymetler Borsası Kurumsal Yönetim Endeksi'ne dahil şirket verilerini bu kapsamda analiz eden ilk çalışmadır. Bilgi kısıtı sebebiyle, kurumsal yönetim derecelendirmesine sahip mali sektör dışı şirket verileri; Uluslararası İç Denetim Standartları ve uluslararası bir karşılaştırmaya konu edilmiştir. İMKB Kurumsal Yönetim Endeksine kote şirketlerin halka açıklanan bilgileri, IIA standartları ve Kurumsal Yönetim İlkeleri'ne göre uluslararası kıyaslamaya tabi tutulmuştur. Elde edilen sonuçlar ışığında, Türkiye'de yaşanabilecek gelişmelere yönelik politika önerilerinde bulunulmuştur.

Anahtar Kelimeler: Kurumsal Yönetim Endeksi, Modern İç Denetim, Denetim Komitesi, Kurumsal Yönetim Komitesi

JEL sınıflandırması: G34, M42

1. INTRODUCTION

Traditionally, corporate governance is defined as the management of an organization in the best interest of its shareholders (Tricker 1994). The OECD principles have expanded the definition to include other stakeholders including employees, creditors, and suppliers (OECD 1999). In April 1999, the OECD issued its "Principles of Corporate Governance", developed by its Ad-Hoc Task Force on Corporate Governance. While these are specifically a "set of non-binding principles," they are presented in the words of the preamble, as "a common basis that OECD Member countries consider essential for the development of good governance practice."(OECD Principles of Corporate Governance 1999, 2). These principles bring a multinational perspective to the principles and practices of corporate governance, which had previously resided within individual state historical, legal, social and cultural contexts.

Today, we are all connected through a vast, automated worldwide web of telecommunications and the Internet. In addition to corporate governance implementation, the increasing complexity of modern business and other organizations has created the need for a specialist in various business controls: the internal auditor. Hence we can better understand the nature of internal auditing today if we know something about the changing conditions in the past and the different needs these changes created all over the world. Over time, the operations of various organizations increased in volume and complexity, creating managerial problems and new pressures on senior management. In response to these pressures, management recognized the possibilities for better utilization of their internal auditors.

There were individuals already set up in an audit function, and there seemed to be every good reason for getting greater value from these individuals with relatively little increase in cost. An early internal auditor often was viewed as a "financially oriented checker of records" and more of a "police officer" than a coworker. Understanding the history of internal auditing is important because this old image still persists, to some extent, for today's modern internal auditors. This is so even though the character of the internal auditing function is now very different. Because internal auditing was initially largely accounting-oriented, this upward trend was felt first in the accounting and financial-control areas. Rather than just report the same accounting-related exceptions -such as some documentation lacking a supervisor's initials- internal auditors began to question the overall control processes they were reviewing.

Subsequently, internal audit valuation work began to be extended to include many non financial areas in the organization. At the same time, internal auditors perceived these opportunities and initiated new types of services themselves. Thus, internal auditors gradually took on broader and more management-oriented responsibilities in their work efforts.

New business initiatives, such as the COSO (Committee of Sponsoring Organizations) internal control framework, "Internal Controls Fundamentals: COSO Framework," or the Sarbanes-Oxley Act (SOA) have caused a continuing increase in the need for the services of internal auditors. In addition, some newer environmental forces have created needs in such areas as protection from industrial hazards, support of quality-control programs, and different levels of business responsibility, including ethical standards. This need for ethical standards includes higher standards for corporate governance, greater involvement of boards of directors and their audit committees, a more active role for stockholders and a changed role for the outside public accountants.

2. LITERATURE REVIEW

Corporate governance issues have received attention from several high-profile commissions, including the Treadway Commission of 1987 in the U.S., the Macdonald Commission of 1988 in Canada, and the Cadbury Commission of 1992 in the U.K. These reports, following earlier scandals, focused on the financial reporting and internal controls aspects of corporate governance more than the practices of the Board of Directors.

However, when the managers are not the owners, agency problem may drag company performance in as much as the managers as the decision makers are not the residual claimants of wealth. As such, these managers may have a tendency to act in their own interests and not of those of the shareholders (Fama and

Jensen 1983). To mitigate such agency problems, it is suggested (Fama and Jensen 1983) that control (ratifying and monitoring) of decisions be separated from its management (initiation and implementation).

Thus modern corporations have board of directors, representing the shareholders, whose main role is to provide the necessary checks and balances. Following poor organizational performance that was characteristic of the 1980s, the 1990s saw more board involvement. In addition, several reforms were initiated including the separation of the positions of CEO and chairman of the board. Critiques claim that the separation of the positions of the CEO and the chairman of the board compromises the authority of the CEO and dampens the entrepreneurial spirit that is so needed for companies to turnaround (Collis and Montgomery, 1998).

The literature on corporate governance has focused on board structures, board composition, CEO duality, board actions, etc. (Beatty and Zajac 1994; Conyon and Peck 1998; Finkelstein and D'Aveni 1994; Johnson, Hoskisson and Hitt 1993; Kosnik 1990; Westphal 1998; Zajac and Westphal 1996). On the other hand, the literature on risk management and internal auditing has focused on assessing risk, and providing structure to manage risk (Liebenberg and Hoyt 2003; Dowd 1999). There have been studies that look into the link between risk management and corporate governance (Kleffner, Lee and McGannon 2003; Bedard and Johnstone 2004; Beasley 1996), and some discussions on the link between risk management and human resource factors (Le and Kleiner 2000; Wang and Kleiner 2000). People are a source of risk but at the same time necessary in managing risk (Erven 2003).

There is a human component in every business activity and decision making. It is important that the right people are selected, trained, and rewarded so that they perform their jobs properly and are also able to take steps in handling the risks within their areas of responsibility.

However, it is argued here that even as governance, internal auditing and risk management structures are in place at the board level, there needs to be a strong link between the board structure and actions, and the implementation of board decisions at the operational level. Because human resources are at the heart of implementing strategies, the internal audit function should play a key role in implementing such strategies. It is argued here that a closer integration among corporate governance, risk management, and internal auditing increases an organization's performance. It is recognized that modern internal auditing function has not received as much attention at the board level as it should (PyneandMcDonald 2001).

However, this trend is gradually changing as companies witness the collapse of good governance and risk management in some leading companies. The operational risk factor has increasingly become a major concern of corporate boards. One of the biggest operational risks is with effective internal control activities related to the key personnel at work process levels (Lee 2000). Choosing the right type of control activity is important in reducing such risks as theft, fraud, embezzlement, pilferage, sabotage, and workplace violence (Wang and Kleiner 2000). Such potential problems further underscore the importance of exercising reasonable care in pre- and post-control monitoring practices.

While risk preferences differ among organizations, the introduction of risk management committee at the board level emphasizes the importance of managing risk. Even as the CEO initiates and implements corporate strategy, there is still need for a board to review risk assessment and management. Proponents of this practice argue that because managers cannot diversify employment risk, mechanisms that reduce risk may be pursued, which may not be in the best interest of the shareholders (Collis and Montgomery 1998).

Alijoyo (2002) concludes that a company cannot achieve good corporate governance without installing an effective internal auditing and risk management system. Such a task requires the judicious action of a board that is both independent, and competent in internal auditing and risk management tools and methodologies.

Internal auditing today involves a broad spectrum of types of operational and financial activity and levels of coverage. In organizations today, internal auditing has moved beyond being a staff activity roughly tied to the internal controller's organization, although internal audit's role is constantly being redefined. Today, modern internal auditors have expanded their activities to all operational areas of the organization and have established themselves as valued and respected parts of the senior management effort. With renewed emphasis from SOA, the modern internal auditor today is formally and actively serving the board of director's audit committee. While internal audit organizations once had an almost nonexistent, dotted line reporting relationship to their audit committee- with little direct communication-the chief audit executive (CAE) today has direct and active level of communication with that same audit committee.

This overall situation reflects major progress in the scope of internal audit's coverage and level of service to all areas of the organization. The internal auditing profession itself, through its own self development and dedication, has contributed to this progress and has set the stage for a continuing upward trend.

A significant step in organizing an effective internal audit function is to obtain authorization and approval by the organization's audit committee of the board of directors. The audit committee provides this broad authorization for an internal audit function through a formal audit charter document. An audit committee also approves internal audit's overall plans for continuing activities through the current period and beyond.

As one of the several operating committees established by the board, the audit committee has a rather unique role compared to other board committees. It consists of only outside directors-giving it independence from management- and should be composed of a specially qualified group of outside directors who understand, monitor, coordinate, and interpret the internal control and related financial activities for the entire board.

3. DOES GOOD-GOVERNANCE= GOOD CORPORATE PERFORMANCE?

A survey of Canadian companies, Allaire and Firsirotu (2003), found that the 25 Canadian companies with the best governance scores performed more poorly than the 25 companies with the worst governance scores. Sonnenfeld (2002) points out that both good and bad companies have adopted the "right" corporate governance practices and many good companies have not. Following good-governance practices does not automatically produce good boards or good corporate performance.

A comparative study of the U.S.A., U.K. and the Netherlands listed companies also found weak correlations but did point out that there is an over-focus in the extant literature on measuring the financial dimensions of company performance (Maassen 1999).

Finally, in Australia, Kiel (2002) studied the top 348 companies listed on the ASX and found few connections between board size, and composition and company performance. Rather, he identified human capital factors especially board members' mix of skills and knowledge as being important for companies' success.

This growing body of evidence suggests that although sound board structures and process are important, they are not by or of themselves sufficient to ensure enhanced corporate performance. This is complicated further when one considers the organisational and individual "cultural" mindset in relation to decision-making that is prevalent amongst the majority of senior executive echelons in both the private and public sectors.

Corporate boards of directors meet behind closed doors. Therefore, it is usually impossible to observe board behaviors and practices directly (Leblanc 2001).

As Leighton and Thain (1997) state, "the board of directors remains a kind of 'black box,' whose internal workings can only be surmised from public information about decisions announced and actions taken." It is a fact that many of the largest corporations are family controlled and there is very little distinction made between ownership and management (La porta, Lopez-de-Silanes, ShleiferandVishny 1998a; La Porta, Lopez-de-Silanes, Shleifer and Vishny 1998b; La Porta, Lopez-de-Silanes and Shleifer 1999). Despite popular perception, Demestz (1983) and La Porta et al. (1998a, b, 1999) also found that concentration of ownership and control exists in western developed countries, including among the largest American corporations. Similar trends are discerned even in Turkey.

4. CORPORATE GOVERNANCE AND MODERN INTERNAL AUDITING APPROACH IN TURKEY

In the ground of corporate governance, the Turkish Capital Markets Board (CMB) issued the corporate governance principles in July 2003 and updated them in February 2005 in order to reveal the changes made to the OECD Principles in November 2004.

These Principles are primarily based on the idea of equality, transparency, accountability and responsibility. While they are normally modeled on the Corporate Governance Principles of the OECD, they also take into concern the particular needs of Turkish company structures and Turkish company law and practice. These Principles are valid on a "comply-or-explain" base and include detailed guidelines on the rights of shareholders, public disclosure and transparency, stakeholders and the board of directors.

Listed companies are under a compulsion to issue an annual corporate governance compliance report showing the extent of their compliance with the Principles and explaining the reasons if any deviation exists. The board of directors and the company can be held liable by investors for deceiving them with wrong or misleading information that is contained in the report. As for the tangible implementation of the Principles, surveys show that there is still room for improvement and that additional time is needed for full application in Turkey.

The Istanbul Stock Exchange (ISE) does not contain the CMB Principles in its listing requirements. However, the CMB and the ISE had joined efforts to set up a Corporate Governance Index, whereby companies can be rated according to their compliance with the CMB Principles and be included in this Index if they exceed a certain rating threshold. This Index is expected to perform as a motivation for better governance in companies, as the value of shares of companies included in the Index are expected to be relatively higher than others.

CMB has issued a decision to the effect that, starting from the 2004 financial year, each listed company must annually issue a corporate governance compliance report, according to the fundamental format set by the CMB and with the minimum content required therein. In this report, CMB requests that each company must explain not only the extent to which it complies with the Principles but also its reasons for any deviations or non-implementation. The corporate governance compliance report must be provided in a different or additional section in the company's annual report and announced on the company's website as well.

Despite these new legislative initiatives in Turkey, most features of corporate governance stay free from strict regulation. The existing Corporate Governance guidelines are voluntary, meaning companies can choose whether or not to comply. However, in the absence of formal regulatory and monitoring mechanisms for corporate governance, neither the Turkish Capital

Markets Board (CMB) nor any others can actually recognize the extent of a company's compliance with voluntary guidelines. The trouble comes from the unobservability of board practices and the problems of interpreting the board disclosures.

Similar to the corporate governance framework, the modern internal auditing is relatively new concept for Turkish companies except the multinationals which are influenced by their headquarters abroad. In today's business environment in Turkey, internal audit (IA) functions are responding to new challenges, changes and expectations. However compared to the other countries, the speed of response is not very fast in Turkey. One of the reasons for this situation is that there is no obligation for companies to establish an internal audit function in the Turkish Commercial Law. Another reason is that most of the companies in Turkey are owned by families and they are not willing to share their power with an independent body in their own properties, i.e. companies.

On the other hand, the internal auditors are highly motivated to contribute greater value as a key element of their organizations' corporate governance framework. If they are given the chance to show their working capacity, the result will be that IA will emerge as an independent, objective assurance and consulting activity designed to add value and improve operations in an organization. Effective IA functions assist financial and operational services of companies to achieve key business objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of corporate governance, risk management and internal control processes.

The primary step is that internal auditor should make a concentrated effort to explain its processes and procedures to the audit committee, the overall board, and to senior management with an highlighting on IIA's internal audit requirements. Once this board presentation is launched, it should turn out to be part of the annual internal audit planning process with ongoing changes being reported.

However, even before launching any such presentation, internal audit should go through its own processes and execute what might be called a "health check" to assess current internal audit practices. This might point to areas where there is room for improvement. The suggestion here is that internal audit should go through a quick self-assessment process, asking itself how it is doing at present and what it should do to improve, and then make improvements as required for the future.

Once internal audit has gone through such a quick self-assessment exercise, audit processes and ongoing activities should be presented to the audit committee as well the overall board and management. The idea is make certain that all parties are aware of internal audit's processes as well as ongoing issues.

The corporate audit committee has the most important responsibility for the corporation's internal audit function. Prior to SOA, this had often been more than a theoretical perception where internal audit reported to the audit committee "on paper" but effectively reported to the CFO or some other senior corporate management. It is accepted that the modern internal audit function today should have a very active relationship with the organization's audit committee.

5. DATA AND METHODOLOGY

In this paper, we try to analyze the current corporate governance implementations and the level of compliance to the Corporate Governance Principals regarding the responsibilities of Board of Directors, Audit Committees and the impact on the modern internal auditing functions in Turkey. Due to data constraints we prefer the non-financial companies which have corporate governance ratings to make a sound comparison with the IIA standards and international benchmarking for Turkey.

Corporate governance index (CGI) is quite new concept in Turkey and there are only 18 listed companies accepted to this index. This rating reflects a good overall performance of the company regarding its current corporate governance structures as measured against the Principles of the Turkish Capital Markets Board (CMB). The rating criteria of CGI are summarized at the Appendix 1.

If we consider the number of listed companies at Istanbul Stock Exchange (ISE), i.e. 319, unfortunately the number of companies at GCI is surprisingly low. For this reason, we could not apply any econometric analysis with such a limited number of samples in our hands rather; we could only be able to use descriptive analysis. However, this may be a contribution to increase the awareness of corporate governance issues in Turkey and also the importance of internal audit functions to achieve strategic goals for Turkish companies in the future.

6. DESCRIPTIVE FINDINGS

We use the non-financial company data listed at the CGI in Turkey. The ratings of these companies are shown in detail at Appendix 2. The company profiles of these non-financial companies are listed at Table 1. These companies are mostly located in Istanbul and also %41 of them has foreign shareholders. This may be a motivation to these companies to get a GCI rating earlier than other companies to satisfy their foreign shareholders' expectations. The compositions of Board of Directors are shown at Table 2.

Based on the Board Compositions, all of these companies are sensitive to the independence criteria and also most of the board members are non-executives. The CMB Principles summarize the major rules that regulate the independence of board members, in this manner also indicating that the board should be composed of at least 2 independent members and/or to at least one third. All of the companies fulfill this rule.

In addition, the CEO and General Manager of the companies is not the same person in none of the companies. The number of Board Committees is given at Table 3. All of the companies have well established Audit Committees. However, other Board Committees are not fully operating. Particularly, none of the companies have Risk Committees at all. Corporate Governance Committees exist at half (%50) of the companies. Hence, there is a room for improvement for companies to increase the effectiveness of Board Committees in Turkey.

The Audit and Corporate Governance Committees' organization and member profile is shown at Table 4 and 5 respectively. Most of the head of Audit Committees and Corporate Governance Committees are not independent. It is one of the tasks of the Audit Committee to ensure that all internal and external audit activities are carried out sufficiently and clearly. Audit Committee advises the Board of Directors in appointing the external audit company and attends this selection process. This also includes a statement on the independence of the audit company. The Audit Committee should analyze the effectiveness and adequacy of the internal control system and the risk management system. It is also responsible for ensuring that measures are taken such that internal controls are transparent in the organization.

Besides, the Audit Committee is responsible for the company's financial disclosure. Internally, the Audit Committee is also responsible for evaluating the internal audit system. There is a sample of Internal Audit (I/A) Processes Performance Metrics Checklist for the Board Committees to monitor the compliance of international standards at Appendix 3.

The major responsibilities of the Corporate Governance Committee are to determine the compliance with CG principles, to develop recommendations on the appointments, structure and effectiveness of the Board of Directors, and to work towards the adoption of a regulation on conflicts of interest.

7. CONCLUSION

Corporate governance is all about who controls corporations and why. In addition, 'Good' governance is now considered as the key to ensuring ethical conduct and socially responsible behavior. Milton Friedman (1988), in defining corporate governance as the conduct of business in accordance with owner or shareholders' desires (usually to show the highest financial returns possible), required that organizations at the same time conform to the basic rules of society as embodied in law and local customs.

The suggestion that there is only one approach to corporate governance is clearly not acceptable. It is suggested that corporate governance is ambiguous, controversial and evolutionary. It is also argued that the 'one size fits all' approach is not sustainable – various disciplines emphasize and privilege different insights and lead to varying analytical insights.

Moreover, different legal systems, business cultures and corporate structures further complicate the picture (Whitley, 1999; Albert 1993). Hence, in such a corporate governance framework, Turkish companies are not exception to this situation. It is a fact that corporate governance is necessary and must be in the agenda of Turkish companies to be competitive and efficient in their operations. On the other hand, the companies in Turkey are mostly small and medium sized (SMEs) and family owned. The governance structures and the performance of the family companies affect the growth opportunities of the Turkish capital market.

There are many weaknesses that may threaten family companies and SMEs in Turkey: the major weaknesses can be summarized not having appropriate risk management systems; not following appropriate norms of company board structure and management (e.g. directors' independence, board committees' establishment, CFO position); lacking corporate governance commitment.

On the other hand, there are some family companies or SMEs that are successful in having good governance practices (e.g. recruit competent and independent board members, employ professional managers on influential positions, and develop internal corporate governance guidelines). Corporate governance structures can put in place strategic decision-making and monitoring procedures, as well as hiring non-family members on influential positions (Zafft 2003).

Modern internal auditing is not widely implemented in Turkish companies since most of them are family companies or SMEs as explained above. This situation is a drawback for them and unfortunately most of them do not have internal audit department or even a single internal auditor staff employed in their organization. The relevant literature on the theory of the internal auditing and corporate governance framework advise that a company's board of directors is an important factor in mitigating the agency problem that arises with absentee ownership.

Considering the recent financial crisis in the world, a number of large corporate failures on the part of management have called board effectiveness into question. Their true economic role is one of decision control, not narrowly defined in the sense preventing dysfunctional management behavior, but in the sense of ensuring that management considers the correct issues and opportunities, and that the company takes appropriate risks.

In other words, boards should ensure that management presents the company with an opportunity set of activities that is as rich as possible. In this sense, the convergence of ideas from senior management and external directors at the board level is a creative process. The board can therefore be thought of as a team of individuals responsible for developing and selecting creative ideas for the advancement of the company. In this respect, we expect that the new Turkish Commercial Code may be a motivation to achieve these targets for the companies in Turkey.

TABLE 1: THE LIST OF NON-FINANCIAL COMPANIES AT GORPORATE GOVERNANCE INDEX

Company Name	Industry	Center of Company	Establishment Year	Registered Capital	Paid Capital	Individual Shareholders	Corporate Shareholders	Foreign Shareholders	Government Shareholders	Public Shareholders
Anadolu Efes	Food and Beverage	İstanbul	1979	900000000	450000000	0	56,2	0	0	43,8
Coca Cola	Food and Beverage	İstanbul	1886	254370782	254370782	0	55,3	20,1	0	24,6
Doğan Gaz.	Paper	İstanbul	1950	150000000	100000000	0	58,61	0	0	41,39
Hürriyet Gaz.	Paper	İstanbul	1960	800000000	421000000	0	60	0	0	40
Dentaş	Paper	Denizli	1972	70000000	70000000	0	79,3	0	0	20
Tüpraş	Chemicals	Kocaeli	1983	500000000	250419200	0	51	0	0	49
Arçelik	Metal Property	İstanbul	1955	500000000	399960000	9,81	68,89	0	0	21,3
Vestel	Metal Property	Manisa	1994	159099886	159099886	0	0	51,59	0	48,41
Otokar	Automotive	İstanbul	1963	25000000	24000000	0	69,49	0	0	30,51
Tofaş Oto Fab.	Automotive	İstanbul	1968	1000000000	500000000	0,23	37,62	37,86	0	24,29
Türk Traktör	Automotive	Ankara	1954	250000000	47000000	0	37,5	37,5	0	25
Tav Havalimanı	Transportation	İstanbul	1997	242187500	242187500	0	36,72	44,88	0	18,4

TABLE 2: THE COMPOSITION OF BOARD OF DIRECTORS OF NON-FINANCIAL COMPANIES AT GCI

Company Name	Board of Directors Size	Executives	Non-Executives	Independent	CEO and GM same	More than 1/2 executives	Less than 2 independents	Independents less than 1/3
Anadolu Efes	13	0	12	1	0	0	1	1
Arçelik	9	1	8	0	0	0	1	1
Coca Cola	10	1	7	2	0	0	0	1
Doğan Gaz.	7	2	5	0	0	0	1	1
Hürriyet Gaz.	10	3	3	3	0	0	0	0
Otokar	7	1	6	0	0	0	1	1
Tav Havalimanı	15	2	11	2	0	0	0	1
Tofaş Oto Fab.	8	1	7	0	0	0	1	1
Tüpraş	7	0	7	0	0	0	1	1
Türk Traktör	8	0	8	0	0	0	1	1
Vestel	7	1	3	2	0	0	0	1
Dentaş	7	0	7	0	0	0	0	1

TABLE 3: THE NUMBER OF BOARD COMMITTEES

Company Name	No of Committees	Audit Committee	Corporate Governance Committee	Risk Committee
Anadolu Efes	2	1	1	0
Arçelik	1	1	0	0
Coca Cola	1	1	0	0
Doğan Gaz.	1	1	0	0
Hürriyet Gaz.	3	1	1	0
Otokar	1	1	0	0
Tav Havalimanı	2	1	1	0
Tofaş Oto Fab.	2	1	0	0
Tüpraş	2	1	1	0
Türk Traktör	2	1	0	0
Vestel	2	1	1	0
Dentaş	2	1	1	0

TABLE 4: THE AUDIT COMMITTEES' MEMBER PROFILE

Company Name	Head of AC Independent	Both of AC Members non-executives	If more than two, majority of AC Members non-executives
Anadolu Efes	1	1	0
Arçelik	0	1	0
Coca Cola	1	0	1
Doğan Gaz.	0	1	0
Hürriyet Gaz.	0	1	0
Otokar	0	1	0
Tav Havalimanı	0	0	0
Tofaş Oto Fab.	0	1	0
Tüpraş	0	1	0
Türk Traktör	0	1	0
Vestel	1	1	0
Dentaş	0	1	0

TABLE 5: THE CORPORATE GOVERNANCE COMMITTEES' MEMBER PROFILE

Company Name	Head of CGC Independent	Both of CGC Members non-executives	If more than two, majority of CGC Members non-executives
Anadolu Efes	0	1	0
Arçelik	0	0	0
Coca Cola	0	0	0
Doğan Gaz.	0	0	0
Hürriyet Gaz.	1	0	1
Otokar	0	0	0
Tav Havalimanı	1	0	0
Tofaş Oto Fab.	0	0	0
Tüpraş	0	1	0
Türk Traktör	0	0	0
Vestel	1	1	0
Dentaş	0	1	0

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APPENDIX 1:
TOTAL CORPORATE GOVERNANCE INDEX CRITERIA

A. THE MAIN CATEGORIES OF CORPORATE GOVERNANCE INDEX (CGI)

Total Corporate Governance Index Criteria
1. The rights and the obligations of shareholders
2. Transparency, disclosure of information and auditing
3. The board of directors
4. CEO and executive management
5. Corporate governance commitment, the role of stakeholders and corporate social responsibility

B. DETAILED CORPORATE GOVERNANCE INDEX CRITERIA

The rights and the obligations of shareholders	Transparency, disclosure of information and auditing	The board of directors	CEO and executive management	Corporate governance commitment, the role of stakeholders and corporate social responsibility
The equal treatment of shareholders Absence of takeover defence Existence of organized and autonomous shareholder department Mechanisms of sufficient and timely information about the dates, place and agenda of the GMS Voting procedures in the GMS	Report of the annual and semi-annual financial statements with clear and understandable way In time publish of the annual and semi-annual financial statement Equal treatment of all investors and financial analysts regarding information dissemination (fair disclosure) for important corporate events Detailed analysis of any deviation from previously announced earnings targets and strategic goal Application of an internationally recognized accounting and auditing system for the balance sheet consistent with the IAS Disclosure of board directors and executive staff members remuneration	Corporate governance indicators Division between the role of the chairman and the CEO Succession plan The composition of the board of directors Non-executive board directors' independence Existence of specified rules regarding board operations and duties The size of the board of directors Board meetings frequency Establishment of board committees Sufficient access of the non-executive directors to the company's executive management New board member's rotation and training procedure Non-executive board directors' remuneration Non-executive board directors' election frequency	The duties and responsibilities of the CEO Executive management staff member's remuneration Disclosure (in the GMS and/or in the company's annual report) of share ownership information of the executive management staff members CEO's election frequency Existence of position of Chief Financial Officer	Existence of written CG rules in the company Easy availability of the company's CG rules to the stakeholders Existence of a Corporate Governance Committee or individual entrusted with CG compliance issues Existence of an efficient CG framework taking account the interests of all stakeholders Corporate social responsibility and environmental awareness

APPENDIX 2:
THE LIST OF COMPANIES WITH CGI RATINGS

Company Name	GCI Rating and Date	The update of GCI Rating and Date	The update of GCI Rating and Date	The update of GCI Rating and Date
1. Doğan Yayın Holding	8.0 *19 April 2006* *ISS*	8.5 *1 August 2007* *ISS*	9.0 *1 August 2008* *ISS*	
2. Vestel Elektronik	7.5 *March 2007* *ISS*	8.5 *February 2008* *ISS*	8.5 *February* 2009 *ISS*	
3. YandY Gayrimenkul Yatırım Ortaklığı	7.88 *April 2007* *SAHA*	8.16 *18 April 2008* *SAHA*	8.16 17 *April* 2009 SAHA	
4. Tofaş	7.57 *28 May 2007* *SAHA*	7.74 *28 November 2007* *SAHA*	7.74 *28 May 2008* *SAHA*	8.16 27 *November* 2008 *SAHA*
5. Türk Traktör	7.57 *23 August 2007* *SAHA*	*7.83* *22 August 2008* *SAHA*	*8.12* *19 August 2009* SAHA	
6. Hürriyet	8.0 *September 2007* *ISS*	8.5 *September 2008* ISS		
7. Tüpraş	7.91 *8 October 2007* *SAHA*	8.20 *6 October 2008* *SAHA*	8.34 *6 October* 2009 *SAHA*	
8. Asya Katılım Bankası	7.56 *2 July 2008* *SAHA*	7.82 2 *July* 2009 *SAHA*		
9. Otokar	7.94 *20 March 2008* *SAHA*	8.12 *20 March 2009* *SAHA*		
10. Şekerbank	7.0 *February 2008* *ISS*	8.0 *February 2009* *ISS*		
11. Dentaş AmbalaJ	7.08 *12 May 2008* *SAHA*	7.82 *12.May 2009* *SAHA*		

12. Anadolu Efes Biracılık ve Malt Sanayi A.Ş	8.10 *11 June 2008* *SAHA*	8.27 5 June 2009 *SAHA*		
13. Yapı ve Kredi Bankası A.Ş	*8.02* *29 December 2008* *SAHA*			
14. Vakıf Yatırım Ortaklığı	*7.81* *28 January 2009* *Turk-KrediRating*			
15. Coca Cola İçecek	8.30 *1 July 2009* *SAHA*			
16. Arçelik	8.21 30 July 2009 *SAHA*			
17. TAV	8.5 4 September 2009 *ISS*			
18. Türk Sinai Kalkınma Bankası (TSKB)	8.77 20 October 2009 *SAHA*			
19. Tek Faktoring	6.83 *17 January 2008* *SAHA*	*7.08* *29 January 2009* *SAHA*		
20. Lider Faktoring	6.97 *5 August 2008* *SAHA*	7.26 *21 May 2009* *SAHA*		

APPENDIX 3:
SAMPLE INTERNAL AUDIT (I/A) PROCESSES PERFORMANCE METRICS CHECKLIST FOR THE BOARD COMMITTEES

1. Does I/A have a formal set of standards and are those standards consistent with IIA Standards?

2. Are new I/A members educated on the use of I/A standards and is overall compliance to standards monitored regularly?

3. Does I/A prepare an annual audit plan and is performance against the plan regularly monitored by the audit committee?

4. Are audit plans developed through a formal risk assessment process?

5. Are individual audits planned and supervised with sufficient attention given to adequate planning and staffing?

6. Is all I/A work documented through a formal set of workpapers and are those workpapers reviewed by appropriate levels of management (workpaper procedures are discussed in?

7. Are audit findings reviewed, as appropriate, with management before release of final audit reports?

8. Are recipients of audit reports required to respond to recommendations with plans for corrective action and are those responses monitored?

9. Are there special I/A procedures in place in the event or fraud or suspected fraud encountered during reviews?

10. Does I/A report the results of its activities regularly to the audit committee?

11. Are overall budgets developed for all I/A work and is performance monitored against those budgets?

12. Do all members of I/A receive adequate training on accounting, internal controls, and technology issues?