Proceedings of the Second European Academic Research Conference on Global Business, Economics, Finance and Banking (EAR15Swiss Conference) ISBN: 978-1-63415-477-2
Zurich-Switzerland, 3-5 July, 2015 Paper ID: Z510

Group of companies and inter-company fraud; A case from Turkey

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Abstract

With regards to greed, especially the greed of the CEO or the owner of the group is another important factor in financial fraud. He/she wants to expand the business without having the expertise in the new industry. I.e. for an industrialist, banking is a new area which requires a completely different expertise. The owners do not know the business. They think that the money deposited in the bank is their own money and can be used in their diversified business activities. This paper explains a real accounting fraud case in a group company in Turkey. It explains how the Group`s bank financed the Group companies and in return how a Group`s company financed the others instead paying its debt back to the Banks. The owners of the Group hired the expertise but always exerted their own will on the professionals. Despite the Banking Regulatory Authority`s warnings, they have manipulated the accounts, changed the records, illegally converted local deposits to off-shore accounts through tailor made programs thus caused millions of dollars tax evasion. The consequence has not been positive, leading thousands of victims of depositors.

Purpose – The paper presents a real case of inter-company fraud where the Group`s Bank lent money to a group company and was never repaid. The company generates its own cash but instead of repaying its debt to the Bank it funds other group companies. Considering the Bank`s being a public depository institution and its illiquid situation, the case presents a fraud within the Group. In this regard the paper is considered to be an exemplary case for the accounting literature.

Design/methodology/approach – The paper analyses one of the Group`s company`s audit reports for the years 2003 and 2004 and explains the type of frauds committed by the Company`s management. The study approximates the total United States Dollar (USD) figures that were inappropriately transferred to the other Group`s companies in year 2003.

Findings – The study examines the real case and discusses the reasons led to the bankruptcy of the Group. Lack of Governmental controls may lead to bankruptcy of banks that have been abused by its owners by transferring loans to other group companies exceeding the legal limits observable by the banks.

Practical implications – Auditors, accountants and accounting lecturers and professors talk about fraudulent accounting practices. The study explains a specific accounting fraud case in a group of companies. It explores the type of inter-company money transfers without a valid base. The author is of the opinion that readers with an accounting background will benefit from reading the case.

Social implications – Economics is the study of allocation of scarce resources to the best use. Public`s savings must be directed to the companies that produces the value added to the society. On the other hand fraudulent money transfers within the group companies involving bank(s) may distort this allocation. Public money-deposits might be wasted by dishonest business owners. The study is aimed to disseminate this information to public in general.

Originality – The case study has been built on a real audit report from Turkey. The names and the locations of the companies have been changed and the figures have been approximated in USD terms. The events and findings on the audit reports have not been changed and each fraudulent event has individually been discussed.

Keywords: Accounting fraud, inter-company transfers, arms` length transactions, fraudulent money transfers between the group companies. **Paper type** – Case study

1. Introduction

Companies, especially group companies under a common management whose tendencies change overtime from full disclosure and transparent reporting to least disclosure and fraudulent reporting may experience similar situations. The author`s goal is to exert such cases and disseminate it to public so that company accountants and auditors-both internal and external become aware of possibilities of similar fraudulent transactions and reporting issues. Fraudsters in many cases, in early stages of business life do business in an honest and transparent way. They have visions and are mostly successful in exerting this vision, make good money and expand their businesses. This might continue for a while, sometimes decades. On the way somewhere there happens an incident, either they become too greedy which normally the case in most of the circumstances or get involved in politics and caught in the radar of governments. Then their trajectory of making business in an honest way should get change. They want to be involved in different industries for which they have no prior experience. In some instances governments force them to divert into new industries and implicitly or explicitly they believe that they have the government support behind them and most of the time this comes through and continues for a while. It is the author`s experience over the last 30 plus years` of observation and working in different industries in Turkey that this is a fact and the same scenario has been repeated many times almost incessantly with different governments. Is fraud a faith that stuck on the developing countries? The answer is no, it is not a faith and it can be changed. In addition, it is not a phenomenon that occurs only in developing countries on the contrary it is also widely spread in developed countries. USA is an example in this respect with Enron, WorldCom, Adelphia etc., Italy and Canada are examples with Parmalat and Nortel cases respectively.

Those companies that they get involved in political pressures have one common mistake that they do not consider that politics as a temporary game, they think that their political support will continue forever and that`s where they go wrong. Democratic countries have elections and companies rely on political support might lose all that power in a few days. All that investment made under the influence of the prior government might be in vain and they might collapse as a group in a few days. This happens and the basic reason is that their growth is a balloon without a strong financial structure. All that growth is financed by state owned banks. When the government support is gone they can`t continue the business with scarce or unavailable resources.

With regards to greed, especially the greed of the CEO or the owner of the group is another important factor in financial fraud. He/she wants to expand the business without having the expertise in the new industry. I.e. for an industrialist, banking is a new area which requires a completely different expertise. The owners do not know the business. They think that the money deposited in the bank is their own money and can be used in their diversified business activities. Unfortunately this is not the case and this belief takes them to get involved in illegal activities. As depicted in the case below their Group`s banks have loaned their group companies by overly exceeding their lending limits and those loans were never repaid. A growth strategy is a positive strategy if the circumstances are appropriate. In a growing healthy economy companies do grow, either internally by expanding their existing businesses or buying other companies or merging with them. Every new business needs its own industrial expertise. If owners think that their prior experience will be sufficient to manage the new business, it might prove to be wrong.

2. Literature review

Intercompany transactions are not a matter of local business but also it is an international problem. Tax avoidance by multinational companies is a serious problem for governments. Since tax systems differ across countries, multinational companies can reduce their tax burden by shifting their profits to countries with relatively low tax rates. Transfer pricing is one such method. Manipulating the transfer price in intra–firm transactions across countries allows multinational companies to move income among affiliates located in different countries (Tomohara, December 2004.)

Some lessons have been learned from past frauds and incorporated into auditing standards and incorporated into auditing standards. Both the standards of the Public Company Accounting Oversight Board (PCAOB) and the AICPA include as a required auditing procedure "examining journal entries and other adjustments for evidence of possible misstatement due to fraud." This was a common auditing procedure, particularly for public companies, but it is now mandatory in every audit of financial statements. This increases the likelihood that the auditor will detect fraud perpetrated via nonstandard journal entries if it is present. This is one of the mandated procedures to further address the risk of management override of controls that is always present (Carmichael, October 2010.)

When Jeffrey W. Greenberg took the helm of notoriously secretive Marsh & McLennan Cos. (MMC), a $12 billion financial-services company, on Nov. 18, 1999, analysts were happily buzzing that Greenberg was a gregarious, outgoing executive. The word on Wall Street was that he would raise the profile of Marsh Mac with more public appearances and open communication than his tightlipped predecessor, A.J.C. "Ian" Smith. They couldn't have been more wrong. In the past four years, Greenberg sightings have been scarce. The company, true to its secretive history, became even more cloistered. But on Oct. 14, Marsh & McLennan was forced into a harsh public spotlight when New York Attorney General Eliot Spitzer charged its insurance brokerage with fraud. In a civil complaint filed in New York State Supreme Court, Spitzer alleges that the company engaged in bid-rigging, price-fixing, and accepting payoffs from insurance companies. Marsh & McLennan, the world's largest insurance broker, is paid millions annually to manage clients' risks and crises. Now its having epic problems of the same nature itself. In a three-month investigation, BusinessWeek spoke with some 50 former and current MMC employees, insurance industry executives, and investigators and discovered that the firm's problems may well go far beyond Spitzer's initial charges. BusinessWeek has learned that MMC and its executives could face a raft of further legal and regulatory problems. Spitzer`s office is mulling criminal charges against several execs connected with the insurance brokering scandal… The Securities & Exchange Commission is probing Mercer's alleged "pay to play" practices of requiring payoffs from money managers who want it to recommend them to pension clients…In the four trading days following Spitzer's Oct. 14 announcement, the stock plummeted 48%, wiping out $11.5 billion in market cap (Vickers, November 1, 2004.)

Is there bad news for insurers and employers? Unity and its conspirators were only one of several such rings at work. In all, said the FBI, the schemes involved nearly 40,000 patients, hundreds of millions of dollars in fraudulent claims, and some of the nation’s largest self-insured employers. Between those ends of the spectrum lies almost every conceivable example of how the health insurance system (and ultimately, all of us who pay into it) is victimized:… Former Houston physician Callie Herpin, sentenced to ten years after pleading guilty to selling some 17,000 prescriptions for narcotic pain relievers for a total of $1.7 million in cash—and also for facilitating $13 million worth of phony motorized wheelchair billings to Medicare (Mahon, December 2009.)

Sitting in jail just north of New York City, awaiting federal prison, is Roy William Harris. No common crook is he. Harris, 41, was once a star oil trader for Salomon's Phibro Energy unit, where he could have been a contender for the top job. Now he stands convicted in one of the biggest bank frauds in recent memory. His crime: lying to a bank group led by Chase Manhattan to disguise huge oil trading losses racked up by Arochem Corp., his private refining company. The banks lost almost $200 million when Arochem went bust in early 1992. Ignoring advice from his first lawyer, Harris refused to cop a plea to get a short prison stint. Instead, lie went on trial and was found guilty by a jury in December 1992 on 20 counts of bank or wire fraud, plus one count of money laundering. In December Harris got \SVz years as a criminal "kingpin." He is appealing (Norman, January 30, 1995.)

South African Businesses are to mount a concerted effort to accurately assess the impact of white-collar crime on the broader economy as the country continues to slip ever lower on official global fraud assessment tables. Business Against Crime (BAC) is currently bringing together a range of organizations and law enforcement agencies in an effort to better understand the magnitude of the problem. International statistics suggest that fraud and corruption lead to 30% of business failures, can consume as much as 5% of a company's turnover and point to more than three-quarters of companies falling victim to criminals inside their organizations. Globally, 65% of frauds have been shown to be perpetrated by staff. And in most cases those perpetrators, when caught, were registered as first-time offenders - suggesting the incidence of white-collar crime is considerably under-detected and unreported. White-collar crime costs the United States more than US$300bn/year, according to the FBI (Whitfield, 11 January 2007.)

The OECD surveyed 18 countries in mid-2006 to look at how widespread these illegal practices are within the real estate sector and explore possible ways to combat them. The main findings confirm that this sector has been used as a conduit for fraud or illicit financial deals in most of the countries surveyed. The actual extent of the problem in these countries remains unclear, however-even in those that have processes to systematically identify cases where money laundering and tax fraud are going on in their real estate sectors. None of the countries were able to report official statistics on these activities, despite information on OECD Observer No 266 March 2008 ECONOMY Tax transactions in real estate usually being more readily available than in other sectors. This may be explained by the rapid rise in these transactions overall over the past decade, with many countries having experienced a property boom (Jimenez, March 2008.)

Short of accounting gimmicks as egregious as those used by Enron, the flexibility provided by GAAP makes it all but impossible to stop many of them. "Many times auditors say, 'I know they're playing a game here, but there's no point at which 1 can say that they've violated a rule, and the valuations are more or less right.'" says John Elliott, dean of Baruch College's Zicklin School of Finance. "You can go to management and say, 'we're uncomfortable with this accounting,' but if an item is the only item floating around that year, management can come back to you and say, 'it's immaterial, it didn't really make a difference this year and it's just conservative." “An Industry observer says accountants and auditors have definitely become more thorough in their reviews of companies' accounting tactics since Enron, but they also admit that many still have the overwhelming tendency to cater to and please management. much of an atmosphere of pleasing the client and not wanting to upset the client, so therefore they miss many of these possibilities when they should actually be looking harder for them,” says Tony Tinker, a professor of accounting at Baruch. He says analysts are still not looking hard enough for fishy situations in companies' accounting. "There's still no spirit of diligence in place....Auditors are still shy about management fraud, and they would like to forget about the big meltdown that occurred and just concentrate on employee fraud" (Tunic, May 23, 2005.)

As it has been mentioned in the above cases, fraud has no boundaries; it can happen in any industry. Auditors-both external and internal in their analysis, should go further enough in their testing and conclusions that even though the transactions have been realized within the boundaries of Generally Accepted Accounting Principles (GAAP), they still have to make sure that if the company-auditee will survive into the future as it has been done in this case study.

Finally, the results demonstrate that auditors' going-concern reporting decisions are quite complex, and appear to incorporate information beyond traditional financial statement information. In reaching their decision, auditors are sensitive to information about management plans. While auditors may be reluctant to "audit" such information, they, like many financial statement users, find such information useful for decision making (Behn, Kaplan, and Krumwiede, March 2001.)

3. The case

This paper explains a real accounting fraud case in a group company in Turkey. Before going into the details of the case a brief discussion of the group`s financial situation is given below: The following information is summarized from the following webpage (http://tr.wikipedia.org/wiki/T%C3%BCrkiye_%C4%B0mar_Bankas%C4%B1_T.A.%C5%9E). Turkish Banking Regulation and Supervision Agency (an authorized semi-governmental organization to regulate the banking industry in Turkey) has rescinded Timarbank`s (all the names in this case has been changed) deposit collection and banking activities on July 3, 2003 and declared that the Bank`s management and supervision will be carried out by Turkish Saving Deposits Insurance Fund (the Fund, a semi-governmental institution to insure the savings deposits of people and takeover the illiquid banks and their group companies for the purpose of paying off the deposit owners). The Fund appoints its own management and auditors to these companies, runs them for a while and then decide whether to sell them to potential bidders or close and liquidate. The takeover decision was taken on the basis of the Banking Law. The fund made a declaration that it would act to protect the interests of the saving deposit owners of the Bank and pay them their savings with interest as soon as possible. Timarbank itself was the nucleus of the group of companies called Nazu Group, besides Timarbank had an off-shore subsidiary called Timar Offshore and another domestic subsidiary called Badabank. The reason that the Bank was taken over was due to its illegally converting its domestic savings accounts to offshore savings accounts and thus creating a vacuum where deposit owners can earn a higher interest and the Bank does not withhold withholding taxes from the interest paid on these accounts leading to tax evasion. The vacuum created was a win situation for both deposit holders and the Bank. The bank`s cost of holding off shore deposits would be lower (due to the banking regulation existed at the time) and thus would be able to reflect some of that advantage to its customers and pay them a higher interest rate. The illegal conversion was made through a program called GM04 on which only a few people were authorized. Despite the Banking Regulatory Authority`s warnings the Bank has illegally converted USD439.3 million equivalent of Turkish Lira (TL), USD17.5 million and USD11.4 million equivalent of Euro domestic savings accounts to offshore savings accounts and thus caused a USD77.7 million tax evasion in the first five months of 2003. Besides the Bank sold Government and Treasury bonds to public which it did not own (fake repo-repurchase agreements), the amount of this type of repo transactions were approximately an equivalent of USD453 million converted at December 31, 2002 rate. The figures given above belonged to year 2003 altogether the bankruptcy of the Bank has caused USD5.9 billion to Turkish economy.

The Fund borrowed this deficit from the Treasury and repaid it from the collections of the sale of Nazu Group`s companies and/or their assets over a course of five plus years. The owner of the Group and his three sons who have been convicted of fraud are at large and said to be living abroad. The group had 233 companies in and out of Turkey on a spectrum of media, manufacturing, telecommunication, construction, electricity production and sale, banking, metal production and sale, shipping etc. The main reason of the Bank`s bankruptcy is the consequence of uncollected loans lent to group companies which exceeded the legally allowed limits for banks. The fraud case on the following pages is stories of one company in this this group.

The name of the company is Samil established in 1977, a subsidiary of Metal Company that was purchased by the Group from privatization in 1995 and taken over by the Fund on March 9, 2004. Metal (parent company of Samil, was established near a seaport in Antalya (a city by the Mediterranean Sea.) Samil was basically established to serve for the needs of Metal and other non-group companies operating nearby. Its main purpose of establishment covered the following major activities:

- Maritime agency for Turkish and foreign flagged ships,
- Loading and unloading of ships, the measurement, weighing of the loads being loaded and unloaded,
- Agency for ship renting on commission,
- Building ports and piers. wharfs and their management,
- Maritime and roadways freighting and agency on commission,
- Management of maritime vehicles within the confines of its occupation,
- Procurement, building, fixing, gearing, dismantling of maritime and roadway vehicles and wrecking within the confines of its occupation,

- Importation of ship wrecks, their dismantling and scrapping within the confines of its occupation,
- Floating of sunk ship wrecks and their scrapping within the confines of its occupation,
- Consultation, contracting, project development, expertise, agency, representation, import and export services within the confines its occupation, etc.

The comparative balance sheets of year 2003 and 2004 have been given below:

COMPERATIVE BALANCE SHEETS						
	TL DENOMINATED		EXCHANGE RATES 1USD=		USD DENOMINATED	
	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2003	Dec. 31, 2004
Cash and banks	11,209	44,947	1.3835	1.3257	8,102	33,904
Trade receivables	15,181	45,404	1.3835	1.3257	10,973	34,249
Related party receivables	4,546,411	5,197,374	1.3835	1.3257	3,286,166	3,920,474
Other receivables and prepaid expenses	69,001	159,486	1.3835	1.3257	49,875	120,679
Current assets	4,641,802	5,447,211			3,355,115	4,109,307
Investments in subsidiaries and associates	51,625	60,924	1.3835	1.3257	37,315	45,956
Land	1,751,337	1,993,722	1.3835	1.3257	1,265,874	1,503,901
Land improvements	48,720	57,079	1.3835	1.3257	35,215	43,056
Buildings	773,318	880,348	1.3835	1.3257	558,958	664,063
Machinery and equipment	2,600,677	2,638,803	1.3835	1.3257	1,879,781	1,990,498
Vehicles	30,893	30,893	1.3835	1.3257	22,330	23,303
Furniture and fixtures	11,371	12,693	1.3835	1.3257	8,219	9,574
Construction in process	5,066,021	5,767,159	1.3835	1.3257	3,661,743	4,350,274
Other fixed assets	6	6	1.3835	1.3257	4	4
Accumulated depreciation (-)	-2,760,943	-2,827,617	1.3835	1.3257	-1,995,622	-2,132,924
Total fixed assets	7,521,399	8,553,085			5,436,501	6,451,750
Other non current assets	6,091	6,388	1.3835	1.3257	4,403	4,443
Total non-current assets	7,579,116	8,620,397			5,478,219	6,502,149
Total assets	12,220,917	14,067,608			8,833,334	10,611,456
Bank loans	5,640,810	5,640,810	1.3835	1.3257	4,077,202	4,254,967
Accounts payable	127,624	181,411	1.3835	1.3257	92,247	136,842
Related party payables	17,639	45,772	1.3835	1.3257	12,749	34,527
Interest accruals	254,764	650,884	1.3835	1.3257	184,144	490,974
Other short term liabilities	62,716	116,770	1.3835	1.3257	45,332	88,082
Total short term liabilities	6,103,552	6,635,646			4,411,675	5,005,390
Long term liabilities	6,018	6,018	1.3835	1.3257	4,350	4,540
Total liabilities	6,109,571	6,641,664			4,416,025	5,009,930
Paid up capital	19,944,856	22,705,224	1.3835	1.3257	14,416,231	17,126,970
Retained earnings	-13,833,510	-15,279,281	1.3835	1.3257	-9,998,923	-11,525,445
Shareholders`s equity	6,111,346	7,425,944			4,417,309	5,601,526
Total liabilities and shareholders` equity	12,220,917	14,067,608			8,833,334	10,611,456

In both years fixed assets have been adjusted for inflation and the positive differences have been included in retained earnings. Due to inflation adjustment on the fixed assets in both years the Turkish Lira (TL) figures have been converted to U.S. Dollar (USD) at December 31 closing rates for presentation.

The followings are the comparative income statements for both years 2003 and 2004:

COMPERATIVE INCOME STATEMENTS						
	TL DENOMINATED		EXCHANGE RATES 1USD=		USD DENOMINATED	
	YEAR 2003	YEAR 2004	YEAR 2003	YEAR 2004	YEAR 2003	YEAR 2004
Net sales	867,805	1,391,631	1.4000	1.3546	619,861	1,027,337
Cost of services	-506,934	-786,797	1.4000	1.3546	-362,095	-580,834
Gross income	360,871	604,834	1.4000	1.3546	257,765	446,503
Administrative expenses	-177,110	-294,884	1.4000	1.3546	-126,507	-217,691
Operating profit	183,762	309,950			131,258	228,813
Interest income	84,766	194,438	1.4000	1.3546	60,547	143,539
Foreign exchange gains	966,998	215,380	1.4000	1.3546	690,713	158,999
Other income	1,800	2,340	1.4000	1.3546	1,286	1,727
Inflation adjustment income	0	208,109	1.4000	1.3546	0	153,631
Foreign exchange losses	-46	-32	1.4000	1.3546	-33	-24
Interest expense	-284,434	-252,324	1.4000	1.3546	-203,167	-186,272
Income before extraordinary items	952,845	677,861			680,604	500,414
Extraordinary gains	166,749	480	1.4000	1.3546	119,107	354
Extraordinary losses	-16,653	-146,473	1.4000	1.3546	-11,895	-108,130
Income before tax	1,102,941	531,868			787,815	392,638
Tax expense	0	-63,081	1.4000	1.3546	0	-46,568
Net income	1,102,941	468,786			787,815	346,070

The TL figures on the income statements have been converted to USD using the annual average exchange rates for presentation. Any foreign exchange adjustment due to conversion has been included in retained earnings.

The reason of presentation of the financials is not to repeat the audit procedures applied on the financials but to indicate what inappropriate accounting procedures have been followed on the accounts presented.

The related part receivables at 2003 and 2004 balance sheets make up the 37.2% of the total assets in both years. Likewise short term bank loans make up 46.1% of the total assets in both years. All that financing was obtained from Group`s Timarbank and its subsidiary Timar Offshore..

In all analysis made below the currency in which the transactions were incurred was in TL unless otherwise indicated. The author has converted them to USD as an approximation by using either the year end or the annual average currency rates as appropriate.

The details of the related party receivables as at December 31 is made of the following accounts:

Samed Iron Company 2003 USD 319,507, 2004 USD 408,087: This is an uncollectable receivable from a group company carried forward from year 2002. Samil, instead of collecting its receivable lent more money to Samed in 2003 and 2004. The additional funding to Samed in 2003 was partly made from cash USD 11,476 and also from Samil`s new borrowings from Timarbank-USD 41,261. 2004 receivable figure is higher than the 2003 despite the fact that the currency rate is lower at December 31, 2004. The reason is that the new management of Samil (appointed by the Fund) used Samil`s cash to fund Samed and converted the receivable to Euro and accrued interest on it.

Metal Company (Samil`s parent) 2003 USD 2,717,827, 2004 3,174,599: This figure is an uncollectable accounts receivable from Samil`s parent company. Samil, instead of collecting its receivable funded Metal USD 9,142 in 2003 and accrued interest of USD 123,643 at December 31, 2003. The new management has funded Metal and converted the receivable to Euro and charged interest increasing the receivable by another USD 331,000 in 2004.

Nasya Company 2003 USD 122,129, 2004 USD 168,615: This is an uncollectable account receivable from a company of the same Group. USD 92,130 was carried over from 2002. Just like the above receivables Samil funded Nasya in 2003 by USD 27,203. The new management converted the receivable to Euro, continued to fund the Nasya by USD 29,738 including interest in 2004.

Mediterranean Metal and Steel 2003 USD 84,332, 2004 USD 95,806: Just like the others above Samil funded this Group Company by USD 25,509 in 2003 from its deposit accounts at Timarbank and Badabank. The increase in 2004 is due to interest accrual of USD 11,474.

Mediterranean Galvanized Company 2003 41,786, 2004 USD 70,233: The uncollectable receivable amount carried over from 2002 was USD 27,942. The difference in 2003 occurred due to additional funding of approximately USD 12,000. The new management of Samil continued to fund the group company, converted the receivable to Euro and accrued interest. The approximate cash funding in 2004 was USD 20,000.

The common fraud committed by the old management of the company is that in all 2003 funding of intercompany receivables Samil used either its own cash or used its bank accounts with Timarbank, and/or Badabank while owing to Timarbank/Timar Offshore of USD4,077,202 excluding interest. Timarbank or Badabank collects deposits from the public. The Group treated the Banks` funds as if it was their own cash. They have transferred the money from the Group`s banks to Group companies without considering that the money belonged to public. Samil, instead of funding other Group companies should have repaid its borrowings by the cash that it generated from its business. The total funding in the above 5 cases is approximately USD 127,000 in 2003. The new management continued funding of the same Group companies in 2004 but the nuance here is that they did not use the Group`s banks for funding. They used the money generated by Samil`s operations.

On year 2003 Income Statement extraordinary gain account includes a figure of USD 106,624 (at December 31, 2002 exchange rate) which represents a cancellation of a previous year`s interest accrual for the loan taken from Timarbank. Since the bank and the company are both in the same group the transaction took place as a consequence of verbal agreement without any written of consent from Timarbank. This is a sign that the transactions between two group companies that were not held in arm`s length.

The following is taken from (http://www.iasplus.com/en/standards/ias/ias24): A statement that related party transactions were made on terms equivalent to those that prevail in arm's length transactions should be made only if such terms can be substantiated. [IAS 24.21]

Based on the above either the interest accrual in the first place was overwhelmingly high or if this is a mutual agreement between two trading parties it should have been on a written form and since this figure belonged to prior year, it should have been corrected on the opening balance of retained earnings in 2003 not in the income statement.

On 2003 and 2004 balance sheets the figures for investments in subsidiaries and associates are USD 37,315 and USD 45,956 respectively. The original cost of investments in these 3 Group company affiliates is USD 7,085 as at December 31, 2002. The figures for 2003 and 2004 are inflation adjusted figures since the date of payment. These three companies are not publicly traded consequently their fair market value can`t be determined nor there is a "discounted cash flow analysis made for these companies." The difference USD 30,230 should be booked into income statement as a loss of impairment.

One of its intercompany customers- Mediterranean Galvanized Company is also a tenant on one of the Company`s premises. There is a rental agreement made between the parties. Auditors could not see the rental invoices for 2001 and the first 10 months for 2002. This is also a violation of Turkish Tax Application law and accounting principles even though the amount is immaterial-about USD 2,000. It is also a violation of International Accounting Standards- (IAS) 18-Revenue Recognition. There is a rental agreement and the tenant occupied the premises and there is no sign that this agreement has been rescinded. That means a service has been rendered and it should be documented by an invoice or receipt.

The following is taken from (http://www.iasplus.com/en/standards/ifrs/ifrs13): The Standard defines fair value on the basis of an 'exit price' notion and uses a 'fair value hierarchy', which results in a market-based, rather than entity-specific, measurement.

Even though the next sentence in the standard says that “IFRS 13 was originally issued in May 2011 and applies to annual periods beginning on or after 1 January 2013,” the author is of the opinion that the fair value has been an option for valuation purposes more than a decade and this financial statements are not meant to be International Financial Reporting Standards (IFRS) complied.

The auditors appointed by the Fund, in their audit report say that they were not able to see the minutes of Board of Directors (BOD) of the company for 2003 neither the logbook of shareholders for the same year. This is a violation of Turkish Commercial Code.

On their report they say that “Since the company is successfully operating and having a potential of expanding its business in the port that it has been serving for so many years and considering its fixed asset structures we believe that it has a value in the market.”

What auditors say is true. Since the company is able to generate its own income and cash, it should survive and even expand its business and to be sold to the highest bidder. However considering the net shareholders` equity figures of 2003 and 2004 USD4,417,309 and 5,601,526 respectively and the uncollectable intercompany receivables of 2003 and 2004 USD3,286,166 and 3,920,474 respectively the Company`s net worth is between USD1-1.5 million ignoring its potential cash generating capacity.

4. Conclusion

In the case above, he owners were able to manage the banks for more than a decade. They hired the expertise but always exerted their own will on the professionals. They did not listen to the warnings from the Central Bank or from Banking Regulatory authorities. Then the last straw broke the camel`s back, 2001 economic crises, a sudden devaluation of the TL against foreign currencies and the bank`s being caught in this situation with foreign currency liabilities overly exceeding their foreign denominated assets. The consequences has not been positive, thousands of victims who had deposits in the banks suffered losses. They thought that their deposits were under the guarantee of the government. Governments do not guarantee all deposits. At the time of the case, the Government guaranteed up to a limit of approximately USD 25,000 of deposits of real persons not commercial deposits of companies. Besides there was a big debate whether the government would pay the fictitious repo accounts which the bank fraudulently sold treasury bonds that it did not own in its portfolio. The Fund did not guarantee such payments but instead declared that they might be payable in the process of liquidation.

Owning a bank for a group is a sensitive issue. By nature banking is a separate industry which requires specialization and prior positive business experience and a record of a successful past in business life. This means that any group wants to divert in banking should be able to separate its other business from banking. Opening a bank is not the same as opening a commercial business. Banking permits are given by higher banking, financial regulatory authorities in general. In Turkey it requires the Government`s consent. That`s another reason in Turkey that those companies who have the political-governmental support have more chances of owning a bank in their groups. This is where the problem starts for some groups. As it is mentioned in the case study, some groups manipulate this privilege, some do not. There are other examples of groups with a bank under the same umbrella. What makes them unique and sound is that they can separate their other operations apart from the bank`s. The group`s bank operate as if it is totally a distinct company from the group and they lend the group companies without exceeding the legal limits.

The case study is an example of how fraud has swarmed the group and consequently victimized the public. The irregular and fraudulent accounting treatments are merely the consequences of efforts to float the other businesses with the funds obtained from the bank. This is illegal and lead to corruption and mistrust in the society. After the 2001 crises in Turkey there were more than 20 groups that were in the same situation like Nazu Group. The total damage was over USD20 billion. All were taken over by the Fund. Some were liquidated and their deficits were covered up from the funds obtained from their liquidations, some were illiquid already at the time of the takeover and did not enough assets to cover up the deficits. The blame was on the owners in the first place and secondly on the governments including the Central Bank for not properly regulating and controlling their activities. The banking activities have been in a better shape in Turkey since 2001 economic crises which created thousands of victims. The lessons were taken and the necessary regulating agencies have been established since then. However politics and nepotism still play an important role in business life in Turkey. Of course this has and will have its economic consequences.

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