A comparative perspective on independent audit of unlisted companies: Cases of Turkey, Japan and Albania[1)]

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Abstract

This study aims to discuss the extent to which independent audits of unlisted companies should be expanded by focusing on thresholds that specify the size of unlisted companies subject to independent audits in three countries that are socially and economically quite different from one another: Japan, Turkey and Albania. Various factors affect stakeholders' need for independent audits. In other words, different criteria may be considered to define thresholds. In this study, to develop suggestions for the thresholds, we analysed types of wrongdoings encountered in these countries and considered their corruption perception scores.

In this study, we first revealed the similarities and differences in the types of wrongdoings encountered in accounting and independent auditing practices in the three countries by applying an in-depth interview method to the relevant interviewees in these countries. The findings indicate that in these countries, the types and intensities of wrongdoings differ in some respects and wrongdoings more or less exist in their accounting practices.

In this context, we suggest that the types and intensities of wrongdoings encountered in these countries and their corruption perception scores should be disregarded when defining thresholds that specify the size of the unlisted companies subject to independent audits. Moreover, we suggest that the thresholds should be suitable for contributing to meeting stakeholders' needs. If very high thresholds are defined for unlisted companies, very few entities will be subject to independent audits. In contrast, if very low thresholds are defined, this audit obligation is highly likely to increase the administration costs of external audit services for very small companies. Extremely low thresholds are also likely to impose an audit obligation *on very small companies, which may result in poor audit quality.*

Keywords: independent audit, wrongdoings, corruption perception

INTRODUCTION

Today, despite the existence of a code of ethics in many countries, different types of wrongdoings[3)] are still encountered in accounting and auditing professions. The term 'wrongdoing' used herein refers to behaviour that is illegal or immoral and that departs from what is ethically acceptable.

An independent audit may be accepted as the best way to fight corruption and wrongdoings encountered in both listed and unlisted companies. In many countries, the number of small- and medium-sized enterprises is high, and they have an important share of and role in the economy of the country in which they operate. In this context, we state that small- and medium-sized enterprises have an economic effect on a country's economy and have stakeholders such as creditors, workers, professionals in different areas, customers, consumers, providers, the state, shareholders, prospective partners and investors. Stakeholders expect independent (external) auditors to find existing wrongdoings and fraudulent transactions and prevent misstated financial statements from reaching them. Stakeholders want to know whether a company has a sustainable structure. In many countries, accounting and audit-related regulations, codes and laws are expected to contribute to meeting stakeholders' need for institutionalisation to increase competitive power and establish public confidence and transparency in the commercial life of a country.

The relevant authority of a country defines thresholds that specify the size of unlisted companies subject to independent audits. However, the thresholds should be logical and suitable for contributing to meeting stakeholders' needs. If very high thresholds are defined for unlisted companies, very few entities will be subject to independent audits. If very low thresholds are defined, we should ask ourselves whether a stakeholder will benefit from the results of the audit activity. The main aim of this study is to discuss the matter of 'thresholds for unlisted companies' of countries that give importance to independent audits of entities.

1. AIM AND SCOPE OF THE STUDY

This study aims to discuss the extent to which independent audits of unlisted companies should be expanded by focusing on size thresholds of unlisted companies subject to independent audits in three countries that are socially and economically quite different from one another: Japan, Turkey and Albania. Various factors affect stakeholders' need for independent audits. In other words, different criteria are considered to define thresholds. In this study, to develop suggestions for defining these thresholds, we first analyse types of wrongdoings encountered in these countries and consider their corruption perception scores.

This study is organised as follows. First, the findings of the research study conducted in 2012 and 2013 that used an in-depth interview method with relevant interviewees in the three countries to obtain types of wrongdoings are explained.

Second, size thresholds of unlisted companies subject to independent audits in the three countries are compared with one another by considering their corruption perception scores and the wrongdoing types encountered. We also consider the 4th European Union (EU) Company Law Directive.

Finally, we evaluate all the criteria and discuss whether size thresholds of unlisted companies subject to independent audits are defined by accounting for the types of wrongdoings encountered in accounting practices and the corruption perception level, which are likely to indicate the corruption/wrongdoing intensity in a country.

Thus, authorities may gain an understanding about the extent to which external auditing of unlisted companies related to the relevant laws and thresholds can contribute to meeting stakeholders' need for institutionalisation and transparency in commercial life of these countries in a real sense.

2. REASON FOR SELECTING THE THREE COUNTRIES FOR INVESTIGATION

We selected Turkey, Japan and Albania for investigation and comparisons for the following reasons.

As defined by Transparency International (TI), corruption generally comprises illegal activities that are deliberately hidden and come to light only through scandals, investigations or prosecutions. No meaningful way exists to assess absolute levels of corruption in countries or territories on the basis of hard empirical data. Possible attempts to do so, such as by comparing bribes reported, the number of prosecutions brought up or the study of court cases directly linked to corruption, cannot be taken as definitive indicators of corruption levels. Rather, they show the effectiveness of prosecutors, the courts or the media in investigating and exposing corruption. Capturing the corruption perceptions of those in a position to offer assessments of public sector corruption is the most reliable method for comparing relative corruption levels across countries (http://cpi.transparency.org/cpi2012/in_detail/).

TI published the corruption perceptions index (CPI), which annually ranks countries 'by their perceived levels of corruption, as determined by expert assessments and opinion surveys'. The CPI generally defines corruption as 'the misuse of public power for private benefit'. As of 2013, the CPI ranked 177 countries and territories 'on a scale from 100 (very clean) to 0 (highly corrupt)' on the basis of how corrupt their public sector is perceived to be. The CPI is a composite index—a combination of polls—that draws on corruption-related data collected by various reputable institutions. The CPI reflects the views of observers from around the world, including experts living and working in the countries and territories evaluated (http://cpi.transparency.org/cpi2013/in_detail/).

The logical expectation is that a correlation exists between the independent audit needs of stakeholders, the perceived level of corruption and the types and intensities of wrongdoings (and corruption) committed by employees (officials). In this context, at first sight, size thresholds of unlisted companies subject to independent audits can be defined by considering intensity, type and the probable consequence of wrongdoings that each company is likely to encounter in its business environment. Albania is a good case for this argument. Therefore, we conducted a research study in these countries that differ from one another with respect to their corruption perception scores. This score may indicate the intensities of wrongdoings committed by people working for the business life of the country in question.

The worldwide Corruption Perceptions ranking of 177 countries published by TI for 2013 show that (www.transparency.org/cpi2013/results)

Japan is ranked 18th (score 74),

Turkey is ranked 53rd (score 50) and

Albania is ranked 116th (score 31).

Japan has a much more orderly and prudent society and a more developed economy than Turkey. Hasegawa (2000, p. 470) asserted that in general government employees including officeholders adhere to the Code of Ethics for Government Service. Bribery is not necessarily rampant as a social custom. In contrast, Japan's social structure and the environment surrounding government employees contain many factors that could be viewed as a hotbed for corruption. In Japan, investigating authorities are under significant pressure to expose corrupt practices by government employees, particularly by officeholders in the national government such as high-ranking government officials and members of the Diet (the Diet is the Japanese parliament).

Albania has a much less developed economy and a lower corruption perception score (31) than Turkey (53). In addition to the previous definition of the CPI, we considered the survey conducted in 2010 by the Institute for Development and Research Alternatives with the support of the United States Agency for International Development. The survey tracked the perceptions of ordinary citizens, public officials and judges regarding corruption in Albania and their experience with corruption.

The survey findings show that the general public perceives corruption to be common among public officials, with 91.8% of respondents thinking that corruption among public officials is either 'widespread' or 'somewhat widespread'. In particular, customs officials, tax officials and doctors are perceived as the most corrupt institutions/groups evaluated. In addition, the general public and public sector employees perceive that the overall transparency in institutions is low (http://albania.usaid.gov/shfaqart/465/26/Corruption_in_Albania:_2010_Survey.htm).

Turkey, as a rising economy, is viewed as being approximately between Japan and Albania, but it is closer to Japan in terms of score and ranking.

3. RESEARCH METHOD

An in-depth interview method was applied to the relevant interviewees in the three countries to obtain types of wrongdoings as follows.

Turkey: The research study was conducted in seven large cities (Istanbul, Ankara, Adana, Gaziantep, Erzurum, İzmir and Hatay) from six different regions of Turkey in 2012 and 2013. The types of wrongdoings encountered in the accounting profession were obtained from accounting academics and professionals (accountants, independent auditors and tax examiners). In addition, the chairs of the accounting profession chambers in these cities were interviewed, and some discipline files in these chambers were examined to obtain types of wrongdoings.

Seventy-three participants from the seven large cities in question were personally interviewed. Each interview lasted approximately one or two hours depending on the conversation. Most participants were selected from among familiar and experienced (wise) professionals. The interviews terminated when the interviewees repeated the types of wrongdoings.

Japan: The research study was conducted in the Tokyo region in 2012, and the types of wrongdoings encountered in the accounting profession were obtained from accounting academics and professionals (accountants, independent auditors and tax examiners). In addition, officials of the Japanese Institute of Certified Public Accountants (JICPA) were interviewed to determine the types of wrongdoings.

Forty-two participants from Tokyo were personally interviewed. Each interview lasted approximately one or two hours depending on the conversation. Most participants were selected from among familiar and experienced (wise) professionals. The interviews terminated when the interviewees repeated the types of wrongdoings.

Albania: The research study was conducted in Tirana in 2013, and the types of wrongdoings encountered in the accounting profession were obtained from accounting academics and professionals (accountants, independent auditors and tax examiners).

Forty-five participants from Tirana were personally interviewed. Each interview lasted approximately one or two hours depending on the conversation. Most participants were selected from among familiar and experienced (wise) professionals. The interviews terminated when the interviewees repeated the types of wrongdoings.

This in-depth interview method was applied for the following reasons.

1) ***The demand to obtain more detailed information:*** Face-to-face interviews with participants provide more detailed information compared with that obtained through a questionnaire. In addition, participants tend to provide brief answers to open-ended questions in questionnaires (Kinnear and Taylor 1996: 361).
2) ***Sensitiveness of the ethics concept:*** Participants are likely to answer the questions according to social norms instead of actual events (Lehman 1989: 315).

4. FINDINGS

Our findings indicate that although accounting professionals are required to comply with ethics codes, wrongdoings—which do not comply with ethics principles—have been encountered in the accounting profession in said countries. Table 1 lists the types of wrongdoings encountered in these countries. The relevant explanations for each country are as follows.

Albania: Most survey participants (approximately 92%) reported that these wrongdoings have been widespread in Albania for years. As Table 1 shows, **32 types** of wrongdoings were encountered in Albania.

Seventeen reported wrongdoings stemming from clients have considerable weight in the 32 cases (53.2% of 32 cases). The rest of the wrongdoings were by accountants (14 wrongdoings or 44%). Only one case was defined as stemming from auditors (2.8%); however, for stakeholders to obtain true financial information about a company in Albania is extremely crucial.

When we use 35 wrongdoings as a base number to compare between the countries, the percentages of wrongdoings stemmed from clients and accountants are noted to be 48.6% (17/35) and 40% (14/35), respectively.

The findings for Albania indicate that the most encountered types of wrongdoings stem from accountants' desires for themselves and the desires and demands of their clients. Most survey participants, particularly accounting professionals, reported that they must accommodate clients' demands because of an aggressive competitive environment in the accounting marketplace. This reality is highly likely to negatively affect the independent audit activities of auditors in Albania.

Turkey: Most survey participants (approximately 90%) reported that these wrongdoings have been widespread in Turkey for years. They also stated that this historical pattern is why these wrongdoings are still encountered in today's Turkey. As Table 1 shows, **35 types** of wrongdoings were encountered in Turkey.

The wrongdoings stemming from clients have considerable weight in the accounting process (18 wrongdoings or 51.5%). The rest of the wrongdoings stemmed from accountants (16 wrongdoings or 45.7%). Only one case was defined as stemming from auditors (2.8%); however, for stakeholders to obtain true financial information about a company is extremely crucial.

The findings indicate that generally the wrongdoings stemmed from accountants' desires for themselves and the desires and demands of their clients. Most survey participants, particularly accounting professionals, reported that they must accommodate their clients' demands because of the aggressive competitive environment in the accounting marketplace. This reality is highly likely to negatively affect the independent audit activities of auditors in Turkey.

Japan: Most survey participants (approximately 95%) stated that encountering wrongdoings in the accounting profession is likely despite the fact that social rules and norms affect business life in Japan; however, these wrongdoings are not widespread in Japan. As Table 1 shows, **27 types** of wrongdoings were encountered in Japan.

Although not widespread, the reported wrongdoings stemming from clients have considerable weight (55.5% of 27 cases). To compare between the countries, the number of wrongdoings used as a base number is 35. Hence, the percentages of wrongdoings stemming from clients and accountants are 42.8% (15/35) and 31.4% (11/35), respectively.

EXPLANATIONS FOR THE JAPAN CASES

The answers above are applicable to small- and medium-sized accountants and businesses.	
Notations:	
1	The Japanese Accountant system is two tiered, and three titles exist in the profession: CPA, Tax Accountant and Accountant. The old 'Accountant' system was abolished in 1946 with the implementation of the CPA system; however, those with licenses are still able to conduct business under the old framework. A tax accountant can only prepare tax filings for clients. With smaller accounting firms and independent accountants, old accountants and tax accountants may act as if they hold a CPA license.
2	Under Japanese law, accountants may sell insurance.
3	Not many incidences occur because tax inspectors are vigorously supervised by the National Tax Agency.
4	Likely
5	It occurs, but very rarely.
6	Although conducted in the past, because tax auditing by the National Tax Agency occurs every few years, easily discoverable manipulations such as manipulating depreciation are probably no longer practised. However, more intricate manipulation methods that are hard to discover are being conducted by some accounting and business firms.

Only one case was defined as stemming from auditors (2.8%); however, for stakeholders to obtain true financial information about a company, even in Japan, is extremely crucial.

The findings indicate that the frequency and number of types of wrongdoings encountered in Japan are much lower than those encountered in Turkey and Albania. Yet, the risks stemming from auditors seem constant. The findings also indicate that the most encountered types of wrongdoings in Japan stem from the desires and demands of clients.

5. INDEPENDENT AUDIT APPLICATIONS IN TURKEY, JAPAN AND ALBANIA

To evaluate the size of the entities subject to independent audits, we review independent auditing criteria and thresholds of unlisted companies in Turkey, Japan and Albania, countries that differ from one another in the level of wrongdoings and the corruption perception score. We also investigate the 4th EU Company Law Directive (2006/43/EC) for EU members or candidates for comparison purposes because Turkey is a candidate country for EU membership.

5. 1. Independent audit of unlisted companies in Turkey

To comply with EU standards, the Commerce Code Commission was established in 1999.

Table 1. Types of Wrongdoings Encountered in Accounting-Related Practices of Three Countries

Types of Wrongdoings Encountered in Accounting-Related Practices of Three Countries	Origin	Albania	Turkey	Japan
1-Some accountants rent out their professional license to individuals unrelated to the accounting profession.	Acc	NA	X	X
2-Although illegal, some accountants establish branch(es) of their accounting firms.	Acc	NA	X	NA
3-Some accountants behave as if they are superior professionals to obtain more clients.	Acc	X	X	X
4-Some professionals use misleading titles. For example, some bookkeepers use the title ‘consultant’ although they are not consultants.	Acc	X	X	**1**
5-Although illegal, some accountants working for a company establish an accounting firm. All accounting procedures in these types of accounting firms are conducted by unauthorised persons such as trainees, their friends or their kin.	Acc	X	X	NA
6-Although illegal, some accountants sell insurance at their accounting firms.	Acc	X	X	**2**
7-Taxpayers behaving with motive to commit tax fraud do not have difficulty finding accounting professionals who can accommodate their desires and demands. Consequently, bad clients are able to find bad professionals.	C	X	X	X
8-Some professionals do not comply with fee tariffs determined by profession chambers. Hence, some clients can easily hire an accountant or independent auditor by paying fees below the minimum fee determined by the professional chamber, which gives an unfair competitive advantage.	Acc	X	X	X
9-The accounting and auditing markets in the country is under the impact of monopolistic competition of two groups: —Monopoly established by international auditing firms. —Monopoly stemming from collaboration between auditors and accountants.	Acc	X	X	X
10-Some accounting professionals decry their colleagues for capturing their clients.	Acc	X	X	X
11-Some accountants fail to update their professional knowledge, such as on IAS, and do not follow changes.	Acc	X	X	X
12-Some accountants fail to pay the social security premiums of trainees. Trainees pay their own social security premiums and work as office personnel without receiving wages.	Acc	X	X	X
13-Some accountants become engaged in the business affairs of their kin. Hence, clients (kin) are highly likely to expect that the accountant will accommodate their wishes and demands, even if they are inappropriate.	Acc	X	X	X
14-Some clients receive fictitious underlying documents consisting of expenditures to reduce profits and taxes payable. Accounting professionals may not become aware of such false documents.	C	X	X	**3**
15-To reduce taxes payable, some clients receive invoices for their businesses, although they buy goods or services to meet their individual needs. For example, a client who purchases a TV for his/her home receives an invoice for the TV in the name of his/her business. Similarly, some clients receive invoices for expenditures related to holidays with their families. Clients use these types of invoices, which are recorded in the General and Administration Expense Account as business trip expenditures.	C	X	X	X
16-Most clients (generally family companies) do not have internal control systems to control procedures their employees perform and to prevent their assets from being stolen by employees and customers. These types of companies risk losing their assets and have high operational costs. They also face survival-related risks.	C	X	X	X
17-Some manufacturing companies hide the real production and sales amounts of products by purchasing raw materials without invoices and by selling products without billing them.	C	X	X	X
18-Some clients prepare sales invoices that reflect sales amounts lower or higher than their actual amounts to reduce or overstate sales revenues.	C	X	X	**3**
19-Some clients reflect wages that are lower than those actually occurring. Thus, the amount of social security premium and income taxes regarding wages are reduced. Because personnel working under these conditions are afraid of being fired, they do not report this situation to the Social Security Institution.	C	X	X	X
20-Funds in the bank account of many family companies are drawn and spent by owners of the company to meet their individual and private needs by being recorded as if the money was placed into the company’s safe. Then, this money is transferred from the cash account to owners’ current accounts as if they	C	X	X	X

owed the company. Thus, irregular dividend distributions occur and owners avoid paying income taxes because of the dividends. This action is called 'disguised dividends'.				
21-Although illegal, some clients use previous years' expense invoices to reduce their tax payable amount.	C	X	X	X
22-Some clients prepare documents that reflect exportation amounts higher than those that actually occur. Hence, clients receive value added tax (VAT) refunds unjustly according to high exportation amounts.	C	NA	X	NA
23-Although some clients (companies) collect notes receivables that were a matter for the court before being collected, they continue to keep allowance expenses in their records (allowance for doubtful accounting) as if these notes receivables were not collected. This action enables a reduction in profits and, accordingly, income taxes.	C	X	X	**3**
24-Some importer clients create documents reflecting the amount of goods (particularly those that are difficult to count and control in customs such as cell phones, Walkmans, toys) imported as lower than the amount of goods actually imported. For example, 30,000 items are actually imported, but only 12,000 items are declared on the document.	C	X	X	X
25-Some clients scheme to overstate their accounts receivables, sales and earnings during the related period by creating advance billings and by booking significant fictitious sales to various customers without contacting them.	C	X	X	X
26-Some accountants, keeping books of more than one company that belong to a holding or an owner, reduce the VAT payable account of the companies by making those companies prepare fictitious invoices. For example, a fictitious sales invoice is prepared by a company of the group, which has a higher deductible VAT account than VAT payable account. This fictitious invoice is prepared for another company of the group, which has a higher VAT payable account than VAT deductible account. Thus, the amount of the VAT payable account is reduced.	C	X	X	X
27-Some accountants work for clients who do not know about accounting transactions and scheme to defraud them by preparing or receiving invoices consisting of fictitious expenditures or false sales amounts. Accounting professionals embezzle these fictitious amounts of money.	Acc	X-few cases	X	X-**4**
28-Some accountants deliberately make records of invoices for overstated promotional expenses. For example, a firm purchases 1,000 units of key holders for promotional purposes and receives an invoice as if it purchased 5,000 units. Then, the accountant deliberately records this invoice in the General and Administration Expenses Account to reduce the tax base.	C	X	X	X
29 Although illegal, some clients do not have a contract with an accountant. In this case, the professional does not accommodate the desires and demands of the client during the accounting period, and the unsatisfied client works with another accounting professional who does accommodate his/her desires and demands.	C	X	X	NA
30-Some clients demand their accountants to make entries in the firm's books and records that reflect depreciation allowances higher than those that actually occurred to reduce the firm's tax base.	C	X	X	X-**5**
31-Clients are known to believe that when a tax-related problem occurs, the problem is solved by bribing the tax official or inspector.	C	X	X	NA-**6**
32-Some auditors require confirmation through facsimile related to considerable amounts of documents and for the balances of certain accounts from third parties, but they should require more detailed knowledge and confirmation from the third parties, if possible, by visiting their offices.	Acc	X	X	X
33-Some auditors fail to recognise a transaction as a 'problem', which may be related to the lack of auditors' impartiality in gathering evidence on a transaction they selected for review. For example, some auditors rely too heavily on hearsay evidence provided by the accountant and management during the company's audit. Hence, they fail to obtain sufficient evidence.	Acc	X	X	X
34-Some auditors are unwilling to give management a 'bad' audit opinion (i.e. a qualified or adverse opinion), even if they are aware of misstatements in the financial statements.	Au	X	X	X
35-Some accountants are oriented towards client(s) when they use their personal judgment to assess certain of the client(s)' items (or assets).	Acc	X	X	NA

Notes: X: Wrongdoing (or case) is encountered in the country. **NA**: Not applicable. **Acc**: Accountants. **C**: Clients. **Au**: Auditor
Origin: Accountant, auditor or client who is the source of the wrongdoing committed in the accounting process.

The Commission, which considered German and Swedish codes, prepared a new commerce code draft in 2007. The New Turkish Commerce Code (hereafter, the new TCC) was adopted by the Turkish Parliament on 13 January 2011 and was promulgated in the Official Gazette on 14 February 2011. The new TCC and the relevant Law on Enactment entered into force on 1 July 2012. Accounting standards and audit-related articles entered into force on 1 January 2013. The following explanations are on the significant changes brought by the new TCC.

The new TCC envisages a system for auditing specified limited liability and joint stock companies. Through the new regulation, an audit currently included among the mandatory organs of the companies and exercised through an auditor who does not necessarily have subject matter expertise is replaced by the independent audit mechanism that should be conducted by CPAs, sworn-in certified public accountants (SCPAs) or certified independent audit firms. The scope of the audit includes the audit of financial statements and/or consolidated financial statements and the annual report. The audit is required to be performed in accordance with Turkish Auditing Standards, which are identical to the International Auditing Standards (IAS). Under this title, two main concepts should be noted because of their close relation to each other: accounting standards and the independent audit of compliance of accounting standards. The new TCC brings mandatory application of the IAS.

In contrast, subsequent to the enactment of the new TCC, Public Oversight Accounting and Auditing Standards Authority (POAASA) was established to provide effective auditing and a public oversight system. The POAASA was authorised to define Turkish accounting and auditing standards, entering requirements and qualifications of independent audit profession. The POAASA also has the authority to monitor activities of independent auditors and audit firms and is expected to redefine Turkish Accounting Standards and then define Turkish Auditing Standards to be in compliance with the IAS.

Audit-related articles in the new TCC

To explain what the new TCC has brought to Turkish business life from the aspect of audit activities, Provisions 397-406 are described as follows.

(Provision 397)-The financial statements of a company and its annual financial report prepared by the board of directors are audited by auditors* in accordance with Turkish Auditing Standards.

(Provision 398)–The auditing of financial statements of the company and its annual financial report as prepared by the board of directors includes auditing inventory, the accounting system, the internal control system and the activities of the board of directors. Auditing also includes determining whether financial statements are prepared in accordance with Turkish Accounting Standards and whether the entity audited faces danger or risks. The auditor's courses of actions should be in accordance with professional codes of ethics. The auditor submits his/her opinion (auditor report) to the general assembly.

(Provision 399)–The auditor is appointed by the general assembly. The auditor may not be changed if no valid reason exists.

(Provision 400)–The independent auditors are selected from among those possessing the title of CPA or SCPA according to CPA and SCPA Law No. 3568. Shareholders or members of management of the audited company may not be an auditor of the said company. The auditor assigned by the independent audit firm to audit a company must be replaced by another auditor for at least three years if the auditor submitted audit reports for that company for seven consecutive years. Auditors may be tax consultants and tax auditors of the company in which they performed audits.

(Provision 401)–The board of directors is obliged to submit all required data and documents that constitute the basis of the data to the auditor to enable him/her to conduct the audit in accordance with the law and with due care and attention.

(Provision 402)–The auditor prepares a report (auditor report) by considering the scope of the audit engagement, reporting objectives and comparable financial statements of the company.

(Provision 403)–The auditor expresses his/her opinion in the auditor report. The report also contains the auditor's evaluations. In an unqualified opinion, the auditor expresses that the financial statements, assets and financial situation of the company give a true and fair view or are presented fairly in accordance with the Turkish Accounting Standards.

(Provision 404)–Auditors and members of the audit team should be honest and objective when performing audit activities. Auditors should obey the confidentiality principle. An auditor may not disclose the information obtained during the course of his/her audit without permission from the client. Otherwise, the auditor is fined.

Because the new TCC brought the mandatory application of International Accounting Standards and independent audits to all joint stock companies and limited liability companies regardless of their size as of 2013, audit-related articles in particular received reactions from actors in Turkey's business world. Specifically, owners of small- and micro-sized entities reacted to the new audit requirements. In contrast, because of the new punishments, the independent auditing activities and the difficulties associated with applying International Accounting Standards, businesses in Turkey were anxious that they would face high administration costs from applications of the new TCC. Therefore, the business community demanded that the government be lenient with some of the articles that may increase administration costs. These applications, to which the business community in Turkey has yet to acclimatise, raised the need for changes to the new TCC. The pressure from the business community in Turkey resulted in a new law, numbered 6335, being passed on 26 June 2012 to soften some applications. The new law states that independent auditors (or audit firms) are allowed to audit the financial statements of all companies other than those exempt by the Council of Ministers because of their size.

Finally, on 23 January 2013 (Official Gazette numbered 28537), the Council of Ministers specified the size of unlisted companies subject to independent audits. According to the thresholds defined by the Council of Ministers, unlisted companies subject to external audits are those that, as of their balance sheet dates, do not exceed the limits of two of the following three criteria (www.kgk.gov.tr/contents/files/tms_seti/TMS/BKK_Usul_ve_Esas.pdf):

- Balance sheet total: TL 75,000,000 (€25,000,000)
- Net turnover: TL 100,000,000 (€33,000,000)
- Number of employees: 250

According to data obtained from the Ministry of Customs and Trade, the current number of all companies subject to independent audits is 843,373 (98,250 joint stock companies and 747,123 limited liability companies). However, after the Council of Ministers specified the size of the entities subject to independent audits, this number is expected to be approximately 10,000. In contrast, according to data obtained from the web page of the POAASA (www.kgk.gov.tr), the current number of independent auditors who have been certified by the POAASA is approximately 8,000.

5. 2. Independent audit of unlisted companies in Japan

In Japan, the main objectives of the accounting and disclosure system under the Companies Act are as follows (JICPA, 2009):

(a) To protect creditors and current shareholders,
(b) To compute the distributable earnings of the company and
(c) To evaluate management's performance of its stewardship function.

In Japan, to meet the objectives and maintain discipline in companies' business activities, the Companies Act provides for an audit regime that varies with the size of, and the corporate governance structure adopted by, companies. Companies falling under any of the following categories are required to undergo an accounting audit: (¥1=€0.0093) (1€=¥107.7)

—Large companies: Capital stock of ¥500 million (approximately €4,650,000) or more or total liabilities of ¥20 million (approximately €186,000) or more, as of the latest fiscal year end (indicating a balance sheet total of approximately €4,836,000);
—Companies that adopt a 'Company with Committees' corporate governance system and
—Other companies that appoint an accounting auditor on a voluntary basis.

5. 3. Independent audit of unlisted companies in Albania

In Albania, Law No. 10091 specifies the criteria that an enterprise should meet for its financial statements to undergo a legal audit. The following companies are required to audit their annual financial statements before their publication:

All companies, independent of their registration status (as limited liability companies or public companies), if they chose to adopt and comply with the International Financial Reporting Standards;

—All joint stock (public) companies that comply with the Albanian National Accounting Standards and
—All limited liability companies that comply with the Albanian National Accounting Standards and that meet two of the following three thresholds at the end of their reporting period: (Albanian Lek (ALL) 1=€0.0071).

1—Total assets meet or exceed ALL 40 million (approximately €284,000) or exceed this amount,
2—Turnover for the same reporting period is greater than or equal to ALL 30 million

(approximately €213,000) and
3—Employed 30 persons or more on average during the same reporting period.

According to the Reports on the Observance of Standards and Codes (ROSC, 2006), the exemption from an annual statutory audit of certain unlisted companies is compliant with the spirit of the 4th EU Company Law Directive. However, the said thresholds are extremely low. Compared with the maximum audit threshold limits set forth in the Directive, very small entities are subject to audit requirements. Although Albania, similar to some small EU Member States, may wish to use lower thresholds, these extremely low thresholds should be recognised as imposing an audit obligation on very small companies, which may contribute to poor audit quality (Dhamo and Shkurti, 2011, p. 34). Dhamo and Shkurti (2011, pp. 13, 14) also stated that these requirements specified in the law for conducting an independent audit of the financial statements create a favourable environment for auditors by enhancing their job market. Because numerous companies in Albania meet these conditions, the need for certified auditors is considerable, which has boosted interest in the profession. Every year, over 50 individuals attempt to pass the examinations set by law and obtain certification as auditors. The clarity of the rules specified in Law No. 10091 and the transparency of the procedures to be followed also contribute to a more regulated, supervised and qualitative audit profession.

However, financial statement users rely little, if any, on the audit opinion issued by local auditors and on the quality of accounting and financial information in general (Perri and Naqellari, 2010).

5. 4. Independent audit of unlisted companies in EU Company Law Directive

The Directive provides for a system of auditing under which companies must have their annual accounts audited by one or more persons authorised by the national law to audit accounts. Such a person (persons) must also verify that the annual report is consistent with the annual accounts for the same fiscal year.

Less strict rules are laid down for small- and medium-sized companies. Member States may lighten their obligations regarding the publication of annual accounts or exclude small companies from the requirement that the annual accounts be audited.

'Small' companies are companies that on their balance sheet dates do not exceed the limits of two of the following three criteria (http://europa.eu/legislation_summaries/internal_

Table 2. Statutory Independent Auditing Criteria and/or Thresholds

Country	**Balance sheet total (€)**	**Net turnover (€)**	**Number of employees**
Albania	213,000	284,000	30
EU (Small)	4,400,000	8,800,000	50
EU (Medium)	17,500,000	35,000,000	250
Turkey	25,000,000	33,000,000	250
Japan	4,836,000*	-	-
*4,836,000 = Capital stock 4,650,000 + liabilities 186,000			
According to the CPI ranking for 2013 among 177 countries, **Japan** was **18th, Turkey** was **53rd** and **Albania** was **116th**, and their scores respective were **74, 50 and 31 (n/100).** **Source:** (www.transparency.org/cpi2013/results)			

market/businesses/companylaw/l26009_en.htm):

・Balance sheet total: €4,400,000
・Net turnover: €8,800,000
・Number of employees: 50

The corresponding figures for ‘medium-sized’ companies are as follows:

・Balance sheet total: €17,500,000
・Net turnover: €35,000,000
・Number of employees: 250

6. DISCUSSION

According to the findings of our research studies and literature review, the countries should recognise today’s developments and anticipate the needs of tomorrow suitably. A critical review of the perceived difficulties and issues that the auditing profession may face in the near future reveals the following list for the three countries.

(a) Considering the aforementioned countries’ thresholds shown in Table 2, the thresholds defined in Turkey are viewed as higher than those defined in Japan and in the 4th Directive. Therefore, compared with EU standards, most companies in Turkey are not subject to auditing. Accordingly, the new TCC prepared with a modern and reformist approach cannot be considered a change in commercial life in Turkey for now.
However, we admit that this period is a transition period and the business market

requires an adequate number of audit professionals who can perform audits of companies. Despite the continuing efforts of the POAASA to provide training and qualifications, there is a lack of auditors who have the professional knowledge and audit experience to conduct audits according to the auditing standards issued by the POAASA.

Conversely, the exemption from an annual statutory audit of specified unlisted companies should be compliant with the spirit of the 4th EU Company Law Directive. In other words, as a candidate country of EU membership, Turkey may dispense small companies from the requirement that the annual accounts be audited as specified in the 4th EU Company Law Directive or exempt smaller companies than those specified in the Directive. Thus, 'small' companies may be those that, on their balance sheet dates, do not exceed the limits of two of the following three criteria or have relevant financials that are less than these criteria.

- Balance sheet total: **TL 13,000,000** or less (€4,400,000)
- Net turnover: **TL 26,000,000** or less (approximately €8,800,000)
- Number of employees: **50**

Furthermore, auditing firms face the following problems in Turkish commerce (Dalkılıc et al., 2012, p. 13):

- Most companies are unwilling to comply with external auditing principles (out of habit and because of the culture of the business world);
- Most Turkish companies view an external audit only as a legal requirement (not as transparency, auditability and so on);
- Family owned entities are very difficult to audit (they are unwilling to be transparent and audited);
- A high degree of the shadow economy exists;
- An external audit is generally used as a tool for the credit analysis of creditors and
- Entities being externally audited lack a budget

(b) Albania should define thresholds higher than those currently applied. Despite the wrongdoings encountered and the country's low corruption perception score, subjecting very small entities to an audit is not a good practice. If the thresholds are very low, such as those applied in Albania, compared with the maximum audit threshold limits set forth in the Directive, quite small (micro) entities are subject to the statutory audit. Consequently, extremely low thresholds are highly likely to impose an audit obligation on very small companies, which may result in poor audit quality. This audit obligation also increases the administration costs from an external audit service for small companies and provides no benefit to stakeholders who may not exist. In this sense, Albania should increase its thresholds to exempt very small entities from a statutory audit. Thus, the administration costs from a poor quality external audit service will decrease for very small companies.

(c) In contrast, considering audit standards, for an audit firm or auditor to conduct an audit of more than one entity does not appear logical if the audit firm (or auditor) lacks a well- qualified and experienced audit team. In that case, certified audit firms (**particularly large firms**) that have a well-qualified and experienced audit team are highly likely to have a competitive advantage in the audit market. This point is crucial for local audit firms operating in the three countries.

(d) For Japan, which is 18^{th} among 177 countries and has a score of 74/100 on the CPI, the threshold of €4,836,000 is quite close to the Directive. According to the findings of our research study, some wrongdoing types are not intensively encountered in the accounting profession in Japan. Still, if wrongdoings exist—more or less than others—in the accounting profession, companies should be subject to independent audits. In particular, in a country such as Japan in which 90% of entities are small and medium sized, the threshold of €4,836,000 seems quite appropriate.

7. CONCLUSION

1. In the three countries (Japan, Turkey, Albania), defining size thresholds of companies subject to independent audits is crucial to achieve the core aim of an independent audit. For example, in Turkey, the new TCC offers a very important opportunity and foundation for institutionalisation, increasing competitive power, establishing public confidence and transparency. The ethical and transparent structures that this change is likely to bring can be established in Turkish commercial life if the thresholds are suitably defined. The same may be said for the other two countries as well.
2. We claim that an independent audit of the specified limited liability and joint stock companies are oriented towards the public and require extensive knowledge and ability

in given subjects such as accounting applications on the IAS, risk management, internal control systems, use of technologic facilities and audit culture. In this sense, to increase the efficacy of the independent audit activities that provide reasonable assurances for commercial life to ensure a desired level of transparency, auditability, accountability and reliability as a natural consequence of the need for reliable financial information and transparency, specified companies should be those that establish an internal control system and those with an audit culture and the economic power to meet the cost of such an audit service.

3. A correlation is highly likely to exist among the independent audit needs of stakeholders, the corruption perception level and the frequency/types/intensities of wrongdoings (and corruption) committed by employees (officials). Even if the findings indicate that the types and intensities of wrongdoings in these countries differ from each another in some respects, wrongdoings—more or less but as a reality—exist in the accounting practices of the three countries. In particular, the internal control system is viewed as a crucial shortcoming of many entities in these countries.

   In this context, we suggest that the types and intensities of the wrongdoings encountered in, and the corruption perception scores of, these countries should be ignored when defining size thresholds of unlisted companies subject to independent audits. We also suggest that the thresholds should be suitable for contributing to meeting stakeholders' needs. If the thresholds for unlisted companies are very high, very few entities will be subject to independent audits. If the thresholds are very low, this audit obligation is likely to increase the administration costs of an external audit service for very small companies. Moreover, extremely low thresholds are likely to impose an audit obligation on very small companies, which may result in poor audit quality, as seen in the case of Albania.

4. As we know, given regulations and the entity's own interests, each company should establish an internal control system to protect its assets. However, if an internal control system exists, the corruption perception level of employees is also extremely important for stakeholders to benefit from the company's internal control system, which can prevent wrongdoings from occurring. As seen from many high profile company scandals that occurred in the US and EU, if employees have a low corruption perception level, they can disable even an extremely complex internal control system of the company for which they work.

In this context, size thresholds of unlisted companies subject to independent audits should be defined by considering the economic effect of the company on stakeholders' interests. Moreover, as in the case of Japan, a threshold may depend on even a single criterion, such as sales revenue, owner's equity or the number of employees, despite exceeding the second criterion.

We conclude that thresholds are best set by considering the business structure and the demand and supply factors that contribute to the stakeholders of a business life.

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Note

1）The first draft of this paper was presented at the 3rd International Symposium on Accounting and Finance, which was held on September 10-12, 2014 at Tokyo Keizai University.

2）Certified Public Accountant

3）Wrongdoing is behaviour that is illegal or immoral.

* On 26 December 2012, the POAASB specified qualifications for becoming an independent auditor. CPAs and SCPAs who want to become independent auditors should have 15 years of professional experience and should pass an examination on accounting- and audit-related subjects held by the POAASB.

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