T.C.
MARMARA ÜNİVERSİTESİ
SOSYAL BİLİMLER ENSTİTÜSÜ
İŞLETME BİLİM DALI

INTERNAL AUDIT OF GOVERNANCE IN TURKEY: AN ANALYSIS IN BIST- 100 COMPANIES

Doktora Tezi

ÖZCAN KONAK

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Danışman: DOÇ ALİ ATİLLA PEREK

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ÖZET

Kurumsal yönetişim, kurumsal dünya ve bir kurumun tüm paydaşları için iyi yönetişim uygulamaları (en iyi uygulamalar) olarak tanımlanabilir. Yönetişim bir kurumun başarısının hayati bir unsuru olduğundan tanımı gereği iç denetimin yönetişimin etkililiğini değerlendirme görevi vardır.

İç denetimin temel görevlerinden biri de kurumda yönetişimi denetlemek olduğu için bu araştırmanın temel amacı, Türkiye'de iç denetim/teftiş birimleri tarafından uluslararası iç denetim standartlarına göre halka açık şirketlerde yönetişim denetimlerinin nasıl yapıldığını ortaya koymaktır. Araştırmada Uluslararası İç Denetim Enstitüsü'nün (IIA) Kurumsal Yönetim Denetim Kılavuz'undan yararlanılmış ve veriler bu kılavuz dikkate alınarak yorumlanmıştır. Araştırma, bu bağlamda sektörler arasında uygulama farklılıkları olup olmadığını ortaya çıkarmıştır. Son olarak, iç denetim birimlerinin organizasyonel yapılarının yönetişim denetimleri üzerindeki etkileri değerlendirilmiştir.

Yapılan literatür taramasında yönetişim denetimi konusunda hem dünyada hem de Türkiye'de sınırlı sayıda bilimsel çalışma bulunması nedeniyle bu araştırmayla literatüre katkı sağlanmıştır. Ayrıca bu tez, Türkiye'de halka açık şirketlerdeki iç denetçilerin yönetişim denetimlerini nasıl gerçekleştirdiklerini ve/veya gerçekleştiremediklerini ortaya koyarak ve analiz ederek hem iç denetim hem de yönetişim literatürüne katkı sağlamıştır.

Bu çalışmada nitel veri analiz yöntemlerinden biri olan yarı yapılandırılmış görüşme tekniği kullanılmıştır. Keşifsel nitelikteki bu araştırmada, BIST-100 Endeksi'ne kayıtlı halka açık şirketlerin denetim bölümü başkanları hedeflenmiş ve bu hedef doğrultusunda farklı sektörlerden 20 şirketin denetim bölümü başkanıyla görüşülmüştür. Görüşmeler içerik analizi yöntemi ile analiz edilmiştir. İçerik Analizinin temel amacı, toplanan verilere dayanarak çeşitli kavramları tanımlamak ve ilişkileri açıklamaktır.

Araştırma bulguları, araştırmaya katılan tüm şirketlerin yönetişim denetimleri gerçekleştirdiğini ortaya koymaktadır. Sadece yönetişimin alt boyutları bazında farklı detay seviyelerine inilmekte ve IIA kılavuzlarında açıklandığı gibi farklı yöntemlerle denetimler gerçekleştirmektedirler.

Yönetişim denetiminin en önemli ve zorlu alt boyutu yönetim kurulunun yönetişim uygulamalarının denetimidir. Araştırma bulgularımızda 20 şirketten sadece 3'ünün yönetim kurulunun yönetişim uygulamalarını denetlediğini tespit ettik. İç denetim birimleri, bir kurumun en üst organı olan yönetim kurulunu, organizasyon yapısı, yetki yetersizliği, kaynak yetersizliği, görevsizlik, sınırların aşılması gibi gerekçelerle denetlemekten kaçınabilmektedir. Dolayısıyla, yönetişim denetimleri tüm şirketlerde yapılsa bile, şirketlerin büyük çoğunluğunun yönetim kurulu yönetişim uygulamalarını değerlendirme ve denetim kapsamına almaması önemli bir gelişme noktasıdır. Bu nedenlerle kurumlardaki iç denetim birimleri, yönetim kurulunun yönetişim uygulamalarını denetlemeye öncelik

vermelidir. Bu denetim faaliyeti, yönetim kurulunun üstünde bir organ tarafından veya yönetim kurulunun kendisi tarafından desteklenmelidir.

Anahtar Kelimeler: İç denetim, iç kontrol, yönetişim, kurumsal yönetişim

JEL Kodları: M42, O16, G34

ABSTRACT

Corporate governance can be defined as the good governance practices (best practices) for the corporate world and all stakeholders of a corporation. Since governance is a vital element of an organization's success, by its own definition, internal audit has a mandate to evaluate governance effectiveness.

As one of the main duty of the internal audit is to audit governance in an organization, the main objective of the research is to reveal how governance audits are conducted in publicly traded companies, according to international internal audit standards, by internal audit/inspection units in Turkey. In the research, the International Institute of Internal Audit's (IIA) Corporate Governance Audit Guide was utilized, and the data were interpreted by taking this guide into consideration. The research discovered whether there are differences in practice between sectors in this context. Finally, the effects of organizational structures of internal audit units on governance audits were evaluated.

Since there are limited number of scientific studies on governance auditing both in the world and in our country in the literature review, this research contributed to the literature. In addition, this thesis contributed to both internal audit and governance literature by revealing and analyzing how internal auditors in publicly traded companies in Turkey perform and/or fail to perform governance audits.

Semi-structured interview technique, one of the qualitative data analysis methods, is used in this study. In this exploratory research, the heads of audit departments of publicly traded companies registered in the BIST 100 Index were targeted, and in line with this target, 20 companies' heads of audit departments in different sectors were interviewed. The interviews were analyzed by content analysis method. The main purpose of Content Analysis is to define various concepts and describe the relationships based on the collected data.

The findings of the research reveal that all the companies participating in the research conduct governance audits. They only go into different levels of detail on the basis of sub-dimensions of governance and they conduct audits with different methods as described in the IIA guidelines.

The most important and challenging sub-dimension of governance audit is the audit of the board's governance practices. In our research findings, we figured out that only 3 out of 20 companies audit the governance practices of the board of directors. Internal audit units may refrain from auditing the board of directors, which is the highest body of an organization, on grounds such as organizational structure, lack of authority, lack of resources, lack of mandate, and overstepping boundaries. Thus, even if governance audits are conducted in all companies, it is an important development point that the

majority of the companies do not include board governance practices within the scope of evaluation and audit. For these reasons, internal audit units in organizations should prioritize auditing the governance practices of the board of directors. This audit activity should be supported by a body above the board of directors or by the board itself.

Keywords: Internal audit, internal control, governance, corporate governance

JEL Codes: M42, O16, G34

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1. INTRODUCTION

The concept of governance, has emerged mainly to regulate the relationship between a owner of the power, the public and the bureaucracy or regulators. Corporate governance, according to the OECD, involves the relationship between a company's management, the board of directors, shareholders, and other stakeholders. Furthermore, corporate governance provides a structure in which the company's objectives, means to achieve those objectives, and performance management are outlined (OECD, 2015).

Since Corporate governance rules are mostly published by public authorities they are generally perceived by experts, corporate executives, and society, as reporting rules that must be followed by companies and professionals. However, corporate shareholders are generally unaware of corporate governance's positive effect on increasing the company's value.

As the governance is so vital for an organization, The Institute of Internal Auditors includes governance in its fundamental purpose as evaluating and improving governance processes in an organization.

After many corporate scandals, business leaders have realized that external audit needs to be improved. Besides, it is unsatisfactory without a well-functioning internal audit as well as an internal control framework. Governance and internal audit are two elements that interact with and complement each other. Lack of an effective governance approach in the business leads to deficiencies in the control mechanism. Only a well-defined and effectively functioning mechanism will make it easier for auditors to perform their duties and ensure efficient use of resources. Stronger internal audit departments can contribute to corporate governance more and as the corporate governance improves in an organization, the sustainability of the organization develops. To achieve these high expectations, a highly skilled internal audit function has to be able to audit and assess the corporate governance in its organization in order to depict its real value-adding quality to the board and shareholders.

The main purpose of the research in the study is to reveal how governance audits are conducted in publicly traded companies, according to international internal audit standards, by internal audit/inspection units in Turkey. Semi-structured interview technique, one of the qualitative data analysis methods, will be used and the heads of audit departments of publicly traded companies registered in the BIST 100 Index will be targeted. The interviews will be analyzed by content analysis method.

The thesis is organized in three main chapters after introduction. In the second chapter of the study, governance concept will be defined within its historical and theoretical framework. In the third chapter internal control and internal audit concepts and theories will be analyzed as they are highly connected with the governance.

In the fourth chapter, the empirical research will be explained in detail and in the fifth chapter there will be conclusions and recommendations based on the empirical research.

2. GOVERNANCE CONCEPT AND ITS TRANSITION FROM GOOD GOVERNANCE TO CORPORATE GOVERNANCE

In this chapter, since it is a particularly broad concept, governance will be defined within its historical and theoretical framework firstly. In the second section, the emergence of the concept of good governance and its application areas will be examined. The concept of corporate governance that was born by the operations of legal entities, including mostly private companies but also associations and foundations, will be discussed in the final section. The reasons behind governance's ever-increasing significance will also be discussed in relevant sections.

Governance is concerned with control and accountability. It is also about who makes the decisions, who has a say in them, and how those decisions are made. There is no specific or precise definition of governance; hence, various delineations are presented in the literature.

The concept of governance is used in many different areas, including public and political management, economic policy and management, the structuring of market economy institutions and regulatory authorities, corporate law, capital markets legislation, local governments, and the management of international institutions. Since it covers all organizational relations in which more than one legal entity or natural person is involved, it is not viable to provide a straightforward and specific definition of this concept.

Whereas governance applies to all structures involving human groups, corporate governance is a concept related to the decision-making processes of companies. The latter will be discussed in detail in the last section.

2.1. History and Definition of Governance

The complexity of the concept of governance makes it difficult to describe it as a straightforward notion. Governance is required at any time and in any environment where a group of people come together to achieve a specific result or goal. The governance literature suggests and uses a wide range of definitions, but all of them are based on three main dimensions. These are authority, decision-making, and accountability - that is, governance determines who has the will (power), who makes decisions, how other people have their opinions heard, and how they are held accountable. (Institute on Governance, 2020) In addition, governance, in the Good Governance Handbook prepared by TESEV within the framework of a comprehensive project, refers to the transformation from a relationship where one side manages the other side to a set of relationships in which mutual interactions are prominent. (Toksöz, 2008)

One can trace the birth of the concept of governance back to the Magna Carta[1]. Before the Magna Carta, the rulings were made only by the king, people did not have a say in governmental affairs, and the king was not accountable to the people. However, after the change of this structure with Magna Karta, the governance models of the states passed through various stages and turned into their present structures.

Each country's governance model varies today due to numerous factors, such as historical processes and social structures. For example, the “Sened-i İttifak”, which can be defined as the Ottoman Magna Carta, was the first fundamental change in management approach in Turkish History. The Sened-i Ittifak, which was published in 1808, is considered as the first Ottoman constitutional text The Bill reorganized the Sultan’s relationship with the local notables. This meant that the Sultan had to share some of his military, fiscal and administrative powers. (Toksöz, 2008).

The use of the definition of governance in the recent past has gained importance as international institutions such as the World Bank and OECD place good governance systems at the core of their development policies.

Governance is a concept that includes control and supervision mechanisms without the necessity of hierarchy. Considering its etymological origin, governance concept derived from Ancient Greek words "kybenan" and "kybernetes", meaning "to direct" and "pilot or ship captain", respectively. (The term "cybernetics" is derived from the same root). The governance process is one in which an organization or society is autonomous and in which the dynamics of communication and control are at the center. (Rosenau, 1995)

According to various sources, the concept of governance in Old French emerged as a word equivalent to the art of governing in the northern lands of France at the end of the 13th century. It was born in the 16th century and developed in the 18th century by integrating the state's respect for civil administration and enlightenment with philosophy, It is indicated that it was used to explain the mutual interaction between the state and the private industry in Europe. (Canıkalp & Ünlükaplan, 2015)

In “Governance and Governability: Using Complexity, Dynamics and Diversity” (Kooiman, 1993) which is a fundamental source in the governance literature, it is stated that governance should manage uncertainty, instability, long-term perspectives, big differences, and even chaos much better than the usual expectation and definition.

[1] Magna Carta or Magna Carta Libertatum is an English document signed in 1215. With this document, the king for the first time restricted his powers and granted some rights to the overlords. It is one of the critical steps that led to the current constitutional order.

In “The New Governance: Governing without Government” (Rhodes, 1996) another basic source in the governance literature, is determined that governance is a concept that has been increasingly used since the 80s and that the concept of governance has at least six different uses. These are;

- Minimal State
- Corporate governance
- New public administration
- Good governance
- Socio - cybernetic system
- Self-organized networks

Although the use of governance concept as corporate governance is a narrow definition of the concept, the way corporate governance deals with the principle of accountability has had a significant impact on the discussion of this principle in new public administration and good governance. In addition, the use of governance in this field shows that private industry management practices also have a significant impact on public administration. (Rhodes, 1996). This effect is particularly noticeable in the use of governance concept as a new form public administration.

The World Bank implements good government concept in its policy of lending to the developing countries by interwinding new public administration and the advocacy of liberal democracy. (Rhodes, 1996)

Defining governance as a socio-cybernetic system manifests the limitations of management systems with a person or institution at the center in the new world order, where there is no single dominant authority. This approach requires activities such as pluralizing the relevant actors for various policies or areas of expertise, establishing mutual connections between those actors, having common goals, and reducing the boundaries between private-public-civil society. (Rhodes, 1996)

Regarding the concept of governance, Stoker (1998) includes five basic propositions: Governance;

- Defines the institutions and actors that are beyond the management but come out of it.
- Eliminates the blurring of boundaries and responsibilities to overcome social and economic problems.
- Determines the power dependency in the relationships between the institutions that will participate in situations that requires collaboration.
- Is about autonomous and self-governing actor networks.
- Defines management's ability to perform without relying on administrative power or use of authority.

In fact, governance defines new tools and techniques for management. The ambiguous and unclear responsibilities prevent finding the real responsible within the institutions or, on the contrary, result in declaring people with limited responsibilities as scapegoats. On the other hand, dependence on power and the emergence of self-governing networks also increases the difficulties in accountability. (Stoker, 1998)

The State Planning Organization of Turkey (SPO) defines governance in the "Good Governance in the Public Sector Specialization Commission Report" as follows:

"Governance gives importance to democracy, the rule of law, and human rights and freedoms; emphasizes participation, efficiency and effectiveness, supervision, decentralization, clarity, transparency, accountability, quality, merit, and ethics. Moreover, governance brings civil society to the fore and paves the way for the development of non-governmental organizations. It is an economic and political order that has an independent judicial system and follows technological advancements." (SPO, 2007)

Governance encompasses mechanisms, processes, and institutions that allow citizens and groups to convey their interests, exercise their legal rights, fulfill their obligations, and manage diversity. It envisages that the government, private sector, and non-profit third sector organizations are all equal. According to this approach, one is not superior to the other. (Özer, 2006)

Governance, as a concept, generally refers to multidirectional interactions, as opposed to karma, which refers to one-way causality relationships. In other words, governance can be described as the overall attitudes and behaviors of public industry, private institutions, individuals and NGOs towards management. In this case, we can also refer to a continuous process, in which disparate and frequently conflicting interests are reconciled, and conciliatory actions are developed and implemented. Instead of being governed by the one-way decisions of the one at the top of the hierarchy, governance is formed by the mutual interaction of several harmonious, and in-coordination and most importantly autonomous actors (Özer, 2006).

Governance, in essence, transforms autonomy and the center's guidance into self-governing networks within the context of an interactive process. It must be taken account that the trio of the governing, governed and third sector are the major actors since no single actor in the public or private sectors has sufficient resource capacity or knowledge to solve the problems on its own (Özer, 2006).

Broadly, governance deals with what processes and systems a company or society works with. In general, people create a 'governing body' to run those processes and systems, such as the official government running a country or the corporate body running a business (Alacaklıoğlu, 2009).

As we review the emergence, meaning, and history of governance as a concept, we can conclude that it is the systemic whole of the actions and decisions of those who hold power whether by having a share in a company or coming to power in the management of a community with or without an election. Last but not the least, it aims at making this system auditable.

2.2. Differences in Management and Governance

As seen in the aforementioned definition made by Alacaklıoğlu (2009), people establish a governance body for the operation of governance systems. The goal of this section is to show that governance is an overarching concept that incorporates management and to highlight the differences between the two.

The traditional management approach's hierarchical and vertical structure differs from the understanding of impartiality in governance. There is a hierarchical relationship between managers and employees, and a supervisory relationship in the traditional understanding. By contrast, governance is based on the relative horizontality and impartiality Relatedly, governance spreads management to the base and, therefore, enables transition to a heterarchical order (Canıkalp & Ünlükaplan, 2015).

Heterarchy is specified as interdependent actions and the simultaneous and spontaneous realization of mutual relations in harmony and order. In this respect, heterarchy includes inter-organizational coordination and multi-center, inter-system interaction with the environment, which organizes communication channels between individuals or stakeholders (Acar, 2017).

Table 2.2-1: Conceptual Differences between Management and Governance

Management	Governance
Hierarchical order	Heterarchical order
Authoritative	Relatively democratic
Unidirectional accountability	Committed to accountability
Based on confidentiality and discretion	Based on transparency and clarity
Strict bureaucratic patterns	Qualified and quality processes
Status quo supporter	Reformer

Source: (Canıkalp & Ünlükaplan, 2015)

Thanks to the increasing importance of governance and its employment as a widespread development policy tool by international institutions, a new understanding has gradually begun to materialize, which considers the individual as a public partner (‘stakeholder’) without disregarding his/her role as a citizen. The individual’s status was identified as ‘partner’ at the Rio Summit in 1992 and as ‘stakeholder’ at İstanbul Habitat II Conference. In the same vein, the governance concept, which

refers to a management mentality that the public makes decisions together with the stakeholders and that the public is accountable to both the individual and the state, was born. This mentality has replaced the public management approach that envisions a more hierarchical relationship between the public and the individual. Public administration, as defined by the governance concept, includes a low-cost, high-quality, effective service approach and a participatory, accountable, and transparent management mentality. (Toksöz, 2008)

Box: About Habitat II (Toksöz, 2008)

The Prime Minister at the time, Süleyman Demirel, at the press conference he held in Istanbul on his return from Rio said, "From now on, we will work and make decisions together with the civil society. This is democracy!". During the Rio Conference, Süleyman Demirel made an attempt that had very positive results for Turkey. He persuaded the United Nations to hold the Habitat II Conference to be held in Istanbul in 1996.

At the Rio Summit, civil society had been accepted as a partner of local governments. This partnership was specified as being a stakeholder at the Habitat II Conference. A stakeholder means the person to whom the money or amount put forward in a bet between two people is entrusted.

During the Habitat II Conference, Recep Tayyip Erdoğan was the host of the conference as the mayor. The decisions made at this conference served as the foundation for the AKP government's local government reform.

The Habitat II Conference was held in three separate buildings at the venue declared as the Conference Valley in Istanbul. Governments gathered at the Lütfi Kırdar Cultural Center, local governments gathered at the Cemal Reşit Rey Hall and non-governmental organizations gathered at the Taşkışla Faculty of Architecture. Since this area is considered an international space in its entirety, non-governmental organizations from both Turkey and around the world have discussed every issue in a free environment at the Taşkışla Faculty of Architecture. One of the slogans hanging on the wall at the Faculty of Architecture in Taşkışla was very interesting: "Let's get radical today and talk to the government." This slogan is very expressive in terms of demonstrating the change in civil society's attitude. During the Habitat meeting, representatives from the US government informed their non-governmental organizations about the intergovernmental discussions and the conclusions of the meeting. During this briefing, they received civil society's opinion. This attitude affected the Turkish Foreign Ministry, as well. Representatives from the Ministry of Foreign Affairs also attempted to provide information to the Turkish civil society and local government officials.

Table 2.2-2: From Management to Democratic Governance

The development of democracy	Direct democracy	Representative democracy	Good governance	Democratic governance
The basis of authority	Land-Community	Election	Participation	Reconciliation
Rights	Direct	Election	Participation	Communication / Information sharing
Authority	Community	Elected representatives	Transparent	Shared
Individual	Effective (Completely)	Passive	Effective (Through institutions)	Effective (Through negotiation)
Conflicts	Resolved	Maintained	Discussed	Are converted
Problem definition	Citizens	Except for the citizens	Mutual	
Decision-making	Simple majority	Exclusive to the elected	Affected by interest groups	Agreement, persuasion, unanimity
Representation	Individual	Political groups	Stakeholders	
Information sharing	Sufficient	Limited	Advanced	Full
Participation	Natural	Environmental	Inclusive	Converter / Suspendive
Communication	Open	Unidirectional	Improved unidirectional	Multi-directional
Implemantation	By community	Institutions	Institutions (public)	Institutions (designed by community)

Source: (Toksöz, 2008)

Another point where governance differs significantly from management is that it increases the trust of the stakeholders in the management bodies thanks to the accountability principle.

2.3. Good Governance

Since governance is an all-encompassing concept, some resources in the literature use the term ‘direct governance’ instead of ‘good governance practices.’ However, an analysis of the emergence of good governance concept and its fundamental principles is critical for corporate governance.

Good governance practices have begun to be expressed as processes and structures that manage political and socio-economic relations in a participatory, transparent, and responsible manner within the framework of power and management problems in countries such as some African countries, which lack stable and well-established state structures. (Özer, 2006)

2.3.1. History of Good Governance

The term "good governance" was first used in the World Bank's report "From Crisis to Sustainable Growth in Sub-Saharan Africa" (World Bank, 1989) due to the fact that one of the root

causes of poor economic performance in the region was the unsuccessful management of public institutions. According to the report, while private sector initiatives and market mechanisms are important, they must be accompanied by good governance, which includes an effective public service, a reliable judiciary, and a government that is accountable to its people. After African countries gained independence, they inherited essentially simple but functioning state systems. However, the sudden emergence of state responsibilities and insufficient human resources led to the deterioration of governance. Moreover, the state became the source, not the solution, of the problems.

The World Bank (1989) report has defined governance as "the practice of using political power to conduct the affairs of a state." Furthermore, it has illustrated the importance of developing a governance model through profound political reforms.

The symptoms of bad governance were defined as follows in a World Bank report published 3 years later (World Bank, 1992):

- Use of public resources for private interests
- Loss of predictability in management and legal system
- Priorities that are incompatible with development and inefficient resource allocation
- Decision-making processes that are hardly defined or untransparent.

According to the World Bank, governance is used to describe overall circumstances of a country or institution. Nevertheless, it can also be defined as corporate governance, which specifically includes regulations governing the operation of the private sector such as reporting requirements, regulatory bodies, and legislative framework (World Bank, 1994).

Transparency is required to ensure performance accountability, but also it is the most important factor in eliminating corruption. Tenders and purchases become more competitive and opportunities for corruption are reduced as a result of transparency. Transparency should not be limited to the internal operations of companies or governments; rather, transparency practices should be expanded to the private sector to allow decision-makers access reliable information in a well-functioning market economy. These include practices such as companies being able to provide accurate financial statements to banks, banks' financial information being clear and accurate so as not to mislead depositors, and the absence of insider trading. (World Bank, 1994).

The willingness to make processes more open and transparent is dependent on the institution's and society's culture, traditions, and patterns of behavior, which are not easy to change (World Bank, 1994).

2.3.2. Definitions and Principles of Good Governance

The World Bank defines good governance as an order characterized by an open and predictable decision-making process, professional bureaucratic management, a government accountable for its actions and operations, and civil society and the rule of law that are actively engaged in the public processes (World Bank; (1989) (1992) (1994)).

Transparency, openness, accountability, participation, effectiveness, adherence to the law, and social responsibility are the fundamental elements of good governance. (Argüden, İyi Yönetişim, 2020)

According to Aktan (2002) good governance is defined as follows:

"Governance encompasses representation, participation, and supervision in state administration, an effective civil society, the rule of law, decentralization, openness, and accountability in administration, quality and morality, rules and limitations, alternative service delivery methods compatible with competition and market economy, and, finally, the political and economic order in which adaptation to the digital revolution exists."

Defining good governance is a hard process, and on the other hand, it is a hazardous one. The United Nations Development Programme (UNDP), for example, has identified several principles regarding this subject. While there are some minor differences in general, these principles are accepted in the literature.

In the literature, there are eight major supplementary elements of good governance. (Özer, 2006). We can summarize these principles as follows:

(a) Transparency: Transparency in management can be achieved by ensuring the free flow of information. This can be accomplished by making procedures, institutions, and information easily accessible.

(b) Accountability: The principle refers to responsiveness, acting according to criticisms and demands, and taking responsibility at times of failure in an institution. In other words, decision-makers in the public, private, and non-governmental sectors must be accountable to the public and to their institutional stakeholders.

(c) Participation: All citizens are expected to participate in decision-making processes, either directly or through intermediary institutions. During policy development, citizens' active participation paves the way for the reconciliation of different interests and leads citizens to act for the common good rather than their own.

(d) Responsiveness: Institutions and procedures should make every effort to serve all citizens. This principle implies that citizens should have confidence in the administration or government. A responsive executive should be in a position that is ready to respond, sympathetic, sensitive to problems, and capable of understanding and implementing the public's needs and wishes.

(e) The rule of law: For the institutions, this principle requires them to operate within impartial legal frameworks. In a similar vein, for individuals, it requires them to accept that their actions are subject to law.

(f) Effectiveness: Processes and institutions must be efficient to produce effective results. Otherwise, systems and institutions will use resources inefficiently.

(g) Fairness: According to the principle, all citizens should have the opportunity to maintain and improve their current level of well-being.

(h) Strategic vision: Public administration leaders should have an effective perspective on good governance and development. Also, they should identify and provide the necessary elements for development.

Figure 2.3-1: Principles of Good Governance



Sources: (Özer, 2006) and (Toksöz, 2008)

The term "good governance" was introduced to Turkish language and literature for the first time during Habitat II Conference preparations. Good governance is a new concept that includes all principles required for the establishment of a democratic government. These principles are participation, transparency, accountability, effectiveness, consistency, impartiality, and adherence to law. (Toksöz, 2008)

Good governance can take place at four levels in social life: public authorities, private sector, NGOs and personal level. Good governance at the level of public administration begins with encouraging the participation of state bodies and public service organizations, continues with the consistency, transparency, and accountability of their management styles, and ends with impartial and effective decisions and practices. Second, good governance in the private sector can occur through two interconnected channels. On the one hand, companies implement corporate governance. Thus, transparency, accountability, participatory management style and efficiency are present in their management structures. By allocating resources to social projects, on the other hand, they encourage executives and other employees to devote considerable time and energy to the NGOs. (Toksöz, 2008)

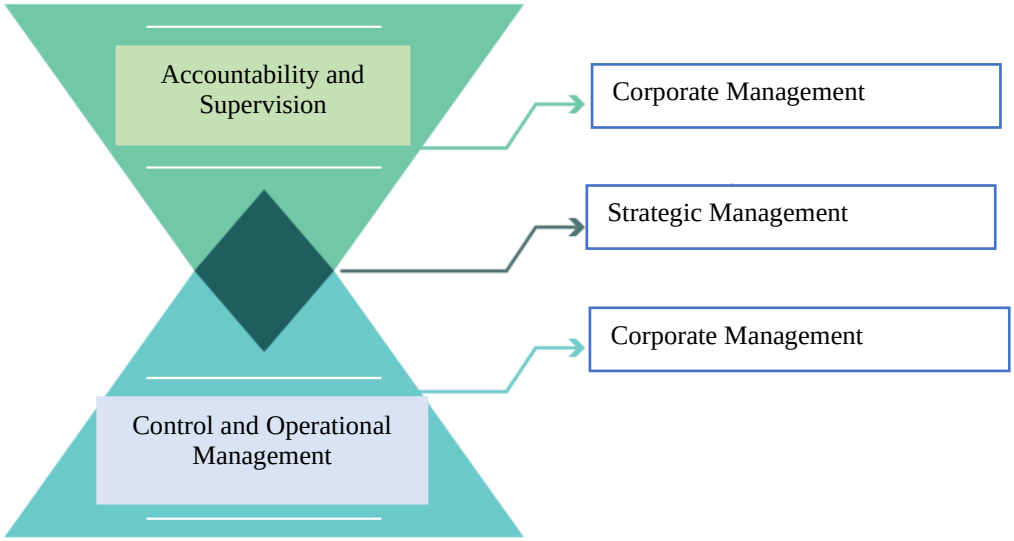
Finally, individuals have an important responsibility for the execution of good governance principles. Every person is a consumer, a citizen and an individual. By upholding good governance principles including consistency, impartiality, transparency, accountability, participation and efficiency, they can contribute to the development of institutions, such as NGOs, and to the improvement of social welfare. (Toksöz, 2008)

2.4. Execution of the Concept of Governance in Institutions: Corporate Governance

Corporate governance is a set of emerging and developing systems based on various disciplines such as macroeconomics and microeconomics, business management, commercial law, capital markets law, strategy, and accounting. Its primary goal is to maximize social benefit through sustainable development and good corporate management. Executing good corporate governance in this field, which is fed by various disciplines, is not a goal that can be achieved solely through legal regulations, regulatory authority coercion or audit. To accomplish this goal, first the board of directors, executives and employees, who have internalized the benefits of good governance for the shareholders, institution, employees, and society, should have an awareness of good governance. For example, if the rules of good trade governance derived from global best practices are not internalized by a society's stakeholders, to expect de facto execution of those rules will be inevitably vain.

Corporate governance is concerned with a company's structure and processes to ensure impartial, responsible, transparent, and accountable corporate behavior. In this respect, it should be differentiated from governance in public administration. Corporate governance should also be discussed separately from management, which is concerned with the tools required to run a business. Corporate strategy is an important point at the intersection of management and corporate governance (International Finance Corporation, 2018). The following figure shows the relationship between management and governance:

Figure 2.4-1: Corporate Governance and Management



Reference: (International Finance Corporation, 2018)

Considering that society is an important stakeholder, the development of governance in companies is critical for progress and social well-being.

In general, corporate governance practices are an important tool for ensuring the long-term viability of institutions. These principles have gradually become widespread and even mandatory in the business world due to the increased complexity of partnership and management structures, failures, misappropriations, scandals and financial crisis at top management level. This background and theoretical framework are discussed in detail in the following sections.

2.4.1. Historical Development of Corporate Governance

Considering the historical development of corporate governance concept, first legal experts have addressed the issue in the academic field. Then, the issue has stood out on the agenda of institutional investors and later has entered the agenda of academics in economics and management.

Due to the broad scope of the topic, it is difficult to pinpoint a specific date for the emergence of corporate governance. After the emergence of corporate structures, corporate governance was born essentially due to the power balance between investors and managers. As a result, the subject's history can be traced back to companies founded in the 16th and 17th centuries, such as the East India Company, the Hudson's Bay Company, and the Levant Company (Cheffins, 2012).

After showing the chronological development of corporate governance in the table below, we will examine the key developments in corporate governance in the United States, the United Kingdom and international circles in more detail.

Figure 2.4-2: The Evolution of Corporate Governance

Date	Developments
1600's	A Board of Directors was created by the East India Company, and control and ownership was separated
1776	Adam Smith warned against weak controls on management and management incentives in his book, The Wealth of Nations
1931	The book "The Modern Corporation and Private Property" was published by Berle and Means
1933 - 1934	In the United States, the Securities and Exchange Commission (SEC) was established
1987	The Treadway Commission (COSO) published a report on fraudulent financial reporting and developed a framework for internal control
1992	Cadbury Report (England)
1994	King Report (South Africa)
1994 - 1995	Rutteman, Greenbury and Hampel Reports (England)
1995	Vienot Report (France)
1996	Peters Report (The Netherlands)
1999	The first corporate governance principles of the OECD
	Turnbull Report (England)
2001	Enron, the seventh-largest company in the United States, declared bankruptcy
	German corporate governance legislation
	Sarbanes-Oxley law in the USA
	Winter Report on the European Union
2003	Higgs Report (England)
2004	The Parmalat scandal in Italy
2015	Following the 2008 financial crisis, the OECD updated its corporate governance principles

Reference: (International Finance Corporation, 2018)

2.4.2. Evolution of Corporate Governance in the USA

The term 'corporate governance' first emerged in the United States in the 1970s. (Cheffins, 2012), During this era there was a significant revolution in its theory, as theoreticians abandoned the myth that companies are managed by boards of directors and started to develop a new model.

The idea that companies should be managed by boards of directors was at the core of the traditional corporate governance model. Although this assumption and rule was present in the legal regulations, in effect, it was the executive directors, primarily the CEO, who managed the companies; that is, the boards of directors did not manage the companies. These executive directors could also be members of the board of directors at times; but their authority to manage the company derived from their status as executive officers rather than board members. The boards of directors usually approve the executive directors' proposals and rarely question or coach them, only changing the CEO in times of crisis. They did not even plan the overall strategy of the company. The reason why the boards of directors are not able to manage the company is not due to the shortcomings of individuals, rather because of structural problems. That is, it was not possible for them to manage the company even if they wanted to. Primarily, the board of directors is dominated by the CEOs and their affiliated teams, while

independent members are not truly independent. In addition, it is not possible for outside members to get to know or take enough time to manage the company (Dent, 1981).

The new model, which was created because the traditional model did not work, is actually the board oversight model. According to this new model, the company is managed by executive senior managers, while the board of directors, which consists of mostly independent members, oversees the performance of the management (Dent, 1981). Corporate governance, which entered the business world, the agendas and dictionaries of academics and public authorities in the 1970s, increased its prominence in the following years.

After the Second World War, a long period of economic growth began in the United States synonymously with a rapid growth in leading companies. In this environment, the operational patterns of businesses were not given great importance and the term "corporate governance" was not in use. The widespread informal payments made by American corporations to foreign public officials prompted the US Securities and Exchange Commission (SEC) to intervene in the issue of corporate governance in the mid-1970s (Cheffins, 2012). In 1976, the term ‘corporate governance’ was first used in a federal official gazette in the United States. The first important action following the use of the term was that the SEC required the New York Stock Exchange (NYSE) to create an audit committee consisting of independent board members of companies as a condition of going public. The NYSE complied with this rule. (Moon, 2019). During this period, the Foreign Corrupt Practices Act (FCPA), which was first published in the United States in 1977, transformed both the fields of corporate governance and internal audit.

Acquisition litigations, board structures, and management fees were all important issues on institutional investors' agendas in the 1980s, allowing corporate governance to be linked to shareholder value and allowing financiers and economists to conduct additional research in this area. (Cheffins, 2012).

The following issues have been pivotal in the transformation of and the debate on new corporate governance model (Dent, 1981):

- Performance review and wages policy for upper management,
- Nomination of board members,
- Determination of auditing and accounting policies and procedures,
- Respecting the rule of law,
- Delegation of managerial responsibilities to company employees and executives' attentive management tasks,
- Review of transactions with related parties,
- Supervision by board of directors and social objectives.

Sarbanes Oxley Act[2] (SOX) which went into effect in 2002 following the Enron scandal in 2001, was the most significant change in corporate governance in the United States. In addition to implementing numerous reforms aimed at strengthening corporate responsibility, improving financial disclosures, ensuring auditor independence, and preventing accounting corruption, this law established *the Public Company Accounting Oversight Board* (PCAOB) to oversee the financial audit sector (US Congress, 2002).

2.4.3. Corporate Governance in England

Since the Cadbury Report was published in 1992, corporate governance has become a major issue in the United Kingdom (Committee on the Financial Aspects of Corporate Governance, 1992). Since then, the Cadbury report has formed the basis for international corporate governance principles, allowing new practices to be implemented in most countries.

The Cadbury report became vital as investors lost trust in the honesty and accountability of publicly traded institutions following the sudden financial collapse of two large groups in the United Kingdom. The two major events that led to this atmosphere were the sudden collapse of the wallpaper group Coloroll and the Asil Nadir, despite their healthy appearance in the published financial statements of the Polly Peck consortium. In fact, while the committee was working, the scandals of two firms, Bank of Credit and Commerce International and Maxwell Group, shocked the financial world and increased the significance of the report prepared by the committee. (The Cadbury Archive, 2020).

The Cadbury report was followed by the 1995 report of the Greenbury Committee, which assembled because of the concerns about the high wages of top executives. Corporate governance principles (*"The Combined Code on Corporate Governance"*) were published based on the Hampel Committee report. The Committee assembled to review the implementation of the objectives put forward by these two reports. (Financial Reporting Council - UK, 2020).

2.4.4. Corporate Governance Regulations of International Institutions

Following the global crises caused by governance problems in the 1990s, the OECD's Business Sector Advisory Group on Corporate Governance prepared a report[3] titled "Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets.". As a result of this report, which was prepared by a commission chaired by Ira M. Millstein, it has been concluded that corporate governance practices are constantly evolving to keep up with changing conditions. Moreover, the report put that there is no single general model or a static and decisive structure, which every country can

[2] Its official name is the "Public Companies Accounting Reform and Investor Protection Act", but it is named after the sponsors of the law, Senator Paul Sarbanes and House of Representatives Michael G. Oxley.
[3] Angel Gurría, Secretary General of the OECD. G20 Ministers and Central Bank Presidents Meeting 4-5 September 2015, Ankara

adopt. Corporate governance practices will continue to differ across countries and cultures and observing these differences will yield significant benefits. Nonetheless, it was suggested that minimum standards should be established in areas such as of board of director oversight and that international rules, particularly in areas such as accounting, should be defined. (OECD, 1998).

Later, the OECD Council of Ministers approved OECD Corporate Governance principles in 1999 and those principles have since become an international reference for decision-makers, investors, companies, and other stakeholders worldwide. After this, updates were made over time due to events such as the dot.com crisis, the Enron scandal, and the 2008 financial crisis. Since its approval, those principles have kept the issue of corporate governance on the agenda and have been a guide for legislative and regulatory initiatives in OECD member countries and non-OECD countries alike. (OECD, 2004)

Indeed, during the presentation of the OECD Principles of Corporate Governance Report, the OECD Secretary-General emphasized that the main goal of good governance is sustainable growth in both state and corporate management and that good governance in all sectors is integrated with each other:

> *"Good corporate governance is not a goal in itself. It is a tool for the creation of market confidence and business integrity, which are necessary for companies seeking equity for long-term investment. As a result, the principles contribute in a timely and tangible way to the G20's 2015 priority of supporting investment as a strong driver of growth.*
>
> *Inclusion is also emphasized in the Principles. Today, millions of households save in stock markets, either directly or indirectly. Furthermore, publicly-traded companies employ over 200 million people. The Principles also address the rights of these stakeholders and their participation in the creation of corporate wealth."*

The European Union's (EU) first step in this regard was the publication of the first EU Action Plan. The plan followed the European Commission's Winter Report in 2003, which was a reaction to major governance scandals around the world. This strategy was built on four pillars: modernizing boards of directors, improving corporate governance disclosures, strengthening shareholder rights, and coordinating corporate governance initiatives across member countries. Following the publication of the European Union's 10-year objectives in 2010, the European Commission published the second EU Action Plan in 2012 in order to increase transparency by setting objectives concerning board structure, and shareholder identification and loyalty The main difficulty that EU faces concerning corporate governance practices is that 28 different countries have different legal and economic infrastructures. Hence, EU regulations are a mixture of soft law and statutory regulations in general (International Finance Corporation, 2015).

Apart from these regulations and studies of international institutions, the King Report, published in South Africa in 1994, is of particular importance. It emphasizes the cruciality of corporate governance for developing countries. The most recent version of the report was published in 2016 (Institute of Directors Southern Africa, 2016).

2.5. Corporate Governance Theories

The change in the SEC's view of corporate governance in the 1970s in the USA and the timing of the FCPA law's coming to the fore coincide with the timing of an important academic publication that re-emphasized the need to improve corporate governance practices in the economics literature. (Cheffins, 2012). A theory regarding a firm's ownership structure is developed in the article (Jensen & Meckling, 1976), which is one of the two most cited works in the corporate governance literature. In this article, the issues caused by leaving the management of public companies to third parties, which is stated as an important social invention, are defined as agency costs. The distinction between stock ownership and control (principal-agent problem), particularly in large companies, is explained in Fama's article (1980) which is another major academic publication on this subject. The costs of ownership and agency problems were discussed in the main publication of corporate governance theory by Berle & Means (1932).

The ownership and agency problems stem mainly from the fact that the utility maximization of the executives, who serve as proxies, is not always aligned with the activities that amplify shareholder value. Executives may be concerned with short-term gains because of their remaining time in the company or they may prefer low-risk projects to secure their careers. The accounting scandals and corporate corruption are ultimate results of this proxy problem. (Baker & Anderson, 2010).

While agency theory assumes that executives will maximize their interests, other theories take different motivations or relationships into account. According to stewardship theory, the goal of executives is to achieve growth and strategic objectives, and therefore, they serve organizational targets rather than their personal ones. They identify with the institution, strive to do their best, and are motivated by the institution's success. (Davis, Schoorman, & Donaldson, 1997).

The stakeholder theory was first mentioned in R. Edward Freeman's book "Strategic Management - A Stakeholder Approach" published in 1984. According to this theory, parties such as employees, customers and suppliers have a significant share in the company. Consequently, their interests should be taken into account alongside the interests of the shareholders. (Freeman, 2010). In short, management decisions should consider the interests of all stakeholders. (Baker & Anderson, 2010).

These corporate governance theories that we have summarized have evolved over the years thanks to social and economic needs and have shaped corporate governance good practice principles at various levels. Furthermore, to overcome the shareholder value maximization problem in the agency theory, incentives such as share and stock options were given to the top executives.

2.6. Definitions of Corporate Governance

There is no single, overarching definition of corporate governance. Nevertheless, it is critical to consider the definitions put forward by various institutions. By institution, we mean not only companies but also associations and foundations.

Corporate governance in the broadest sense is the regulation of the management of any institution that people create to achieve a purpose in modern life. In a narrower sense, it refers to all kinds of laws, regulations, codes, and practices that allow an institution to attract human and financial capital, operate effectively, and thus create economic value for its partners in the long term while respecting the values of the society to which it belongs. The major universal principles of corporate governance are impartiality, accountability, transparency, and responsibility. In the light of these principles, corporate governance strives for the highest level of performance, profitability, success, and competitiveness (Türkiye Sanayici ve İşadamları Derneği, 2002).

Compared to publicly traded companies (BIST 100), small and medium enterprises (SMEs) lack an elaborate awareness for corporate governance in Turkey. Similar studies on enterprises in other provinces are also available.

Corporate governance is the sum of processes, conventions, policies, laws, and rules that affect the management and control of a company. Corporate governance also applies to the relationships between stakeholders and the organizational objectives. Shareholders, executives, and the board of directors are the stakeholders. Other stakeholders are employees, suppliers, customers, banks, regulators, environment, and society. (Alacaklıoğlu, 2009)

Corporate governance is a complex issue. Accountability, fiduciary duties and mechanisms for supervision and control are all important principles of corporate governance. Individuals in any corporate governance system should follow the rules of the ‘game’ to protect the interests and well-being of all stakeholders. Another focal point is economic efficiency. Corporate governance, in a broad sense, refers to all of the rules, relationships, systems, and processes that companies use to exercise and control supervisory authority. (Alacaklıoğlu, 2009).

Corporate governance is difficult to quantify because it encompasses all systems involving institutional management and control. Some of those systems are not easy to quantify numerically.

Governance means more than policies and procedures. It is concerned with how we make decisions, set goals, and monitor progress. It is about motivating, disciplining, and rewarding labor relations and behavior. Furthermore, effective governance is a work in progress. Legislations change over time, new trading requirements emerge, and stakeholder needs diversify (The Institute of Internal Auditors, 2019d).

According to the Cadbury report, which is considered as the basis of recent principles and practices, corporate governance is the system in which businesses are managed and controlled. Boards of directors oversee governance, while shareholders appoint board members and auditors and ensure that a solid governance structure is in place (Committee on the Financial Aspects of Corporate Governance, 1992).

Corporate governance, according to the OECD, involves the relationship between a company's management, the board of directors, shareholders, and other stakeholders. Furthermore, corporate governance provides a structure in which the company's objectives, means to achieve those objectives, and performance management are outlined (OECD, 2015).

Corporate governance is the application of ethical and effective leadership by the governing body to achieve the following governance objectives (Institute of Directors Southern Africa, 2016):

- Ethical culture,
- Good performance,
- Effective control,
- Legitimacy

Corporate governance, according to the Australian Securities Exchange (ASX) Corporate Governance Council, is the framework of rules, relationships, systems, and processes through which authority is exercised and controlled in organizations (ASX Corporate Governance Council, 2019). According to the Australian Institute of Governance (Governance Institute of Australia, 2020), governance encompasses the system in which an organization operates and is controlled, as well as the mechanisms by which the organization and its employees are held accountable. Ethics, risk management, compliance, and administration are all elements of governance.

According to Ira M. Millstein, who has made a great contribution to the literature, corporate governance is a combination of laws, regulations and voluntary private sector practices that enable a company to attract financial and human resources, work efficiently, and therefore, provide stability by creating long-term economic profit for its shareholders without harming the interests of beneficiaries and the public (TKYD, 2020).

According to Argüden (2020) corporate governance, in its broadest terms, forms the basis of corporate trust. Although there is no single formula for ensuring this trust, the universal principles developed for good governance can be certainly utilized in this area, as well. One of the fundamental principles of good state management is the separation of powers, which can be achieved in corporations by separating the chairman of the board of directors and the general manager or by delegating financial control to an independent third institution. Sharing information is one of the most fundamental aspects of allocating trust. As a result, another key to establishing trust is to provide all stakeholders with the level of information they require in a fair, easy, and timely manner. Institutional success today necessitates a participatory approach by decision-makers, the adoption of a culture of transparency and accountability, being impartial and consistent, and corporate management structures that are trustworthy.

Institutions must earn trust in terms of not only financial but all resources they use to create value. Transparency is the primary way to build trust. Every person and institution that uses the resources of others can access even more resources and achieve sustainable development if they follow the principle of impartiality and accountability (Argüden, Yönetim Kurulu Sırları, 2020).

Contrary to common belief, corporate governance is a management culture, not a set of rules. Argüden (Yönetim Kurulu Sırları, 2020) explains this view as follows:

> *"The fact that the board of directors acts in accordance with the principles of governance and emphasizes the importance of this issue accelerates the organization's role as a model, and therefore, the adoption of corporate governance throughout the structure. Corporate governance means not only preventing decision-makers from abusing their powers, but also ensuring that they use them prudently, impartially, and in a value-creating manner. Company management is in charge of running the business on behalf of shareholders and other non-shareholder stakeholders. However, it is also necessary to guarantee that there is no conflict of interest between the directors and the shareholders and that the management's risks are consistent and balanced. Corporate governance is a set of behaviors, a culture, and a climate that adds value beyond rule compliance and takes into account responsibilities and balances. Success and sustainability in corporate governance is ensured through regular measurement, evaluation and improvement of performance in this area."*

2.7. Consequences of Corporate Governance Issues

The main factor in a person's decision to join a company (via financial capital, expertise, or labor) is the belief that they will receive a fair share of the company's revenues. If some people receive more than a fair amount, others may end their relationships with the company, indicating a possible

collapse. Corporate governance is critical in preventing such collapses because it is the primary mechanism for establishing trust among all stakeholders. (Alacaklıoğlu, 2009)

The gravity of corporate governance has been highlighted dramatically in the early twenty-first century as a series of corporate collapses caused by management misconduct, mismanagement, and neglect have resulted in a massive meltdown in shareholder wealth. Owners, or shareholders, began to question who oversaw the sustainability and growth of their investments' value, assuming there was any in the first place (Baker & Anderson, 2010).

Inadequate and weak corporate governance practices led to the reputational or financial destruction of some large institutions in the last few years. Some of them are summarized below:

Raiffeisen Bank: Switzerland's financial sector supervisory authority (FINMA) stated in a press release in June 2018 that a major corporate governance weakness was identified as a result of the ongoing corporate governance investigation and sanctions would be imposed. According to FINMA, the bank's approach to managing conflicts of interest was insufficient and the bank's board of directors had not adequately supervised the previous CEO, who potentially pursued his self-interest at the expense of the bank (Swiss FINMA, 2018).

The regulatory authority's emphasis on corporate governance issues in the bank scandal and the fact that despite a potential control deficit the board of directors was held accountable for the CEO's activities clearly demonstrates the necessity for implementing and auditing good governance.

Carillion: The company's board of directors, which has a highly experienced board and no problems with its independently audited financial statements, prepared this end essentially with a series of erroneous transactions. Acquisitions that resulted in heavy indebtedness were not avoided, aggressive accounting policies such as early revenue recording were followed, dividends were continued to be paid instead of receiving capital support from shareholders, and high bonuses were paid to senior managers (Burgess, 2018).

The Carillion experience has also revealed a weak spot in the UK corporate governance system that it is heavily shareholder-oriented and places other stakeholders in the background. Although the auditors, managers, board of directors and shareholders were all aware that the company was deeply indebted no action was taken. In the end, many stakeholders such as employees, suppliers, and customers became devastated. (Trades Union Congress - UK, 2018). In this sense, the Carillion case is an epitome of the aforementioned shareholder theory.

Good corporate governance practices are an important tool to ensure that effective capital allocation is maximized for both private sector and companies, in addition to reducing the cost of

sourcing. Considering what we have discussed so far, we can conclude that companies with better governance structures are more beneficial to the economy and society alike. Companies that internalize good governance practices (also known as "corporate companies") are acknowledged as adding more value to their employees, consumers, households, and the regions and countries in which they operate. Due to the fact that good governance provides confidence, these companies also gain a viable advantage over their competitors.

According to (Kaufmann, 2003) for example, poor financial governance increases the financial system's liabilities. This situation distorts public institutions, and the deteriorating financial system and public finances may lead to a financial crisis in the future. As explained above, this transmission mechanism is critical for demonstrating the contribution of good governance to society and the economy in the private sector. A similar situation was observed in Turkey during the 2001 and the earlier financial crises. The problems faced by the banks with bad governance structures had a snowball effect on the economy and led to a major crisis. After those crises, legal regulations introduced mandatory comprehensive governance rules and financial criteria to the banking sector.

According to OECD statistics, approximately 75% of joint-stock companies in countries the economies of which are based on industry are either family-owned or controlled by families. Nearly one-third of Fortune 500 companies are family businesses. Worldwide studies show that less than 30% of family businesses live to the third generation and less than 15% are managed by the third generation. (Alacaklıoğlu, 2009)

The three most important reasons why family businesses fail or go bankrupt are insufficient financial planning, failure of provisions for the transition to the next generation and failure to allocate funds for paying inheritance and wealth taxes. The main factor that deteriorates the conditions is the death of the founders. If the family has not official resolutions, such as the family constitution to solve the problems between family and business through the councils it has established, dissolutions threaten the organization. As the family organization becomes more crowded and complex, structures such as the board of directors and the family council need to be incorporated. The initial reaction to those structures could be discomfort and resistance to these structures can occur. A family business's ‘lack of good corporate governance’ not only harms or even destroys it, but it can also harm important sectors of the national economy (Alacaklıoğlu, 2009).

Table 2.7-1: Fraud Detection, Corporate Scandals and Financial Reporting Findings

Corporate Governance Weakness	Satyam	Parmalat	Enron	Global Crossing	Tyco	Qwest	Lehman Brothers	Citigroup	World.Com	Total Red Flags
Powerful CEO and Insider Board Influence	Y	Y	Y	Y	Y	Y	Y	Y	Y	9
Weak internal control	Y	Y	Y	Y	Y	Y	Y	Y	Y	9
Focus on short-term performance	Y	N	Y	Y	Y	Y	Y	Y	Y	8
Weak or no ethic code	Y	Y	Y	Y	Y	Y	Y	Y	Y	9
Opaque strategy and disclosures	Y	Y	Y	Y	Y	Y	Y	Y	Y	9
CEO has low tolerance to criticism	N	Y	Y	N	N	Y	Y	Y	Y	6
Insider stock sales	N	N	Y	Y	Y	Y	N	N	Y	5
Senior management turnover	Y	Y	Y		Y	Y	N	N	N	5
Independence conflicts with auditors	Y	Y	Y	Y	Y	Y	N	N	Y	7
Independence conflicts with investment bankers		Y	Y	Y	Y	Y	N	N	Y	6
Red Flags-Total	**7**	**8**	**10**	**8**	**9**	**10**	**6**	**6**	**9**	

Reference: (Grove & Basilico, 2011)

An important lesson to be learned from the scandals resulting from a lack of corporate governance, the entirety of which would be a study in itself, is that good governance does not merely refer to compliance with the rules issued by regulatory authorities. Rather, it is critical for a company to establish better oversight and accountability systems in order to create a corporate culture that involves internal and external stakeholders.

2.8. Principles of Good Corporate Governance

Institutionalization, which is based on the stabilization of institutions in terms of certain rules, laws and values and bringing a standard to their behavior, will ensure more effective results in terms of accountability, transparency, efficiency, and performance in terms of control and participatory management of enterprises when adopted together with the concept of governance. Corporate governance is critical in building corporate stakeholders' (small-large shareholders, boards of directors, suppliers, funders, customers, and the like) trust in the institution. Accordingly, there is a positive correlation between a firm's institutional reliability, the interest shown by national and international market participants in a firm, and corporate performance. (Bay, 2017)

Corporate governance establishes a framework within which the company's objectives are set and the methods for achieving these goals and evaluating performance are designed. Good corporate governance should provide appropriate incentives for boards of directors and top management to pursue goals that benefit the company and its shareholders in addition to facilitating effective oversight. The existence of an effective corporate governance system on a corporate basis and throughout the economy provides the confidence necessary for the proper functioning of the market economy. (OECD, 2004)

The quality of corporate governance affects the cost that companies bear to access capital for growth. It also influences the confidence of those who provide this capital either directly or indirectly since they need to be reassured that they will be able to share the value created by the companies on fair and equivalent terms. In this sense, corporate governance rules and practices provide a framework for bridging the gap between household savings and real-economy investments. Thus, good corporate governance will reassure shareholders and other stakeholders that their rights are protected, while also allowing businesses to lower their capital costs and to gain access to capital markets. Even if a company does not primarily rely on foreign capital, a credible corporate governance framework supported by an effective supervisory and enforcement mechanism will help increase domestic investor confidence, lower the cost of capital, support the proper functioning of financial markets, and ultimately lead to more stable sources of finance (OECD, 2015).

Corporate governance is a paradigm that encompasses a variety of topics such as ethical rules, legal compliance, and environmental protection. This paradigm is the unifying framework of corporate governance principles, which aim at ensuring institutional success by achieving the highest performance possible. Without this framework, neither a good moral approach nor environmental awareness will be sufficient to make an institution successful. The responsibility that comes with success as a result of corporate governance principles guarantees that an institution passes on its core values to future generations while also satisfying the expectations all of its shareholders and stakeholders. (Türkiye Sanayici ve İşadamları Derneği, 2002).

The directors of an independent joint stock company are different from the boards of directors and managers of group companies that are directly obliged to implement the macro policies of the controlling shareholder. As a result, the corporate governance principles that to which they should comply with must be also unique (Tekinalp, 2010).

Good corporate governance, a broader definition that includes being a descent company and having business ethics, strongly supports ethical and responsible business practices by promoting sound management systems. However, corporate governance is a distinct set of principles, the main purpose of which is to ensure that the company is managed in accordance with its interests (International Finance Corporation, 2018).

The OECD's corporate governance principles are based on four fundamental values (International Finance Corporation, 2018):

- Impartiality: All shareholders, including minority and foreign shareholders should be treated equally and their rights should be protected. All shareholders should be able to receive reasonable compensation if their rights are violated.
- Responsibility: Stakeholders' rights should be defined in accordance with the law. Active cooperation between companies and stakeholders in creating prosperity, jobs and sustainability should be encouraged.
- Transparency: The corporate governance framework should ensure that all important company issues, such as financial position, management structure, performance and ownership are disclosed in a timely and correct manner.
- Accountability: The corporate governance framework should provide strategic guidance to the company, effective monitoring of management by the board, and accountability of the board to the company and shareholders.

Although there are governance principles identified by various international institutions, the corporate governance principles of the OECD, which has the widest application area in the world, consists of six basic elements:

a. Providing the foundation for an effective corporate governance framework
b. Shareholders' rights, fair treatment of shareholders and basic partnership functions
c. Institutional investors, stock markets, and other intermediaries
d. The role of stakeholders
e. Public disclosure and transparency
f. Responsibilities of the board of directors.

The first task of providing a good corporate governance environment is taken on by the state. Corporate law, securities law, accounting and auditing standards, bankruptcy law, contract law, employment law, and tax law have an impact on corporate governance requirements and practices. Human rights and environmental laws also have an impact on corporate governance practices. Considering those interactions, policymakers must ensure that there are no legislative conflicts that would hinder good governance (OECD, 2015).

In addition to establishing indirect or direct legislation and institutions needed for good governance and ensuring that they work in harmony, the public authority should also make explicit regulations and monitor implementation of them to guarantee that the rights of shareholders are protected in a fair and easy system. For instance, it is a fundamental partnership right to elect board members. In order for the selection process to be effective, shareholders must be able to participate in the selection process of board members and vote on individual or a list of candidates. To this end, in

many countries shareholders are provided with the opportunity to access the voting documents of the company on the condition that abuse is avoided. Regarding the nomination of candidates, boards of directors in many companies have established nomination committees to ensure compliance with established nomination procedures and to ensure a stable and qualified board of directors. It is considered good practice for independent board members to have an important role in that committee. (OECD, 2015)

The third element of good corporate governance includes principles concerning institutional investors, stock markets, and intermediaries. In particular, for institutional investors act as intermediaries on behalf of fund owners, it is their responsibility to exercise their shareholder rights. Furthermore, because not using those rights may have serious repercussions, it is important to explain the policies followed by institutional investors to public. (OECD, 2015)

The fourth element of good governance pertains to ensuring the optimum participation of stakeholders other than company shareholders in the governance process.

Long-term company success is the result of collaboration between various resource providers, including investors, employees, lenders, customers, suppliers, and other stakeholders. In this context, all stakeholders' legal and contractual rights should be respected. Moreover, mechanisms for employee participation in the governance process should be developed to the greatest extent possible and access to necessary information should be provided. In addition, the establishment of ethical rules and reporting mechanisms, which are of great importance in stakeholder relations, constitutes one of the basic elements of good corporate governance. Unethical or illegal practices do not only trigger financial losses but also create serious reputational risks. (OECD, 2015) As a consequence, regulating ethical mechanisms is critical for a company and its executives, stakeholders and particularly shareholders.

The fifth element of good governance is to ensure that all essential company issues, such as financial position, performance, partnership structure and management, are disclosed in a timely and accurate manner. Surely, it is expected that public disclosure requirements will not impose unreasonable administrative or financial burdens on companies. (OECD, 2015) It is one of the insurances of good corporate governance to have mandatory regulations regarding the disclosure of related party transactions so that the shareholders would feel protected at the highest level possible and that the shareholders would acknowledge how they stand with other shareholders and related parties.

Last but not the least, conceivably the most important governance principle for the effective and successful management of a company in the corporate governance best practices guide of OECD (2015) is the responsibilities of the board of directors. Indeed, since the board of directors is the highest and most responsible body in the governance of a company the primary obligation to the shareholders and all stakeholders rests with the board of directors.

Board structures and procedures differ across and within countries. Some countries have two-tier boards that separate the supervisory and management functions into separate bodies (for example, Germany has a two-tier system). In most cases, these structures include a ‘supervisory board’ made up of non-executive board members and a ‘management board’ made up entirely of executive members. Other countries have a unitary board of directors made up of both executive and non-executive board members. Some countries also have a separate legislative body designed for supervision. (OECD, 2015)

Companies can manage their risks in the most effective way, avoiding costly lawsuits and reputational problems on three basic conditions. First, corporate governance principles should go beyond just being seen as a compliance issue. Second, secure internal control should be instituted. Finally, rules and procedures should guarantee responsibility and accountability in management decisions.

2.9. The Role and Status of Board of Directors in Corporate Governance

The primary stage in the establishment and development of companies is the realization of an entrepreneur's business idea and then the transformation of the structure into a legal entity. When considered from this point of view, companies are principally founded by individuals, and family companies form the basis of them. Even if we go far beyond this early stage, large family businesses still play an important role in the world economy.

The first stage in a family (or start-up) company is an informal management stage in which the founder assumes all responsibility and authority. Nobody can object to this organization and the only goal is the company's survival. Structures such as the board of directors (and family council) must be added as the family or partnership system becomes more crowded and complex. There is a clear distinction between the responsibilities of those who run the company and the shareholders for whom they are accountable, as well as the members who own the company. The final step in good governance practices is building an independent board of directors that runs and oversees management. This board particularly supports the CEO and his/her team. At the same time, the Board of Directors is responsible to the shareholders as a distinct institution. Shareholders no longer conduct business. Ideally, they act as guardians of family assets and secure the future of the company by choosing the right board of directors for sustainable growth (Alacaklıoğlu, 2009).

In addition to guiding the company's strategy, the board of directors is primarily responsible for monitoring company performance and generating adequate returns for shareholders by avoiding conflicts of interest and balancing competing demands. For boards of directors to carry out their responsibilities effectively, they must be able to exercise impartial and independent judgment. Another important responsibility of the board of directors is to audit the risk management organization and the

systems mandated to ensure that the organization complies with statutes at large regarding tax, competition, labor, environment, equal opportunity, health, and worker safety (OECD, 2015).

Many countries have board structures in their legal systems. However, countless professionals and company owners consider those structures from the perspective of legal responsibility only, not from a genuine management or performance point of view. In many of the companies studied, the board of directors was not well respected, and business was conducted informally between shareholders or as a family matter. According to studies conducted in Europe, the boards of directors in real life have four different prototypes, such as advisory board, board of representatives, proactive board of directors or executive board, and the most ideal prototype is the one that reflects the real corporate structure, which is proactive. Considering the companies in Turkey, it has been observed that most boards of directors function like executive boards (Alacaklıoğlu, 2009).

For ideas and actions in companies to be evaluated by an impartial person other than the shareholders, job descriptions should be formalized, family protocol booklets should be written for family companies, independent non-executive members should be appointed to the board of directors or an independent advisory board should be established. An ideal corporate board of directors should consist of mostly non-shareholders, competent independent members and a small number of family representatives (Alacaklıoğlu, 2009).

In performing its duties, the board should not appear or act as an individual representative group of the various components. Although certain board members may be nominated or elected by certain shareholders, the board members have to be impartial to all shareholders while performing their duties. This principle is critical if the controlling shareholders are in a position to elect all members of the board of directors (OECD, 2015).

In fulfilling its audit control responsibilities, the board of directors must encourage the reporting of unethical or illegal behavior without fear of punishment. For this purpose, ethical rules should be defined within the company and a compliance and ethics contact line should be provided to all stakeholders who want to report their concerns The Board of Directors must take the lead in ensuring effective risk management oversight. Moreover, the board should guarantee that senior management's oversight is carried out properly. Typically, this entails establishing internal audit systems that report directly to the board. It is good practice for internal auditors to report to the board's audit committee or an equivalent body that is also responsible for managing relationships with independent auditors. This practice is good because it allows for regular board involvement. Furthermore, it should also be considered good practice that the most critical accounting policies, which form the basis for financial reports, are reviewed by that committee or equivalent body and are reported to the board of directors.

However, the board should continue to be ultimately responsible for overseeing the company's risk management organization and for ensuring the integrity of its reporting mechanisms (OECD, 2015).

In addition, companies are required to establish and endorse measures to ensure the effectiveness of their internal control, compliance and ethics programs, and compliance with statutes at large, regulations and standards, such as laws criminalizing bribery and other forms of corruption. Companies must establish compliance programs to comply with legal regulations in different areas, including capital markets, competition, taxation, and environmental law. Moreover, those programs should build the core of the company's ethical rules. Compliance programs should also cover affiliates and, if possible, third parties such as agents and other intermediaries, consultants, dealers, suppliers, and business partners (OECD, 2015).

The separation of the roles of chairman and chief executive officer reinforces the impartiality and independence of the board of directors in some countries with a single-tier board system. The mechanism in question can also help ensure the company's high-quality management and the effective functioning of the board of directors. In some countries, the chairman or chief executive may be assisted by the general secretary of the company. It is a good governance practice to establish specialized committees within the board of directors to support the entire board of directors in the risk management functions and in the audit of financial statements depending on the size and risk profile of the company. When board committees are formed, the board should clearly define and explain their duties, member composition and working principles of Committees. (OECD, 2015).

2.10. Final Remarks on Corporate Governance and the Need for Audit

The concept of governance, as seen in our literature review above, has emerged mainly to regulate the relationship between a powerful state administration (i.e., the power), and the public and the bureaucracy. The fundamental mentality here is based on the principles of auditability, accountability, and transparency. The effort to ensure good governance for private companies, also known as corporate governance, can cardinally be construed as paralleling public administration objectives.

For example, the main objective of the World Bank's global governance practice has been determined as ensuring that countries create competent, effective, open, participatory, and accountable institutions. The reason for this is that the half of the world's population does not trust government institutions. Based on this information, as parts of society, individuals should question how much they trust private companies, which are the primary actors of production, employment, and development and how much they know about the institutional structures of those companies. Surely, non-public institutions are primarily accountable to their shareholders. Nonetheless, given that the entire society is

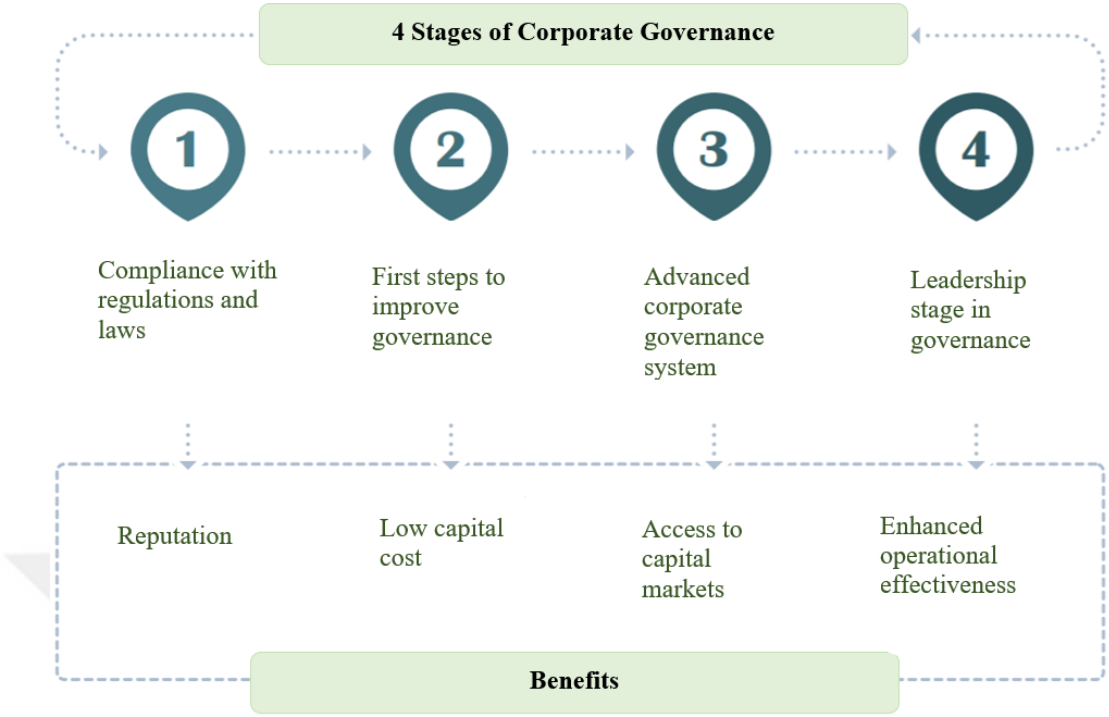
a stakeholder in and of itself, improving corporate governance can have a direct impact on a country's development and social welfare.

Since Corporate governance rules are mostly published by public authorities they are generally perceived by experts, corporate executives, and society, as reporting rules that must be followed by companies and professionals. However, corporate shareholders are not aware of the positive effect of corporate governance on increasing the value of the company, although this is the main objective of corporate governance. Principally though, if good corporate governance is perceived as corporate culture including both internal and external stakeholders, rather than normativity, corporate culture has a positive impact on company success. Consequently, good governance will be achieved.

Regularity bodies, the media, and all segments of the society irrespective of company's sphere of influence must be counted as stakeholders, if a company would like to achieve its good corporate governance objectives.

The Gilgamesh epic in the 4200-year-old Sumerian inscriptions echoes with the idea that governance can bring success if it is internalized, rather than being done only for the sake of blind obedience to rules. The gods introduce a 'doppelganger' (i.e., a twin) to the society as a check and balance mechanism, as response to the despotism of Gilgamesh. Even though, this top-down solution seems to work at first, the situation gradually becomes worse. The reason for this deterioration is the fact that the society does not internalize this top-down 'reform.' (Acemoğlu & Robinson, 2019). Likewise, real good corporate governance can be accomplished when values (such as culture and ethical practices) are internalized by all levels of an institution.

Figure 2.10-1: Stages and Benefits of Good Corporate Governance



Reference: *(International Finance Corporation, 2018)*

Improvements in the company's governance practices create better oversight and accountability, as they minimize the risk of corruption and self-interest. Accountability, effective risk management and internal control acts as a preventive measure by containing potential problems before they lead to a crisis. Good governance practices also strengthen decision-making processes. In institutions where the company's governance structure defines roles and responsibilities well, the board of directors, committees, and shareholders can make better decisions by receiving more accurate and timely information. Advanced corporate governance streamlines the company's business processes, improves operational performance, and reduces investment costs, which, in turn, contributes to a growth in sales and profits. Additionally, an effective governance system helps ensure regulatory compliance, allowing companies to avoid shareholder complaints as well as costly litigation such as conflicts of interest, corruption, bribery, and other disputes arising from insider trading. Furthermore, good corporate governance is critical in resolving conflict between minority and majority shareholders. Consequently, company officials have the opportunity to reduce the risk of personal liability (International Finance Corporation, 2018).

Good corporate governance should be divided into two categories: dealings with shareholders and deeds of company management. The issue of agency and its cost lies at the core of the corporate governance theory. Hence, good corporate governance aims at properly briefing all beneficiaries, especially the shareholders. However, establishing an audit committee and other similar committees and

complying with regulations are not the only deeds that must be done to increase shareholder value. The establishment of secure internal control systems and the transparent operation of the decision-making mechanism by putting rules and procedures in writing to ensure responsibility and accountability in management decisions also constitute the foundations of good governance practices within the organization.

Unless governance principles such as participation, effectiveness, efficiency, and sustainability are internalized, rather than remaining on paper, corporate governance objectives cannot be achieved. In other words, good governance practices in the private sector start, above else, in relation to the internal dynamics of an organization. Monitoring strategic plan management, creating an effective accountability mechanism for budget management, identifying the proper roles to create an authority architecture, and finally, truly implementing ethical codes are the foundations of corporate governance.

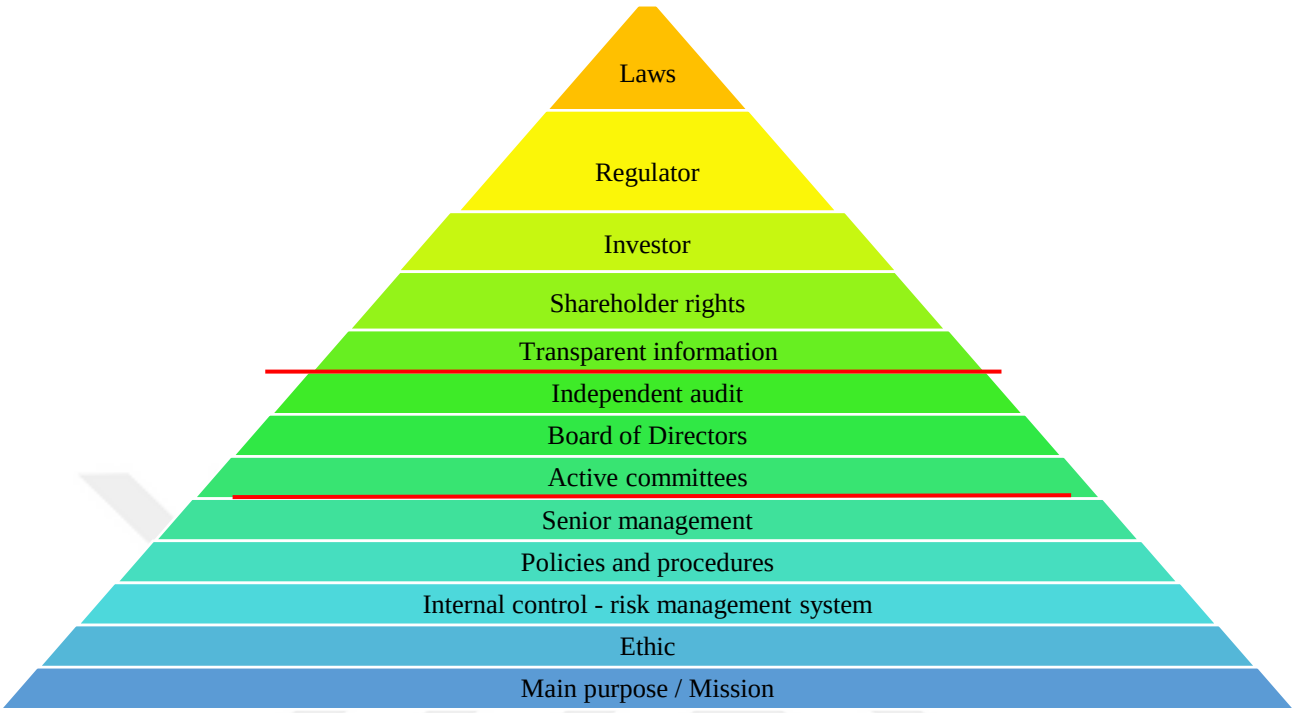
Sometimes good governance mechanisms may not work well with investors but work very well within the company, or vice versa. Essentially, it is the application of good corporate governance practices in both areas that will develop companies and increase the level of development of society in general through the private sector. For example, it is good corporate governance practice to inform and train employees to avoid being in a position of conflict of interest with the company; there are written rules on this subject, as well as on how to report and audit such cases.

Interaction with the human resource, which is an institution's most asset, is one of the most important success factors in corporate governance. Although it is not included in the institutions' financial statements, one of the most precious assets in real balance sheets of an institution is its talented employees. A company can be established and live on debt without any cash assets; yet it cannot achieve sustainability without its employees. Internalization of a good governance model based on principles such as openness, participation, efficiency, and effectiveness increase employee loyalty to the company, as the workforce is a critical stakeholder of a company.

Good governance is not a ‘tool’ that can be taken off the shelf and put into operation. After the seeds are planted, it takes years for them to grow and develop. In order to be successful, it must become an integral part of the shareholders, executive family if any, and company culture. Good governance for family businesses must begin with the owner family (Alacaklıoğlu, 2009).

Below, we show the important concepts within the scope of good corporate governance practice on a pyramid from the inside to the outside of a company (bottom-up). The rules and the section below should be considered as the foundation of the pyramid, while the board of directors and committees should be identified as the base of pyramid and the beginning represents relations with the stakeholders.

Figure 2.10-2: Governance from Inside out



Note: This pyramid representation, which describes corporate governance from the inside to the outside, belongs to the author.

Institutions can give confidence to their clients, suppliers and workforce, the whole financial system in terms of easier access to the capital and loan markets, and the whole society. The prerequisite of this confidence is implementing good corporate governance practices in all aspects of business life.

As in every area, there is room for improvement in governance. The issue is to identify it. Unfortunately, the available data indicates that insufficient progress has been made in reviewing institutional governance. Governance-related publications and briefings convey certain governance characteristics, but do not shed much light on the effectiveness of governance. Disclosures about the number of board meetings, executive backgrounds, and executive pay and benefits provide information about the governance structure yet not about the governance's success. As a matter of fact, even if a company's board meetings are held at the right frequency and in perfect timing, governance can still be ineffective (The Institute of Internal Auditors, 2019d).

Considering the discussion in this section, it can be concluded that there is a need to audit and review the performance of the corporate governance structure, which is critical for the sustainability of companies.

3. INTERNAL CONTROL AND INTERNAL AUDIT

3.1. Introduction to Internal Control and Internal Audit

Governance, enterprise risk management, and internal control are exceptionally significant concepts for any organization, considering the highly complex and volatile business environment. We have discussed governance both within a theoretical and practical framework in the first part and we will crystalize the connection between governance and internal audit in this part. To illustrate this connection in more detail, we have to start our discussion with a broader and related concept of internal control. Since internal audit's definition includes the assessment of all these three concepts, it has a vital role in governance, risk, and internal control. The relationship of these three concepts is depicted in the figure below:

Figure 3.1-1: Governance, Risk and Control[4]



The concepts of control and audit are two separate words in English, while their Turkish counterparts are often confused and used interchangeably. As we will discuss in more detail, the main purpose of control is to reveal the points of errors and weaknesses and to prevent the recurrence of those errors by taking corrective measures. In this aspect just like a measurement and weighing process, control is the management's evaluation and correction activity (Cömert, 2016).

[4] Source: (Committee of Sponsoring Organizations of the Treadway Commission, 2013)

Conceptual confusion is even more extensive in Turkey when it comes to real sector entities. We believe that this more prevalent confusion stems from incorrect guidance of certain regulations. Considering this confusion, we aim at clarifying internal control and internal audit concepts in the following parts. First, we will discuss the details of internal control to have a better understanding of internal audit. After setting the base of internal control and its connection with internal audit, we will extend our research into internal audit.

3.2. Internal Control

In his article on accounting history, (Hay, 1993) states that the internal control concept was first mentioned in professional statements in the 1920s. Most of the developments occurred after 1950. The American Institute of Accountants - AIA (the most recent name is AICPA) was the leading institution for the development of the concept during that era. The concept emerged mainly thanks to the auditing of accounting requirements and procedures. Below is the first definition published by AIA in 1949 (American Institute of Accountants. Committee on Auditing Procedure, 1949) which was used for 39 years:

> *"Internal control comprises the plan of organization and all of the co-ordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies."*

3.2.1. Internal Control Literature

Jensen's classical article (Jensen M. , 1993) about the failure of internal control systems argues that since the 1970s the internal control systems of companies have failed to deal effectively with the changes in the economic environment. Hence, he claims that internal control systems have needed a revival, starting with remaking the boards as the main component of an effective control mechanism. Jensen suggests that especially a board culture that puts politeness ahead of frank truth-telling failed internal control systems.

Jensen's findings and arguments paved the way for further research in better corporate governance and its interaction with internal control systems.

Focusing on SOX regulations, Doyle et al. (2007) have examined the determinants of weaknesses in internal control for firms that show material weaknesses. Their research has concluded that small, young and financially weak firms had serious entity-wide control problems. By contrast, companies that have more complex and rapidly changing structures with no serious financial issues show less severe weaknesses. Their findings strengthen the argument that there is no unique remedy for

internal control and every organization has to design its own framework considering its business objectives.

European countries' internal control regulations also had a significant positive effect on corporate governance. Evidence from Germany is displayed in Brown et al.'s (2014) article investigating the effect of internal control regulations on earnings quality. Their results show that German firms experienced an increase in timely loss recognition and a decrease in earnings smoothing after German legislation on control and transparency. Additionally, the sensitivity of capital investment efficiency to earnings quality increased after the regulation, which means that the reform had positive consequences for capital resource allocation. As a result, their work confirms that effective internal control and risk management systems increase accounting quality.

In their recent article, Shu et al. (2018) have researched the relationship between corporate integrity and internal control quality by using a unique survey data to measure corporate integrity. Their findings show that corporate integrity is significantly and negatively associated with internal control weaknesses. This conclusion indicates that corporate integrity can improve the quality of internal control.

In their literature survey article, Chalmers et al. (2019) have studied internal control in accounting research by reviewing the works on the determinants of internal control quality and its economic magnitudes for stakeholders. They have covered countries regulating control disclosure along with unregulated settings and both developed and emerging economies. Their analysis projects two main findings. Firstly, internal control has a significant effect on decision-making. Secondly, t is a positive correlation between audit committee characteristics and internal control quality.

Organizations may evaluate internal control by the well-known three lines model, which was updated by IIA in 2020. According to this model (The Institute of Internal Auditors, 2020),

- Business line departments are the first line, as they are mainly responsible for maintaining effective internal control in their daily operations. This line is the most significant in an organization's internal control system; however, employees in this line seldom recognize that they form a vital part of an internal control system. This lack of recognition increases the other lines' concern for improvement and responsibility.
- Supporting functions, such as compliance, legal, enterprise risk management, and financial control create the second line since their main responsibility is to clarify internal control requirements and evaluate compliance with internal standards.
- Finally more importantly, internal audit is the third line as it evaluates and reports on internal control and makes suggestions to management for the implementation of improvements. Ideally, the internal audit department's structure in an organization has to

be separate and independent enough from the line departments but close enough to track the strategy and operations.

According to Pickett (2005), effective controls are measures that work and provide a reasonable probability of ensuring that operations are prosperous, and assets are protected. Viewing internal control as a dynamic concept that runs across an organization as opposed to a series of simple procedures takes the matter o a more sophisticated level.

Turnbull explains where control responsibility lies in an organization as follows (Turnbull, 1999):

> *"The board of directors is responsible for the company's system of internal control. It should set appropriate policies on internal control and seek regular assurance that will enable it to satisfy itself that the system is functioning effectively. The board must further ensure that the system of internal control is effective in managing risks in the manner which it has approved."*

As organizations grow, they need a formal control framework as a foundation for their control systems. IIA highlights the importance of a set of organizational criteria for auditors in Standard 2210.A3. Adequate criteria are prerequisites of evaluating controls. That is, if adequate, internal auditors should use such criteria in their evaluation. If inadequate, internal auditors should work with management to develop appropriate evaluation criteria (The Institute of Internal Auditors, 2016).

The control mechanism has to have a simple design and a well-defined structure so that it can be comprehended by all potential users. Since control starts with setting standards and ends with reviewing, corporations should establish monitoring mechanisms. Control types are classified into four categories in general (Pickett, 2005):

- Directive controls aim at ensuring that there is a clear direction and drive towards achieving the stated objectives.
- Preventive controls ensure that systems work and risk is mitigated before it occurs.
- Detective controls aims at picking up transaction errors that have not been prevented.
- Corrective controls provide refurbishing solutions to the identified problems and to the threats to the business.

The internal control system exists at the core of the entity's management and permeates all the activities of the business, rather than being a separate unit added to the business later. The internal control system should be an ordinary part of enterprise units' processes and activities.

Internal control has two dimensions as managerial and accounting control in order to achieve its objectives. Managerial control covers all methods and procedures related to business management's plans, the efficiency of activities, and adherence to management policies. Managerial controls are an important tool that are used to comply with business policies. Accounting control covers all procedures and methods that are directly related to the protection of business assets and the reliability of financial records. These types of controls are generally in the form of authorization, authenticity, integrity, accuracy in records, and classification of transactions (Sabuncu, 2017).

As the uncertainty of achieving objectives grows, more measures are needed to shrink this ambiguity. Nevertheless, the measures will normally cost money and time and will tend to involve doing more work. It may be suggested that controls tend to cost money and slow an organization down and they cannot guarantee success. Consequently, whereas internal control can benefit an entity to achieve its objectives, it is not a panacea (Pickett, 2005).

According to Pickett (2005) sound governance systems are vital:

> *"If there is a sound system of corporate governance in place and if this underpins a robust control environment then an organization may develop a control policy, perhaps as part of the risk policy. Where none of the control infrastructure that has been mentioned is in place, then board awareness seminars on internal control may be used to start the ball rolling."*

The internal auditor should have the ability to evaluate the organization in terms of effective control issues before any worthwhile internal audit can begin. The consulting role of internal audit implies that the auditor assists establishing the control framework, whereas the assurance role puts forward that internal audit can continue to make sure the framework is possessed by management and functions well. Risk management and internal control are both essential aspects of business success (Pickett, 2005).

3.2.2. COSO and Internal Control

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a joint private sector initiative established in the USA in 1985 to support the National Commission on Fraudulent Financial Reporting. It mainly works on neglected or overlooked factors that can lead to fraudulent financial reporting and develops recommendations for public firms, independent auditors, the SEC, other regulators, and educational institutions. The commission is named after its first president James C. Treadway. The National Commission was sponsored jointly by five major professional associations headquartered in the US: the American Accounting Association (AAA), the American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), The Institute of Internal Auditors (IIA), and the National Association of Accountants (currently the Institute

of Management Accountants [IMA]) (Committee of Sponsoring Organisations, 2021). Today, it is accepted all over the world as an institution that guides corporate governance, business ethics, internal control, corporate risk management, fraud, and financial reporting with a critical approach.

COSO published Internal Control-Integrated Framework in 1992 and revised the framework in 2013. Since the sponsoring organizations take COSO's guides as a point of reference in their regulations, the impact of the Committee's guides on the US literature and legislation is elevated. In addition, COSO publications and frameworks extensively affect regulators and private institutions all over the world.

After the publication of the COSO framework, most of the US corporations determined it as their basis for compliance with Section 404 of SOX. Many G-20 countries modeled their financial reporting legislation connected to internal control with concepts in the framework. Therefore, many organizations around the world selected the COSO framework to create and constantly improve their systems of internal control, not only for reporting but also for better governance practices (Schandl & Foster, 2019).

Broadly, internal control's objective is to support entities in achieving significant goals and sustain and improve their performance. In this context, COSO's Internal Control Framework facilitates organizations' developing systems of internal control effectively and efficiently for them to adapt to volatile, and uncertain business environments, mitigate risks to acceptable risk appetite levels, and support sound decision-making and governance of organizations.

An effective system of internal control requires more than rigorous adherence to policies and procedures. Using management's and board of directors' judgment is vital to determine the extent of control. The new COSO framework extended the reporting category of objectives from only financial to include other important forms of reporting, such as non-financial and internal reporting. Since internal control is not a serial process but naturally a dynamic and integrated one, the COSO framework is designed in a way that can be applied to all organizations (large, small, not-for-profit, or government bodies) (Committee of Sponsoring Organizations of the Treadway Commission, 2013).

According to the revised COSO framework, internal control is defined as follows (Committee of Sponsoring Organizations of the Treadway Commission, 2013):

> *"Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance."*

The definition includes fundamental concepts that should be discussed in more detail to have a better understanding of the framework. These fundamental concepts are;

- Achievement of objectives,
- Process,
- Affected not only by procedures but also people
- Provides reasonable assurance,
- Adaptable to entity structure.

COSO Framework's objectives are summarized in three main categories (Committee of Sponsoring Organizations of the Treadway Commission, 2013):

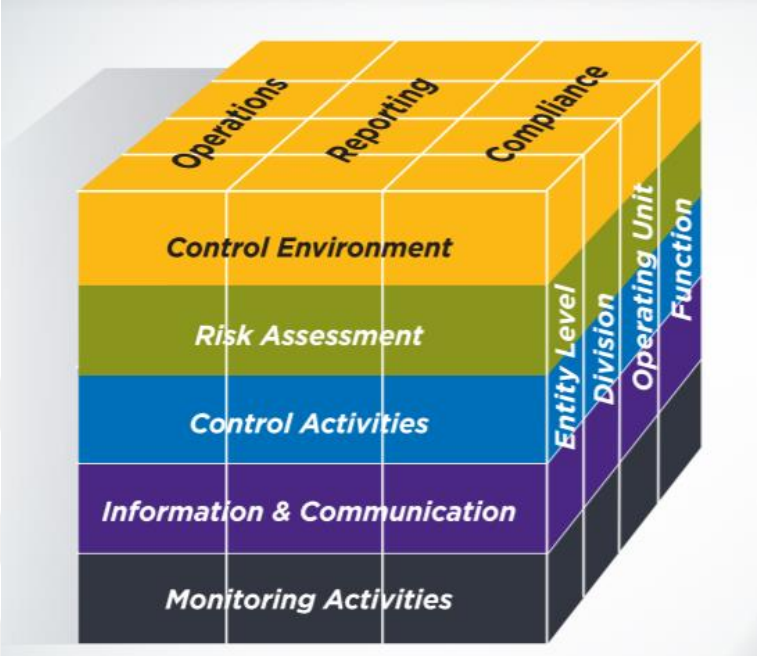
- Operating objectives connect to the effectiveness and efficiency of the entity's operations, including overall performance goals, and safeguarding value against loss.
- Reporting objectives are related to both internal and external reporting including non-financial reporting. This objective covers reliability, timeliness, transparency, and other terms set by regulators or internal policies.
- Compliance objectives pertain to adherence to laws and rules that are relevant to the entity.

The internal control framework has 5 components (Committee of Sponsoring Organizations of the Treadway Commission, 2013):

- The control environment is the set of standards, processes, and structures providing the base for executing internal control across the organization. The board of directors and senior management is vital for implementing better standards for internal control.
- Risk assessment is the basis for determining how to manage risks in an organization. Risk assessment requires the establishment of objectives interconnected at different levels of the entity. Since risk is the possibility of an event that might adversely affect the company, risk assessment is a critical component of an internal control system to shelter the organization.
- Control activities are the actions established through policies and procedures to mitigate risks. Control activities can be preventive or detective in their nature. In addition, control activities may cover manual and automated activities, such as authorizations, approvals, verifications, and performance reviews. Segregation of duties lies at the center of control activities.
- Information and communication are essential for the organization to perform internal control since it enables employees and other stakeholders to get clear communication from C-level that the control is a serious responsibility of all levels in an organization.
- Monitoring activities such as continuous or separate evaluations ascertain whether internal control components are present and functional.

The objectives and components of internal control described above have a close relationship and it is commonly depicted in the form of a cube including the third dimension as the entity's organizational structure.

Figure 3.2-1: Relationship of Objectives and Components[5]



The Framework sets out 17 principles demonstrating the fundamental concepts of components. Since principles are expanding components, an entity should apply principles together to achieve effective internal control.

[5] Source: (Committee of Sponsoring Organizations of the Treadway Commission, 2013)

Figure 3.2-2: Five Components and 17 Principles of Internal Control[6]

5 components	17 principles
Control environment	1. Demonstrates commitment to integrity and ethical values 2. Exercises oversight responsibility 3. Establishes structure, authority, and responsibility 4. Demonstrates commitment to competence 5. Enforces accountability.
Risk assessment	6. Specifies suitable objectives 7. Identifies and analyzes risk 8. Assesses fraud risk 9. Identifies and analyzes significant change
Control activities	10. Selects and develops control activities 11. Selects and develops general controls over technology 12. Deploys control activities through policies and procedures
Information and communication	13. Uses relevant information 14. Communicates internally 15. Communicates externally
Monitoring activities	16. Conducts ongoing and/or separate evaluations 17. Evaluates and communicates deficiencies

If a major deficiency exists in the presence and functioning of a single component or relevant principle, or more, the entity cannot conclude that there is an effective internal control system. When there is no major deficiency and a system of internal control is indicated as effective, the executive team and the BoD can be considered to have reasonable assurance. Limitations of internal control are given below (Committee of Sponsoring Organizations of the Treadway Commission, 2013):

- Suitability of objectives,
- Human judgment in decision making,
- Simple errors,
- The ability of management to override internal control,
- Collusion,
- External events.

Entity-level controls are the ones that have a prevalent influence on the organization's internal control system. The maturity of the entity-level control structure significantly affects the assessment and the associated results (Schandl & Foster, 2019).

In order to enhance the accuracy of understanding of each principle, there are 87 points of focus[7] in the COSO Framework. Points of focus represent significant characteristics associated with the

[6] Source: Adapted from the COSO Internal Control Integrated Framework (Committee of Sponsoring Organizations of the Treadway Commission, 2013).
[7] Points of focuses and related components are depicted in more detail in (Committee of Sponsoring Organizations of the Treadway Commission, 2013).

principles and, as such, provide support to the principles to which they pertain (Protiviti, 2013). For instance, the first principle of the Control Environment component is: *"The organization demonstrates a commitment to integrity and ethical values."*

There are four points of focus for this principle (Committee of Sponsoring Organizations of the Treadway Commission, 2013):

- *"Sets the "Tone at the Top" – The board of directors and management at all levels of the entity demonstrate through their directives, actions, and behaviors the importance of integrity and ethical values to support the functioning of the system of internal control.*
- *Establishes Standards of Conduct – The expectations of the board of directors and senior management concerning integrity and ethical values are defined in the entity's standards of conduct and understood at all levels of the organization and by outsourced service providers and business partners.*
- *Evaluates Adherence to Standards of Conduct – Processes are in place to evaluate the performance of individuals and teams against the entity's expected standards of conduct.*
- *Addresses Deviations in a Timely Manner – Deviations from the entity's expected standards of conduct are identified and remedied in a timely and consistent manner".*

Since every internal control framework has limitations, the expectation from internal control is limited merely to reasonable assurance.

These points assist the corporation in identifying deficiencies. When a deficiency exists, management must assess the severity of the impact of that deficiency on the internal control system. A major deficiency in internal control is an internal control deficiency or a combination of deficiencies that severely reduces the probability of achieving objectives. Such deficiencies occur when a component (which could be a single principle or multiple principles) is not present or functional. The existence of a major deficiency inhibits the organization from an effective internal control system (Protiviti, 2013).

As we will discuss in more detail in the monitoring and internal audit relationship part, these points of focuses are essential for better functioning of a system and provide supporting material for better monitoring and assessment for the framework.

3.2.3. Other Internal Control Frameworks

The Criteria of Control (CoCo) is another control framework that includes remarkable learning dynamics. The Canadian Institute of Chartered Accountants (CICA) developed CoCo, which is an international standard like the COSO model. According to CoCo,

"Control is as much a function of people's ethical values and beliefs as it is of standards and compliance mechanisms. Control should cover the identification and mitigation of risks."

There are two risks that are more fundamental to the sustainability and success of the organization. They are failure to identify and exploit opportunities and failure to respond and adapt unexpected risks. CoCo model is similar to COSO model in its design. Its main components are purpose, commitment, capability, action and monitoring – learning (Pickett, 2005).

Information Systems Audit and Control Association (ISACA) is an international professional body that has created the most well-known IT control framework: Control Objectives for Information and Related Technology (COBIT). COBIT is widely applied in corporations in order to achieve effective governance over IT since it directly affects business success.

3.2.4. Implementation of Internal Control System

Integrating an internal control system in an organization starts with the initiative of the board of directors. The most efficient path is improving the board governance and involving directors with internal control know-how or, at least, mindset. Even if the board has some level of consciousness on the subject, the experts can explain the importance and implementation phases of internal control thorough sophisticated board presentations.

Generally accepted and utilized method for implementing an internal control system is to develop a risk and control matrix (RCM). The RCM is a document that identifies all internal controls in the process, and specific descriptions and category attributes related to each control. Each identified control includes, at least, the following information (Schandl & Foster, 2019):

- Unique control identifier,
- Control description
- Objective
- Risk related to objective of control
- Frequency of control
- Title of responsible control owner
- Control type (manual or automatic, preventive or detective, fraud or non-fraud)
- Related COSO principle

Risk control matrices pave the way for management for evaluating existing controls of the organization based on the Framework principles and best practices. Gap assessment identifies design or implementation weaknesses (or effectiveness) and categorizes weaknesses according to their severity or

significance levels. This evaluation recommends an action plan to the organization for the alleviation of weaknesses.

Design testing is an essential phase of framework implementation. It should be noted that timing and extent of testing depends on various criteria as well as management judgement The common methods of testing are

- Inquiry,
- Observation
- Document examination,
- Re-performance,
- Data analytics.

In order to assess the adequacy and effectiveness of internal control continuous monitoring system provides more robust insight than regular periodic monitoring. Continuous monitoring usually involves the automated testing of full population via scenarios versus sample testing; hence, it offers a more comprehensive assessment, especially when its results are shared with the management in a timely manner (Schandl & Foster, 2019).

3.2.5. Internal Audit's Role in Internal Control

Internal control is often confused with internal audit, and even worse, in many organizations internal control has become subordinate to internal audit (Hightower, 2008), (Cömert, 2016). Both has the same purpose, which is to add value and improve an organization's operations. They both use similar reviewing techniques and tools to assess the business. Internal control differs from internal audit due to the fact that it is not just about evaluating compliance posture from an oversight role. Nevertheless internal control has to be proactive in defining, documenting and testing the company's objectives and operations. Many companies use internal control as a pre-audit where line managers may render opinions about business practices and the governance structure.

Internal audit is an independent function established within the organization to provide reasonable assurance to the board of the organization. Also, internal audit has two main dimensions as managerial and financial. These dimensions include the auditing of functions and systems of internal control.

Lack of proper or effective internal control system may cause loss of assets, management failures and misconduct. Hence, compared to internal audit, internal control mechanism is more vital for entities However, as the difference is not well-known or the subject of internal control is less known than internal audit, it is generally expected from internal audit to replace internal control and exercise

control over daily operations. Internal control is not a subfield of internal audit. Rather, internal audit functions as the monitoring component of internal control. Hence, in order to achieve creating an effective internal control system, management should acknowledge that internal control is not only the responsibility of internal audit, and the required awareness should be raised across the organization (Sabuncu, 2017).

Internal control is a holistic system assisting an organization in to achieving its objectives. Internal control is a system and internal audit is a function. Independent from which framework is applied, all internal control systems require effective monitoring systems for assessing functionality and effectiveness of controls. Hence, as an independent function, internal audit is critical for the success and sustainability of an effective internal control system. Unlike management or second line functions, internal audit is not a function that is responsible for identifying risks or setting control activities. However, internal audit is able to support functions that have internal control responsibilities thanks to its consulting activities. In fact, we can define the internal audit activity as an extended and ongoing consulting project that evaluates the internal control system.

Internal control framework's monitoring activity is conceptually the best endeavor describing internal audit's role in internal control. Accordingly, we will discuss monitoring in more detail below. First, we must distinguish monitoring from control activities. Basically, control activities respond to specific risks and monitoring activities assess if controls are operating as expected.

Monitoring activity can be conducted by ongoing evaluations or separate evaluations, or the combination of them. Ongoing evaluations are generally routine operations, built in processes and performed on a real-time basis. On the other hand, separate evaluations are management's, internal audit department's and/or external parties' objective evaluations. Higher priority risks require both ongoing and separate evaluations, ongoing evaluation results feed the separate evaluation and the frequency of separate evaluations depend on both results. Separate evaluations may include below with variety of scope, nature and frequency (Committee of Sponsoring Organizations of the Treadway Commission, 2013):

- Internal audit
- Compliance or IT security objective evaluations
- Cross-function evaluations (e.g. quality audit department leading a cross functional team for internal control evaluations)
- Benchmark evaluations
- Control self-assessments

Since internal audit assurance and consulting activities are supposed to be independent and objective, internal auditing vastly contributes to the accountability, risk management, corporate

governance, and reputation in entities. Internal audit's status and effectiveness has a direct impact on the success of monitoring component in an internal control framework. Thus, we will analyze internal audit theory and practice in more detail in the next part of our study.

3.3. Internal Audit

In the first chapter of the thesis, we have discussed concepts of governance and corporate governance comprehensively. Our research has shown that major corporate scandals starting at the 1980s triggered the development of corporate governance regulations. All those corporate governance regulations clearly confirms that internal control systems are the main remedy for governance problems. Naturally, every internal control framework needs a sound monitoring system, and the corporate world has acknowledged the importance of internal audit system to achieve a better monitoring mechanism.

As mentioned in the internal control part of our study, internal audit is a vital part of internal control. Audits serve two significant control functions. Firstly, they are detective control mechanisms by which auditors identify and investigate deviations from standards. Secondly, they are preventive control mechanisms, as the expectation of an audit could deter individuals from engaging in fraudulent activities or errors.

3.3.1. Internal Audit Definitions from a Historical Perspective

The word audit is of Latin origin and originates from the word "audire" which means hearing. The hearing activities originates from examining accounts through verbal reading which is the same activity of examining the accounts. In the accounting literature, auditing is generally used to express activity in accounting / financial audit synonymously (Cömert, 2016).

The need for all types of auditing mainly comes from the the need to have independent verification of record keeping and prevention of asset misappropriation or fraud in organizations. The origin and history of auditing goes back to the invention of accounting which dates back to 4000 B.C. in the Near East (Bailey, Gramling, & Ramamoorti, 2003).

Following economic and industrial developments as well as political transformations, internal audit took its formal position in the US with the establishment of the Institute of Internal Auditors (IIA) in 1941. Nonetheless, in the early years of IIA, internal auditing was still perceived as an extension of external accounting auditing, which was a profession focusing mainly on financial statement reviews accounting-related functions. Internal auditors had only a "limited responsibility in the total managerial spectrum (Brink, 1999).

By the early 1990s, internal auditors gradually began to enlarge their experience and expertise and to develop industry specialization such as health care, energy, financial services, or technology.

Simultaneously, professional and educational backgrounds of audit staff began to diversify including a large proportion of non-accounting majors and internationally oriented employees (Bailey, Gramling, & Ramamoorti, 2003).

According to Kagermann et al. (2008), auditing is defined as a "*systematic process of objectively obtaining and evaluating evidence regarding the current condition of an entity, area, process, financial account or control and comparing it to predetermined, accepted criteria and communicating the results to the intended users"*. The criteria may be a legal requirement (such as the Sarbanes Oxley Act) or an internal enterprise regulation.

In order to discuss the internal audit theory, one must firstly define internal audit. As a starting point IIA's internal audit mission and definition statements set the base.

The Institute of Internal Auditors (IIA) officially adopted a new definition in June 1999 and the new definition shifted the focus of the function from simple assurance to value added standards-driven approach with a heightened identity (Nagy & Cenker, 2002).

The mission of internal audit articulates what internal audit aspires to accomplish within an organization (The Institute of Internal Auditors, 2021):

> *"To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight."*

In line with the mission that IIA sets, Internal Auditing states the fundamental purpose, nature, and scope of internal auditing (The Institute of Internal Auditors, 2021):

> *"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."*

The definition above is internationally accepted and extensively used by private and public sector entities, as well as local and international regulators. Henceforth, we will analyze the definition sentence by dividing into sub – concepts, in a similar way that (Pickett, 2005) did in his article:

Although the history of internal audit includes accounting and internal financial control practices, the definition starts specifically with "internal" word which provides a unique role to internal audit function.

The definition specifies internal audit activity as independent and objective, which is the foundation of the trust that internal audit creates in the society and, particularly, in its respective organization. Internal audit function requires sufficient status, and it has to be able to keep its distance from the operation under review. Any problems in independence and objectivity are major flaws for a systems. CAE should immediately notify the Board about those issues.

"Assurance and consulting": Particularly the consulting role of the definition reflects the final stage of development in internal audit and function's modern target in corporate governance. Although the primary role of the function is to provide independent assurance about the organization's risk and control environment, this fundamental transformation in the function's role results in a strategic business partnership for top management and for the supervision arm of the Board.

Internal audit is not a core business function unlike production or sales. However, it is an essential support service function reporting solely to the board of an organization. Because it is a service function, main objective of internal audit has to be improving client satisfaction. In order to address client satisfaction, internal audit is designed to add value to the organization it serves. Every internal auditor has to internalize adding value as a primary objective in an organization to maximize the quality of audits and strengthen the appreciation of the function.

The definition also includes improving an organization's operations, which means that internal audit is not a onetime check procedure or error-detection operation. Instead, the activity's main target is continuous improvement in business transactions.

Internal audit, as a globally recognized profession, presents a systematic and disciplined approach by providing a clear set of professional standards. Therefore, audit executives have to set internal principles, which comply with IIA performance standards.

Diligent audit techniques require not only reviewing of documents and records, but also full evaluation of the scope of audit. Hence, the definition includes "evaluate" and "improve" terms in order to address that every internal auditor has to keep in mind that only diligent evaluation activity creates improvement in any kind of process.

The definition finally includes risk management, control and governance processes since internal audit can achieve its primary objectives by evaluating and improving these heavily interconnected processes. As we have shown in our discussion of these concepts and their relationship with internal audit in the previous chapters, internal audit is an integral part of these processes, in addition to having the responsibility to evaluate their effectiveness.

In their critical article Nagy & Cenker (2002) have questioned the new definition after its launch from various aspects. They have researched whether the new definition reflects the day-to-day activities of internal audit departments and whether they have sufficient resources and expertise to function as consultants.; Furthermore, they have focused on the level of coordination with other corporate governance actors and the position of newly defined internal audit department. Their findings reflect that internal audit function varies significantly from company to company. Whereas a traditional assurance role is assigned to the function in some companies, in others the function is more value-added consulting oriented. Moreover, the findings show that it is mainly company management that defines the framework of the function's role contrary to the expectation that it would be the professional body, standards, internal audit professionals themselves or the audit committee. One of their remarkable finding is that many audit executives approach consulting function with hesitation due to its temporary nature and lack of resources or expertise.

The independence and objectivity of an internal audit function is crucial for an organization. IIA Standard 1100 catalyzes the principles of independence and explains it as the autonomy from conditions that threaten the ability of the internal audit activity to carry out its responsibilities in a neutral way. This independence can be achieved through a dual reporting system where internal audit functionally reports to the Board instead of reporting to the executive level on administrative issues (The Institute of Internal Auditors, 2016).

3.3.2. Internal Audit Literature Survey

Agency theory is first integrated into internal audit by Adams (1994). Adams has examined how agency theory can explain internal audit function and has set a framework for further research. His agency theory perspective illuminates the reasons behind the differences of internal audit applications, form and practices among distinct businesses. According to his hypotheses, complex businesses need internal audit department more than others. Furthermore, structures of audit departments differ due to the ownership – control structures of firms. Additionally, internal auditors' practices and focuses differ according to regulations or the publicly trading situation of the firm., Finally, his perspective enlightens why organizational changes affect internal audit departments in different ways.

In his article Spraakman (1997) has pictured the contemporary circumstances in the academia. He has claimed that unlike external audit, academic researchers ignored internal audit for a long time, contrary to its strong acceptance in professional practice. Hence, the lack of interest in research has inhibited the establishment of a collective theory. Spraakman is the first one in the literature who has argued that a transaction cost economics (TCE), which is a variation of the agency theory, would be highly appropriate in order to set a theoretical framework for internal audit.

Transaction cost economics in general and asset specificity in particular are useful to account for internal audit's role, rationale and size. Since asset specificity broadens the need to assess the conditions of any contract and the degree of compliance to contract terms, subsequently the need for audits also increases. The level of information asymmetry and behavioral assumptions of TCE also influence the need for audit (Paape, 2007).

In his experimental study, Spraakman (1997) the possibility of using the audit findings for cost reduction. He has empirically tested the usefulness of internal audit operational findings for economizing within a TCE context. He has discovered that an organization's size is positively correlated with a need for internal audit, i. e., as the organization size grows the need for internal audit augments. In short, asset specificity and size are the most determining factors in internal audit as the theory suggests.

In their article Mihret (2014) has discussed internal audit from a very distinct theoretical perspective. In order to explain the capitalist demand for internal audit, they adopt the labor theory perspective. According to Mihret, internal auditing developed from the transformation of capitalism during the 20th century, when capital gradually succeeded in institutionalizing structural control of labor processes, where employees, management, and the board of directors are responsible for realizing the expected return on capital. In their theory, internal audit's assurance services to execute business activities and its advisory services to enhance efficiency and effectiveness are part of a mechanism to control the labor process.

In a recent comprehensive study, Behrend & Eulerich (2019) have analyzed the evolution of internal audit literature, considering the articles published between 1926 and 2016. Their research indicates that the occurrence of certain events, such as the foundation of the Institute of Internal Auditors or the issuance of the SOX legislation increased the academic interest in this subject. Their conclusion suggests that potential synergies of well-functioning audit committees and internal auditors are vital in augmenting audit committee effectiveness. For future research, they recommend focusing on how reporting lines of internal audit promote the function's effectiveness and which internal audit-related information is valuable to financial investors in their potential investment decisions.

In their article Vadasi et al. (2019) have explored internal audit effectiveness in relation to its impact on corporate governance. Authors' empirical findings specify that internal audit professionalization positively affects internal audit effectiveness, while company specifications determine the level. The positive flow of internal audit's contribution to corporate governance enhances when internal audit function complies with international standards and when audit team has professional certifications in their area. In companies which have separate CEO from the chairman and qualified audit committee members, internal audit effectiveness also flourishes.

Internal auditors conduct business that is relevant to their employers or companies they interact with. However, interest in researching the subject remains inadequate. For instance, there is a lack of research focusing on the effects of internal audit on companies' financial reporting for stakeholders. Internal audit quality and earnings management is an important area that is subject to focus and research in the literature. One of the most cited studies on this is Prawitt et al.'s (2009) article. They have used a unique data set that was not available prior to their work and have investigated the relationship between internal audit function quality and earnings management. They have measured the function's quality using a composite index comprising six separate components of internal audit function quality based on AICPA's Statements on Auditing Standards (SAS) No. 65 (The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements). Their data suggest that internal audit function quality is linked with moderation at the level of earnings management. Their finding is consistent with the general expectation that internal audit quality is negatively correlated with earning management practices.

In their article aiming at building a research model for internal auditing Sarens & De Beelde (2006) have displayed that the influence of interactions with senior management was large while the influence of the audit committee on internal auditing practices was limited. They have also stated that augmenting interactions with the audit committee will stimulate internal audit to emphasize their assurance role. In addition, their research has shown that internal control system has an influence on internal auditing practices. If reinforced by a weak control environment, weak internal controls result in a more active internal audit focus on the perfection of the internal control system. Therefore, internal audit's advising to improve the internal control or the involvement in specific consulting activities on control awareness have a noteworthy role in the organization.

As the business activities become more complex, the need for better corporate governance increases and the development of internal audit follows the evolution of corporate governance. As the agency and transaction cost economics theories imply, information asymmetry, principal needs, and asset size affects the structure of internal audit organization. In addition, internal control weaknesses augment the requirement for and focus on internal audit in organizations of all sizes.

We will use this literature survey in the following sections of the thesis to develop a model for corporate governance and to discuss the connection between audit and governance.

3.3.3. Internal Audit Standards and Guidance

Internal audit, control and corporate governance literature has significant effect on the practical side of the internal audit. Both the standard setter body and practicing professionals and internal audit departments benefit from the literature.

International Professional Practices Framework (IPPF) preserves the new definition of internal auditing in with a structural blueprint (Bailey, Gramling, & Ramamoorti, 2003). The revised IPPF in 2015 is the conceptual framework that organizes authoritative guidance, the three categories of which are:

- Mission: *"To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight."*
- Mandatory guidance (including core principles, definition, standards and ethics),
- Recommended guidance, including implementation guidance and supplemental guidance.

Figure 3.3-1: International Professional Practices Framework (IPPF)[8]



The Framework sets the base for internal audit practice globally; hence, we will thoroughly discuss mandatory and recommended guidance to have a better understanding of guidance. Starting with the core principles, all together they articulate internal audit effectiveness. In order to consider an internal audit function effective, all principles should be present and operate effectively. The core principles are presented below (The Institute of Internal Auditors, 2021):

[8] Source: (The Institute of Internal Auditors, 2021)

Figure 3.3-2: Internal Audit Core Principles[9]



Principle-focused standards, the most recent version of which has been effective since January 1, 2017, are the main part of mandatory guidance after core principles. They provide a framework for performing and promoting internal auditing. The Standards consist of statements of basic requirements, interpretations, which clarify terms or concepts within the statements and, finally, the glossary terms. The Standards comprise of two main categories called attribute and performance standards. The first category addresses the attributes of organizations and employees performing internal auditing and the second one describes the nature of internal auditing and provide quality criteria. There are 11 overarching and 41 underlying Standards in total (The Institute of Internal Auditors, 2016).

Figure 3.3-3: Internal Audit Standards[10]

Attribute Standards	Performance Standards
•1000 – Purpose, Authority and Responsibility	•2000 – Managing the Internal Audit Activity
•1100 – Independence and Objectivity	•2100 – Nature of Work
•1200 – Proficiency and Due Professional Care	•2200 – Engagement Planning
•1300 – Quality Assurance and Improvement Program	•2300 – Performing the Engagement
	•2400 – Communicating Results
	•2500 – Monitoring Progress
	•2600 – Communicating the Acceptance of Risks

[9] Source: (The Institute of Internal Auditors, 2021)
[10] Source: (The Institute of Internal Auditors, 2016)

Final part of mandatory guidance is code of ethics that applies to all internal audit professionals. Its purpose is to promote an ethical culture in the profession of internal audit. It positions the principles and expectations governing the behavior of individuals and organizations. Moreover, it defines the minimum requirements for conduct and behavioral expectations. Code of ethics extends beyond the definition to include two essential components. First componenet is the set of principles relevant to the profession and the practice. Second component is the rules of conduct that describe behavior norms expected of internal auditors. Principles and rules of internal audit cover four main concepts, which are integrity, objectivity, confidentiality and competency (The Institute of Internal Auditors, 2021).

The first part of recommended guidance includes implementation guides that assist internal auditors at applying the standards and ethics code. First part of the guidance include the approach, methodologies, and consideration, but do not detail processes or procedures (The Institute of Internal Auditors, 2019b).

Supplemental guidance, on the other hand, provides detailed guidance for directing internal audit. Topics of audit practice, sector-specific issues, as well as processes and procedures and examples of deliverables are included in the supplemental guidance. Main chapters of supplemental guidance cover the topics below:

- Internal Audit Strategy and Best Practices,
- General Best Practices,
- Global technology audit guides,
- Financial services practice guides,
- Public sector practice guides,
- Model internal audit activity charter.

3.3.4. Internal Audit Method and Practice Topics

Since internal auditors do not have the minimal regulatory standards to review the written records and documents prescribed in a legislation, they can examine all operations and systems. Internal auditors can chase both formal and informal ways to gather crucial information. In addition, they are able to gain the cooperation of other parts of the organization more easily and have long term relationships compared to external assurance providers. Accordingly, internal audit can receive crucial disclosures that are not available to other parties externally and internally. Having these advantages, internal audit is able to obtain important information on an organization’s efficiency practices, such as purchasing, production or sales (Spraakman, 1997).

Internal audit activity covers various topics and areas in an organization, if there is an effective internal audit organization. Thus, organizations and boards that are aware of the importance of internal audit and its relation to good governance support the development of this function. After analyzing theoretical aspects of internal audit in the previous parts of this chapter, we will discuss internal audit methods and practices in order to create the link between internal audit theory and the main topic of our thesis, which will be a practical implementation of auditing governance.

Although it is not limited to this segmentation, we can describe internal audit practice topics into 10 categories below:

- Management audit,
- Financial (finance and accounting) controls audit,
- Operational audit,
- Business continuity audit,
- Third party (business) audit,
- IT audit,
- Fraud audit,
- Compliance audit (competition, tax, data protection)
- Performance audit
- Follow–up audits.

Management audit reports on whether the management of the organization or the audited departments comply with existing policies, guidelines, and procedures and whether their decisions and the connected internal controls are effective and efficient (Kagermann, Kinney, Weber, Busch, & Eckes, 2008).

Financial controls audit practice covers the financial health and integrity of financial tables and testing of financial controls. Selected financial audit topics may cover:

- Analytical procedures on financial data,
- Cash and equivalents,
- Accounts receivable,
- Receivable provisions,
- Accrued liabilities,
- Loan agreements,
- Accounts payable,
- Revenue analysis and revenue recognition,
- Cost and expense reviews

Financial audit aims at examining the accounting and financial data of the organization, while the focus may vary depending on the risk based plan. Audit may cover either the accounts and financial data as whole or individual accounts (Kagermann, Kinney, Weber, Busch, & Eckes, 2008).

Operational audit is concerned with the issues regarding organizational and workflow structures. Internal audit teams touch all operational business units and audit encompasses all issues of process design, internal controls, risk management, as well as financial accounts of the operational unit (Kagermann, Kinney, Weber, Busch, & Eckes, 2008). We can summarize some of the selected operational audit topics below:

- Purchasing
- Sales Processes
- Financial management,
- Logistics and warehouse management,
- Human resources,
- Production,
- Quality control,
- Research and development.

In addition to main audit categories that we have examined above, these specific audit types exist in a combined manner in most practical audit projects. For instance, in large group of companies, conglomerates or holding companies, usually there are central internal audit units located in headquarters. Those units make their audit plans for operational subsidiaries, including both the local country and overseas destinations. During this kind of full scope subsidiary audits, internal audit teams apply several types of audit categories in a comprehensive manner. A similar approach could be adopted for consulting projects or thematic audit projects.

3.4. Internal Audit on Corporate Governance

3.4.1. Academic Literature on Auditing Governance

Our literature survey results show that while the research on the relationship of corporate governance and internal audit is limited, the literature on auditing the corporate governance is even more inadequate.

Other than the academic literature, there is almost no regulation in place that applies to the internal audit for private non-financial institutions in Turkey. Government has its own legislation on financial management and control for governmental organizations.

Accordingly, one of the reasons that makes our study crucial is the fact that it will scrutinize a rarely analyzed subject. In this section, we will discuss the literature that concentrates on the connection between internal audit and corporate governance.

Corporate governance and internal audit are integral parts of corporate best practice spiral. Audit and monitoring is vital for better governance and, relatedly, better governance in internal audit function is essential for improvement. Therefore, the best practice in internal audit and standards require performance evaluations and transparent reporting on internal audit activity.

Internal audit standards and procedures stand for providing a systematic and disciplined approach while assessing governance and internal controls. Accordingly, non-compliance with standards and procedures results in corporate governance weaknesses and requires disclosure to the highest governing body or annual reports.

According to Kirkpatrick (2009) the significance of corporate governance upswings in economic crisis eras, as corporate governance pave the way for transparency and accountability, which is an essential factor for society-wide value creation.

According to Regoliosi & d'Eri (2014), corporate governance reports (which are generally required by a regulation) provide complete set of information on oversight objectives of a company by explaining the compliance to corporate governance best practices. Furthermore, other features, such as the quality of the internal auditing function or the sensitivity of top management to issues about internal controls and risk management, should be taken into consideration while formulating a judgment on the quality of corporate governance.

In their paper, evaluating more than 700 CAE answers, Sarens et al. (2012) investigate variables that are theoretically linked with the internal audit function which have active role in corporate governance in an organization. They have discovered that internal audit having an active role in corporate governance has significant and positive correlation with good corporate governance. Risk-based audit plan, quality assurance and improvement program, and audit committee input to the audit plan are essential contributors to the success of internal audit. In summary, they have argued that internal audit's principal contribution to corporate governance emerges thanks to its relationship with the rest of governance actors, such as the audit committee, external audit and top management.

Cohen et al. (2004) designate this sophisticated interaction amongst governance mechanisms as the corporate governance mosaic.

In order to synthesize the role of internal audit function in corporate governance, Gramling et al. (2004) have adopted the four-cornerstone perspective of corporate governance. These cornerstones

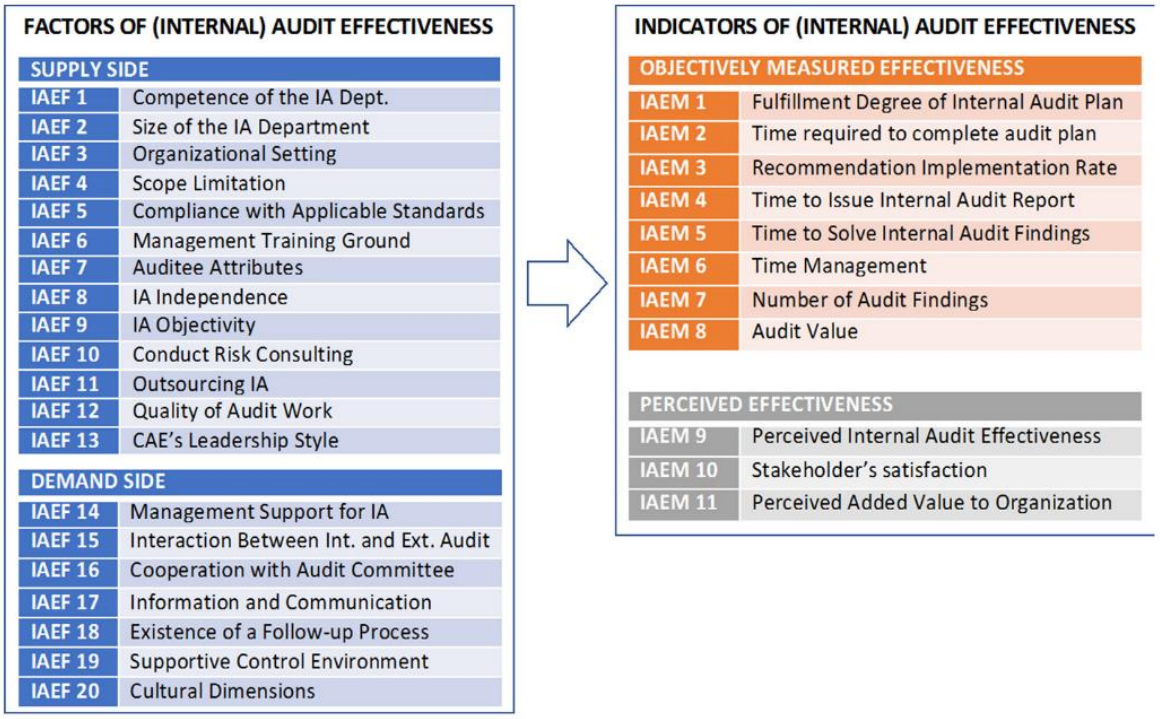
are independent auditors, audit committee, management, and internal audit function. Their model argues that internal audit serves as a critical resource for all other three actors responsible for corporate governance.

A significant contribution to European internal audit literature is the study of Regoliosi & d'Eri (2014) on the relationship between good governance and internal audit quality of Italian listed firms. They have assessed the quality of corporate governance through a proxy that considers certain features of internal audit departments and pooled them to create an internal audit global quality index. After testing the index on a sample of Italian listed firms, they have concluded that there are significant relations (positive or negative) between the degree of compliance to some corporate governance regulations for listed firms and the index.

In their international study of internal audit function quality, by using a unique international sample Jiang et al. (2018) has studied organizational and environmental factors that influence firms' incentives to develop high-quality internal audit functions. Their findings confirm that complex firms and firms having environmental challenges have a higher demand for monitoring and advising, and therefore, a higher need for formal and more effective controls. Their practically and academically significant finding suggests that internal audit function quality has a negative correlation with CEO power, whereas it has a positive relation to board monitoring and audit committee diligence. Their conclusions also underline that other key players in corporate governance have meaningful effect function's quality. The last finding argues that as local corporate governance codes become stronger, internal audit function's development becomes more cultivated.

In their recent systematic literature review Turetken et al. (2020) aim at introducing a framework that presents how internal audit effectiveness can be operationalized and what factors are available to influence the effectiveness, since it is challenging for organizations to assess the effectiveness of internal audit and to understand the factors that influence audit effectiveness. Their thorough analysis and systematic review resulted into the integrated framework below:

Figure 3.4-1: Integrated Framework for IA Effectiveness[11]



Another significant role of internal audit in governance is auditing corporate culture. According to UK Financial Reporting Council (2016) staff surveys, whistleblowing and governance structures are the most common proxies that internal audit can use to audit organizational culture. Other proxies may include HR criticism data and exit interviews, customer complaints, value statements and their adoption into recruitment, performance management, reward and incentive structures. Supplier feedback is also a useful measure of corporate culture.

There is a challenge for measuring the level of corporate governance. Governance covers all of the systems of direction and controlling which are complicated to quantify. Governance does not merely refer to policies and procedures. Rather, it is concerned with making decisions, establishing objectives, and monitoring. Corporations can achieve continuous improvement in effective governance as long as they can identify measurement. In order to tackle this challenge, a scorecard makes governance evaluation easier for U.S. public companies (The Institute of Internal Auditors, 2019c).

The American Corporate Governance Index (ACGI), developed by IIA and the Neel Corporate Governance Center at the University of Tennessee in Knoxville, goes beyond measures, such as the number of board meetings. The index is based on governance principles that reflect viewpoints of leading organizations, such as COSO and King Commission. The Guiding Principles of Corporate

[11] Source: Turetken et al. (2020)

Governance in the report intend to describe the basis of good governance (The Institute of Internal Auditors, 2019a).

Kagermann at al. (2008) take wide-ranging cases from SAP AG company internal audit practices into consideration in their book. They mention that the audit department of SAP has a critical role in developing the corporate governance structure of the organization. Audit department (Global Internal Audit Services) cooperates with other departments in the implementation of governance requirements and orchestrates all the individual activities required to meet its goals. Particularly, audit findings may result in a need for publishing additional guidelines, policies and procedures or to develop existing versions. Audit department has the responsibility to initiate development of such documents and supplement their progress.

The case of SAP underlines the essential need for auditing corporate governance. Additionally, it shows that auditing can improve corporate governance, although it does not initially target governance issues.

Internal audit activity supports compliance within the corporate governance structure in two ways. First, it is an integral component of the monitoring system. Second, its audit reports provide a critical and large information set that can improve the recognition of and respect to compliance requirements. Internal Audit is involved in corporate governance approach in different ways described below (Kagermann, Kinney, Weber, Busch, & Eckes, 2008):

- Audit departments function to support the supervision role of the Board. Hence Board delegates its fiduciary and governance responsibilities including tasks aimed at direct compliance with a governance code to audit departments to a certain extent.
- Internal Audit's numerous fieldwork activities contribute significantly to delivering reliable, accurate and transparent information about financial statements.
- Internal control system audits include both process evaluations during individual audits and systematic compliance tests to prepare the disclosures for regulations such as SOX.
- Monitoring the risk management system further promotes internal audit's integration into the corporate governance framework of a company.
- Internal Audit prompts other departments to formulate guidelines and principles. The purpose is to create a framework of guidelines to enable the management to control and test compliance.
- Cooperation with external auditors.
- Internal Audit is not responsible for ensuring that the controls integrated into the processes are actually applied. This is the duty of the employee or the executive in charge of the

process. As a best practice, many global companies implement control processes within their IT systems.

3.4.2. Internal Audit Standards and Practice Guide on Auditing Governance

IIA Standard number 2110, which is a performance standard, covers governance subject. The standard defines the concept of auditing governance as follows (The Institute of Internal Auditors, 2016):

> *"The internal audit activity must assess and make appropriate recommendations to improve the organization's governance processes for:*
>
> - *Making strategic and operational decisions.*
> - *Overseeing risk management and control.*
> - *Promoting appropriate ethics and values within the organization.*
> - *Ensuring effective organizational performance management and accountability.*
> - *Communicating risk and control information to appropriate areas of the organization.*
> - *Coordinating the activities of, and communicating information among, the board, external and internal auditors, other assurance providers, and management."*

3.4.2.1. Making strategic and operational decisions

At this point, it is important to examine theoretical and practical definitions of the concept of strategy because it is often confused with different concepts such as goals and plans in both practice and academic literature.

According to Lafley & Martin (2013), strategy is a relatively new field of study. Until the mid-20th century, practices that are today defined as strategy were simply referred to as management. According to Michael Porter (Porter, 2015), the essence of a company's ability to create a sustainable competitive advantage over its competitors requires making informed decisions to and building the company on those decisions in order to deliver unparalleled value. Thus, strategy is essentially "a set of decisions made to position a company to sustainably outperform and create more value than its competitors in its industry" (Lafley & Martin, 2013).

Strategic decisions basically have five characteristics. First, they are large and risky decisions, often with long-term implications, and are difficult to reverse. Secondly, they are a bridge between immediate strategic tasks and long-term strategy. Moreover, they are key sources of organizational learning. In addition, they play an important role in the development of individual leaders and managers. Finally, they intersect with different functions and academic disciplines (Papadakis, 1997). To

summarize, strategic decisions are the basic decisions about how to achieve a goal, while operational decisions are the actions taken to realize this strategy.

According to IIA 2110 standard, for achieving to assess governance processes in the organization, an internal audit team may examine and review below topics (The Institute of Internal Auditors, 2016):

- *"Board meeting minutes, which may help to gain a more comprehensive understanding of how such decisions are negotiated and ultimately made,*
- *Board policy manual or related governance documents,*
- *Past audit reports.*

This review usually reveals whether stable, consistent and established decision-making processes have been developed within the organization. Moreover, interviewing department head could contribute to the understanding of how this kind of stategical and operational decisions are made."

3.4.2.2. Oversight of risk management and control

According to governance standard 2110 of the International Standards on Internal Auditing, the internal audit activity typically reviews the annual risk assessment process to determine how an organization conducts oversight of its risk management and control activities (The Institute of Internal Auditors, 2016).

As one of the most important elements of corporate governance processes, the existence of an effectively functioning internal control system in enterprises is very crucial. This is because a sound internal control system forms the basis of trust in an enterprise. The importance of internal control for corporate governance has increased the vitality of internal audit activities, which provide an independent assessment of the adequacy and effectiveness of internal controls for corporate governance processes, and has even elevated an effective internal audit unit to the position of one of the first conditions of corporate governance (Bostan & Grosu, 2010).

As a part of risk management, internal audit's contribution to the prevention of corporate risks faced by businesses is another important issue that increases the importance and mission of internal audit for corporate governance. Internal audit is based on a framework for identifying, responding to, and managing the different strategic, operational, financial, and compliance risks facing an organization (Guxholli, Karapici, & Gjinopulli, 2012). Internal audit provides objective assurance to the board on the effectiveness of risk management. Indeed, both board executives and internal auditors recognize the

objective assurance by internal auditors. That is, significant business risks are appropriately managed and that risk management and internal control are safeguarded as two of the most important ways in which internal audit provides value to the organization (The Institute of Internal Auditors, 2009).

To this end, the internal audit activity may also review minutes of meetings where the risk management strategy has been discussed. It may also examine previous risk assessments and interview key risk management-related personnel, such as compliance, risk, and finance staff. The information gathered in this way can be compared to benchmarking values and current industry trends to ensure that all significant risks have been assessed (The Institute of Internal Auditors, 2012).

3.4.2.3. Developing the necessary ethical and other values within the organization

Institutionalization of ethics in businesses emerges in the form of mission and value statements, codes of conduct, recruitment and training processes, and prevention of misconduct and unethical behaviors. Practices related to mission and values usually become concrete with the creation of ethical codes. The process of preparing a code of ethics includes the following stages:

- Identification of values,
- Analysis of other codes that may be relevant
- If necessary, obtaining external expert assistance,
- Obtaining contributions and opinions from various levels within the organization,
- Including detailed regulations for those in sensitive issues or positions for the company,
- List of responsible roles for the execution of the code,
- Clear statement of sanctions and processes in case of violations of codes.

In order to prevent misconduct and unethical behavior, which is one of the most important dimensions of ethics, it is necessary to develop an ethics hotline policy and ethics hotline investigation processes. Businesses have developed various auditing techniques to audit the compliance of their employees' behaviors with ethical rules. These techniques aim at reducing the opportunity element in making ethical decisions and to resolve conflicts related to the business environment. An ethics hotline is a special telephone line, e-mail or form that is made available for the purpose of reporting an unethical act or providing answers to ethically related questions (TÜSİAD, 2009).

To assess how an organization promotes ethical principles and values both internally and among external business partners, internal audit examines the organization's relevant objectives, programs, and activities. These include mission and value statements, codes of conduct, hiring and training processes, fraud and unethical behavior prevention and whistleblowing policy, and ethics hotlines and investigation processes. Surveys and interviews can be used to measure and assess whether

the organization's efforts have created sufficient awareness of its ethical standards and values (The Institute of Internal Auditors, 2012).

While conducting an end-to-end audit of a process or a department, the audit unit also analyzes an organization's ethical principles and values. The internal audit unit should examine and evaluate how organizations promote and develop ethical principles and values in their relations with internal and external stakeholders. When these are audited for a process, it is evaluated whether there is a design and implementation that will guarantee compliance with the code of conduct, ethical values, mission and vision of the organization. The unit explores whether there are ethical violations within the process or the audited department, and whether the ethical violations found in the past have been concluded in accordance with the established procedures (The Institute of Internal Auditors, 2012).

3.4.2.4. Ensuring effective organizational performance management and accountability

To assess how an organization ensures effective performance management and accountability, internal audit may review organizational policies and processes related to compensation, objective setting, and performance evaluation. The internal audit activity may also review relevant metrics (e.g., key performance indicators) and incentive plans (e.g., bonuses) to determine whether they are appropriately designed and implemented to prevent or detect inappropriate behavior or excessive risk-taking and to support activities aligned with the organization's strategic objectives. (The Institute of Internal Auditors, 2019b).

3.4.2.5. Communicating risk and control information to the necessary units of the organization

To assess how well an organization communicates information about risks and controls to relevant units, internal audit has the task of determining whether information about risks and controls is communicated in a timely manner and whether it is complete and accurate. For this purpose, internal reports, bulletins, minutes, and e-mails can be examined. Surveys and interviews can be used to determine staff knowledge of their responsibilities for risk and control processes and the impact of not fulfilling those responsibilities on the organization (The Institute of Internal Auditors, 2019b).

This issue is also important in terms of the internal control framework as one of the five key components of the COSO internal control framework is information and communication (Committee of Sponsoring Organizations of the Treadway Commission, 2013).

In the course of assurance and consulting engagements, internal audit normally also assesses how the auditee communicates information about risk and control to other units (The Institute of Internal Auditors, 2019b).

3.4.2.6. Coordinating activities and exchanging information among the board of directors, internal and external auditors, other assurance service providers, and senior management.

To assess an organization's ability to coordinate its activities and communicate among the various parties involved, internal audit may look at the meetings attended by these groups (for example, the board of directors, audit committee, and finance committee) and determine how often these meetings are held. Members of the internal audit activity may attend these meetings as participants or observers and review meeting minutes, work plans, and reports distributed among these groups to learn how these groups coordinate their activities and communicate with each other (The Institute of Internal Auditors, 2019b).

3.4.2.7. Methods of Governance Audit

Internal auditors would take various actions to assess governance practices and they would make recommendations to improve them. They may provide independent and objective assessments of the design and effectiveness of governance processes within the organization. In addition to or instead of providing assurance, internal auditors may choose to provide advisory services. This might be a preferable approach, particularly if there are known issues or if the governance process is not yet mature. When providing advisory or assurance services, the head of internal audit may decide to use continuous and ongoing monitoring, such as assigning internal auditors to observe meetings of governance-related bodies and to make ongoing recommendations to those bodies. Corporate governance is often not based on the results of a single audit. Rather, the internal audit activity's assessments of governance are more often based on information obtained from a variety of audit engagements over time (The Institute of Internal Auditors, 2012). If an overall governance assessment is appropriate, the following considerations are taken into account:

- Audit results on the specific governance processes identified above.
- Governance issues arising from audits not specifically focusing on governance, such as
- Strategic planning
- Risk management processes
- Operational efficiency and effectiveness
- Internal control over financial reporting
- Risks related to IT, fraud and other areas
- Compliance with applicable laws and regulations

- The results of management assessments (e.g. compliance reviews, quality audits, control self-assessments).
- The work of external assurance service providers (e.g., statutory investigators, public audit bodies such as the Court of Accounts and financial advisory firms) and regulatory authorities.
- The work of internal assurance service providers or second line of defense functions (e.g., employee health and safety, compliance and quality).
- Other governance-related information, such as adverse events that provide opportunities to improve governance processes.

3.5. Final Remarks on Internal Control and Internal Audit

As governance, internal control, and internal audit are greatly related concepts, we have analyzed the interconnectedness of these concepts from theoretical and practical perspectives. Since there is a conceptual confusion on control and audit concepts, we have put forward a broader concept, which is internal control.

Internal control literature asserts that stronger and more effective internal control frameworks significantly improve decision-making processes and accounting quality in the business world. The establishment of internal control is definitely one of the main responsibilities of the board of directors and various legislations including corporate governance codes in many jurisdictions regulate this responsibility as a rule of thumb. The three lines model created together with risk and audit standard-setting bodies internationally provides a clear vision for organizations about positioning internal control frameworks.

Globally and most accepted control framework in the business world is COSO's updated internal control framework and its five main components have a deep connection with internal audit, although the monitoring component directly requires an effective internal audit function for the framework's success. Internal control is a holistic system for an organization achieving its objectives. In summary, internal control is a system and internal audit is a function.

The role of Internal Audit has changed from strictly a "retrospective inspection function" to a forward-looking strategic partner over the past decades. Even many departments' names or structures changed from the board of inspection or inspection department to Internal Audit. Many organizations transformed their perspective on auditing; hence, they re-organized their audit function as a separate internal audit department. The shifting titles are not the only proof of evolution[12]. Independently from the department name, long-lasting internal audit departments also started to perform value-added

[12] Many departments in developed countries had internal audit name but their functions were limited.

internal audit activities as well as assurance. After the emergence of new regulations as a reaction to corporate scandals, the focus of regulators and corporations on corporate governance increased considerably. This increase, in turn, triggered a surge in the importance of internal audit. Since all integral components of good corporate governance, such as transparency or accountability, require independent and objective monitoring, the internal audit function became an essential and strategic department for organizations.

According to Kagermann et al. (2008) the management process and management goals guide internal audit since management actions affect business risks. Moreover, by focusing on management activities, internal auditors can identify areas where they can create more value by generating additional information and guidance. Thus, during auditing, internal auditors could start to transform their vision from a limited audit schedule to a focus on topics that require proactive audit procedures.

Internal Audit adds substantial value to an organization by developing, reflecting on, and recommending best practices to improve the internal control systems of an organization. Consequently, management, as well as the individual departments, can pinpoint significant potential for improvement options in their operations. In addition, as internal audit improves information and communication flows, reliability and trust in the security and stability of the organization, and the confidence among employees will increase in the long term. If a problem occurs in a global corporate organization and if it is solved by the audit department according to standardized procedures, the trust awareness of the organization rises to a prominent level (Kagermann, Kinney, Weber, Busch, & Eckes, 2008).

The level of complexity in business activities and the need for better governance arising from principal-agent asymmetries determines the requirement, position, structure, size, focus, effectiveness, and efficiency of internal audit functions.

Internal audit guarantees the objective evaluation of the corporate governance processes of the company it operates in (the audit client) and helps achieve compliance with corporate governance principles. Together with the risk management team, the function determines the risk profile of the company and evaluates the internal control and risk management systems.

In their practical case study report that discusses the corporate culture and the role of boards, UK Financial Reporting Council (2016) highlights the importance of internal audit in providing direct assurance to the board. The report states that obtaining a realistic view of the culture at the coalface is a widespread problem for boards across the globe. Internal audit needs to have effective mechanisms for communicating its concerns to board members about culture to tackle this common problem. This need stems from the fact that internal audit has the potential to be an important assurance provider to the board alongside all business functions including risk and compliance.

Thanks to Basel regulations, in most European countries financial services firms have the regulatory mandate that the head of internal audit is required to report to the audit committee and, fortunately, we see that it is considered a best for other sectors, as well.

According to UK Financial Reporting Council (2016), internal auditors will need to develop a broader set of skills than the traditional ones and place more emphasis on understanding the pressures driving the behaviors and the business. Internal audit may suffer from a misperception that it is backward minded and is not always valued as highly by management. As our literature survey clarifies, the credibility of internal audit is fundamental and its appropriately resourcing is vital. In their case study, the FRC report also asserts that some companies stepped to strengthen function's role and reputation, for instance by requiring business units to be always audit ready and gave no more than a month's notice before any audit.

Although the research on corporate governance and internal audit relationship is unexpectedly limited when compared to other areas of management or accounting, our literature survey depicts that there is an increasing academic interest on the interdependency of these two concepts. Particularly, the empirical research on the quality and effectiveness of internal audit support the academic literature reviews. Our research on governance, control and audit has enlightened and has supported us on our research topic "the internal auditing of corporate governance", which has a modest place in academic literature.

All empirical studies and conceptual analysis, as well as academic books on the literature, highlight the importance of internal audit in corporate governance. The main target of this thesis is going into more detail about the mechanism of internal audit's assessment role in corporate governance itself. The literature survey in this chapter is a connecting bridge for next chapters' empirical research.

After many corporate scandals, business leaders have realized that external audit needs to be improved. Besides, it is unsatisfactory without a well-functioning internal audit as well as an internal control framework. Governance and internal audit are two elements that interact with and complement each other. Lack of an effective governance approach in the business leads to deficiencies in the control mechanism. Only a well-defined and effectively functioning mechanism will make it easier for auditors to perform their duties and ensure efficient use of resources. It will also bring internal audit and management closer to each other and facilitate harmony among parties. When it comes to obtaining the maximum benefit from internal audit to improve corporate governance, the critical point will be the positioning and staffing of the function. The literature survey claims that as a company sets the level and reputation of the internal audit department higher and selects a more reputable audit executive with the correct skillset, the level of contribution in strengthening corporate governance practices escalates. In summary, stronger internal audit departments can contribute to corporate governance more and as the

corporate governance improves in an organization, the sustainability of the organization develops. In order to achieve these high expectations, a highly skilled internal audit function has to be able to audit and assess the corporate governance in its organization in order to depict its real value-adding quality to the board and shareholders.

4. INTERNAL AUDIT OF GOVERNANCE IN TURKEY: ANALYSIS OF BIST-100 INDEX COMPANIES

4.1. Purpose of The Research

The main objective of the research is to reveal how governance audits are conducted in publicly traded companies, according to international internal audit standards, by internal audit/inspection units in Turkey. The public companies are considered to have a corporate structure. Secondly, the aim is to discover whether there are differences in practice between sectors in this context. Finally, the effects of organizational structures of internal audit units on governance audits will be discussed.

The theoretical framework of governance audit is set out in the International Institute of Internal Audit's (IIA) Corporate Governance Audit Guide (The Institute of Internal Auditors, 2012). In the research, the IIA's guide was utilized, and the data were interpreted by taking this guide into consideration.

4.2. Subject and Importance of the Research

Simply put, governance is a mix of processes and structures designed to help an organization achieve its purpose. These processes and structures are not only influenced by the risks that affect the company's ability to achieve its objectives. They are also affected by the organization's efforts to mitigate known risks and discover unknown ones. This is where internal audit plays a vital role. Internal audit strengthens corporate governance by providing assurance and insight to senior management on the processes and structures that lead the business to success through a risk-based audit approach. Especially as risk grows and becomes more complex, the role of internal audit increases and the scope of the audit expands from assessing the effectiveness of risk management and internal controls to areas such as culture and behaviors, sustainability, and non-financial reporting metrics. A proactive and agile internal audit provides assurance and advisory services to senior management in managing the risks of new technologies, geopolitical situations, cybersecurity, and disruptive innovation.

The subject of this thesis is the audit of governance practices in Turkey. It aims at revealing how those practices are carried out in the companies registered in the BIST 100 Index. Those companies have been selected because of their corporate structure and since they have a mandatory internal audit/inspection unit. Sectoral differences will be displayed, too, if any. In this context, the International Institute of Internal Auditing (IIA)'s Corporate Governance Audit Guide, which is accepted as the theoretical framework of governance audit, is taken as a reference in our research. On the other hand,

since there are limited number of scientific studies on governance auditing both in the world and in our country in the literature review, this research aims at contributing to the literature.

Another aim of this thesis is to contribute to both internal audit and governance literature by revealing and analyzing how internal auditors in publicly traded companies in Turkey perform and/or fail to perform governance audits, which is one of the three main audit areas (namely; control, risk management and governance).

4.3. Research Method and Limitations

Semi-structured interview technique, one of the qualitative data analysis methods, is used in this study. In this exploratory research, the heads of audit departments of publicly traded companies registered in the BIST 100 Index were targeted, and in line with this target, all 100 companies were tried to be reached by phone and email, but 20 of the heads of audit departments of enterprises in different sectors who responded to the appointment request were interviewed.

Since the data obtained cannot be subjected to hypothesis tests such as quantitative data analysis method due to the nature of this research, the results of the research are more representative of the sample group. While forming the sample group, the sector distribution in BIST 100 index was taken into consideration. In fact, companies across the Borsa İstanbul (BIST) index are grouped under 14 sectors[13]. Companies from only 10 sectors are included in the BIST 100 index. Two of these sectors are Manufacturing (40 companies) and Financial Institutions (33 companies), so 73 of the companies in the BIST-100 are in these two sectors. Since the companies in the Financial Institutions sector do not form an operationally and managerially homogeneous structure, two sub-groups were formed combining sub-sectors with similar business models. These sub-groups are named as "Financial Institutions" and "Holdings-Investment Trusts" (also referred to as Holdings and YO). Banks, insurance companies, leasing-factoring companies, asset management companies and brokerage houses are grouped under "Financial Institutions". Moreover, holdings and investment companies, other financial institutions, real estate investment trusts, securities investment trusts and venture capital investment trusts are grouped under "Holdings-Investment Trusts".

Since very few companies are listed under the remaining sectors, sectors with less than 10 companies are grouped under "Other" category. Therefore, to make more meaningful evaluations, the sectors in which the companies subject to the research are analyzed under these 4 sector groups defined in the research.

[13] In Borsa Istanbul's sector taxonomy, there are main sectors and sub-sectors under them. Borsa Istanbul General Directorate can make changes in the BIST-100 index on a quarterly basis. For this reason, companies in the BIST-100 index are not fixed. The BIST-100 sectors and companies considered in the study include companies in the index list defined as of December 2021.

Qualitative research is defined as research in which qualitative data collection methods such as observation, interview and document analysis are used and a qualitative process is followed to reveal perceptions and events in a realistic and holistic manner in a natural environment (Yıldırım & Şimşek, 2016). Exploratory research aims at presenting statistics on the subject with small-scale samples on subjects about which relatively little information is available and frequently utilizes focus group and interview techniques (Yıldırım İ. , 2010). Based on this feature, the data in this study were collected through semi-structured interviews and maximum variation sampling. Furthermore, a qualitative sampling method was used to select the companies to be interviewed. The purpose of this method is to reveal the unique dimensions of each situation in the main population and similar characteristics among these diverse situations. The goal here is not to make generalizations about the population, but to reveal the similarities (and differences) between heterogeneous situations.

Publicly traded companies in Turkey have a heterogeneous structure in terms of the sectors in which they operate. In addition, these companies are subject to different legislations and regulations of various regulatory bodies depending on their sectors. This situation significantly affects and differentiates the governance and internal audit structures of companies. Thus, in order to reflect this heterogeneity, companies from different sectors should be included in the study. For this reason, the distribution of publicly traded companies in Turkey according to 4 sectors is analyzed and the companies to be interviewed are determined by taking into account the sectoral characteristics.

Within the framework of the thesis study, face-to-face and online interviews were conducted with internal audit department heads (Chief Audit Officers) between May 2022 and November 2022. The interviews were analyzed by content analysis method. The main purpose of Content Analysis is to define various concepts and describe the relationships based on the collected data (Yıldırım & Şimşek, 2016). In addition, Content Analysis is one of the techniques that enable reading and interpreting existing documents (texts, pictures, etc.) and making extrapolations (Krippendorff, 2012). In Content Analysis studies, qualitative texts are analyzed conceptually and thematically. Directly observable or hidden relationships between concepts can be revealed (Yıldırım İ. , 2010). The scope of internal audit activities, as frequently stated, is presented according to the organization's governance and the findings obtained from the analysis are presented according to the topics and with the participants' own statements. Content-free or ambiguous responses that were expressed by the participants but did not carry information value (for the purposes of thesis) were not included in the research.

4.4. Research Findings

As we have explained above, no analysis program was used to examine the data obtained through qualitative method from the interviews with the heads of Internal Audit Units. Instead, the researcher created the conceptual labels, themes and subcategories himself. After the interviews were

completed, the data on the recording device were transcribed verbatim. At the same time, the interviews were listened to again during in-depth analysis.

For the selection of the companies to be interviewed in the research, sectoral characteristics were taken into consideration. First of all, the number and ratio of BIST-100 companies in each sector were determined. In the selection of the companies to be interviewed, the rate factor was taken into consideration in terms of representing the relevant sector. For the reason explained above, BIST-100 sectors are categorized into four main groups and Table 4.4-1 below shows both the number of companies in the BIST-100 and the sector-based distribution of the companies included in the research.

Table 4.4-1: Number of Companies in BIST-100 and in the Scope of the Research by Sector

	Number of Companies in BIST-100	**Number of Interviewed Companies**
Sector	**Frequency (N)**	**Frequency (N)**
Manufacturing	40	8
Financial Institutions	12	4
Holding and Investment Trusts	21	4
Other	27	4
Total	100	20

The interview form, which was prepared to reveal the current situation regarding the audit of governance activities of BIST-100 companies, consists of two parts. The first part of the interview form includes questions about the sector in which the companies operate, their organizational structure and the organizational structure of the audit unit. The second part consists of open-ended questions prepared to display the current situation regarding governance audit in those companies.

Considering the information received from the heads of audit, each of whom is an expert in the field, the profiles of the companies included in the research regarding the sector, organizational structure and audit structure are as follows:

Table 4.4-2: Profile of the Companies Included in the Research

Company	Industry	Foreign Partner	Authority to which the internal audit unit reports	CIA-certified employee	Internal Evaluation	Independent External Assessment	Risk Executive	Ethics Board
Manufacturing								
Company-1	Manufacturing-1	No	CFO	Yes	No	Yes	No	Yes
Company-4	Manufacturing -2	Yes	Audit Committee	Yes	Yes	Yes	Yes	Yes
Company-7	Manufacturing -3	Yes	Audit Committee	Yes	Yes	Yes	Yes	Yes
Company-9	Manufacturing -4	No	CEO	Yes	Yes	No	Yes	Yes
Company-11	Manufacturing -5	No	Audit Committee	No	Yes	Yes	Yes	Yes
Company-12	Manufacturing -6	No	Audit Committee	Yes	Yes	Yes	Yes	Yes
Company-17	Manufacturing -7	No	Board of Directors	Yes	No	No	No	Yes
Company-19	Manufacturing -8	Yes	Board of Directors	Yes	Yes	Yes	No	Yes
Financial Institutions (FI)								
Company-6	FI-1	Yes	Board of Directors	Yes	Yes	Yes	Yes	Yes
Company-15	FI-2	Yes	Board of Directors	Yes	Yes	Yes	Yes	No
Company-16	FI-3	Yes	Board of Directors	Yes	Yes	Yes	Yes	No
Company-18	FI-4	No	Board of Directors	Yes	Yes	Yes	Yes	No
Holding and Investment Trust (Inv)								
Company-3	Holding and Inv-1	No	Board of Directors	Yes	No	No	Yes	Yes
Company-5	Holding and Inv-2	No	Board of Directors	Yes	Yes	Yes	Yes	Yes
Company-13	Holding and Inv-3	No	Board of Directors	No	No	No	No	Yes
Company-20	Holding and Inv-4	No	Board of Directors	Yes	No	No	Yes	Yes
Other Sectors								
Company-2	Other-1	No	Audit Committee	Yes	Yes	Yes	No	No
Company-8	Other-2	Yes	Audit Committee	Yes	Yes	Yes	No	Yes
Company-10	Other-3	Yes	Board of Directors	Yes	No	Yes	Yes	Yes
Company-14	Other-4	No	Audit Committee	Yes	Yes	No	Yes	Yes

The scope of internal audit activities is to assess the organization's governance processes, risk management and internal control processes. The role of internal audit with respect to governance processes is defined in the IIA Standard No. 2010 as *"....developing the necessary ethical and other values within the organization, ensuring effective corporate performance management and accountability, communicating risk and control information to the necessary areas of the organization, coordinating the activities of the board of directors, audit committee, internal and external auditors, and senior executives, and communicating necessary information between them"* (IIA Standard 2110). The data obtained from the interviews were classified under these headings. In the following subsections, findings related to these sub-dimensions of governance audit, which are defined separately in the IIA guidelines, are presented.

The first sub section below presents the general findings regarding "governance practices in companies". They are also presented in the following sections together with the sub-dimensions of governance audit. In other words, companies' practices and audit activities related to the sub-dimensions of governance are explained together. In this way, each sub-dimension of governance implemented and audited in each sector are evaluated together.

4.4.1. Governance Practices of Companies

Audit heads of the interviewed companies were asked to provide information about governance practices in their companies. When the responses on these issues are grouped by sectors below.

When Table 3 is analyzed, the board of directors, independent members and board committees are described as basic governance practices in all sectors. On the other hand, in the manufacturing sector, the budget process, ethical assessments and risk management are prevalent. In the financial institutions sector, executive membership structure, credit committees, ethics and compliance management, regulations and corporate governance rating are specified as basic practices. In the holdings sector, delegation of authority through signatory authorities, determination and breakdown of corporate objectives, strategic planning processes, risk management and written rules are depicted. In the Other sector, executive committees such as independent audit and broadly participatory operations committees are explained in detail.

Although we have summarized the main governance practices reported by heads of audit in this sub-heading, governance practices of companies related to each governance sub-dimension are discussed in more detail in the relevant sections.

Table 4.4-3: Definition and Practices of Governance by Sector

Sector	Key governance practices of companies
Manufacturing	Board of Directors, independent members, investment committees, budget process, ethical assessment, risk management
Financial Institutions	Board of Directors, independent directors, executive directors, credit committee, compliance, ethical considerations, financial decisions, corporate governance rating, committee charters
Holding and Inv	Board of Directors, Committees, Signatory powers and breakdown of objectives, strategic plans, risk management, specific authorities, procedures, policies
Other	Board of Directors, Independent members, audit committee, independent audit, executive committees, operational committees with broad participation.

The information provided by the heads of audit participating in the study about governance practices directly overlaps with the sub-dimensions of governance in the IIA's governance audit practice guide. Heads of audit have cited boards of directors, risk management, internal control, strategic plans and budget as key governance practices.

4.4.2. Audit or Assessment of Strategic and Operational Decision Making in Governance

Governance within a company does not exist as a separate process or structure. It is embedded in the relationships between an organization's risk management and internal control practices. An effective governance system should have elements of risk and control, starting with the determination of the corporate strategy.

According to IIA Standard No. 2110, to assess a company's processes of making strategic and operational decisions, internal audit reviews board meeting minutes, board policies, and past audit reports to gather information about how decisions are deliberated and made (The Institute of Internal Auditors, 2016). This review tests whether decision-making processes are stable, consistent, and a part of an established system.

In response to the questions in the semi-structured interview, the heads of audit of the companies participating in the study provided detailed explanations about the governance practices and auditing activities of their companies in the first sub-dimension of governance, namely “strategic and operational decision-making”. The governance practices and audit activities of the companies regarding this sub-dimension are presented in Table 4 below by combining the answers of two separate questions.

Table 4 shows the governance structures and practices by sector with respect to strategic and operational decision-making, as well as practices for their oversight. First of all, the board of directors and committees are mentioned as the main governance structure in all sectors. This is because the main

task of boards of directors is to guide strategy and make strategic decisions. In addition, senior management, executive committees and boards, and approval flows and procedures are defined as governance practices in all sectors. In the financial institutions sector, the risk management committee and the credit committee stand out from other sectors in making strategic decisions.

There is no significant difference between sectors regarding the practices related to the audit of this sub-dimension of governance. In all sectors, operational and tactical decisions and practices are audited to assess compliance with strategy. In addition, in the manufacturing, finance and holding sectors, delegation of authority and approval flow rules are also audited within the scope of governance audit.

Table 4.4-4: Strategic and Operational Decision Making, Implementation and Audit by Sector

Sector	**Governance structure and practices related to strategic and operational decision making**	**Audit of governance practices related to strategic and operational decision making**
Manufacturing	Board of Directors, Committees, Strategy Department, Rules of approval flow, Delegation of authority table, Policies and Procedures	Control of compliance with rules of approval flow, Control of compliance with delegation of authority
Financial Institutions	Board of Directors, Committees: Asset-Liability Committee, Risk Management Committee, Executive Committee, Senior Management operational acceptance rules	Audit of strategic technology decisions, audit of levels of authority, audit of compliance of decisions with strategy
Holding and Inv.	Board of Directors, Committees, Senior Management, Policies and Procedures, Rules of approval flow	Audit of compliance of decisions taken with the strategy, audit of compliance with rules of approval flow, audit of strategic planning and budget process
Other	Board of Directors, Committees, Executive Committee, Senior Management	Audit of compliance of decisions with strategy

The audit of conformity with strategy assesses whether executive and operational decisions are consistent with the organization's strategy. The head of audit of Company 1 in the manufacturing sector has described the audit of conformity with strategy as follows:

"For example, the company's own strategic plan adopted by the company, the decisions made at the executive board meetings that have previously been taken at the management meetings, the company's mission and vision, annual targets, and compliance with those, of course, just as we audit compliance with the decisions of the board of directors, we also evaluate the business and transactions in terms of compliance with these criteria and targets" (Company-1: Manufacturing).”

Moreover, the head of audit of Company-9 in the manufacturing sector has shared the following concrete example of a fit to strategy audit:

"We also evaluate the alignment of the activities carried out by the audited process with the strategic direction of the strategic company. For example, we have a digitalization strategy. We also analyze what activities can be automated in the process we audit. Sometimes, operation teams may not want to change due to past habits or may not realize this due to habits. As an external eye, for instance, we can develop suggestions to support this strategy" (Company-9: Manufacturing).

Again, the head of audit of Company 9 has stated that they audit the consistency and stability of strategic and operational decision-making processes and criteria in line with the definition in the IIA guidelines*:*

"Again, regarding strategic operational decision-making, we try to understand how decisions are made and what kind of process is followed in the interviews we conduct in each process. Again, we examine the criteria used in decision-making, the decisions of the commissions, their minutes, authorization structures, approval structures. We examine how standardized and consistent these are." (Company-9: Manufacturing)

In addition, the audit head of Company 6 in the financial institutions sector stated that they audit strategic decision-making processes related to technology issues, which is another dimension regarding the audit of strategic decisions. Strategic technology decision-making in the financial institutions sector is subject to various regulations and is audited within the framework of the obligation imposed by these regulations.

"I mean, to be honest, the work in that direction is only on the technology side. Again, that is also due to obligation. Actually, as I said, there is a strategy committee in the bank, I don't know if it is a process, I mean, one of the committees is the strategy committee. Strategic decisions are made in the bank committees with the participation of the BoD members" (Company-6: Financial Institutions).

Apart from these, important findings have also been obtained regarding the oversight of budget planning processes, which is another dimension related to strategy. The importance of budget planning processes in this dimension of governance is critical, as they serve as a bridge between strategic decisions made by the highest governance body of the organization and the implementation of executive operational and strategic decisions.

"For example, in 2021, we audited the planning processes of the whole group..... coincidentally coincided, you know, how all these budget planning etc. were taken, how the assumptions were made, how the assumptions were created, all of them, you may not call them strategic, there are also operational things, but we looked at that whole process, for example. Apart from that, the company has taken this decision, maybe not from that perspective, but for example, when we are auditing an investment, we can say that we understand whether the necessary things have been done about it,

whether the evaluation of factors such as its feasibility has been made in the meantime within that holistic structure. (Company-5: Holding and Investment Trusts)"

Another audit of strategic and operational decisions is conducted within the scope of approval processes and authority responsibility sharing. In terms of approval processes, audits are conducted on whether the decisions are in compliance with the rules of approval flow. The rules of approval flow are systems created to ensure that decisions are made by the right and authorized persons in companies. Those systems reveal in advance who is authorized to make decisions. Henceforth, there is a hierarchy of authority within the system. This hierarchy of authority requires decisions to be made at appropriate levels of authority. For instance, the question of whether the decision that should be made with a board member has included his/her participation is within the scope of this audit.

The head of audit of Company 16 from the financial institutions sector has pointed out that audits are conducted on whether decisions are taken at the appropriate level of authority and stated the following:

"We also take into account whether the strategic and operational decisions are made at the appropriate level of authority with the appropriate approvals in different processes, or whether the main theme and main messages decided at the board level, as I just told you, are observed in the decisions in practice" (Company-16: Financial Institutions).

It was also emphasized that audits are conducted to ensure that the decisions are not made by a single person and that those decisions are made after deliberation. The head of audit of Company 14 has described audits that are conducted in this regard as follows:

"... A decision must have more than one person's signature behind it, and we need to challenge what is presented to those signatories. Because when you issue something to the general manager, he/she knows those five or six slides you presented, whether they are right or wrong, whether the reporting that constitutes it is correct or not, and naturally, since we challenge them, we actually go to the point where the strategic decision is made. ... (Company-14: Other)

Now, when we audit this, we challenge from the strategic decisions at the top to the (...) working principles used below, so there is our manager, the director of that subject, the deputy general manager of trade, so those decisions are questioned, plus there are areas of interaction with other departments" (Company-14: Other).

In explaining the methods of their audit in the area of strategic and operational decision-making, the head of audit of Company 1 stated that they review the minutes of board and committee meetings, policies and past audit reports to gather information on how decisions are made.

"Our current method is to audit whether the decisions are made in line with the company's policy within the scope of governance, such as whether there are budget overruns, whether approval has been requested for them, whether the investment committee approvals have been obtained for investment decisions" (Company-1, Manufacturing).

The findings obtained for this subdimension show that companies conduct audit practices in all sectors regarding strategic and operational decisions. Strategic and operational decision-making is on the agenda of audit units as a fundamental governance audit issue in all internal audit activities.

4.4.3. Findings on the Development of Ethical and Other Values

Institutionalization of ethics in businesses occurs in the form of mission and value statements, codes of conduct, recruitment and training processes, and prevention of misconduct and unethical behavior. These are usually put into practice through the creation and implementation of ethical codes.

To assess how an organization promotes ethical principles and values both internally and among external business partners, the internal audit activity examines the organization's relevant objectives, programs and activities. These include mission and value statements, codes of conduct, hiring and training processes, fraud and unethical behavior prevention and whistleblowing policies, and ethics hotlines and investigation processes (The Institute of Internal Auditors, 2016).

While conducting an end-to-end audit of a process or a department, the audit unit also examines the organization's ethical principles and values. The internal audit unit should analyze and evaluate how organizations promote and develop ethical principles and values in their relations with internal and external stakeholders. When these are audited for a process, it is evaluated whether there is a design and implementation that will guarantee compliance with the code of conduct, ethical values, mission and vision of the organization in the operation of the process. It is inspected whether there are ethical violations within the process or the audited department, and whether the ethical violations found in the past have been concluded in accordance with the established procedures (The Institute of Internal Auditors, 2012).

In line with the answers given by the heads of audit, the governance structure and practices related to ethics and other values and the activities related to the audit of these practices are presented on a sector basis, taking into account the IIA's definition. The answers to two separate questions on governance practices regarding ethics and other values and how they are audited are presented in Table 5 below as labels.

If the governance practices summarized in the table are examined, it can be concluded that the main common components for all sectors are ethics committees and codes of ethics. Codes of ethics are

referred to also as compliance rules. In addition, ethical hotlines are particularly prominent in all sectors. The table shows that whistleblower hotlines are not mentioned in the financial institutions sector. The main reason for the lack of special emphasis on whistleblowing hotlines in financial institutions is that preventive control systems in the financial sector are highly developed and auditing activities are widespread and intensive. In addition, in the holding and manufacturing sectors, trainings and fraud investigation processes are explained as governance practices. This is because the heads of audit in the holding and manufacturing sectors see fraud investigations, which are essentially an internal audit activity, as a part of governance practices.

When the audit of governance practices related to ethics and other values is analyzed by sectors, there is no significant difference among the companies. In all sectors, ethical misconduct investigations are conducted as the main audit activity. Again, when Table 5 is analyzed, it is seen that audit units in the holding and financial institutions sectors emphasized awareness raising and training on ethical issues as an important part of their audit activities.

Table 4.4-5: Governance Practices and Audit on Ethics and Other Values by Sector

Sector	**Governance structure and practices related to Ethics and Other Values**	**Audit of governance practices related to Ethics and Other Values**
Manufacturing	Ethics Committee, Ethical rules, Ethical whistleblowing policy and ethical whistleblowing hotline, Notifications from outside the ethical hotline, Training processes, Investigation processes	Detection of ethical violations and audit of compliance with ethical codes, Referral of ethical issues to the committee, Operation of disciplinary processes
Financial Institutions	Ethics Committee, Code of Ethics	Conducting ethics investigations, ethics awareness activities and trainings
Holding and Inv.	Ethics Committee, Ethical rules, Ethical whistleblowing policy and ethics hotline, Training processes, Investigation processes, Mission and value statements	Detection of ethical violations and compliance with ethical codes, Referral of ethical issues to the committee, Compliance with ethical rules and raising awareness, Investigation of reports of ethical violations
Other	Ethics Committee, Ethical rules, Ethics hotline, Notifications from outside the ethics hotline	Referral of ethical issues to the committee

Ethical codes form the basis of corporate ethics. These codes serve as a guide for correct and ethical practices in the relations of the organization with all its stakeholders (personnel, suppliers, government, and the like). These codes include, for example, definitions and rules that guide the organization to avoid conflicts of interest and corruption in relations with external stakeholders and to avoid mobbing and harassment in relations with internal stakeholders. Audit units also carry out audit and consultancy activities on the establishment, operation and updating of this set of rules.

The audit head of company 12 from the manufacturing sector explained that the code of ethics is implemented as a part of a global ethics program:

"In our Holding, we have a global ethics and honor board, and this global ethics and honor board evaluates ethics-related notifications from all companies. There is an ethics program, which includes regulations, training programs, penalty scales, etc. This is also implemented by the Company. As I mentioned earlier in relation to ethics, all these already have policies and regulations" (Company-12, Manufacturing).

Ethics Committees are a common governance practice in the implementation and development of codes of ethics and the assessment of violations. Heads of audit have also emphasized this issue. The head of audit of Company 14, which operates in the Other sector, explained the functioning of the ethics committees as follows:

"I am a member of the ethics committee, and besides me, four of our deputy general managers are members. That is, we have a five-member structure. The head of Human Resources is the chairperson of the board, but everything is democratically discussed, the reports are examined, and the board is challenged so that there are no gaps. We have a moral behavior guide, and within that framework, a sanction decision is issued, and in a processual sense, cautionary decisions are issued. That is, like an audit finding, like a small audit report, and sanctions are applied in that way, and axioms for measures are opened on that side. I mean, even our general manager does not interfere with that board, let me put it that way. The final decision is made by the board. All four members of the board said A, for example, let's say I say B. Again, since I am independent from the executive, I can bring that issue to the Audit Committee, that is, it can also be brought to the Audit Committee, so that it can be brought to the Audit Committee to say that such a decision was taken here, we have a comment, for your information" (Company-14, Other).

The Head of Audit of Company 7 from the manufacturing sector explained how the Ethics Committee works as a platform:

"... after these are reported, there may be disciplinary processes. After they are discussed, there may be disciplinary processes. In the disciplinary processes, there is a disciplinary board defined by the company, there is an HR director, there is a CFO, there is an independent deputy general manager. If the issue is related to HR or financial affairs, its manager does not participate. There is such a platform where they have voting rights and we only participate to explain the issue. That is, to explain the issues when needed, and give legal opinions, and after they make the decision, the decision will be implemented by the company" (Company-7, Manufacturing).

In order to prevent misconduct and unethical behavior, ethics hotline policy and ethics hotline investigation processes are developed. Various aduiting and prevention techniques aim at reducing the opportunity element of making unethical decisions in an organization. It has been observed that most of the interviewed enterprises have an ethics hotline. Notifications received by this ethics hotline are

evaluated and concluded within the appropriate framework and forwarded to the executive units to take the necessary actions.

The head of audit of Company 3 from the Holding sector explained the functioning of the whistleblowing hotline. He has also put that the audit unit is the communication bridge between the whistleblowing hotline and the Ethics Committee:

"In order to make the evaluation of this a little more effective, we went for a structure like this: I am a member of the ethics committee in the community. I can directly see all the messages that fall on the ethics line. I am also the rapporteur of the board. This is how we ensure effectiveness within the company. All incoming issues are evaluated by the ethics committee, whether they are very relevant or not, without any kind of discrimination. Those that are not relevant are already passed in three seconds. This is not an issue about us. If necessary, a relevant issue can be discussed for two hours or three hours. In this way, we can have a clear view on the implementation and perception of ethical rules. As I said, this can be audited periodically within the group" (Company-3, Holding and Investment Trusts).

In the interviews, the common point that has emerged predominantly in terms of auditing is the investigation of ethical violations. The audit manager of Company 7 from the manufacturing sector exemplified the issue as follows:

"We investigate corruption, theft, mobbing, harassment, etc. When we are constantly approached about ethical issues, we investigate them and report them" (Company-7, Manufacturing).

The head of audit of Company 14, which operates in the Other sector, has explained the functioning of the whistleblowing hotlines and misconduct investigation processes as follows:

"Ethical issues are also an area of our responsibility. There are ethical reporting channels. These can reach us in all kinds of ways, either through ethical non-compliance forms, which are defined and operated within special security frameworks, by writing directly to the ethics committee, through the mailbox, or through the phone line, and so on. We, as internal audit, have an investigator who conducts the investigations and presents them to the ethics committee (Company-14, Other).

In order to prevent ethical incompatibilities at an early stage, measures should start at the recruitment stage. Thus, it is important for organizations to publicly announce their ethical principles and set standards in advance. Following the ethical assessments made during the recruitment process, the second stage is to provide extensive ethics training to newly recruited staff and existing staff. Ethics trainings provide detailed information about the organization's code of conduct and the mechanisms to be used in case of ethical non-compliance. These activities also form the basis of awareness activities.

One of the duties of internal audit units is to conduct relevant audits to determine the level of awareness, compliance and implementation of ethics within the organization. In the holding and manufacturing sectors, these activities were expressed as both governance and audit practices.

The Head of Audit of Company 3 from the Holding sector states below how they have addressed this issue:

"It is a difficult issue in terms of the level of compliance with ethical rules; but when you put it on paper, the level of awareness, whether there are notifications of ethical violations, and related issues such as those regarding the units audited, serious results can be obtained. In other words, you can understand how widespread it is, what level of awareness has been reached and whether there are significant violations (Company-3, Holding and Investment Trusts).

The audit head of Company 6 from the Financial Institution sector has made the following observations regarding regular ethics trainings:

"For example, we provide mandatory trainings to all employees every 6 months, whether you agree or not, to explain how valuable this job is for us. I think this is something that summarizes the seriousness of the organization, meaning its approach to the issue" (Company 6: Financial Institutions).

Questionnaires and interviews can also be used to measure and evaluate the level of awareness of ethical standards and values in the process. The level of enforcement of the organization's ethical rules in relations with third parties such as personnel, customers and suppliers is an important part of internal audit activities.

The head of audit of Company 12 from the Manufacturing sector explained that they conduct audits of ethical review and registration processes:

"... As I mentioned about ethics, all of these already have policies and regulations, and we go through them in a period of two to three years to ensure compliance with them. At the same time, what has been done so far, how the records of these have been kept and how they have been reported is internally audited" (Company 12: Manufacturing).

As it can be concluded from above findings, internal audit units have the primary function of spreading ethical values within the organization or improving ethical values by eliminating violations. Internal audit units fulfill this function as a part of governance oversight, sometimes in ordinary operations and sometimes in special governance audits. However, on occasion even the final decisions of the bodies authorized to take decisions on ethical issues can be referred to the Audit Committee, which is a higher authority, by an independent department such as the audit unit.

4.4.4. Findings on Risk Management and Oversight of Control

According to governance standard 2110 of the International Standards on Internal Auditing, to determine how an organization conducts oversight of its risk management and control activities, the internal audit activity typically reviews the annual risk assessment process. To this end, the internal audit activity may also review the minutes of meetings where the risk management strategy was discussed, review previous risk assessments, and interview key risk management-related personnel, such as compliance, risk, and finance staffs. The information gathered in this way can be compared to benchmarking values and current industry trends to ensure that all significant risks have been assessed (The Institute of Internal Auditors, 2016).

Considering these explanations in the IIA Standards and Guidelines, the governance structure and practices related to risk management and control oversight, and the activities related to their oversight were investigated on a sector basis in line with the answers given by the audit heads. The answers to two separate questions on governance practices related to risk management and control oversight and how they are audited are presented as labels in Table 6 below.

Looking at the governance practices summarized in the table, the main common components for all sectors are early risk identification committees and risk management units. In addition, while the internal control framework is emphasized in the manufacturing sector, the quantification of risks and internal systems leadership practices in the financial institutions sector differ from other sectors due to the impact of legislation. In holdings, risk management policies and determination of risk appetite differ from other sectors. The Other sector, by contrast, has emphasized IT and operation security risk specialists as distinct governance practices according to the diverse requirements of its sub-sectors.

When the audit of risk management and control oversight activities in Table 6 is analyzed by sectors, there is no significant deviation except for financial institutions. In the Manufacturing, Holding and Other sectors, the main audit activities are the audit of risk limits, the quality of the risk policy and internal control of processes. In the Financial Institutions sector, in addition to these, due to the nature of the sector, money laundering legislation, IT risk, credit risk and legal compliance risk audit are performed.

Table 4.4-6: Governance Practices and Oversight of Risk and Control Oversight by Sector

Sector	Governance Practices for Oversight of Risk and Control	Governance Audit Practices on Risk and Control Oversight
Manufacturing	Head of risk management, internal control framework, risk committee	Risk management audit, quality audit of risk policy, fraud risks, internal control audit
Financial Institutions	Risk management committee, internal control department, quantification and measurement of risks, critical risk indicators, internal systems department	Risk management audit, quality audit of risk policy, internal control audit, black money legislation audit, IT risks audit, credit risk and legal risks audit, reputational risk

Holding and Inv.	Risk management chairmanship, authorization matrices, risk management policy, risk committee, risk appetite determination	Risk management audit, internal control audit
Other	Risk early detection committee, risk and control department, financial risk specialist, IT risk department, security risk specialists	Internal control audit, compliance management audits, IT risks audit

Boards often delegate the risk management process activity to the organization's executive team. Structures vary according to the size, complexity, and maturity of the organization. In some organizations, there may be a separate manager (or team) responsible for risk, or in some organizations the internal audit department may be assigned specific risk management responsibilities. When conducting an audit of risk management, internal auditors should regard the qualitative aspects of this function as well as the formal processes. For example, the quality of the risk policy or risk universe is as important as their presence (IIA Practice Guide: Auditing Corporate Governance, 2012).

The audit activity related to the quality of risk management, risk policy or risk universe starts with reviewing the decisions and processes in the platforms and meetings where the risk management strategy is discussed and decided. At this stage, the activities of mapping and prioritizing risks and defining risk limits and measures in case of exceeding limits become the main sub-headings of risk management audit. Heads of audit from the finance and manufacturing sectors have given the following examples in this regard:

"We look at how risks are managed within each process of risk management; but we also conduct a separate corporate risk management audit. We examine how corporate risks are identified, how they are prioritized, and what kind of actions are taken for acceptable risk levels" (Company 9: Manufacturing).

"The important is to ensure that reporting is done with correct information. Mostly we don't see mistaken data but we see that some information based on the correct data is evaluated or depicted in different ways. We see that some more positive information is pushed front, while negative information may be neutralized in certain reporting processes" (Company 16: Finance).

"We challenge operation teams for Business continiutiy scenarios, such as precautions in pricing department for any possible system break. We challenge IT risk management from data leakege perspective. We audit precautions against any possible data leakage to a competitor. By this method we also audit its Governance within the process." (Company 14: Other)

In the Financial Institutions sector, unlike the Other sector, IT auditing emerges as a mandatory type of audit as required by legislation.

"There are either specific audits expected from the inspection boards, especially the Banking Regulation and Supervision Agency (BRSA). For example, in the BRSA's regulation on information systems electronic banking, the BRSA asks for assurance from us on whether the governance of IT and IT risks and related issues operate within the framework set out by the legislation, and expects us to provide this every two years. Hence, an audit is conducted on this matter" (Company 15; Financial Institutions).

The following example is given about the audit of money laundering and other legal compliance risks in the Financial Institutions sector:

"Pursuant to MASAK legislation numbered 5549, a compliance program, i.e. financial crime compliance program, customer identification program or banking at program with different names in different countries, is referred to as financial crime compliance program in our country, from end to end, for example, from training, risk assessment, risky control activities, activities of compliance teams where these will be managed on the secondary line, to whether these are in your subsidiaries if you are a financial group" (Company 15- Financial Institutions).

The following information has been provided regarding asset liability risk and credit risk supervision in the financial institutions sector:

"The bank has an asset liability committee for asset liability management. This committee makes decisions. This is of course very important in terms of financial statements. Secondly, apart from the risk management committee, we have a committee that we call the risk acceptance and product committee. This committee has a very important function. What is it? If we are going to launch a new product in the bank, for example, a new card will be launched or a process will change in the bank, all of these process changes have to come to this committee and the committee must be unanimous in order to make a decision. There are business lines, the technology side, as well as first and second level control responsibilities and risk management units" (Company 6 - Financial Institutions).

"Every year we review these things from a risk perspective. That is, before we make our annual audit plan, we conduct a risk study on each sub-process dimension. So we consider credit risk, operational risk, financial risk, all risks. If we think that one of the risks for that sub-process is high, we prioritize it accordingly. Of course, in practice, legal risk and credit risk are our higher priority risk categories when we make our annual audit plan. Nevertheless, if you ask whether we take them into consideration, yes we do" (Company 16- Financial Institutions).

In addition to these findings, there are two types of risk that are not explicitly mentioned in the IIA's guidance, but were specifically highlighted by the participants. These are fraud risk and reputational risk. Fraud risk is the risk of unexpected financial, operational, or reputational losses as a

result of corrupt activities of internal or external stakeholders (Committee of Sponsoring Organizations of the Treadway Commission, Internal Control-Framework and Appendices, 2013). The head of audit of Company 9 has pointed to this risk and has stated that he/she audits fraud risks within each process:

"Within the scope of auditing fraud risks, as internal audit, we need to take fraud risks into consideration in each process audit. Especially in commercial processes, these risks may be a little more due to their nature. We evaluate fraud risks in every process" (Company-9: Manufacturing).

The head of audit of Company 6 has explained reputational risk as follows and has mentioned the measurement and audit of this risk:

"Reputational risk is not a very difficult risk to quantify. We measure reputational risk as follows. You know there is a customer complaint unit or a call center or something like that. If the number of calls received in this context exceeds, say, a hundred a day, the yellow alarm lights up. If it exceeds two hundred, it means that there is something wrong with our reputation. So let's check this out. That is how it is monitored through indicators" (Company 6: Financial Institutions).

In addition to the assessments made on the oversight of risk management, some findings were also found regarding the oversight of internal control. Enterprises in the Manufacturing and Other sectors made the following statements regarding internal control oversight:

"In the establishment of internal controls, we have minimum internal control standards in a way to observe the basic internal control principles at work, and through them, mostly financial reporting units and operation units establish their internal controls by observing them, including the separation of duties and reporting" (Company 4: Manufacturing).

"Again, that is also one of our activities, we also implement internal control, I mean I have been trying to create the system for more than a year, we have created a significant number of scenarios, close to a hundred or even more than a hundred, based on certain scenarios, we have drawn up risk scenarios, we apply the ones we choose from them to the ecosystem by drawing reports at certain periods, and we conduct additional examinations on alarming situations" (Company 14- Other).

In line with what has been stated by the head of audit of Company 5, which operates in the Holding company sector, heads of audit are often involved in the governance practices of risk and control oversight in an advisory role. This situation also contributes greatly to the audit departments to perform their oversight function more effectively:

"We already follow the risk very closely. I am also involved in it. I attend the audit committees of the companies. I also attend the risk committees. My friends in risk, too, attend the risk committees. I

mean, in terms of monitoring how it is going, we have a monitoring system with this structure, it is reassuring (Company 5: Holding and Investment Trust)."

When all the findings of the research related to the risk and control oversight sub-dimension are evaluated together, it can be concluded that the internal audit departments of the companies play an active role in governance practices related to risk and control oversight, and that they perform intensive risk and control audits, albeit at different levels.

4.4.5. Communicating Risk and Control Information to the Necessary Units of the Organization

To assess how well an organization communicates information about risks and controls to the appropriate units, the internal audit activity has the responsibility to determine whether information about risks and controls is communicated in a timely manner and is complete and accurate (The Institute of Internal Auditors, 2016). The findings regarding the governance practices and audit activities of the companies within the scope of the study in the sub-dimension of communicating risk and control information to the necessary units of the organization are evaluated by sectors.

In the interviews with the heads of internal audit, the responses regarding governance practices and audit activities in the sub-dimension of communicating risk and control information to the necessary units of the organization were collected on a sectoral basis. The answers to two separate questions regarding the governance practices of this sub-dimension and how they are audited are presented as labels in Table 7 below.

When the audit of the communication of risk and control information within the organization is analyzed by sectors, coordination meetings between control, risk and audit units and the role of heads of audit units as advisors to internal executive committees seems to be particularly prominent in the manufacturing, financial institutions and holding companies sectors. In the Other sector, the review of integrated management systems and large meetings for process improvement have been described as serving this purpose. Additionally, in the Manufacturing sector, it has been explained that risk management and compliance audits contribute to this purpose. Last but not the least, in the Holding sector, consultancy for the processes of establishing internal regulations and conducting risk audits has been emphasized.

Table 4.4-7: Governance Practices and Audit on Communicating Risk and Control Information by Sector to the Necessary Units of the Organization

Sector	Practices for Communicating Risk and Control Information	Audit Practices on Communicating Risk and Control Information
Manufacturing	Internal executive committees	Coordination meetings of internal control, risk and audit units, risk management audit, compliance audit
Financial Institutions	Reporting of risk and audit committees to the Board of Directors, mandatory trainings every 6 months, internal executive committees	Interdepartmental coordination of the audit unit, and the involvement of the audit unit as an advisor in executive committees
Holding and Inv	Internal executive committees, risk coordination committee, information security, PDPL committees	Heads of audit serve on in-house executive committees and provide oversight. Internal legislation consultancy and risk audits serve these purposes
Other	Executive committees and Operational risk specific committees	Integrated management systems review and process development meetings

The heads of audit of Company 16 and Company 5 in the Financial Institutions and Holdings sector have described their oversight and consultancy activities to ensure the effective functioning of internal executive committees in communicating risk and control information as follows:

"Risk and control information is necessary for the organization, as well as for reporting on the process. We definitely review them, whether it is done in the right period, whether it is done at the right level, and most importantly, I think the most important part is whether this reporting is done with the right information, because the findings we usually come across here are never that wrong information or data is used (Company 16: Finance)"

"How effective is compliance management, and we also have looked at it on a group basis. For example, we have put sustainability on our agenda this year and we will look at it in the whole group. The existence of mechanisms as well as the functioning of these mechanisms is important for us, so when we go into that detail, of course, it is important to establish the mechanism, but sometimes it happens on paper, the committee is established, the committee does not meet, or you look at it, it may not talk about enough things, I give this as an example, but we look at how effective it has been (Company-5: Holding and Investment Trust)"

Regarding the assurance on the communication of risk and control information through process development meetings and management systems reviews with wide participation, the head of audit of Company 14 from the Other sector has made the following explanations:

"There are management review meetings of integrated management system. These are standardized within the scope of ISO system. They are broadly participated. In those meetings, the targets or the deficiencies are discussed. Moreover, the ecosystem is penetrated and all of these are

recorded and actions are opened in the system. That is, the problem and the date is determined. This is relevant for almost all activities."

Let me give one more example. We have a meeting about guest experience related to guest services. It was a widely participated meeting. Now it is easier to do these things. Thirty or forty people from the top of the teams participate and the top management is slightly involved in the event. The issues are directly circulated downwards. (Company 14- Other)"

According to the relevant IIA standard, surveys and interviews can also be used to determine employees' knowledge of their responsibilities for risk and control processes and the impact that failure to fulfill those responsibilities would have on the organization. Assurance and advisory engagements can also assess how a unit communicates risk and control information to other units (The Institute of Internal Auditors, 2016).

The head of audit of Company 3 in the Holding sector has explained the contribution of consultancy work on the development of internal legislation and risk audits to the information dissemination sub-dimension below:

"Our audit department conduct the advisory role mentioned in Internal Audit definition and standards during the creation of internal legislation. If we do not provide this, it means that we are not really doing anything. Therefore, in any kind of transformation, at least one or two competent people from audit team should be giving opinions. We are doing this very effectively. We are really doing it properly here. When this is not done, I think there is a very big deficiency for a company" (Company 3: Holding and Investment Trust).

"In periods like the one we are going through, the most important risk is liquidity. In this case, the auditor should go and check very strictly whether there will be a problem in terms of liquidity in terms of payments, whether there are transactions against authorization limit sor whether there is an irregularity" (Company 3: Holding and Investment Trust).

The head of audit of Company 9 in the Manufacturing sector has described the impact of compliance audits as follows:

"Compliance is a very comprehensive concept. Take, for example, legal compliance. Every process actually has to comply with the laws and whatever legislation is relevant to it. Antoher example is human resources. While conducting the human resources audit, check compliance with the legislation, human resources labor law. In addition, we conduct tests on this or the PDPL, the law on the protection of personal data. If we see that personal data is kept during the audit of the process in the relevant

process, we also look at compliance with the PDPL. Again, during an OHS and environmental audit, we examine the relevant legislation and conduct tests on compliance" (Company-9: Manufacturing).

The fact that our research findings are limited under this heading indicates that the communication of risk and control information sub-dimension of governance is not considered by internal audit units as an issue to be sufficiently focused on in governance audits. In order to improve this result in organizations, governance audit guidelines should be developed based on IIA guidelines.

4.4.6. Findings Regarding the Evaluation / Audit of the Board of Directors' Governance Practices

Internal audit units may examine meetings such as board of directors, audit committee, and finance committee meetings to assess the organizations and make determinations on issues such as the frequency of meetings. Internal audit teams can attend these meetings as participants or observers and review meeting minutes, work plans, and reports distributed among these groups to learn how they coordinate their activities and communicate with each other (The Institute of Internal Auditors, 2016).

In the interviews with the heads of internal audit, the responses regarding the Board of Directors' governance practices and the evaluation activities of this sub-dimension have been collected on a sectoral basis. The responses are labeled in Table 8 below.

Looking at the board governance practices summarized in the table, the main common component for all sectors is the presence of board committees and the general secretary of the board of directors. As expected, these are the main governance practices in publicly traded corporations and there is no noteworthy variation among sectors.

When it comes to auditing the governance practices of the Board of Directors, it has been revealed that only three companies (n=3) conduct board governance audits. Two of these companies operate in the Finance sector and one in the Manufacturing sector. Table 8 shows that these three companies conduct an audit and evaluation by examining the minutes of board meetings and the way decisions are made. In companies other than these three companies, no work is carried out in the dimension of auditing or evaluating the governance practices of the Board of Directors.

Table 4.4-8: Governance Practices and Oversight of the Board of Directors by Sector

Sector	Board governance structure and practices	How is Board governance practices audited?
Manufacturing	Board Committees	Examination of the minutes of the board of directors meeting, Examination of the way decisions are taken
Financial Institutions	General Secretariat of the Board of Directors, Board Committees	Examination of the minutes of the board of directors meeting, Examination of the way decisions are taken

Holding and Inv	Secretary General of the Board of Directors, Committees	There is no special audit
Other	Secretary General of the Board of Directors, Committees	There is no special audit

As stated by the IIA, an audit of the governance of an organization's board of directors is conducted by reviewing meeting minutes, work plans and reports. The audit leader of Company-16 in the financial institutions sector has suggested that they review the minutes of board and committee meetings and conduct the assessment by communicating missing issues:

"We conduct our Governance audits as reviewing board minutes whether they fit into company standards, checking the agenda items to ensure all significant Board decision topics are covered, reviewing minutes and Board decisions to include legal requirements" (Company-16: Financial Institutions).

Considering the fact that the board of directors is the most important unit where democracy functions for an organization, decisions should be made in accordance with the democratic method. For this purpose, issues such as whether the board of directors actually convenes, how often it convenes, and whether the members attending the meeting meet the quorum are important. The head of internal audit of Company-6 from the financial institutions sector has drawn attention to this issue and has stated that they explore board practices in this respect.

As part of our business, I mean, we already provide assurance regarding these as required by applications. We check the frequency of board meetings, whether it really convene, whether the decisions are recorded in the ledger. We need to make documentation accordingly" (Company-6: Financial Institutions).

An important indicator of the democratic functioning of the board is the way in which decisions are made. Therefore, whether board decisions are discussed sufficiently is also an audit issue in terms of governance. As stated in the IIA's practice guidance, internal audit units can attend board meetings as observers and monitor whether the decisions made are adequately discussed. They can also review the minutes, work plans, and reports distributed at the meeting. The head of audit of Company-11 in the Manufacturing sector has put that although they do not directly participate in board meetings, this issue is observed by them. In addition, they express their objections when necessary due to insufficient discussion of the decisions:

"There were times when the resolutions were very generic. We criticized them from time to time. Similarly, there were times when the resolutions of the committees always had the same wording in their minutes. We criticized this, too. I think these are important issues, so we criticized them and

suggested that a minute should be prepared in a way that would enable them to provide more satisfactory information. In this way, we confirmed the accuracy of the board decisions in terms of documentation" (Company-11, Manufacturing).

Similarly, the head of audit of Company-6 has stated that although they do not have the opportunity to directly observe this issue because they could not attend the board meetings, they are able to offer opinions and suggestions by indirectly examining the documents and papers submitted to them.

"Obviously, the audit unit does not have the opportunity to directly observe this because it does not attend the meetings. Nonetheless, it can be achieved through some mechanisms. For example, what we do is this. Before the board of directors meeting, the agenda items of the board of directors are sent to me. Here, the members of the board of directors want something like this. Does the board of auditors have anything to say about those issues before the board of directors meets? In other words, this brings internal audit to a preventive point. I think the fact that such an action is being taken here is an indicator that they are questioning it. However, as I said, to be honest, I cannot measure it; but at least I feel and experience that this is actually taken into account with this system that had been established" (Company-6: Financial Institutions).

Unlike the sub-dimensions of governance in the previous sections of the research, it has been revealed that only 3 companies audit the practices of the board of directors. Only 1 out of 8 companies operating in the Manufacturing sector and 2 out of 4 companies operating in the Financial Institutions sector conduct board governance audits. Accordingly, there seems to be no relationship between board governance audit and sectors.

More meaningful results can be obtained when the audit activities of the surveyed companies are considered together with the status of auditing board governance practices. As shown in the table in Annex-1, 14 of the 20 companies in the scope of the research have a formal quality assurance program in their internal audit department and have an independent external evaluation of the audit department within the scope of this program (Annex-2). The three companies that conduct board governance audits (Company-6, Company-11, Company-16) are among these 14 companies that have independent assessments and formal quality assurance programs. Therefore, it appears that the high level of compliance with IIA standards and the implementation of a formal quality assurance program contribute to a significant level of awareness of the audit of board governance.

11 of the 14 companies that have independent assessments do not conduct board governance audits. This shows that formal quality assurance programs or independent assessments are not sufficient for internal audit to grasp all dimensions of governance, and that cultural and organizational differences specific to companies also have a significant impact. In other words, an independent assessment of the

audit function does not guarantee an audit of board governance, yet it is an important milestone in achieving this awareness.

4.4.7. Reasons for Not Auditing the Board of Directors' Governance Practices

The majority of the heads of internal audit (n=17) stated that they do not audit the governance practices of the board of directors in their companies. In order to deepen the issue of board governance oversight, respondents were asked why they do not oversee the board's governance practices. The reasons for this are summarized in Table 9 below:

Table 4.4-9: Reasons for not auditing governance pratices and processes of the Board of Directors

Reason	N
Organizational structure	11
Not in the job description of the audit department	6
Not demanded by the board	4
Not considered a risk issue	2
Lack of resources	2

The most important reason for not being able to audit the governance practices and processes of the board of directors is the organizational structure. In one example each from the Holding and Manufacturing sectors, audit heads pointed to the organizational structure as the main reason for not being able to audit board governance practices:

"This actually stems from the organizational structure. Because the board of directors wants certain things to be audited within the principles determined by itself and, in classical terms, it wants to be assured in this regard, as we call the function of providing assurance. Anyway, since the direction is given from there, we turn and look in that direction, we don't turn and look back. There is actually nothing else, there is no other explanation. The whole framework, how to conduct inspections, has been determined by the regulations. Where to look is also determined, and when we operate in accordance with this, we don't really look back to the source that made these regulations..."(Company-3, Holding)

"The position of the unit that will do this in the organization is important, you know, if you are auditing the practices of the board of directors, for example, then a department under the board of directors will have difficulty in auditing this, it will be difficult to ensure this independence, so I don't think it will be very possible in our structure. (Company-1, Manufacturing)

The position of the internal audit unit within the organizational structure of the enterprise is one of the main factors that determine the contribution of internal audit activities to governance

processes. Because how the internal audit unit is positioned within the organization and the limits of the authority given by the management to the internal auditor are important for the effective conduct of internal audit activities. For this reason, an appropriate organizational structure is required within the enterprise in which the internal audit unit can perform its activities independently and objectively and is supported to the extent that it can maximize the expected benefit (Özbirecikli & Tüm, 2015).

When certain conditions are provided within the business organization where independence and professionalism are encouraged, the internal audit function actively contributes to the creation of an effective corporate governance environment. In this respect, the best that businesses can do for corporate governance is to establish an internal audit function that i) reports to a sufficiently high level in the organization to be able to perform its role independently, and ii) has an active and effective reporting line to the board of directors (The Institute of Internal Auditors, 2020). The absence of such an organizational structure may prevent board governance practices from being auditable.

The results of our research also show that in some cases, audits of board governance practices are not conducted even though the audit function has the most appropriate organizational structure in theory. In this respect, the findings are important.

"Because there is a practical reason, that is, we report to a subcommittee of the board of directors, not to the board of directors, we are responsible to the audit committee. The audit committee members of the company are independent members, so the practices taken by the audit board of directors, etc. are not our focus of interest. Nevertheless, in the future, if there is such a definition, if the company defines a member or a mechanism in the board of directors, we will report directly to them. If such a need is defined, we can do this. However, there is no such need at this stage." (Company-7, Manufacturing).

Accordingly, the results show that although the organizational structures of the audit units of BIST-100 companies are largely in compliance with the standards, even this organizational structure constitutes an obstacle for the audit of the governance of the board of directors.

The implication here is that companies are unable to conduct board governance audits despite being able to report to a sufficiently high level in the organization. Although this issue is interpreted by internal audit managers that the organizational structure is not appropriate, it can be mainly attributed to the low level of awareness. As a matter of fact, the statements of the head of the audit unit of Company-10 in the manufacturing sector, which reports to the board of directors, support this conclusion:

"I report to the board of directors. It does not make sense for me to audit the person I report to. I have never suggested it. I will do it if they ask me to" (Company-10, Manufacturing).

The internal audit activity helps the organization achieve its objectives by bringing a systematic and disciplined approach to assess and improve the effectiveness of governance, risk management and control processes (IIA, Practice Guide, p.5). For this reason, the heads of audit of all companies participating in the study have stated that they conduct governance audits. However, when it comes to auditing the governance practices and processes of the board of directors, some companies suggest that this is not included in the internal audit function's job description.

"The effectiveness of the board of directors or whether the issues that need to be discussed are discussed sufficiently or not, or whether the board members are in compliance with the skill sets that they should have is outside our own job description." (Company-1: Manufacturing)

"No, we don't, because it is not within our jurisdiction. It is not within our audit scope; it is only within the scope of the audit of independent audit firms or regulators such as regulatory supreme boards, which we can only call external audit" (Company-15: Bank).

As seen in the examples above, there is no homogeneity across sectors in terms of oversight of board governance. In the manufacturing and financial institutions sectors, there are institutions that audit board governance, yet there are also institutions that consider this task out of scope.

Another reason for the lack of board governance oversight is that the board of directors does not have a clear mandate in this area.

4.4.8. General Findings on Governance Audit Approaches in BIST-100 Companies

When the results presented in the previous sections are evaluated together, it has been revealed that the governance audit practices in BIST-100 companies are also made in line with approaches in the IIA's theoretical framework. These practices are;

- Audit of governance of a single process
- Audit of selected Governance sub-dimensions
- Comprehensive governance audit

These three different types of governance audits, together with the original data expressed by the heads of audit departments, are described respectively below.

Table 4.4-10: Type of Governance Audit Approach

Approach	Sectoral distribution of the approach (number of companies)	Explanation of the approach

Audit of the governance in sole process	Manufacturing (5) Holding and Inv. (2) Financial Institutions (1) Other (3)	Audit of all governance practices of the process or unit included in the audit scope.
Audit of selected sub-dimensions of governance	Manufacturing (2) Holding and Inv. (2) Financial Institutions (1) Other (1)	Auditing each sub-dimension of governance (ethics, risk management, compliance, etc.) as a separate function or process, covering the whole company and its operational units.
Comprehensive governance audit	Financial Institutions (2) Manufacturing (1)	Defining governance audit within the audit universe, auditing both the governance of the process and the horizontal audit of the governance together.

It is possible to explain these types of audits in the following sections, as expressed by the heads of audit:

4.4.8.1. Audit of Governance in The Sole Process

This method is described in the IIA governance review guide as follows (The Institute of Internal Auditors, 2012):

"Including governance in audits that focus more directly on business operations or support activities. – In this approach, a component of those audits would include the interface of the governance processes with those operations and activities. Governance audit work at the operations and support activity level will provide detailed information to internal audit on how well governance practices are understood and practiced throughout the organization. Over time and if desired by the board, the internal audit activity may be able to provide assessments on the state of governance within the organization as a whole, using this work as a basis for that opinion."

It has been understood that a special governance audit study is not carried out within the audit programs of the companies gathered under this group, but the governance of each process is audited. Companies have production, marketing; sales, finance, etc. departments in their organizations. The activities carried out by these units touch on different processes, and a series of governance mechanisms emerge while making certain decisions in the operation of these processes. Auditing or evaluating the governance mechanisms within these processes can be expressed as the governance audit of the process. This is illustrated in panel A of Figure 4.4-1 below. Governance audit of the process means auditing of ethics, compliance, risk management, decision mechanisms, etc. of the processes in operational units. In short, the governance audit of the process is the handling of the audit topics, which The IIA expresses as the sub-dimensions of governance, within a regular process audit of a sole process.

Often, corporate governance is not based on the results of a single audit. Rather, the internal audit activity's assessments of governance rely more heavily on information obtained as a result of various audit engagements over time (The Institute of Internal Auditors, 2016).

This explanation in the standards is basically in line with the findings of the research. Our research findings show that most companies do not base their governance audit on the results of a single audit, on the contrary, different aspects of governance are subject to audit in various audit tasks.

4.4.8.2. Horizontal Audit of Selected Sub-Processes of Governance

The methodology for auditing selected sub-processes of governance is described in the IIA Governance Assessment Guide as follows (The Institute of Internal Auditors, 2012):

"Audits of specific governance practices selectively such as objective setting, strategic planning, code of conduct, internal control, enterprise risk management, compliance with laws, performance measurement monitoring, communication in the organization and board governance practices."

Horizontal audit is the evaluation of an activity or transaction in more than one unit in an organization. This audit is conducted to measure the effectiveness and efficiency of units that carry out similar activities or operations. Horizontal audit of governance is the audit of each sub-dimension (ethics, risk management, compliance, and the like) as a separate function or process, covering the entire company and operational units. This type of audit is expressed in panel B in Figure 4.4-1.

4.4.8.3. Comprehensive Governance Audit

The methodology for a comprehensive audit of governance is described in the IIA Governance Assessment Guide as follows (The Institute of Internal Auditors, 2012):

"A single audit including all processes that focus specifically on governance. This approach might be practical only in small organizations or as a high-level review to determine whether additional processes are needed and whether the existing processes, taken together, give the board all the information it needs to fulfill its governance responsibilities."

When a general governance audit is preferred, how to conduct it is explained in the implementation guidance for IIA Standard 2110 as follows (The Institute of Internal Auditors, 2016):

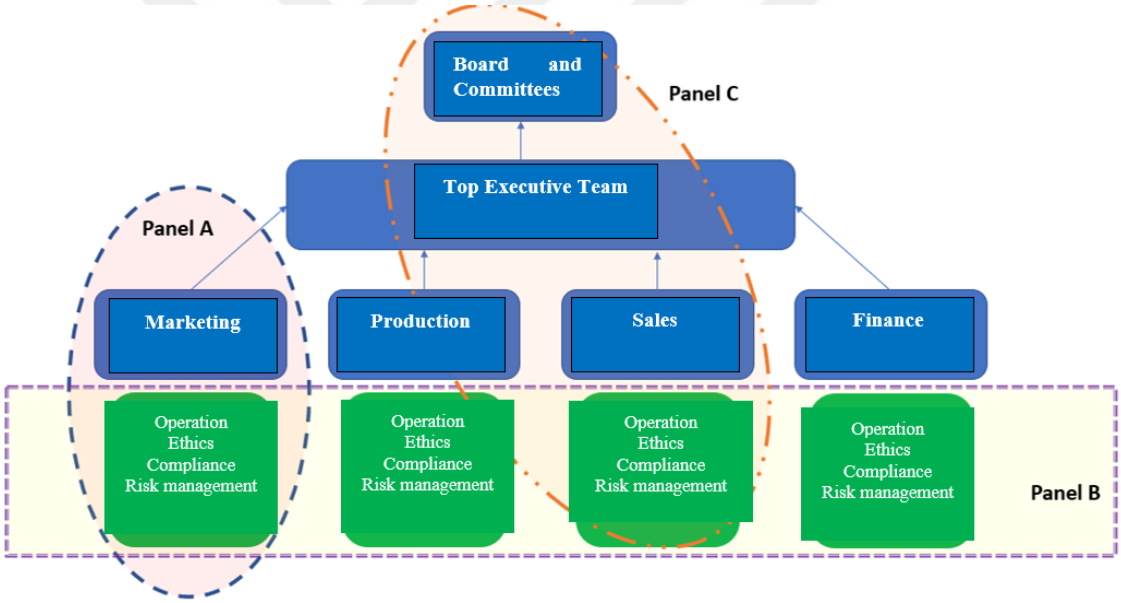
"Where an overall governance assessment is appropriate, the following considerations are taken into account:

- *Audit results on specific governance processes.*
- *Governance issues, particularly from audits that are not governance-oriented,*
- *Results of management reviews (e.g. compliance reviews, quality audits, control self-assessments).*

- *The work of external assurance service providers (e.g., statutory investigators, public audit bodies such as the Court of Accounts, and financial advisory firms) and regulatory authorities.*
- *The work of internal assurance service providers or second line of defense functions (e.g., employee health and safety, compliance and quality).*
- *Other governance-related information, such as adverse events that present opportunities to improve governance processes."*

Comprehensive governance audit refers to the situation where governance audit is defined within the audit universe of companies. This type of audit can be defined as both the governance audit of the process and the horizontal audit of governance. Hence, performing the audit shown in Panel A and Panel B in Figure 4.4-1 together and auditing the governance practices of the board of directors indicates comprehensive governance audit.

Figure 4.4-1: Different Methods of Governance Audit – Theory and Practice



According to the results of this research, the distribution of the types of governance audits conducted by the companies is shown in Table of Annex 3. When this table is analyzed, it is seen that governance audits are conducted in all BIST-100 companies, governance issues in the process are audited mainly in the audit of processes, and comprehensive audit of all end-to-end governance processes is conducted by 3 companies.

The findings in this section of the research show that the governance audit models of the BIST-100 companies included in the research conform to the three different methods described in the theory. However, although the theory described in the IIA guidelines suggests that comprehensive governance audit is generally appropriate for smaller companies, BIST-100 companies, especially finance

companies and manufacturing companies, too, could practice it. In other words, if only the theory, i.e. the IIA guidance, is considered, no BIST-100 company would be expected to conduct comprehensive governance audits. However, our research illuminates that certain BIST-100 companies conduct comprehensive governance audits.

5. CONCLUSION AND RECOMMENDATIONS:

As it can be seen from the analysis in the first part of the study, the concept of corporate governance is a set of good practices built on the concept of good governance. Corporate governance is a necessity for organizations to be long-lasting, to provide benefits to society, to give confidence to their shareholders and, most fundamentally, to be well governed. In short, given that governance is a set of systems, the level and efficiency of governance practices within the organization must be evaluated or audited.

Ensuring that corporate governance principles such as participation, effectiveness, efficiency and sustainability are internalized not only on paper but also in all practices within the company would guarantee that the best practices are achieved. Practices such as monitoring strategic plan realizations, an effective accountability mechanism for budget realizations, an authority architecture built with the right role design, and ethical codes that are genuinely implemented are the foundations of corporate governance.

Internal audit units are the most qualified bodies to assess the governance level and structure of an organization. Even if different institutions such as regulator, independent and other external auditors are assigned and authorized to evaluate governance, they are not able to evaluate the governance of an organization better than the internal audit unit. Mainly internal auditors have widespread and intensive access to all individuals, institutional memory, access to information and documents, and a much better command of the corporate culture.

In relation to the above argument, this research has three main purposes. Firstly, it has aimed at revealing how governance audit is conducted in publicly traded companies in Turkey, which have internal audit/inspection units and are considered to have a corporate structure, according to international auditing standards. Secondly, it has questioned whether there are differences in practice between sectors in this context. Finally, the research has analyzed the effects of organizational structures of audit units on governance audit.

In line with these purposes, the subject of the thesis is determined as revealing how the audit of governance practices is carried out in companies registered in the BIST 100 Index in Turkey and showing sectoral differences, if any. Companies listed in the BIST 100 index have been selected because they have corporate structures and mandatory internal audit/inspection units.

The findings of the research are reported in separate sections according to the sub-dimensions of governance audit in accordance with IIA guidelines. In general, it is understood that all the companies participating in the research conduct governance audits. They only go into different levels of detail on

the basis of sub-dimensions and they conduct them with different methods as described in the IIA guidelines.

While governance audit is important, the most important and challenging part/ sub-dimension of governance audit is the audit of the board's governance practices. This is noteworthy because the board of directors is at the heart of the concept of governance. Governance practices and principles in an organization are basically guided by the board of directors. The governance body at the top of an organization is the board of directors. Therefore, if it is desired to improve, develop or monitor governance in an organization, the board of directors should be considered at first and foremost.

For these reasons, internal audit units in organizations should prioritize auditing the governance practices of the board of directors. This audit activity should be supported by a body above the board of directors. Internal audit units may refrain from auditing the board of directors, which is the highest body of an organization, on grounds such as organizational structure, lack of authority, lack of resources, lack of mandate, and overstepping boundaries.

In our research findings, we have figured out that only 3 out of 20 companies audit the governance practices of the board of directors. Thus, even if governance audits are conducted in all companies, it is an important development point that the majority of the companies do not include board governance practices within the scope of evaluation or audit activities.

Conclusions and recommendations regarding the research findings of the sub-dimensions of governance are presented below.

5.1. Strategic and Operational Decisions:

The findings obtained for the first sub-dimension, "governance practices related to strategic and operational decisions", indicate that companies conduct audit practices in this sub-dimension in all sectors. Even if companies' audits related to this subdimension are not always a specific audit topic, auditing strategic and operational decisions is on the agenda of audit units as a fundamental governance audit topic in all internal audit activities. In all sectors, operational and tactical decisions and practices are audited for compliance with the strategy within the scope of audit activities. In addition, delegation of authority and rules of approval flow in the manufacturing, finance and holding sectors are also subject to audit within the scope of governance audit.

An important point of improvement observed from the results is that audits generally focus on decisions related to the implementation of strategic decisions. However, very few audit heads have mentioned auditing the decision-making processes at the initial stages of strategic decision-making. In

this respect, it is considered important to audit or evaluate the board sessions where strategic decisions are made and to audit the board's decision-making mechanisms and governance practices.

5.2. Promoting Ethics and Other Values:

There are no significant differences across sectors in the audit of the promotion of ethics and other values. The main audit activity in all sectors is ethical misconduct investigation. In addition, in the holding and financial institutions sectors, awareness raising and training on ethical issues are also seen as an important part of the audit activity.

As it can be seen from these findings, internal audit units have the essential functions of disseminating ethical values within the organization, eliminating ethical violations and improving ethical values. This important function is sometimes carried out during governance reviews in regular process audits and sometimes in special governance audits. Furthermore, the involvement of audit units and heads of audit in ethics decision-making committees in an advisory role and capacity is crucial and is a normal extension of the audit activity in this subdimension. Finally, it is an example of good practice that the final decisions of the bodies authorized to decide on ethical issues can be escalated to a higher authority, the Audit Committee, by the independent audit function.

According to our findings, all companies declared that they have ethical codes as governance practices. Thanks to the existence of these ethical codes, it is aimed to prevent the emergence of unethical practices in the business. In order to understand whether these ethical codes have become widespread within the institution, it is not enough to carry out ethical audits through documents. Governance audit on ethics and culture needs to grasp the establishment's input, including even the recruitment phases and orientation processes. In addition, evaluations should be made using focus group interviews and qualitative methods. Thus, evaluation and consultancy services will be provided to the company by the internal audit department in an area that is difficult to measure quantitatively.

5.3. Risk Management and Oversight of Control

In the audit of risk management and control oversight activities, risk limits, the quality of the risk policy and internal control audits are performed in the Manufacturing, Holding and Other sectors. In the Financial Institutions sector money laundering legislation audits, IT risks audits, credit risk audits, and legal compliance risks audits are performed additionally due to the nature of the sector.

In addition, there are two other types of risk that are not explicitly included in the IIA's guidance in the definition of sub-dimensions but were emphasized by the participants. These have been identified as fraud risk and reputational risk.

When the findings of the research are evaluated together, it is understood that the internal audit departments of the companies also play an active role in governance practices related to risk and control oversight. Also, they perform intensive risk and control audits, albeit at different levels, due to the close cooperation effect this provides. Audit departments' advisory role in the execution processes and governance practices related to risk and control is an example of good practice as it contributes to the sustainability of organizations.

5.4. Communicating Risk and Control Information to the Necessary Units of the Organization

Particularly prominent supervisory activities include collaboration meetings between control, risk, and audit units to communicate information to the necessary units of the organization, and the role of heads of audit units as advisors to internal executive committees. The review of integrated management systems and large meetings for process improvement also serve this purpose. Finally, advising on the development of internal regulations and conducting risk and compliance audits is also an important finding regarding the communication and dissemination of information for the organization.

The fact that our research findings are relatively limited in this sub-dimension compared to other sub-dimensions, and that the consultancy role is more predominant than the audit activity indicates that the communication of risk and control information sub-dimension is not sufficiently focused by internal audit units in regular audit plans. In order to improve this result in organizations, governance audit guidelines based on the IIA guidelines should be developed both within companies and national audit institutes. On the other hand, the development of academic literature on this subject, which is open to research innovations, would also contribute to practice.

5.5. Auditing the Governance Practices of the Board of Directors

Only three companies audit the governance practices of the Board of Directors. Two of these companies operate in finance and one in manufacturing. The companies make an assessment by examining the minutes of board meetings and the way decisions are made. Other companies do not perform any work in this sub-dimension. There is also a lack of homogeneity across sectors in the oversight of Board governance.

When the information on the audit unit characteristics of the companies is examined, 14 of the 20 companies in the study implement a formal quality assurance program for the internal audit unit. All these companies also have an independent external evaluation of the internal audit function. When the audit activities of the companies and the audit of board governance practices are examined together, three companies that conduct board governance audits are among the 14 companies that have

independent evaluations and a formal quality assurance program. On the other hand, companies which do not have independent quality also do not audit or evaluate BoD governance practices. Based on this finding, having an independent quality review contributes positively to conducting an audit of BoD governance. This suggests that implementing a formal quality assurance program with a high level of compliance with IIA standards has a positive awareness effect on board governance oversight.

A deeper analysis of the findings reveals that 11 of the 14 companies that commission independent evaluations do not conduct an audit of board governance. This finding suggests that formal quality assurance programs or independent evaluations are not sufficient to ensure audit board governance practices, even though they are important for awareness-wise. The main reason for this result is that companies have their own unique organizational and cultural elements. To summarize, independent review of an internal audit unit does not guarantee that board governance will be audited in the company. However, there is a strong indication that it will create an important awareness on this issue.

5.6. Reasons for Not Auditing the Board of Directors' Governance Practices

An important result of the research can be observed by considering the responses of companies regarding the lack of audit of board governance practices. In general, the audit heads of the companies have considered the audit of board governance practices as auditing the board of directors and have put that this practice is not organizationally possible. Although this issue is interpreted by internal audit heads as an outcome of organizational structure, it can be changed with higher level of awareness. The results of our research show that in some cases, audits of the governance practices of the board of directors are not conducted despite the fact that the audit unit has the most appropriate organizational structure in theory.

According to the results, another factor for not conducting board governance audit is that the board has not requested one. Internal audit managers have argued that the board of directors is the highest decision-making body of the company. They have stated that the audit unit reports directly or indirectly to the board of directors so such a request must come from the BoD for any governance audit or assessment work.

Accordingly, an important conclusion and recommendation is to review the body to which internal audit units in organizations report. Appointment or empowerment of internal audit units by a higher body than the BoD, such as the general assembly, would provide shareholders and BoD itself with a higher level of assurance. In addition, dismissal of a company’s head of audit should require the approval of General Assembly of the company. There must be regulation changes or revisions in company articles of associations in order to apply these recommendations. For instance, certain

amendments to the commercial code could empower internal audit units supported by a body above the board of directors.

Another suggestion that can be drawn from these results is that starting with the Banking Regulation Agency (BRSA) regulations and then expanding to the capital markets legislation, the audit of the governance practices of the board of directors in companies can be made mandatory through regulations. If the framework of the audit is also determined by the regulations to be issued, widespread board governance audits can be practiced in all institutions. In this way, if there are poorly functioning boards of directors, which is the root cause of poor governance, these problems will be visible at an early stage.

In addition, regulators may monitor or supervise the conduct of board governance audits in companies in order to establish the practice of these regulatory arrangements.

5.7. Differences in Governance Audit Implementation Methods

The survey displays that governance is audited in all companies. All companies audit governance based on the global definition of internal audit. However, the results of our research clarify that they all conduct governance audits with different methods and at different levels. In fact, the theory and literature in the IIA guidelines envisages such a variation.

The findings of the study illustrate that the governance audit models applied in the BIST-100 companies within the scope of the study are consistent with the three different methods described in the theory. Unlike the theory, however, comprehensive governance audit can also be applied to large financial companies and manufacturing companies in the BIST-100.

In addition, the following findings have been obtained regarding the governance audit:

- There is no specific and significant differentiation in audit types according to sectors.
- Implementation of a formal quality assurance program and independent external quality review in the audit unit have a significant impact.

5.8. General Recommendations

To sum up, audit of board governance would be of great benefit, especially to shareholder groups. Governance practices of BoD should also be audited, and it is not enough to do this only through the mechanisms of the current legislation and regulations, especially by reducing it to general assembly meetings, or to leave it only to independent auditors. Internal audit units should have the authority to audit BoD governance practices in a way that also reassures company shareholders or raises red flags when necessary. If the board of directors in an organization does not have the right structure, does not

work effectively or even does not function, it should be the duty of the internal audit unit to express an opinion on these issues. At this point, internal audit units should go beyond being a body reporting to the board of directors and should be able to alert shareholders (especially shareholder groups with management control) and send a message that the company's governance needs to be improved at the board level.

Companies can add specific wordings into their articles of associations about establishing internal audit departments complying with international standards.

As a result, internal audit departments should consider auditing the governance practices of the board of directors more extensively and intensively within the scope of governance audits. Even though this study focuses on publicly traded organizations, audit departments of non-publicly traded organizations also have a fundamental responsibility to alert their shareholders about areas of improvement in the board's governance practices.

Further research can be conducted on private companies in Turkey (for instance private companies in ISO-500 list) in order to evaluate auditing of governance in private companies and the researcher can make comparisons with our results.

Our research also paved the way for creating surveys and quantitative empirical studies. To contribute international literature, researchers can conduct qualitative or quantitative researches for European or the US listed companies.

Last but not least, more researchers may conduct research on the audit of every single sub-dimension of governance.

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ANNEX:

ANNEX 1 : Relationship between Audit Unit's Quality Assurance Program Implementation and Governance Audit

Is there a Board Governance Audit?	Does your audit unit have a formal quality assurance program in place?		
	Yes	No.	General Total
Yes	3	0	3
No.	11	6	17
General Total	14	6	20

ANNEX 2: The Relationship between Independent Quality Review of the Audit Unit and Governance Audit

Is there a Board Governance Audit?	Has the audit unit (so far) undergone an independent Quality Review audit?		
	Yes	No.	General Total
Yes	3	0	3
No.	11	6	17
General Total	14	6	20

ANNEX 3: Breakdown of Governance Audit Types

Types of Governance Audit	Frequency (N)
Governance Audit of the Process	11
Audit of Sub-Dimensions of Governance	6
Comprehensive Governance Audit	3
Total	20

ANNEX 4: Breakdown of Governance Audit Types by Sector

Audit Type	Sector in which the company operates				
	Finance	Other	Holding and YO	Manufacturing	General Total
Sub Dimension	1	1	2	2	6
Comprehensive	2	0	0	1	3
Process	1	3	2	5	11
Total	4	4	4	8	20

ANNEX 5: List of BIST-100 Companies as of December 2021

Code	Company Name	Main Sector
AFYON	Afyon Çimento Sanayi T.A.Ş.	Manufacturing
AKBNK	Akbank T.A.Ş.	Financial Institutions
AKSA	Aksa Akrilik Kimya Sanayii A.Ş.	Manufacturing
AKSEN	Aksa Enerji Üretim A.Ş.	Electricity, Gas and Water
ALGYO	Alarko Gayrimenkul Yatırım Ortaklığı A.Ş.	Financial Institutions
ALARK	Alarko Holding A.Ş.	Financial Institutions
ALBRK	Albaraka Türk Katılım Bankası A.Ş.	Financial Institutions
ALKIM	Alkim Alkali Kimya A.Ş.	Manufacturing
AEFES	Anadolu Efes Biracılık Ve Malt Sanayii A.Ş.	Manufacturing
ARCLK	Arçelik A.Ş.	Manufacturing
ASELS	Aselsan Elektronik Sanayi Ve Ticaret A.Ş.	Technology
BERA	Bera Holding A.Ş.	Financial Institutions
BIMAS	Bim Birleşik Mağazalar A.Ş.	Wholesale and retail trade, restaurants and hotels
BRSAN	Borusan Mannesmann Boru Sanayi Ve Ticaret A.Ş.	Manufacturing
BRYAT	Borusan Yatırım Ve Pazarlama A.Ş.	Financial Institutions
BRISA	Brisa Bridgestone Sabancı Lastik Sanayi Ve Ticaret A.Ş.	Manufacturing
CCOLA	Coca-Cola İçecek A.Ş.	Manufacturing
CEMAS	Çemaş Döküm Sanayi A.Ş.	Manufacturing
CEMTS	Çemtaş Çelik Makina Sanayi Ve Ticaret A.Ş.	Manufacturing
CIMSA	Çimsa Çimento Sanayi Ve Ticaret A.Ş.	Manufacturing
DEVA	Deva Holding A.Ş.	Manufacturing
DOHOL	Doğan Şirketler Grubu Holding A.Ş.	Financial Institutions
DOAS	Doğuş Otomotiv Servis Ve Ticaret A.Ş.	Wholesale and retail trade, restaurants and hotels
ECZYT	Eczacıbaşı Yatırım Holding Ortaklığı A.Ş.	Financial Institutions

EGEEN	Ege Endüstri Ve Ticaret A.Ş.	Manufacturing
EGGUB	Ege Gübre Sanayii A.Ş.	Manufacturing
ECILC	Eis Eczacıbaşı İlaç Sınai Ve Finansal Yatırımlar Sanayi Ve Ticaret A.Ş.	Financial Institutions
EKGYO	Emlak Konut Gayrimenkul Yatırım Ortaklığı A.Ş.	Financial Institutions
ENJSA	Enerjisa Enerji A.Ş.	Electricity, Gas and Water
ENKAI	Enka İnşaat Ve Sanayi A.Ş.	Construction and Public Works
ERBOS	Erbosan Erciyas Boru Sanayii Ve Ticaret A.Ş.	Manufacturing
EREGL	Ereğli Demir Ve Çelik Fabrikaları T.A.Ş.	Manufacturing
ESEN	Esenboğa Elektrik Üretim A.Ş.	Electricity, Gas and Water
FENER	Fenerbahçe Futbol A.Ş.	Education, Health, Sports and Other Social Services
FROTO	Ford Otomotiv Sanayi A.Ş.	Manufacturing
GSRAY	Galatasaray Sportif Sınai Ve Ticari Yatırımlar A.Ş.	Education, Health, Sports and Other Social Services
GLYHO	Global Yatırım Holding A.Ş.	Financial Institutions
GOZDE	Gözde Girişim Sermayesi Yatırım Ortaklığı A.Ş.	Financial Institutions
GUBRF	Gübre Fabrikaları T.A.Ş.	Manufacturing
SAHOL	Hacı Ömer Sabancı Holding A.Ş.	Financial Institutions
HDFGS	Hedef Girişim Sermayesi Yatırım Ortaklığı A.Ş.	Financial Institutions
HEKTS	Hektaş Ticaret T.A.Ş.	Manufacturing
IHLGM	İhlas Gayrimenkul Proje Geliştirme Ve Ticaret A.Ş.	Real Estate Activities
IHLAS	İhlas Holding A.Ş.	Financial Institutions
INDES	İndeks Bilgisayar Sistemleri Mühendislik Sanayi Ve Ticaret A.Ş.	Technology
IPEKE	İpek Doğal Enerji Kaynakları Araştırma Ve Üretim A.Ş.	Mining and Quarry
ISFIN	İş Finansal Kiralama A.Ş.	Financial Institutions
ISGYO	İş Gayrimenkul Yatırım Ortaklığı A.Ş.	Financial Institutions
ISMEN	İş Yatırım Menkul Değerler A.Ş.	Financial Institutions
JANTS	Jantsa Jant Sanayi Ve Ticaret A.Ş.	Manufacturing
KRDMD	Kardemir Karabük Demir Çelik Sanayi Ve Ticaret A.Ş.	Manufacturing

KARSN	Karsan Otomotiv Sanayii Ve Ticaret A.Ş.	Manufacturing
KARTN	Kartonsan Karton Sanayi Ve Ticaret A.Ş.	Manufacturing
KERVT	Kerevitaş Gıda Sanayi Ve Ticaret A.Ş.	Manufacturing
KRVGD	Kervan Gıda Sanayi Ve Ticaret A.Ş.	Manufacturing
KCHOL	Koç Holding A.Ş.	Financial Institutions
KONYA	Konya Çimento Sanayii A.Ş.	Manufacturing
KORDS	Kordsa Teknik Tekstil A.Ş.	Manufacturing
KOZAL	Koza Altın İşletmeleri A.Ş.	Mining and Quarry
KOZAA	Koza Anadolu Metal Madencilik İşletmeleri A.Ş.	Mining and Quarry
LOGO	Logo Yazılım Sanayi Ve Ticaret A.Ş.	Technology
MGROS	Migros Ticaret A.Ş.	Wholesale and retail trade, restaurants and hotels
MPARK	Mlp Sağlık Hizmetleri A.Ş.	Education, Health, Sports and Other Social Services
NTHOL	Net Holding A.Ş.	Financial Institutions
NETAS	Netaş Telekomünikasyon A.Ş.	Technology
NUHCM	Nuh Çimento Sanayi A.Ş.	Manufacturing
ODAS	Odaş Elektrik Üretim Sanayi Ticaret A.Ş.	Electricity, Gas and Water
OTKAR	Otokar Otomotiv Ve Savunma Sanayi A.Ş.	Manufacturing
OYAKC	Oyak Çimento Fabrikaları A.Ş.	Manufacturing
PARSN	Parsan Makina Parçaları Sanayii A.Ş.	Manufacturing
PGSUS	Pegasus Hava Taşımacılığı A.Ş.	Transportation, Storage and Communication
PETKM	Petkim Petrokimya Holding A.Ş.	Manufacturing
RTALB	Rta Laboratuvarları Biyolojik Ürünler İlaç Ve Makine Sanayi Ticaret A.Ş.	Manufacturing
SASA	Sasa Polyester Sanayi A.Ş.	Manufacturing
SELEC	Selçuk Ecza Deposu Ticaret Ve Sanayi A.Ş.	Wholesale and retail trade, restaurants and hotels
SKBNK	Şekerbank T.A.Ş.	Financial Institutions
SOKM	Şok Marketler Ticaret A.Ş.	Wholesale and retail trade, restaurants and hotels
TAVHL	Tav Havalimanları Holding A.Ş.	Financial Institutions

TKFEN	Tekfen Holding A.Ş.	Financial Institutions
TKNSA	Teknosa İç Ve Dış Ticaret A.Ş.	Wholesale and retail trade, restaurants and hotels
TOASO	Tofaş Türk Otomobil Fabrikası A.Ş.	Manufacturing
TRGYO	Torunlar Gayrimenkul Yatırım Ortaklığı A.Ş.	Financial Institutions
TCELL	Turkcell İletişim Hizmetleri A.Ş.	Transportation, Storage and Communication
TUPRS	Tüpraş-Türkiye Petrol Rafinerileri A.Ş.	Manufacturing
THYAO	Türk Hava Yolları A.O.	Transportation, Storage and Communication
TTKOM	Türk Telekomünikasyon A.Ş.	Transportation, Storage and Communication
TTRAK	Türk Traktör Ve Ziraat Makineleri A.Ş.	Manufacturing
GARAN	Türkiye Garanti Bankası A.Ş.	Financial Institutions
HALKB	Türkiye Halk Bankası A.Ş.	Financial Institutions
ISCTR	Türkiye İş Bankası A.Ş.	Financial Institutions
TSKB	Türkiye Sınai Kalkınma Bankası A.Ş.	Financial Institutions
TURSG	Türkiye Sigorta A.Ş.	Financial Institutions
SISE	Türkiye Şişe Ve Cam Fabrikaları A.Ş.	Financial Institutions
VAKBN	Türkiye Vakıflar Bankası T.A.O.	Financial Institutions
ULKER	Ülker Bisküvi Sanayi A.Ş.	Manufacturing
VERUS	Verusa Holding A.Ş.	Financial Institutions
VESBE	Vestel Beyaz Eşya Sanayi Ve Ticaret A.Ş.	Manufacturing
VESTL	Vestel Elektronik Sanayi Ve Ticaret A.Ş.	Manufacturing
YKBNK	Yapı Ve Kredi Bankası A.Ş.	Financial Institutions
ZOREN	Zorlu Enerji Elektrik Üretim A.Ş.	Electricity, Gas and Water