

Special Audit in Joint Stock Companies

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I. Introduction

In joint stock companies, there are three types of audit mechanism, namely (i) statutory audit, (ii) optional audit and (iii) special audit.

In accordance with the Turkish Commercial Code No. 6102 (“TCC”), all joint stock companies are subject to statutory audit. Said article stipulates that statutory audit is conducted pursuant to article 398 of the TCC and the relevant regulation (“Regulation”) to be introduced by Ministry of Customs and Trade and the Council of Ministers, as the case may be.

In order to determine the joint stock companies that are subject to the statutory audit within the scope of article 398 of the TCC (known as also “independent audit”), the Council of Ministers has determined certain criteria. The joint stock companies that meet such criteria are liable to duly appoint an independent auditor and have the company audited. In accordance with article 398 of the TCC, content of the statutory audit is annual financial statements and board of directors’ activity reports. Other joint stock companies, which fall out of the scope of the criteria determined by the Council of Ministers, are subject to the statutory audit in accordance with the Regulation. However, the Regulation has not been introduced yet. Therefore, the statutory audit to be conducted in accordance with the Regulation has not been clarified and it is not applicable at the time being.

On the other side, joint stock companies may also intentionally subject themselves to an audit (optional audit). In practice, optional audit is a widely accepted mechanism amongst the joint stock companies in order to properly determine vulnerabilities of and potential risks for the company. The optional audit may be conducted at a regular basis or when necessary. Content of the optional audit and qualifications of the auditor are determined according to specific need of the company.

As another audit mechanism, article 438 of the TCC enables shareholders of joint stock companies to request special audit. In this respect, each shareholder is entitled to request a special audit from general assembly of the company for clarification of certain issues and in case of certain circumstances. In this article, we will explain concept of special audit mechanism in joint stock companies in the light of relevant articles of the TCC.

II. Special Audit

i. Pre-condition for Requesting Special Audit:

As per article 438 of the TCC, in order for a shareholder to request a special audit, that shareholder or any shareholder of the company should have duly consumed its “right to information and examination”. This is a pre-condition for requesting the special audit.

In accordance with article 437 of the TCC, the scope of “right to information and examination” is as follows:

- Financial statements, consolidated financial statements, auditor’s reports, and the board of directors’ annual activity report and suggestion as to profit distribution shall be available at the head office and branches of the company for review of the shareholders starting from at least 15 (fifteen) days in advance of the annual general assembly meeting. Financial statements and consolidated financial statements shall be available at the head office and branches of the company for information of the shareholders during 1 (one) year. Each shareholder is entitled to request a copy of the income statement and balance sheet of the company at company’s own cost.
- During general assembly meeting of the company, each shareholder may request information from (a) the board of directors regarding the company’s business and/or (b) the statutory auditors regarding their audit methods and results. The information to be provided to the shareholders should be honest and accurate, in accordance with principles of accountability and good faith. The request of information may only be rejected by general assembly of the company on the grounds that an explanation to be given will cause disclosure of the company’s trade secrets and jeopardize the company’s interests.
- If any information has been provided to a shareholder outside the course of a general assembly meeting, the same information with an identical scope and details should also be provided to other shareholders during the general assembly meeting, upon their request, even if such matter is not listed in the agenda of the meeting. In such cases, the board of directors may not refrain from sharing this information based on the arguments of trade secret and the company’s interests.
- For being able to evaluate a certain part of the commercial books and the company’s correspondences regarding the questions raised by a shareholder, a clear consent of the general assembly or a specific board resolution is required. The evaluation may be made by an expert if such consent has been granted by general assembly or board of directors of the company.
- If a shareholder’s request of information is rejected or not duly answered without any justification at the general assembly meeting, such shareholder may apply to the Commercial Court of First Instance within 10 (ten) days following the rejection or within a reasonable time period in case of other circumstances. The Commercial Court of First Instance will review the file and may order the company to share the information with the shareholder. The court’s decision will be final and binding.
- Information rights of shareholders may not be abolished or limited through the articles of association or a corporate body resolution.

According to a decision of the Court of Appeal’s 11th Civil Department numbered 2015/97 E., 2015/13293 K., the plaintiff has requested appointment of a special auditor from the Commercial Court of First Instance on the grounds that (a) the company has not duly made available relevant information/examination requested by the plaintiff and (b) the general assembly

of the company has rejected special auditor request of the plaintiff. The Commercial Court of First Instance has rejected request of the plaintiff due to the fact that the procedure of exercising right to information and examination is subject of a pending lawsuit and the pre-condition has not been satisfied yet. We understand by this decision that the plaintiff has already initiated another lawsuit to obtain the relevant information in accordance with article 437 of the TCC. Therefore, the Commercial Court of First Instance has not accepted appointment of the special auditor before conclusion of such lawsuit.

ii. Procedure of Requesting Special Audit:

As per article 438 of the TCC, provided that right to information and examination has already been exercised by any shareholder, each shareholder has the right to request a special audit during the general assembly meeting in order to clarify certain issues and for consuming its shareholding rights, even though such an audit is not included in the general assembly's agenda. At this point, subject of the information/examination and the special audit request should be concerning to the same subject.

If the general assembly approves the special audit request; either the company or each shareholder (not only the shareholder that requested the audit) may apply within 30 (thirty) days to the Commercial Court of First Instance for appointment of a special auditor. In this case, costs of the special auditor are covered by the company.

If the general assembly does not approve this request; the shareholders representing at least 1/10 (one tenth) or having the total nominal value of TRL 1,000,000 of the share capital in non-public companies and 1/20 (one twentieth) of the share capital in public companies may apply to the Commercial Court of First Instance within 3 (three) months following rejection of the general assembly, for appointment of a special auditor in accordance with article 439 of the TCC. In order to apply to the court, only the share capital ratio and amount are taken as a basis to calculate the foregoing thresholds. In such a case, voting right privileges are not considered. If the court accepts the special audit request, it may hold the applicant shareholders liable for costs of the special auditor.

As stated in the decision of the Court of Appeal's 11th Civil Department 2015/1059 E., 2015/13774 K., the relevant Commercial Court of First Instance has rejected appointment of the special auditor on the grounds that the plaintiffs does not represent at least 1/10 (one tenth) of the company's share capital.

iii. Appointment of the Special Auditor

Article 439 of the TCC stipulates that in order for the court to accept the request, the Commercial Court of First Instance should be convinced that founders or corporate bodies of the company have explicitly violated articles of association of the company or the applicable laws, and caused damage to the company and the shareholders. If the Commercial Court of First Instance accepts to appoint a special auditor, it shall determine the specific scope of the examination pursuant to the request, and appoint one or more independent experts. The independent experts should have knowledge and expertise in accounting, financing and/or legal matters.

As per article 440 of the TCC, the Commercial Court of First Instance will evaluate the case after hearing the company and the shareholder(s) that made a request for special audit. If the Commercial Court of First Instance rejects to appoint special auditor, its decision will be final and binding. In accordance with the decisions of the Court of Appeal's 11th Civil Department numbered 2015/6077 E., 2015/13085 K. and 2015/1936 E., 2015/8065 K., appeal request of the plaintiff against decision of the Commercial Court of First Instance rejecting appointment of special auditor on grounds that the Commercial Court of First Instance's decision is final and binding.

iv. Duties of the Special Auditor

In accordance with article 441 of the TCC, special audit should be conducted within a reasonable time period and without hindering the company's works unnecessarily. Special auditor should keep company's trade secrets confidential.

v. Special Audit and the Auditor's Report

As per article 441 of the TCC, the board of directors shall allow the special auditor to examine the commercial books, company's correspondences and all its assets including cash, negotiable instruments and properties. Shareholders, corporate bodies, agents, employees, trustees and liquidators of the company shall provide all required information to the special auditor. In the event of any dispute, it shall be settled by the court and the court's decision shall be final and binding.

In accordance with article 442 of the TCC, special auditor should first submit its draft report to the board of directors of the company for their review and seek their opinion on the draft. Once the report is finalized, auditor should submit its detailed final report to the court by explaining results of its examinations. Accordingly, the court should deliver a copy of the report to the company.

Upon the company's request, the court may decide that disclosure of the report may jeopardize the trade secrets or interests of the company, and not to share the report with the shareholders that requested special audit. In this respect, list of the clients, costs, price formation etc. may be considered the primary trade secrets and projects; investments and relations may be considered as the primary interests. In such a case, the court would conceal such information within the report.

The court also grants opportunity to the applicant shareholders and the company to convey their opinions and additional questions regarding the disclosed report.

Even if the court has decided that the report should not be disclosed, the board of directors shall submit the report and relevant evaluations of the court to the next general assembly meeting in accordance with article 443 of the TCC. During 1 (one) year following the date of general assembly, each shareholder may request from the company a copy of the auditor's report and opinion of the board of directors regarding the auditor's report.

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III. Conclusion

Special audit is an effective audit mechanism that enables shareholder to have knowledge regarding specific matters of the company so long as the courts conclude the court process swiftly. Such knowledge and the special audit report may also constitute a basis for the liability cases to be initiated by the shareholders in future against the founders or corporate bodies of the company.

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