

One of the Greatest Fraud Case in the World: The Imar Bank Case from Turkey

Goksel Yucel Burcu Adiloglu*

Accounting Department, School of Business, Istanbul University, Avcilar- Istanbul, Turkey

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Abstract

Turkey, a bridge between two continents, has experienced severe bouts of financial instability and came across into a severe financial crisis in 2001. During the 1998-2001 period 20 banks were transferred to the Savings Deposit Insurance Fund (SDIF) due to the erosion of their equity. These banks, the half of the 40 commercial banks of Turkey which are operating at that time, were also audited. Except for one or two of these banks all had judicial process because of their improper loans, etc. operations. In 2002, after triple auditing (two independent auditing companies and a sworn bank auditor) robust banks continued their activities. Imar Bank which was the one of these banks also was transferred to the Savings Deposit Insurance Fund in 2003. Imar Bank produced false financial statements to the creditors of the banks, including its depositors, and misleading reports to the supervisory authorities over a prolonged period. Fraudulent reporting of the bank showed that the management was able to misappropriate funds not reported in the financial statements by failing to account for a substantial volume of deposits. The examination revealed that there were discrepancies between the official deposit balances and actual balances. Total deposits of the bank amounted approximately 1,1 billion dollars according to the audited balance sheet prepared by the bank. However, based on the examination, the real amount was much higher than the reported. The actual amount was 6,1 billion dollars and 5 billion dollars was unregistered. Deposits were paid to depositors by the government. Unfortunately, it was the one of the greatest fraud case in banking sector in the world. During this crisis period it is indicated that there was a defect in the banking sector with regard to transparency. In this paper it is briefly discussed the underlying reasons behind this fraudulent reporting of Imar Bank and the failure of banking regulation and supervision functions in the country.

Keywords: Fraud, fraudulent reporting, Imar Bank, Turkey

1. Introduction

There are many fraud cases in the history of economic systems due to the lack of successful control systems. Imar Bank scandal, ten years ago, was probably the greatest fraudulent financial reporting case in the banking history. Turkey, officially the Republic of Turkey is a contiguous transcontinental country. Its larger part (sometimes called Anatolia) is in Western Asia, and the smaller (sometimes called East Thrace) in Southeastern Europe. Turkey is a member of the Council of Europe, NATO, OECD and the G-20 major economies. Turkey began full membership negotiations with the European Union in 2003, having been an associate member of the European Economic Community since 1963 and having joined the EU Customs Union in 1995. 2013 estimated basic key figures as are: Population 77 million (greatest city Istanbul 14 million), area 302,535 sq miles, GDP per capita \$19. Before 10-15 years ago the country was shocked by bankruptcies of twenty private commercial banks which were the half of the kind of the banking companies.

2. A Brief History of Banking System in Turkey during 1990's

Turkey had an average inflation rate 50 % for thirty years (from 1973 to 2003). One of the main economic problems of the government was the high foreign and domestic debt rates of the state. During the first half of 1990's there was approximately 70-80 banks in finance system of the country, few of them were state owned, most of them were family companies. The supervising agency for the banks was Central Bank of the Republic of Turkey. The main financing source of the banks were foreign loans instead of saving deposits and the main investments were the Government bonds or bills because of high real interest rates of these kinds of financial instruments. And they used these high rated financial assets also for repurchase arrangements. The banks were not willing to give loans. Briefly, economic structure problems occurred a weak, corrupted, unhealthy banking system. There was a great lack in adequate accounting standards. Although high inflation rates there were no regulations for inflation adjustments or disclosure of restated financial statements. There was an independent auditing system of the banks designed in 1986 by Central Bank but based on poor accounting standards.

In the second half of 1990's about 20 banks went to bankruptcy like a domino effect. Except few of them, in most of the banks were transactions not allowed by the law, back to back loans etc. The saving deposits were guaranteed fully by the government agency, Saving Deposits Insurance Fund (SDIF), which was under the umbrella of Central Bank and restructured as independent agency in the year 2003. Because of strong crisis in the financial sector of economy the Banking Regulations and Supervision Agency (BRSA) was established in

2000 and our story began... After bankruptcies in 20 banks, BRSA set up some new regulations. First they prepared its own Accounting Standards based on IFRS's with some little differences. And for the year end of 2001 they set up strong regulations with the independent audit procedures. BRSA accepted the year end for a new era in banking sector. According the specific regulations for 2001 all financial reports of the banks would be audited by an independent auditor, which would be selected by the bank. During this period there was approximately 100 audit companies which were authorized for independent audit of the banks, including Big Four (Big Five in this year). In the next step BRSA selected a second audit company to audit the audit work of the first audit company. And in the third step the Sworn Bank Auditors (government officers) had the right to control the audit procedures of the first two steps. As result of these strong procedures it was determined one of the banks (Pamukbank) was also in bankruptcy and all assets and liabilities of the bank was transferred to SDIF, because of high level of non-performing loans. The remaining banking companies were strong enough. The list of these 54 banks is given in Exhibit 1 (Banks Association of Turkey, 2003). Our case, our example, Imar Bank was on of these banks with sufficient ratios.

In the report of BRSA it was especially highlighted: "According to the Program for Strengthening Banks' Capitals the banking companies were audited in three steps and except Pamukbank all of them are strong enough." (BRSA Report, 2002)

3. History of Imar Bank

Imar Bank was established in 1928 with the full name of Turkey Imar (Reconstruction) Bank Inc. In 1984 the bank was purchased by one of the rapidly developing economic groups of Turkey, Uzan family (group). Uzan Group owned in 1990's media, energy, cement and construction companies, totally 233. Two of the energy companies (Cukurova and Kepez) were operated with the license of the Government, and they were among big sized companies of the country. Telsim was one of the two GSM companies of Turkey. The group owned also a soccer (football) team in the Super League of Turkey, Istanbulspor.

Imar Bank was a financial institution, which has offered the highest interest rates for saving deposits. Because of many suspecting transactions of the Imarbank, the company was closely watched by government agencies. But as explained above, Imarbank had no problems with its financial position as of the end of 2001.

The next year end, 2002 everything with banking operations and financial positions was seemed normal, except the loss amounting 92 trillion Turkish Lira (\$ 56 million).

In the independents auditors' report it was mentioned (Imar Bank's Financials and Independent Auditors' Report for 2002, Istanbul, 28 April 2003)

*Türkiye İmar Bankası A.Ş. (Imar Bank)
Independent Auditors' Report
for the period 1 January - 31 December 2002*

(last paragraph)

In our opinion the accompanying financial statements present fairly, in all material respects, the financial position of Türkiye İmar Bankası A.Ş. (Imarbank) as of December 31, 2002 and the results of its operations and cash flow for the year ended in accordance with the prevailing accounting principles and standards set up as per the existing regulations described in Article 13 of the Banking Act and other regulations.

Istanbul, 28 April 2003

*Gözlem Independent Auditing and Consultancy Company
A.Atlı, Partner*

4. Signals in 1990's

The collapse of Imar Bank as such was not a major surprise to close watchers of the Turkish banking sector but the financial damage that resulted and the way it took place was truly shocking. The takeover as such was not a big surprise because Imar Bank had been on the Treasury's watch-list – the regulatory authority before the BRSA was established – for almost ten years, as its loan portfolio, characterized by an exceptional connected-lending practice, consisted mainly of (direct and indirect) loans to companies owned by the Uzan Group. Once the BRSA was established, the new authority requested that Imar Bank shareholders re-capitalize the bank and reduce exposure to the Uzan Group. As no action was taken on either front, BRSA appointed a board member with veto powers in July 2001 and another representative was appointed to the board in December 2001. In 2002, during the May recap program, the bank reduced its risk to Uzan Group companies; shareholders injected capital into Imar Bank and the BRSA decided to withdraw the board member with veto powers in August 2002. With a BRSA representative still on the board, the problem seemed resolved and a takeover was avoided. (Steinherr et

al.,2004)

5. Transfer to the SDIF (June 2003-July 2003)

The bank was hit again in June 2003 when the charters of the two regional power companies (Çukurova and Kepez), which provided the bulk of the cash flow of the Uzan companies, were revoked by the Electricity Regulatory Board, July 12, 2003. This news led to a run on the bank and liquidity problems resulted. The board members of Imar Bank refused to cooperate with the BRSA and resigned their posts in late June. Meanwhile, the BRSA had only four board members and could not take a decision because a decision required at least five members. Upon the appointment by the government of the fifth member, the BRSA cancelled the deposit-taking license of Imar Bank and declared that all personal deposits were under government guarantee. (Steinherr et al.,2004)

During this period, Uzan family tried to transfer their own shares in Imar Bank (about 99% of total shares) to the employees of Imar Bank and Uzan Group.

After strong inspections and controls of Imar Bank's accounting and IT systems, the SDIF has determined these followings:

- a) There was an organization chart in the bank but it had no meaning because most of the major duties belongs to board of directors.
- b) The qualifications of the employees of the Imar Bank were not sufficient enough to manage the bank because the main operation of the bank was to finance the companies of Uzan Group.
- c) Merkez Yatırım (Merkez Yatırım Inc.), IT Company of Uzan Group was providing IT services of the accounting system of Imar Bank. but there was no written contract between Imar Bank and Merkez Yatırım.
- d) There were accounting systems in Imar Bank branches but the main system was in Merkez Yatırım and it controlled all the data of branches.
- e) IT system was also controlled by the top management of Imar Bank, by this authority they changed all the accounting records and manipulated.
- f) Data processing center destroyed by the bank's managers. In addition to this, all of the legal books and main and auxiliary records were either shifted away or destroyed and they have never reached.

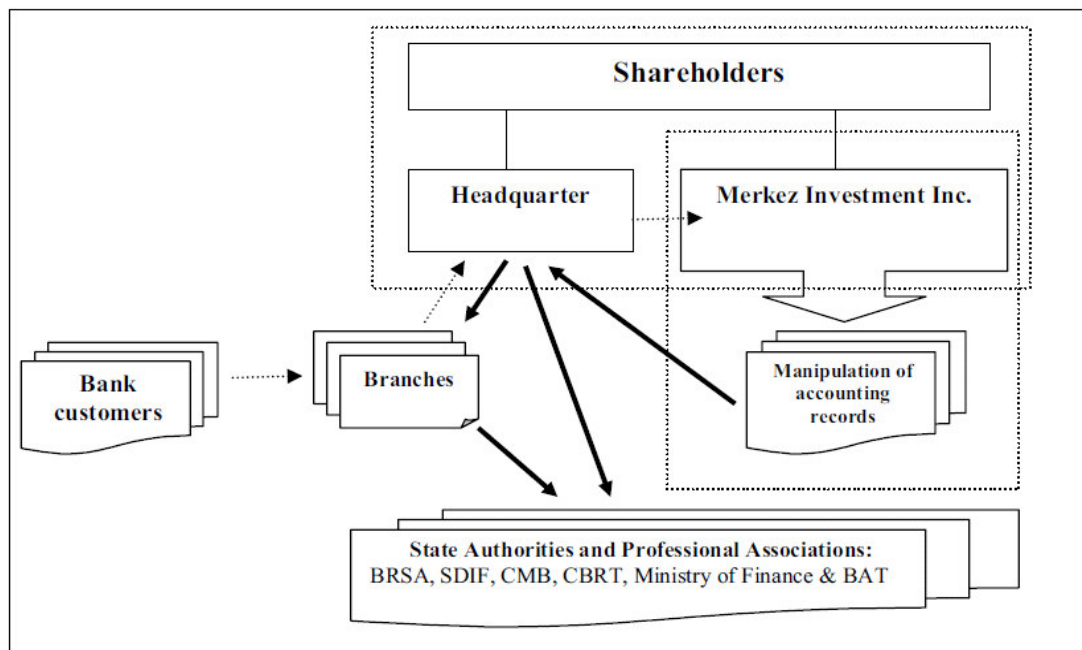


Figure 1. Manipulation of accounting records

Source: Aktan et al.,2009; BRSA (2003), *Endeavors to Strengthen Turkish Banking Sector and The Imar Bank Case (in Turkish)*, Presentation, October.

Two programs were used in manipulating data. One of them was used for showing deposits, taxes to be paid and expenditure accountings lower by giving fictitious debit-receivable records. The other one was used to delete bond transactions from subsidiary records. Legal ledger samples such as subsidiary ledgers, balance, book of final entry etc., which were produced by using manipulated data were delivered to the branches. The branches transferred all records displaying actual data to the main memory existing in the top management. Deposits (time and saving) amount was reduced based on account through a program called GM04 that only a few people were authorized to use. Adverse records were issued for the required date, sum, account and branch. Some

phrases such as “account closing” and “paid” were put on the subsidiary ledgers sent to the branches for the records produced by using GM04 and any remark was not provided. (see Figure 1).

g) Total deposits of the bank amounted approximately 1,1 billion dollars according to the audited balance sheet prepared by the bank. However, based on the examination, the real amount was much higher than the reported. The actual amount was 6,1 billion dollars and 5 billion dollars was unregistered. Exhibit 2 shows the balance sheet of Imar Bank as of July 3, 2003, according to bank records and after adjustments by SDIF

Exhibit 2

IMARBANK
Balance sheet as of July 3, 2003
(thousand Turkish Lira = US \$ 719)

	according to Bank records	after adjustments by SDIF
Cash on hand and in the Central Bank	171.598	2.931
Financial assets held for trading	-108.672	28
Banks	913.085	10.638
Loans	514.080	514.717
Non-performing loans	4.548	907.080
Allowance for non-performing loans	-4.548	-907.080
Investments in associates	415	415
Investments in subsidiaries	835	835
Reserve deposits in the Central Bank	60.728	59.545
Other receivables	94	59
Accrued interest receivables	131.931	3
Fixed assets	15.570	15.570
Intangibles	53	53
Other assets	533.417	7.688.233
Total assets	2.233.134	8.292.427
Deposits	1.567.254	8.443.802
Miscellaneous payables	741.752	898.820
Other liabilities	286	286
Tax liability	37.967	37.857
Accrued interest payable	307.118	316.163
Provisions	4.979	7.697.488
Shareholders' equity	-426.222	-9.101.989
Total liabilities and shareholders' equity	2.233.134	8.292.427
Deposits (expressed in US \$)	1.126.710	6.070.310
	US \$ 1,1 billion	US \$ 6,1 billion

Amount of deposits not recorded in official books	US \$ 5,0 billion
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The examinations revealed that the bank’s information technology (IT) firm, which was a group company that solely did business with the bank, had partly deleted and damaged the magnetic records of the bank during the takeover. A double record-keeping system was discovered: one official, one unofficial. That is to say, the bank had a double accounting system where the true information existed at the branch level, but headquarters falsified it and then reported it to BRSA. All previous onsite examinations were also done through the fake records. (Hayali et al. , 2012)

As a result of this destroying process, it was proved rather difficult for the government officials to investigate and audit the bank’s records. Investigations carried out under such difficult circumstances showed

that the documents and records submitted by the bank to government officials were simply manipulated by the former administrative officers of the bank and that the bank had collected from the ordinary folk, under the name of deposits and treasury bond sale, much more than it was initially recorded in the bank's financial books and records, and that the taxes collected from such depositors by means of stoppage were not at all passed on to fiscal authority (SDIF, Imar Bank, 2009)

The examination revealed that there were discrepancies between the official deposit balances and actual balances on July 3, 2003, SDIF took into consideration official records reported to BRDA. It is important to note that the deposits had been guaranteed by SDIF. After it was seen that many of the depositors accounts were not stated in official records, on August 4, 2004 their own documents started to be collected by depositors and it was obvious that deposit collection process is hidden from the public authority. Therefore Imar Bank rose as a Turkey's fifth largest bank by its total saving deposit. Deposits were paid to more than 300,000 depositors by the insurance fund. However, investors who bought government bonds were not paid at that time, because those were not deposits and were not covered by the insurance. In 2007, a law was enacted by the parliament that requires the Treasury to make payments to bond holders. (Ayaz,2008)

The president of Turkey's Savings Deposit Insurance Fund (TMSF), Ahmet Ertürk, said in an interview "What happened in (the Imar Bank incident) was a chain of corruption and irregularity that was set to disrupt the entire financial system of the country". Ertürk also notes that there is not any other example of deposits that kept off the record in the world.

In 1990, the Capital Market Board cancelled the license of Imar Bank to sell government securities to its customers. However, the bank itself, even after the withdrawal of its license, advertised sales of government securities to customers and apparently conducted ascertain volume of such business. The Istanbul Stock Exchange also continued to register such transactions. The securities were alleged to be held by the bank to the order of customers. There is no process for verifying the existence of securities in such cases. Second important issue in this Imar Bank fraud case is to sell government securities without any license.

It is amazing that all of the previous audit reports of the bank were unqualified.

One other important fraudulent act realized in this case is less important than first two issues as mentioned above. Because of all these unofficial records tax evasion was being done in this country.

6. SDIF's Liquidation Process

More than 200 companies of the Uzan Group were seized for six years (2003-2009) by the SDIF after it was discovered that the Uzan's fraudulent banking operations. From the liquidation assets of the Uzan Group SDIF generated cash amounting 6,2 billion dollars. For example Telsim (GSM operator) sold to Vodafone, media companies (including Star TV, the first private TV channel of Turkey), energy and construction companies also a soccer club sold in this period. Although Uzan Group's judicial process because of their improper loans, etc. operations SDIF was successful in liquidation process.

But it is not easy to say that the Imar Bank's judicial process because of the improper operations has successful results. Only some of the middle level managers were subject to prison penalties while the main have fled abroad and still have not found.

We think Imar Bank is an unique and huge fraud case in the World banking history in which the saving deposits amounting \$ 5 billion were not recoded in official books.

7. Conclusion

Imar Bank has been a major case a private commercial bank whose real records revealed, only upon the intervention of the banking authority (OECD, 2004) The Imar Bank scandal, which took place during 1990's and at the beginning of 2000's, was one the greatest banking corruption case in the history of the Turkish Republic. During this period it was indicated that there was a defect in the banking sector with regard to transparency. The Imar Bank case suggested a number of changes were needed to the legal framework, the financial and human resources devoted to supervision, and, most importantly in this case, to the management and organization of the supervisory process. After this scandal many new issues which are related to transparency such as implementing International Financial Reporting Standards, audits regarding International standards, risk management, internal controls, corporate governance etc. had taken place within the banking system. In addition to these, with BRSA processes to establish a bank has been made difficult, tight regulations have been imposed for the issue of banking licenses, which had been easier before the crises. After all these regulations, today banking is probably the most reliable, successful and attractive sector in Turkish economy.

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Exhibit 1

List of the Turkish Banks as of December 31, 2002 (ranked by total assets)

(billion TL = US \$ 610 as of Dec.31.,2002)

	Bank	Estab. Year	Total Assets (billion TL)	Total loans (billion TL)	Total deposits (billion TL)	Total equity (billion TL)	Net income/loss (billion TL)	Branches	Number of employees
1	T.C. Ziraat Bankası A.Ş.	1863	37.689.012	4.763.903	27.957.076	4.161.008	156.295	1.173	23.330
2	Akbank T.A.Ş.	1947	24.452.559	6.282.849	16.595.823	3.248.938	685.448	626	9.011
3	Türkiye İş Bankası A.Ş.	1924	23.731.290	7.234.647	16.720.074	4.247.536	310.816	839	14.873
4	T. Garanti Bankası A.Ş.	1946	19.563.059	5.658.648	13.163.403	1.678.355	123.074	304	7.407
5	Yapı ve Kredi Bankası A.Ş.	1944	18.825.275	7.086.165	12.987.504	2.739.012	1.101.454	419	10.435
6	Türkiye Halk Bankası A.Ş.	1938	17.409.175	1.206.394	11.466.915	1.827.468	593.718	546	9.228
7	T. Vakıflar Bankası T.A.O.	1954	12.733.306	3.388.647	9.454.079	758.939	306.100	300	7.600
8	Koçbank A.Ş.	1985	6.654.246	2.480.747	4.459.633	399.371	-149.132	134	3.257
9	Pamukbank T.A.Ş.	1955	5.810.297	1.631.375	5.838.131	-1.211.840	-2.056.591	194	4.974
10	Finans Bank A.Ş.	1987	4.926.857	1.733.860	3.658.454	535.196	188.426	126	2.811
11	Türk Eximbank	1987	4.597.470	3.684.934	0	1.104.206	106.059	2	370
12	T. Dış Ticaret Bankası A.Ş.	1964	3.894.487	1.241.702	2.240.932	568.886	81.942	147	2.735
13	Oyak Bank A.Ş.	1984	3.518.921	1.074.697	2.773.864	413.799	37.409	221	3.590
14	Bayındır Bank A.Ş.	1958	3.499.840	267.028	946.223	585.941	379.978	9	912
15	Denizbank A.Ş.	1997	3.371.191	838.960	2.607.741	399.685	17.274	161	2.860
16	HSBC Bank A.Ş.	1990	3.169.005	1.411.971	1.893.509	738.391	30.048	163	3.525
17	Türk Ekonomi Bankası A.Ş.	1927	2.373.182	801.872	1.691.487	255.785	18.514	75	1.673
18	Şekerbank T.A.Ş.	1953	2.191.348	493.300	1.856.022	103.830	10.343	196	2.948
19	İller Bankası	1933	1.845.493	1.212.575	0	1.035.889	358.077	1	3.004
20	T. Sınai Kalkınma Bank A.Ş.	1950	1.604.475	817.529	0	199.715	18.063	3	302
21	Citibank N.A.	1980	1.457.406	483.816	1.045.259	215.181	32.678	24	1.064
22	Alternatif Bank A.Ş.	1992	1.247.543	300.312	851.119	40.730	10.125	23	486
23	Türkiye İmar Bankası T.A.Ş.	1928	1.158.024	610.996	976.043	148.005	-92.958	169	1.521
24	Anadolubank A.Ş.	1996	1.142.887	329.952	974.608	66.173	16.974	48	826
25	Tekstil Bankası A.Ş.	1986	1.082.031	322.265	751.191	94.669	58.473	35	840
26	Tekfenbank A.Ş.	1992	567.388	132.409	437.981	61.567	16.963	33	654
27	T. Kalkınma Bankası A.Ş.	1975	448.620	171.046	0	329.644	-52.107	1	800
28	Bnp-Ak Dresdner Bank A.Ş.	1985	443.683	47.399	187.363	95.792	20.552	2	105
29	Abn Amro Bank N.V.	1921	309.955	22.801	63.201	73.367	-935	1	117
30	Turkish Bank A.Ş.	1982	300.628	10.955	240.704	46.450	2.563	13	183
31	Arap Türk Bankası A.Ş.	1977	290.641	38.500	56.309	47.884	2.873	3	177
32	WestLB AG	1990	287.058	160.636	133.234	27.181	4.850	1	75
33	Adabank A.Ş.	1985	280.046	90.962	183.428	70.328	-6.434	82	516
34	Credit Agricole Indosuez	1990	222.268	73.005	0	15.168	-3.436	1	30
35	Deutsche Bank A.Ş.	1988	219.011	23.408	0	50.215	9.671	1	29
36	Takas ve Saklama Bankası	1995	214.721	7.801	0	120.873	23.806	1	230
37	Société Générale (SA)	1989	158.855	26.975	7.624	36.170	36	1	50
	Bank	Estab. Year	Total Assets (billion TL)	Total loans (billion TL)	Total deposits (billion TL)	Total equity (billion TL)	Net income/loss (billion TL)	Branches	Number of employees
38	MNG Bank A.Ş.	1991	132.968	59.810	79.057	43.548	2.329	6	179
39	Credit Suisse First Boston	1998	122.266	0	0	30.995	-5.018	1	24
40	Bank Mellat	1982	115.069	28.946	33.339	11.309	2.072	3	39
41	JPMorgan Chase Bank	1984	97.662	0	6.346	37.939	2.374	1	43
42	Nurol Yatırım Bankası A.Ş.	1999	67.674	21.251	0	35.231	1.404	3	50
43	Banca di Roma S.P.A.	1911	65.720	21.082	16.842	10.969	-1.736	1	31
44	GSD Yatırım Bankası A.Ş.	1998	59.168	42.556	0	23.909	1.004	1	30
45	Çalık Yatırım Bankası A.Ş.	1999	58.352	3.962	0	31.563	4.951	1	24
46	Fiba Bank A.Ş.	1985	57.431	14.608	19.310	31.885	-2.755	2	64
47	ING Bank N.V.	1997	47.128	2.807	4.674	32.835	-2.475	1	26
48	C Kredi ve Kalk. Bankası	1999	38.215	3.028	0	10.255	-1.407	1	24
49	Diler Yatırım Bankası A.Ş.	1998	34.628	1.746	0	31.973	-201	1	20
50	Habib Bank Limited	1983	27.249	2.718	2.337	6.459	389	1	14
51	BankEuropa Bankası A.Ş.	1984	24.661	112	3.088	20.956	-3.023	2	97
52	Taib Yatırım Bank A.Ş.	1987	17.467	1.629	0	3.266	-834	1	18
53	Tat Yatırım Bankası A.Ş.	1992	10.587	446	0	3.640	-448	1	11
54	Credit Lyonnais Turkey	1987	7.990	529	4.061	2.409	-637	1	29
	Total		212.675.488	56.370.271	142.387.988	25.698.648	2.356.998	6.106	123.271