

## Press Release

July 29, 2008

### **FSC RELEASES DRAFT AMENDMENT TO THE ACT ON EXTERNAL AUDIT OF STOCK COMPANIES**

The Financial Services Commission organized a joint private-public Task Force (from Apr. to June, 2008) composed of officials from the government/supervisory authority, business representatives and accounting experts to establish an advanced accounting system. The Task Force conducted a rigorous review of major issues relevant to Korea's accounting system and devised improvement measures. Based on the review and a public hearing held on June 4, the FSC drafted the Amendment to Act on the External Audit of Stock Companies and the Amendment to Certified Public Accountant Law.

Opinions collected during the 20-day announcement period from July 29 to August 17 are to be reflected in the Amendments before submitting them to the upcoming regular National Assembly session after completing relevant procedures like deliberation by the Regulatory Reform Committee/the Ministry of Legislation and the vice ministerial-cabinet meeting. Announcement of the revised Enforcement Decree of the Act on External Audit of Stock Companies is scheduled in August.

#### Key Changes

The primary objective of the draft amendments is to bring about changes that will facilitate international convergence of accounting standards and efficiency in line with the full introduction of IFRS by: (i) relieving unlisted companies of the excessive accounting burden; (ii) build infrastructure including legislation for the adoption of IFRS, and (ii) improving supervisory system and reinforce expertise to boost accounting transparency.

#### **1. Revision of the Act on External Audit on Stock Companies**

- Changes in Title/Composition of Financial Statements and Consolidated Financial Statements (draft article 1-2)

Change title/composition of financial statements to align with the IFRS, (as is) balance sheets, statements of income, statements of appropriations of retained earnings, statements of change in equity, statements of cash flows, (to be) statement of financial position, statement of comprehensive income, statement of changes in equity, statement of cash flows, notes to financial statement

- Elimination of combined financial statements (draft article 1-2, 1-3)

Combined financial statements are becoming increasingly unnecessary with the implementation of the Prohibition of Provision of Guarantee for Affiliate's Debt and improvement in corporate governance. Nor do they exist in other countries. (The Fair Trade Commission is currently preparing disclosure rules on large scale business groups.)

**Business groups subject to/exempt from preparation of combined financial statements**

	1999	2000	2001	2002	2003	2004	2005	2006
Preparation required	30	36	33	40	48	49	52	54
Preparation exempted*	13	22	22	28	34	37	37	38
Actual preparation	17	14	11	12	14	12	15	16
Percent	56.7%	38.9%	33.3%	30.0%	29.2%	24.5%	28.8%	29.6%

\* Exemption is given when consolidated financial statements cover more than 80% of total asset.

- Reduction in the application scope/reporting frequency of Internal Accounting Control System (IACS) (draft article 2-2)

All companies subject to external audit (as of the end of '07: 18,074) used to be subject to IACS, but unlisted firms designated by the Presidential Decree are to be exempted from IACS. Reporting frequency will also be decreased to one time a year. In other countries such as the U.S. and Japan, IACS is applied only to listed companies whereas unlisted firms which lack accounting personnel are also required to abide by IACS in Korea.

- Abolition of the mandatory auditor rotation policy for stock listed corporation (draft article 4-2)

As the mandatory auditor rotation policy is to be repealed in 2011 when IFRS will be fully adopted, lead partner rotation rules will be further strengthened to better ensure independence of external auditor. Rotation of lead audit partner after three years will be required with a 3-year cooling-off period.

For the purpose of strengthening independence of auditor, Korea applies both the 6-year mandatory auditor rotation policy and the 3-year lead partner rotation policy whereas major advanced countries like the U.S., the U.K., and Japan are implementing lead partner rotation policy only.

- Resolution of submission/disclosure overlap of Financial statements (Auditors'

report) (draft article 8)

Devise reasonable solution to submission/disclosure overlap of financial statements (Auditors' report) among listed companies and auditors based on international standards. (as is) listed firms: 3 times, auditors: 3 times → (to be) listed firms two times, auditors: one time

- Upward revision of maximum court sentence for accounting fraud (3 years → 5 years) (draft article 20)

Whereas the U.S. set the maximum sentence at 25 years, Korea's maximum punishment for violation of accounting standards is three years of imprisonment, which makes it a relatively less effective deterrent than a longer sentence in major advanced countries like the U.S.

- To prepare consolidated financial statements according to IFRS, a parent company will be granted the right to demand submission of accounting information from a subsidiary (draft article 6-2), Australia and Japan also confer statutory right to control accounting information.

## **2. Revisions of the Certified Public Accountant Law**

- Strengthen re-registration/renewal requirements for CPA license (draft article 7, 8, 9, 10-2)

Introduce tighter re-registration/renewal requirements in order to enhance expertise of CPAs (complete education requirement under the enforcement decree).

- Tighten in-service training requirement for CPAs (draft article 7, 53)

For further professional development of CPAs and to conform to international standards, a uniform in-service training requirement of three years will be applied. People who are exempt from the first test will be required to go through in-service training for two years.

Currently, CPAs need to complete a three year in-service training to carry out audit related services. For non audit services, the required in-service training period is one year. In-service training is exempt for people who are exempt from the first test.

- Ease restrictions on CPAs associated with accounting firms (draft article 26)

Regulations will be revised to allow CPAs associated with accounting firms to perform functions not related to suspension as a member of accounting firms during the period of partial suspension of duties. Under the current regulation, even during the partial suspension period, not total suspension, CPAs are not able to carry out functions as a member of accounting firm s.

- Allow accounting firms to buy insurance policy instead of setting aside damage compensation reserve (draft article 28, 37)

Accounting firms with insurance policy which covers all business activities including audit services are going to be exempt from damage compensation reserve requirement.

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