

## Revision to *the Act on External Audit of Stock Companies*

### I. Background

The Act on External Audit of Stock Companies (hereinafter referred as “the Act”) has gone through major improvements since the bill was enacted in 1981. Among them, **the latest revision, passed by the National Assembly on September 28, 2017, is the most far-reaching reform of Korea’s accounting and audit practices, compared to a Korean version of the Sarbanes-Oxley Act.** To deter a repeat of major accounting scandals in recent years, the revised bill contains **fundamental changes in a wide range of issues, including external auditor independence, corporate accountability, and penalties against wrongful acts.** Those changes will set higher standards for all stakeholders in their role, including companies, auditors and financial regulators, to further advance Korea’s accounting reform efforts. The revised bill will take effect November 1, 2018, one year after the date of its promulgation.

### II. Key Provisions

#### **Companies, greater accountability and stronger internal control**

1. **The scope of companies subject to external audit, currently limited to ‘stock companies’ under the Act, will be expanded to include ‘limited liability companies (LLCs).’**

\* Specifics about companies subject to external audit and the scope of disclosure of audit reports will be delegated to the subordinate Enforcement Decree of the Act.

2. **The right to appoint an external auditor, currently exercised by the company’s management, will be transferred to *internal audit organizations* such as the ‘statutory auditor’ or the ‘audit committee.’**
3. **Companies will be held more accountable for preparation of their financial statements.**
  - ▶ A company shall not require an external auditor to prepare financial statements on its behalf.
  - ▶ If a company fails to submit financial statements to the external auditor and the Securities and Futures Commission (SFC) within the statutory deadline, six weeks before the general meeting of shareholders, the company’s representative director shall disclose reasons for non-compliance.
4. **Companies will be required to have more effective internal control relating to accounting management.**
  - ▶ The levels of an external auditor’s inspection relating to internal accounting management will be intensified from the current ‘examinations’ to ‘audit.’
  - ▶ The company’s representative director shall report the operational status of internal accounting management system at the general meeting of shareholders.

**5. Internal audit organizations will take a bigger role in disclosing wrongful acts and taking corrective measures.**

- ▶ If an external auditor informs the statutory auditor or the audit committee of any of wrongful acts, they shall appoint an outside inspector to investigate and request the management to take corrective measures.

**6. Unlisted large companies and financial institutions will be subject to the same levels of accounting regulations as listed companies.**

- ▶ An external auditor appointed by those companies shall be limited to an accounting firm.
- ▶ The external auditor shall be allowed to conduct an audit for three consecutive business years.

**Auditors, more independence and stringent audit quality control**

**7. Designation of an external auditor by the SFC will be expanded into a wider range of companies as a supervisory tool to ensure fair accounting practices.**

- ▶ For all listed companies and unlisted companies whose ownership and management are not separated, the SFC shall designate an external auditor for every three in nine years.  
*✕ This shall not apply to companies found in no record of wrongful acts, as the results of audit reviews by the Financial Supervisory Service (FSS) in recent six years.*
- ▶ The cases subject to the SFC's designation, currently limited to ones with specific reasons, will be expanded to many other cases – e.g. a company's violation of financial reporting requirements; upon shareholders' request; or a company's failure to meet the standards for appropriate audit hours, etc.

**8. Non-audit service restrictions on external auditors will be tightened.**

- ▶ Non-audit services that an external auditor is prohibited from providing to a client company will be widened to the extent of advanced countries.
- ▶ The external auditor shall not provide non-audit services not only to a client company but also to its subsidiary companies.

**9. Registration will be required for an external auditor of a listed company.**

- ▶ Only a registered accounting firm, which meets certain requirements such as audit quality control system in place, shall qualify for an external auditor of a listed company

**10. Accounting firms will be held more accountable for audit quality control.**

- ▶ The revised bill includes provisions that set standards for audit quality control and clarifies responsibility of the accounting firm's representative director for audit quality control.
- ▶ The SFC may publicly disclose its recommendations for improvement and the implementation in accordance with the results of a quality control review.

**11. Standards for appropriate audit hours will be set for the assurance of audit quality.**

- ▶ Companies and accounting firms which fall short of the standards for appropriate audit hours will be given disadvantages.

12. **A company shall appoint an external auditor within 45 days from the commencement of each business year, shortened from the current period of four months.**

**Regulators, *enhanced supervisory role and stricter disciplinary action***

13. **Penalty surcharge will be introduced under the Act.** (No upper limits)

- ▶ Company: 20% or less of the amount of accounting fraud
- ▶ Relevant individuals of the company: 10% or less of the amount of the penalty imposed on the company.
- ▶ External auditor: five times or less its remuneration

14. **The revised bill includes provisions to discipline an accounting firm's representative director and executive officers responsible for audit quality control.**

- ▶ If a serious audit malpractice occurs out of negligence of quality control responsibilities, the SFC may take actions such as a recommendation for dismissal, or suspension of the accounting firm's directors and responsible executive officers.

15. **Companies and external auditors relating to accounting fraud will face tougher penalties.**

- ▶ Imprisonment: less than 10 years, up from the current penalty of 5 to 7 years
- ▶ Fine: less than one or three times unfair profits, which could be bigger than the current penalty of KRW50 million to KRW70 million.
- ▶ Limitation period for liability claims for damages: 8 years, up from the current 3 years.

16. **Supervision on accounting firms will be strengthened.**

- ▶ An accounting firm shall report immediately to the SFC if serious issues arise in its management, assets, and quality control.

17. **Whistleblowers will be better protected.**

- ▶ The revised bill includes provisions that enable the SFC to punish or fine those who give any disadvantageous treatment to a whistleblower or make public his/her personal information.