

## ACCOUNTING REVIEW PROCESS TO BE MADE MORE EXPEDITIOUS AND TRANSPARENT

The FSC introduced a plan to bring about improvements to the accounting review process with aims to prevent the prolonging of the review process and to ensure the protection of the right to defense for businesses undergoing scrutiny during the review process by the Financial Supervisory Service (FSS). The period of the review process will be one year in principle with a six-month extension allowed upon approval from Governor of the FSS for unavoidable reasons. To guarantee the right to defense for businesses undergoing scrutiny, improvements will be made to the contents of the prior notification form and the period for which businesses can access the Q&A document will be extended.

### **BACKGROUND**

An accounting review (or inspection) examines whether a company's financial statement and audit report have been prepared properly according to the relevant accounting and auditing standards. It is a supervisory function that seeks to protect various stakeholders such as investors and to encourage sound business management activities as well.

Accounting review is an important aspect to bringing about innovation in capital markets and improving investor trust.<sup>1</sup> Transparency in capital markets begins with the accuracy and promptness in the accounting information being disclosed and accounting review as a supervisory mechanism induces accurate accounting practices by businesses through identification and correction of inappropriate accounting information. In addition, under the principle-based IFRS system that recognizes diversity in accounting practices, accounting review provides guidance for businesses in conducting their accounting practices.

The government has continued to make efforts to bring about improvements to the accounting review system since the accounting reform.<sup>2</sup> With an introduction of the financial statement review system, the processing time for minor violations has been reduced considerably.<sup>3</sup> The adoption of an adversary procedure during the review

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<sup>1</sup> New administration's major policy task #36: "Promoting venture capital with innovation in capital markets and improvements to investor trust"

<sup>2</sup> As imposing administrative sanctions, such as a fine, removal from office, bringing a charge to prosecutor, depending on the motive and seriousness of violation can have a serious consequence for business activities, it is very important to ensure accountability, fairness and legitimacy in the process of seeking administrative orders.

<sup>3</sup> To help improve credibility of financial statements through prompt corrections of accounting errors, minor mistakes are handled and their cases terminated with an issuance of warning by FSS Governor.

process<sup>4</sup> has helped to strengthen companies' right to defense, thereby enhancing the fairness of sanctions and reasonableness.

However, there continues to be calls<sup>5</sup> for the need to speed up the accounting review process and more effectively guarantee companies their right to defense. Thus, the government has prepared a plan to improve the accounting review process and strengthen the right to defense for businesses.

## **KEY MEASURES**

### **I. PROMOTE EXPEDITIOUS CONCLUSION OF AUDIT REVIEW BY STIPULATING THE PERIOD OF AUDIT REVIEW FOR ONE-YEAR IN PRINCIPLE**

**(AS OF NOW)** Due to the lack of a restricted time period for accounting review under the current law on external audit of stock companies, there have been cases where accounting review for business sectors that are particularly complicated such as the bio sector went on for three to four years.<sup>6</sup>

**(TO BE CHANGED)** To help bring the period of accounting review within a more reasonable timetable, a specific time period for accounting review will be stipulated in relevant regulation. In principle, the time required for accounting review will be restricted to one year, and when needed for extending the period for unavoidable reasons,<sup>7</sup> a pre-approval should be obtained from FSS Governor.<sup>8</sup> Also, the changed regulation will require the FSS to specify the accounting review period as being one year in principle on the official notification document being sent to the businesses and auditors and to make further notification if the review period is extended along with the reason for extension and the extended period.

### **II. STRENGTHEN THE GUARANTEE OF THE RIGHT TO DEFENSE FOR BUSINESSES**

a) Allow documentation of the review process by an agent

**(AS OF NOW)** A business being scrutinized for accounting review is allowed to have an agent participate in the review process according to the Administrative Procedures Act, but it is currently prohibited for an agent to film, record or document the review process.<sup>9</sup> Restricting the act of documenting has led to the problem of businesses having to respond to the Accounting Oversight Deliberation Committee (AODC) and the Securities and Futures Commission (SFC) without being adequately aware of

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<sup>4</sup> During the deliberation process being carried out by the Accounting Oversight Deliberation Committee and Securities and Futures Commission, the company whose accounting practice is under scrutiny and the oversight enforcement agency have a chance to present their cases to each other on factual matters and application of law.

<sup>5</sup> These issues have been decided at the 7th provisional meeting of the Securities and Futures Commission on March 11, 2022.

<sup>6</sup> Statistics on how much time it took for accounting review in recent four years (2018-2021, 225 cases total, excluding closed cases): Within 1 year (136 cases or 61%), 1-2 years (65 cases or 29%), 2-3 years (19 cases or 8%), 3 years or more (5 cases or 2%)

<sup>7</sup> When it is difficult to carry out oversight activities due to an interruption to accounting review or a delay in document filing by a business.

<sup>8</sup> 6-month extension granted with possibility of additional extensions.

<sup>9</sup> Subject to expulsion upon being caught.

their own testimonies or problematic issues at hand.

**(TO BE CHANGED)** Business agents will be allowed to document key information regarding questions and answers via handwriting.<sup>10</sup>

b) Allow early access to Q&A document for businesses

**(AS OF NOW)** For the confirmation documents written and signed by the business under scrutiny which recognize specific facts related to the work carried out by the business, immediate access to the document is possible. However, access to the Q&A document<sup>11</sup> is allowed after the issuance of prior notification by the FSS (10 days prior to the expected enforcement date of administrative order). As such, it has been pointed out that businesses undergoing review by relevant authorities (AODC or SFC) are not able to adequately exercise their right to defense in practice as there is no sufficient time for businesses to accurately review charges being brought against them.

**(TO BE CHANGED)** Access to Q&A documents will be made possible<sup>12</sup> about two weeks earlier than before to guarantee sufficient time for businesses to exercise their right to defense.<sup>13</sup>

c) Make document requests in writing

**(AS OF NOW)** In the process of carrying out accounting review, there have been numerous cases where authorities made a request of documents via verbal communication to the business undergoing review. Due to the lack of clarity in verbal communication, it has been pointed out that there have been confusions regarding specific details and scope of requests being made and that the business under scrutiny may face the burden of submitting unnecessary and excessive amount of documents.

**(TO BE CHANGED)** Requests for documents made through verbal communication will need to be supplemented with an electronically written request format (text message, email, fax, etc.) within three business days.

d) Make contents of prior notification more specific

**(AS OF NOW)** With some of the contents contained in prior notifications—such as the

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<sup>10</sup> Example from the National Policy Agency (self defense notes): Self defense notes are provided with information on defendant's right to self defense and how to exercise it during the investigation process. The notes also contain blank spaces where defendants can take notes about the investigation process. In a similar vein, the Korean Institute of Certified Public Accountants will come up with and provide notes for accounting review.

<sup>11</sup> Q&A document is a written document of questions and answers exchanged by the accounting review enforcement agency and the business being scrutinized during the accounting review process, which is used as an important lead by the Accounting Oversight Deliberation committee and Securities and Futures Commission.

<sup>12</sup> Immediately after sending out questionnaire before issuing a prior notification.

<sup>13</sup> Major steps in an accounting review process: a) initiate accounting review → (b) carry out inspection (including Q&A) → (c) send out questionnaire → (d) approval of proposed corrective order → (e) prior notification of corrective order → (f) deliberation by Accounting Oversight Deliberation Committee → (g) decision by Securities & Futures Commission

justification for determining the motive of illegality, factual relationship and reason for arriving at a particular indicated amount—not being detailed enough, it has been pointed out that businesses undergoing scrutiny had to respond to the AODC and the SFC without sufficiently understanding about the issue at hand.

**(TO BE CHANGED)** The accounting review enforcement body’s decision on factual relationship and specific penalty standards being applied will be provided in detail. First, the items included for deliberation by the AODC such as the basis for violation and detailed calculation of problematic amount will also be included in prior notifications. Prior notifications will include specific wordings of the accounting and auditing standards that have direct relevance to the problematic items. Second, prior notifications will also contain information about the justification for determining the motive<sup>14</sup> and the expected level of administrative order that are also included as items for deliberation by the AODC.<sup>15</sup>

e) Enhance information provision about the use of interest protection mechanisms

**(AS OF NOW)** It has been pointed out that in some cases businesses undergoing accounting review are not necessarily well aware of their interest protection mechanisms available under the current rules on the administration of accounting review. There have been cases where a business undergoing accounting review did not make use of necessary documents such as audit reports which can be brought in and accessed or seek professional assistance from company’s own accountant in the Q&A process due to their lack of awareness about these information.

**(TO BE CHANGED)** The FSS will actively inform businesses undergoing accounting review that they can bring in and access documents<sup>16</sup> necessary for the Q&A and throughout the accounting review process and seek assistance from company’s own accounting professional.<sup>17</sup>

## **FURTHER PLAN**

**(REVISING RULES)** Authorities plan to issue a notice of rules change to the Regulation on External Audit of Stock Companies in June 2022 and finalize the revision in the third quarter of this year.

**(IMPROVING WORK PRACTICES)** Authorities will immediately begin to implement the measures that require no changes to the current regulation.

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For press inquiry, please contact Foreign Media Relations at [fsc\\_media@korea.kr](mailto:fsc_media@korea.kr).

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<sup>14</sup> However, on intentional act of violation, an adjustment to animosity will be made when there are concerns of obstruction to investigation through collusion, destruction of evidence, breach of confidential information, etc.

<sup>15</sup> Present expected amount of a fine, detail and basis of calculation, period of designating an external auditor, etc.

<sup>16</sup> There are no restrictions for an auditor to bring or access audit reports or financial statements and for a business representative to bring or access relevant company documents.

<sup>17</sup> According to the relevant provisions of the Regulation on External Audit of Stock Companies and the Administrative Procedures Act, a business under scrutiny may request for the presence of a corporate employee during the review process.