

EC Conference 2010

Independent Audit Oversight in Korea

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Dr. Ho Joong Kim

**Chief Accountant
Financial Supervisory Service**

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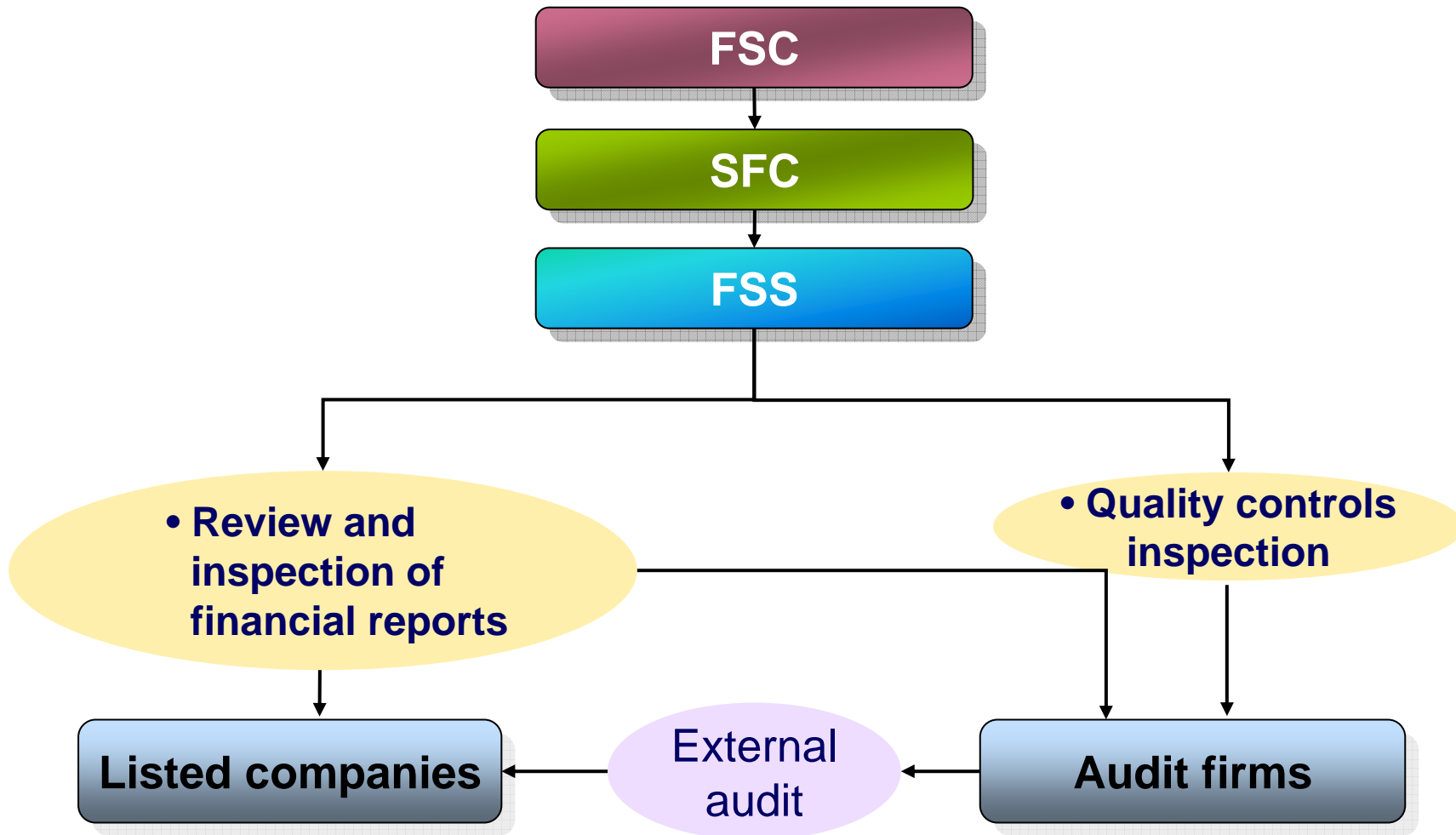
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I. Audit Regulators in Korea

I. Audit Regulators in Korea

Overview of Audit Regulators



I. Audit Regulators in Korea

1. Financial Services Commission (FSC)

- Established as a government agency
- Principal decision-making authority overseeing the supervision of financial services firms as well as capital markets and audit firms
- 9 Commissioners, including Chairman and Vice Chairman

2. Securities & Futures Commission (SFC)

- Established as a government agency under FSC
- Supervision of capital markets, investigation of violation of securities laws & review of audit activities
- 5 Commissioners, including FSC Vice Chairman as SFC Chairman

I. Audit Regulators in Korea

3. Financial Supervisory Service (FSS)

Establishment

- Established as a quasi-governmental organization
- Executive arm of FSC and SFC

Functions

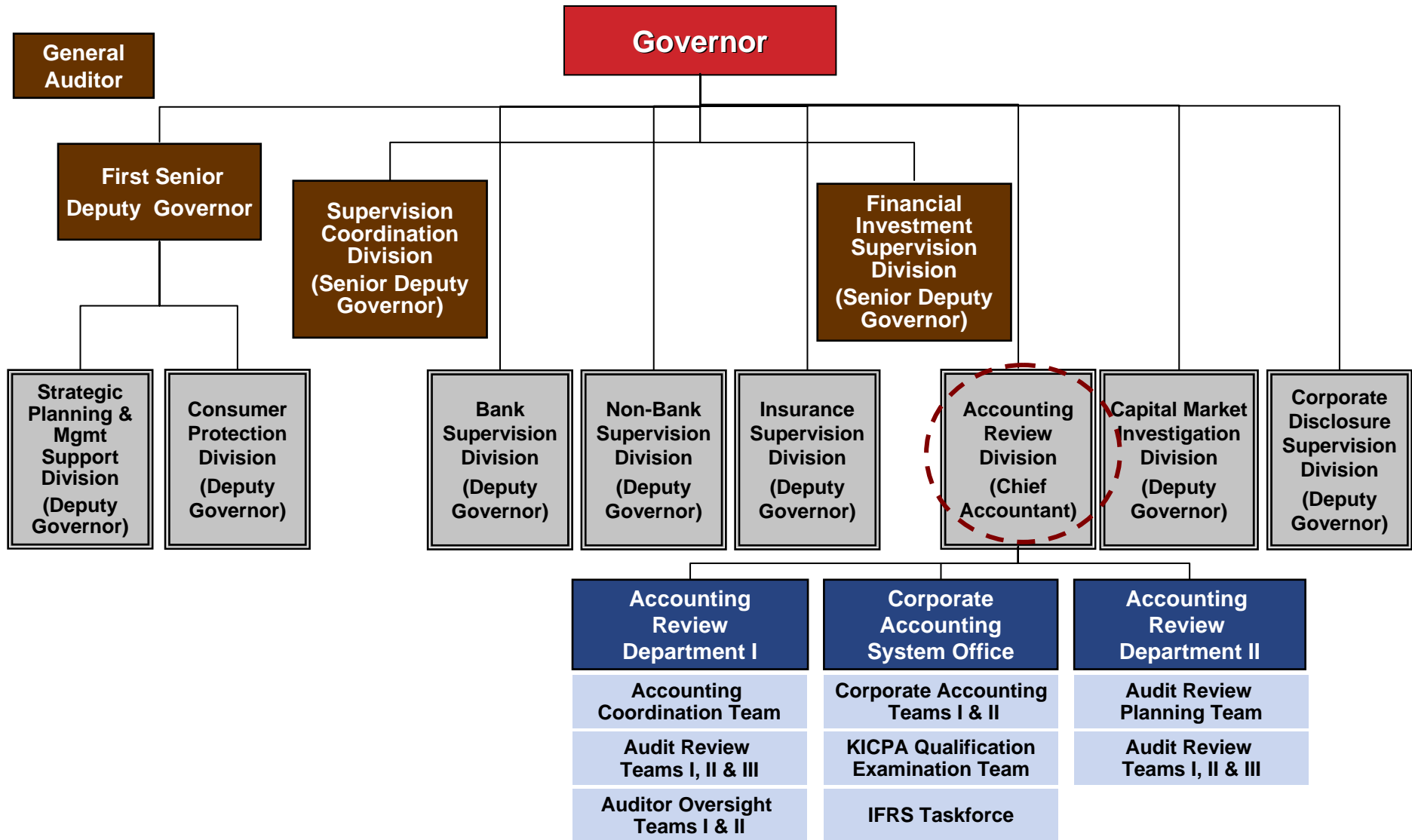
- Supervision and examination of financial services companies
- Enforcement of securities laws and regulations
- Audit regulation: i) review of financial reports;
ii) inspection of auditors;
iii) enforcement and interpretation of GAAP & GAAS;
iv) administration of CPA examination

Executive Officers and Staff

- Governor, 12 executive officers, and 1,647 staff employees

I. Audit Regulators in Korea

Organizational Chart of FSS



I. Audit Regulators in Korea

4. Independence of Audit Regulators

Independence Safeguards

- No practicing CPA who may potentially pose conflict of interests may serve as a Commissioner of FSC or SFC
- The accounting profession cannot recommend any candidates for a senior position in FSC, SFC, or FSS

Financial Independence

- Audit regulators are funded independently from the auditing profession
- ✓ FSC/SFC: funded by the government
- ✓ FSS: funded by Bank of Korea, financial companies, and securities issuance fees



II. Audit Services Industry in Korea

II. Audit Services Industry in Korea

Companies Subject to External Audit

- ✓ 17,272 stock companies, including 1,756 publicly-held companies, were subject to independent external audit as of Sept 2009

CPAs & Audit Firms

- ✓ Number of CPAs: 12,378 (as of Sept 2009)
- ✓ CPAs employed by audit firms: 7,069 (57% of the total)
- ✓ Number of audit firms: 110

Financial Performance of Audit Firms

- ✓ Revenues: KRW1,531 billion (US\$ 1.3B) as of Mar 2009



III. Audit Regulations in Korea

III. Audit Regulations in Korea

Overview of Audit Oversight System

Establishment & interpretation of GAAP & GAAS

Professional standards

Inspection of quality controls

Auditors

Accounting Transparency

Companies

Review of financial reports

CPAs

Administration of CPA examination

III. Audit Regulations in Korea

1. Review of Financial Reports and Auditors' Reports

(1) History

Dec 1980

- Act on External Audit of Stock Companies

Dec 1981

- Began to review financial reports

Dec 1989

- Introduced the Auditor Designation Rules

Dec 2003

- Introduced assessment of internal controls over financial reporting & restrictions on non-audit services by auditors

Jan 2005

- Securities Class-Action Suit Act

III. Audit Regulations in Korea

1. Review of Financial Reports and Auditor's Reports

(2) Overview

- The FSS examines compliance with GAAP and GAAS by companies and their auditors
- The FSS reviews financial reports and auditor's reports of listed companies, while the KICPA reviews auditor's reports of non-listed companies

	2006	2007	2008	2009
No. of listed companies reviewed	218	280	273	218
No. of listed companies	1,592	1,641	1,709	1,746
	13.7%	17.1%	16.0%	12.5%

III. Audit Regulations in Korea

1. Review of Financial Reports and Auditor's Reports

(3) Sanctions

Companies	Auditors	CPAs
Referral for criminal investigation/prosecution	Referral for criminal investigation/prosecution	Referral for criminal investigation/prosecution
Restrictions on new securities issuance	Recommendation for business suspension	Recommendation for Work suspension
Monetary fines	Monetary fines	Warning & admonition
Recommendation for dismissal of officers	Warning & admonition	Ban on audit on certain companies
Designation of auditors	Payment to joint damages fund	Retraining
Warning & admonition	Ban on audit on certain companies	
58 companies sanctioned	37 audit firms sanctioned	65 CPAs sanctioned

III. Audit Regulations in Korea

2. Inspection of Audit Firms' Quality Controls (QC)

(1) History

Mar 1990

- Introduced the inspection of auditors' QC systems

1990-1995

- Inspected 140 auditors for 6 years

Jun 2001

- Inspection authority delegated to KICPA

Apr 2006

- Direct inspection of auditors by FSS

Mar 2007

- Statement of Protocol with PCAOB

2007-2009

- Inspected 24 auditors (5 joint inspections with PCAOB included)

III. Audit Regulations in Korea

2. Inspection of Audit Firms' Quality Controls (QC)

(2) Overview

- FSS inspects whether audit firms have adequate QC systems in accordance with QC standards and audit engagements in accordance with auditing & QC standards
- FSS directly inspects 23 major auditors, which audit 81% of listed companies, and other auditors are inspected by KICPA (delegated by SFC/FSS)

	No. of Audit firms	Frequency	2007	2008	2009
Big 4	4	2 years	2	2	2
Medium-sized	9	3 years	2	4	3
Small-sized	10	3-5 years	4	2	3
Total	23		8	8	8

III. Audit Regulations in Korea

3. Professional Standards

GAAP

- KASB develops standards
- FSC approves new standards after deliberation by FSS
- IFRS to be fully adopted starting FY2011
- Obtained EC equivalence in 2008

GAAS

- KICPA develops standards and FSC approves them
- New ISA to be adopted starting FY2011

QC Standards & Ethics Code

- KICPA develops standards
- ISQC and international Code of Ethics used as benchmarks

III. Audit Regulations in Korea

4. Issues Related to Setting up Auditor Inspection System

(1) Shortage of Inspectors

Issues

- Inspecting quality controls of all 110 audit firms required more than 20 inspectors
- ✓ Neither securing new inspectors nor transferring the existing staff to new quality control teams was not easy

Solution

- The new teams were staffed by 8 inspectors: FSS concentrates on inspection of 23 major audit firms, including those registered with foreign regulators, while others are inspected by KICPA
- ✓ The 23 audit firms audit 81% of listed companies (98% of market value)

III. Audit Regulations in Korea

4. Issues Related to Setting up Auditor Inspection System

(2) Inspections Overlapped

Issues

- Audit regulators in EU, US, and Japan directly inspect foreign firms
- ✓ For audit firms in a jurisdiction with an appropriate oversight system, the direct inspection by other foreign regulators causes overly high compliance costs

Solution

- International audit regulators need to develop a framework to assess the appropriateness of oversight system of each country
- ✓ Audit regulators may grant inspection exemption to audit firms in other jurisdiction with an appropriate oversight system



THANK YOU



Q & A