



# Transplanting the Audit Committee in Korean Soil

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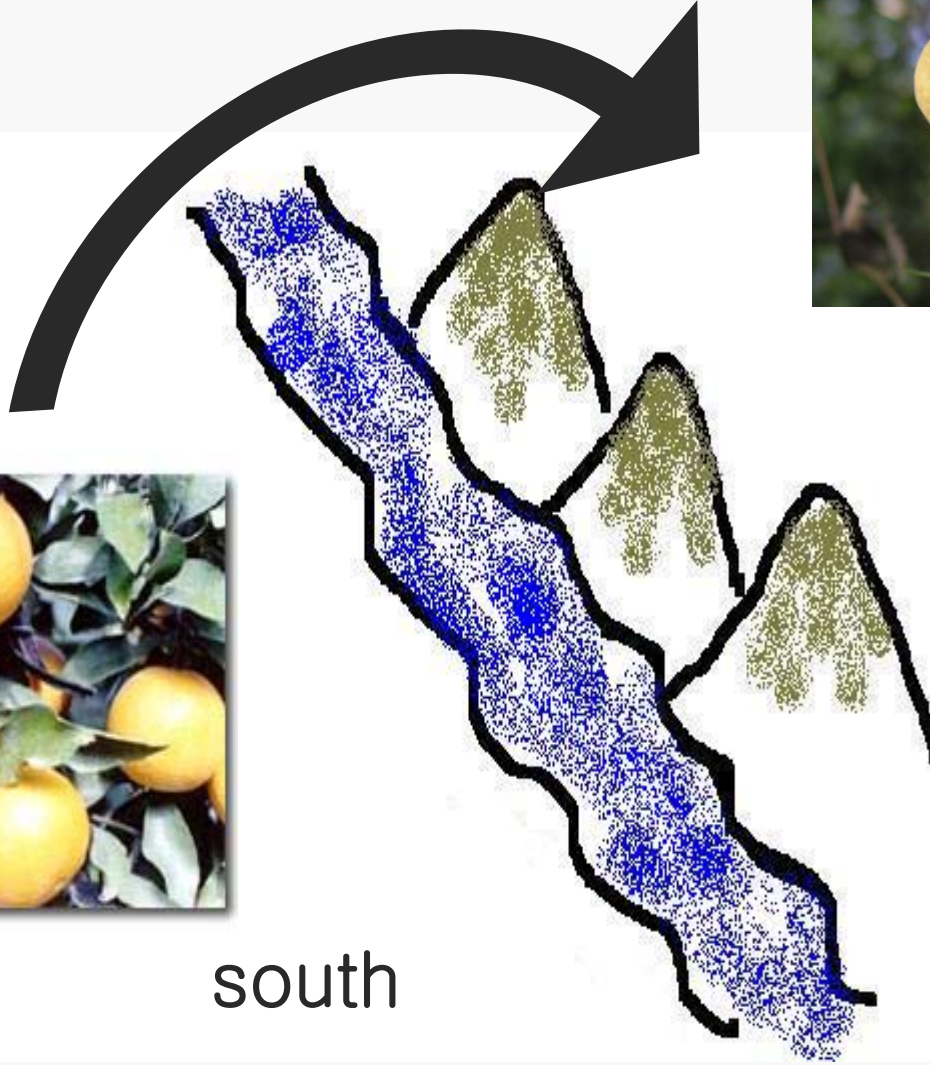
Seoul National University

# Transplant

north



hardy orange



orange

south



# CORPORATE AUDITORS

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- ◆ Creature of the Japanese Code
- ◆ Appointed at the GSM to monitor the board
- ◆ Power over accounting as well as operational matters
- ◆ No power to appoint or dismiss directors or officers
- ◆ Fail to play a significant role

# AUDIT COMMITTEE

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- ◆ Commercial Code: revised in 1999 to allow a corporation to establish an audit committee in place of a corporate auditor
- ◆ The Securities Transaction Act (applicable to listed firms): revised to **require** a large listed firm to establish an audit committee
- ◆ Pressure from IMF, IBRD

# Response to Audit Committee

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- ◆ Business Community: hostile
- ◆ Legal Commentators: hostile
- ◆ Government made compromises
- ◆ Result: mixture of corporate auditors and the U.S. style audit committee

# Adoption of Audit Committee

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	Listed firms	Firms with Audit Co	Mandatory	Voluntary
2004	666	132	74	57
2005	662	136	77	59

# Grounds of Criticism

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- ◆ Self-audit: participation of the members in the board may be better to restrain questionable management behavior
- ◆ Subordinate nature of the audit committee: power specified by the statutes, not delegated by the board
- ◆ Too much work for part-time outside directors: it will depend on the role the audit committee is expected to play

# Audit Committee vs. Corp. Auditor

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- ◇ Collegial organ
- ◇ Participating in the decision-making process of the board
- ◇ Power to dismiss and appoint CEO
- ◇ Q: Is it desirable as a matter of policy to require firms to adopt the audit committee in place of the corporate auditor?



# Unique Features of the Audit Committee in Korea

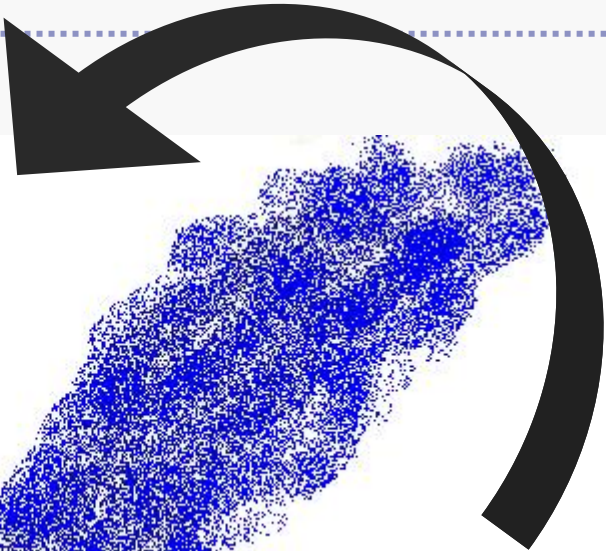
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- ◆ Selected at GSM – 3% limit applicable
- ◆ Former regulator as financial expert
- ◆ Full time member
- ◆ Operation audit
- ◆ Separate staff supporting the audit committee?

# Audit Committee



Korea



USA

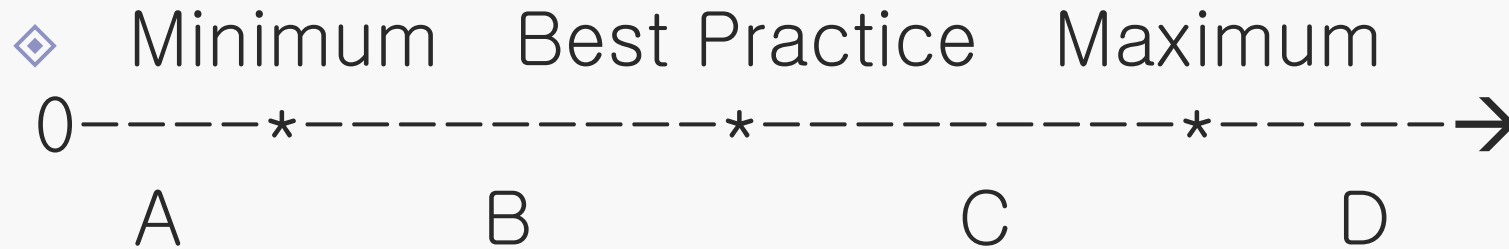
# What should the audit committee do?

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- ◇ Power of the audit committee extensive, covering almost every aspect of business operation
- ◇ The audit committee enjoys a considerable amount of discretion as long as it is not in violation of the Korean equivalent of fiduciary duty
- ◇ In theory, too much, as well as too little, action may result in liability. But it may be difficult in practice to hold the audit committee liable for too much action.

# Liability of the Audit Committee

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- \*Liability if it falls in Zone A or Zone D
- \*Minimum, Best Pr., Maximum are all unclear
- \*It will be difficult in practice to hold the audit committee liable for excessive audit (D)
- \*The problem with the audit committee has been too little action (A): possibility of too much action?

# Likelihood of too much action

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- ◇ Risk averse director
- ◇ Overly enthusiastic director
- ◇ Director with nothing else to do
- ◇ Director interested in expanding its influence
- ◇ Ignorant director

# Costs of too much action

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- ◆ Equipped with the power to conduct an operation audit, an activist audit committee may slow down, if not cripple, decision-making process
- ◆ Competent people tend to be busy and may want to avoid serving on the audit committee
- ◆ Signs of too much action? : full-time member, separate supporting staff

# How to discourage too much action?

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- ◆ Clarify minimum to reduce uncertainty involved: court's role
- ◆ Persuade the court not to ask too much of the audit committee
- ◆ Develop best practice as soon as possible

# Future of the Audit Committee in Korea?

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- ◇ The power of operation audit has been given primarily because the legislators were not sure of the independence of the board
- ◇ As outside directors become more reliable, there is less justification for the operation audit
- ◇ Without the operation audit function, the audit committee will be more like the one in U.S.



# Concluding remarks

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- ◇ Convergence in form believed to be more difficult to achieve than convergence in function
- ◇ Convergence in form, but no convergence in substance?
- ◇ Situation in the U.S. thirty years ago?
- ◇ A longer-term perspective is recommended

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Thank you!