

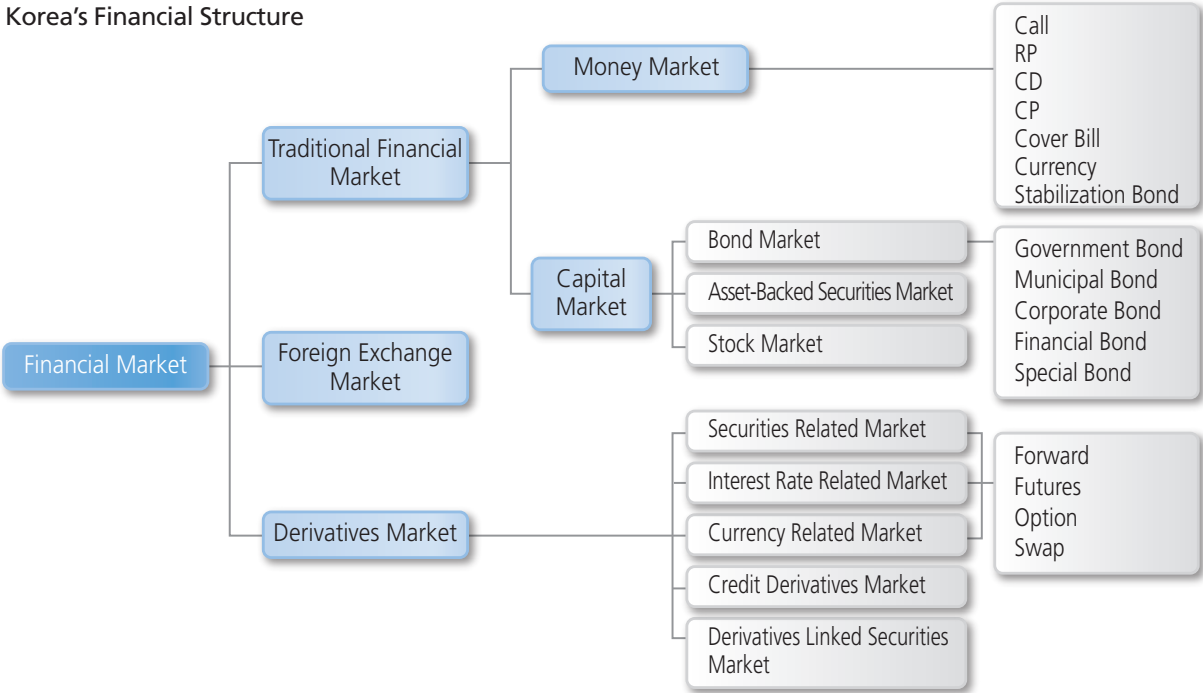
# Finance / Accounting

## 1. Korea's Financial System

The Korean financial market consists of a financial market in the traditional sense, in which short- and long-term financial products are traded in relation to the procurement and operation of funds, a foreign exchange market, and a derivatives market.

- Money Market
- Capital Market
- Financial Derivatives Market
- Foreign Exchange Market
- Structure of Financial Institutions

Korea's Financial Structure



## 1-1 Money Market

The money market is a market in which short-term financial products are traded - generally with a maturity of less than one year - to control short-term fund excesses or deficiencies between economic entities such as businesses, households, governments, financial institutions, and so forth. The money market in Korea consists of the call market, which plays an important role in the operation of the monetary credit policy of the Bank of Korea, and the markets for RPs, CDs, CPs, cover bills, and currency stabilization bonds.

The money market is largely divided into the 'intercompany' market, which controls short-term fund excesses or deficiencies between financial institutions, and the 'customer' market trading, through which short-term funds are traded between financial institutions and customers. The call market is the most representative of the financial markets among all financial institutions in Korea. The CP and cover bill markets are customer markets frequently used by businesses and financial institutions, respectively, to secure short-term funds. Furthermore, the RP and CD markets combine the features of both markets.

## 1-2 Capital Market

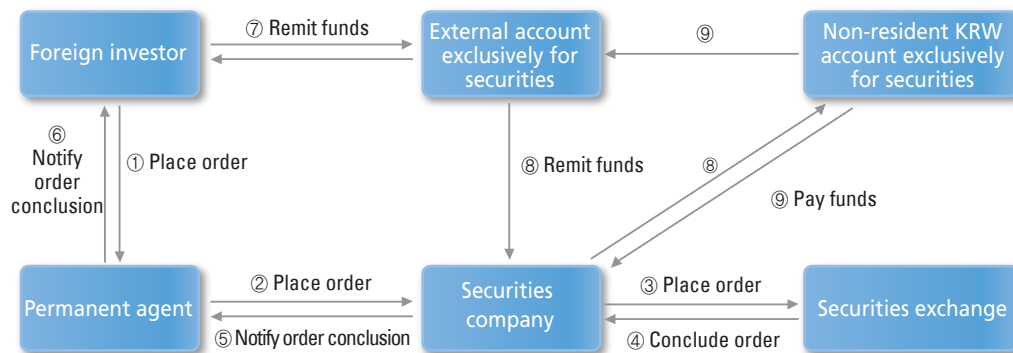
The capital market is a market in which businesses, governments, or local governments can secure long-term investment funds. In a broad sense, it includes facility loans and other long-term loans from a bank; more specifically, it refers to markets where government bonds and corporate bonds, securities and so forth are issued and distributed. Securities traded in the capital market are largely divided into stocks and bonds.

### Foreigners' Securities Investment

Investment by foreigners in domestic securities was promoted step by step in consideration of its effect on macro-economic variables, such as currency, interest rate, exchange rate, etc. Currently, foreigners can acquire all securities in accordance with the Financial Investment Services and Capital Markets Act.

In order for foreign nationals to invest in domestic securities, they should create an 'external account exclusively for securities investment' and a 'non-resident KRW account exclusively for securities investment' under their own name, register as a foreign investor at the Financial Supervisory Service (FSS), and receive an investor registration number (ID). Foreign investors can purchase domestic securities by designating a permanent agent to place purchasing orders through securities companies, and then have the funds remitted to the external account used exclusively for securities investment. Conversely, in order to sell domestic securities, the funds have to be remitted to the non-resident KRW account used exclusively for securities investment. The same amount will then be transferred to the external account used exclusively for securities investment to recover the invested amount.

< Procedures for Foreign Investment in Domestic Securities >

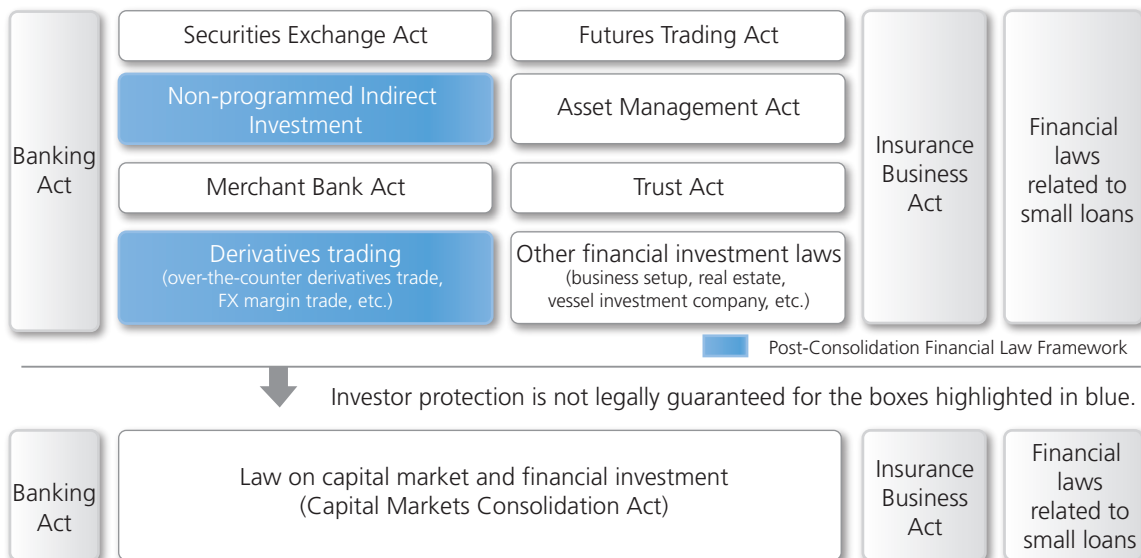


※ **The Financial Investment Services and Capital Markets Act**

With the implementation of the Financial Investment Services and Capital Markets Act in February 2009, the strictly separated fields within the existing capital market in the finance sector - such as securities companies, asset management companies, merchant banks, futures companies, trust companies, and so forth - were consolidated. This measure is expected to bring changes to the Korean capital market that will encourage financial companies centering on investment banks and private equity funds to become larger and more specialized and to expand derivatives' underlying assets, which will support Korea's growth into a major financial hub.

<The Financial Investment Services and Capital Markets Act & Changes to the Financial Law System >

**Korea's Financial Law System**



## &lt; Key Points of the Financial Investment Services and Capital Markets Act &gt;

| Category  | Details  |
|---|--|
| Expansion of the scope of work for financial investment companies | <ul style="list-style-type: none"> <li>Permits the combined operation of all financial investment businesses (investment dealing, investment agent, consolidated investment, investment entrusts, trusts)</li> <li>Small sum payment function &amp; foreign exchange handling are allowed in principle.</li> </ul> |
| Shift to a comprehensive concept of financial investment products | <ul style="list-style-type: none"> <li>Includes all future new financial investment products to be released</li> </ul>   |
| Reinforcement of the investor protection system                   | <ul style="list-style-type: none"> <li>Strengthens notice obligations: Investment agents to compensate for defective sales, and companies to bear the burden of compensation.</li> <li>Introduces a mandatory 'know your client' policy.</li> </ul>  |
| Expansion of consolidated investments (asset management)          | <ul style="list-style-type: none"> <li>Includes all asset-worthy property as investment objects</li> <li>Abolishes asset restrictions on investment objects per fund type</li> </ul>   |

## 1-3 Financial Derivatives Market

Financial derivatives are financial products devised to avoid risks resulting from fluctuations in the value of underlying assets. Depending on the trading method, the instruments used may include forwards, futures, options, swaps, etc. Furthermore, depending on the underlying assets, financial derivatives are divided into currency, interest rate, stocks, credit-related products, etc. Also, trades are categorized into exchange trades and over-the-counter trades depending on the location of the trade. The exchange market is where financial derivatives, the aspects of whose trade other than the price are standardized, are traded. The over-the-counter market is where non-standardized financial derivatives are traded directly, rather than through exchanges.

## &lt; Types of Key Financial Derivative Products &gt;

| Category      | Exchange trade   | Over-the-counter trade   |
|---------------|--|--|
| Currency      | <ul style="list-style-type: none"> <li>Currency futures</li> <li>Currency futures options</li> <li>Currency options</li> </ul>                   | <ul style="list-style-type: none"> <li>Forward exchange</li> <li>Currency swaps</li> <li>Currency options</li> </ul>                                     |
| Interest Rate | <ul style="list-style-type: none"> <li>Interest rate futures</li> <li>Interest rate futures options</li> </ul>                                   | <ul style="list-style-type: none"> <li>Forward rate agreements</li> <li>Interest rate swaps</li> <li>Interest rate options</li> <li>Swaptions</li> </ul> |
| Stocks        | <ul style="list-style-type: none"> <li>Options on stocks</li> <li>Index futures</li> <li>Index options</li> <li>Index futures options</li> </ul> | <ul style="list-style-type: none"> <li>Options on stocks</li> <li>Equity swaps</li> </ul>  |
| Credit        |  | <ul style="list-style-type: none"> <li>Credit default swaps</li> <li>Total return swaps</li> <li>Credit linked notes</li> </ul>                          |

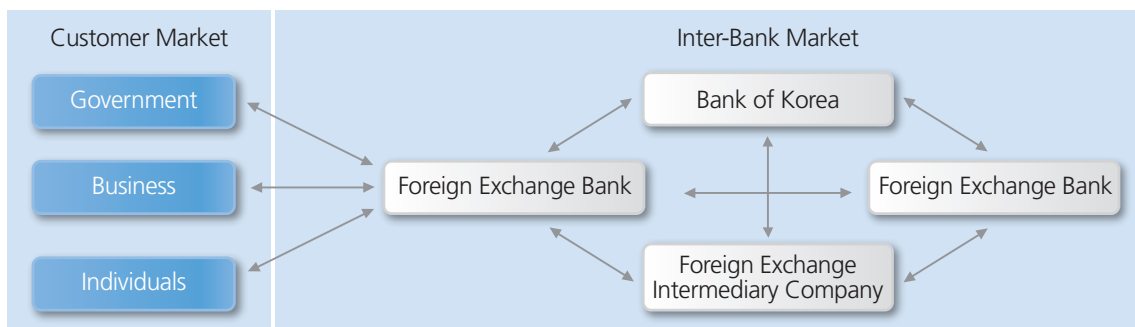
**< Comparison of Exchange & Over-the-Counter Trades of Financial Derivatives >**

| Category         | Exchange trade   | Over-the-counter trade  |
|------------------|--|---|
| Trade conditions | Trade unit, settlement conditions, etc. are standardized.  | Decided through discussions between the trading parties concerned         |
| Trade location   | Exchanges  | Contracts are mostly concluded by phone, etc. through dealers or brokers. |
| Trading parties  | Trading is allowed only for exchange members. Others trade through the members.                              | No limits   |
| Deal counterpart | Exchanges  | Buyers, sellers, and/or their agents involved in the deal                 |
| Settlement       | Daily settlement. In most cases, only the balance is settled before maturity through offsetting transaction. | In most cases, goods are delivered or transferred at maturity.            |
| Deposit          | Deposit at exchange  | Dealers and brokers set credit limits per customer or demand deposits.    |

**1-4 Foreign Exchange Market**

Depending on the parties to the transaction, the foreign exchange market can be divided into the inter-bank market and the customer market. The inter-bank market refers to the foreign exchange market in the narrow sense, and has some features of the wholesale market. The Korean inter-bank market is characterized by the fact that more transactions go through brokers than direct transactions, unlike the foreign exchange markets of developed nations. The customer market is a form of retail market in which banks deal in foreign exchange transactions with individual and institutional customers.

**< Structure of the Foreign Exchange Market >**



Participants in the Korean foreign exchange market include foreign exchange banks, intermediary banks, foreign exchange authorities, and customers including individuals, businesses, and governments. Foreign exchange banks include all commercial banks that handle domestic foreign exchanges. Life insurance companies and securities companies were first allowed to participate in the foreign exchange market in July 2002. So far, securities companies registered as intermediary companies include NH Investment & Securities, Mirae Asset Daewoo Securities, Merrill Lynch International Incorporated Seoul Branch and Yuanta Securities Korea.

An inter-bank market is divided into a direct transaction market where transactions are carried out directly between the dealers of foreign exchange banks; and an exchange stock market where transactions are carried out through brokerage businesses. The majority of foreign exchange banks take part in the latter.

Korea's three representative fund brokerage companies are the Korea Money Brokerage Corporation (established in 1996 as a company specializing in short-term financing between financial institutions), Seoul Money Brokerage Services, Ltd. (established in 2001), and Korea Inter Dealer Broker (established in 2006). Overseas companies include ICAP Foreign Exchange Brokerage, Tullett Prebon Money Brokerage, Nittan Capital Money Brokerage, GFI Korea Money Brokerage, Tradition Korea, and BGC Capital Markets and Foreign Exchange Broker.

#### < Inter-Bank Exchange Transactions >

| Category               | KRW/USD Transactions   |
|------------------------|--|
| Transaction Type       | Spot exchange, futures exchange, foreign exchange swap               |
| Transaction Unit       | Over USD 1 million, in units of USD 500,000                          |
| Asking Method          | Ask in units of KRW 0.1 on the KRW price of USD 1                    |
| Transaction Conclusion | Computer automatically concludes orders placed by phone and e-orders |
| Transaction Time       | 09:30-12:00, 13:30-16:30   |

### 1-5 Structure of Financial Institutions

According to the financial services provided, financial institutions in Korea are categorized into banks, non-bank deposit handling institutions that handle financial products similar to bank deposits, securities companies and asset management companies, insurance companies, and other financial institutions.

#### < Korea's Financial Institutions >

| Category  | Subcategory 1                         | Subcategory 2                                      |
|---|---------------------------------------|--|
| Banks   | General banks                         | Commercial banks                                   |
|   |                                       | Local banks  |
|   |                                       | Foreign bank branches                              |
|   | Special banks                         | Korea Development Bank                             |
|   |                                       | Export-Import Bank of Korea                        |
|   |                                       | Industrial Bank of Korea                           |
|   |                                       | Nonghyup Bank                                      |
| Non-bank deposit handling institutions            | Merchant banks                        | Merchant banks                                     |
|   | Mutual savings banks                  | Mutual savings banks                               |
|   | Credit cooperative institutions       | National Credit Union Federation of Korea          |
|   |                                       | Korean Federation of Community Credit Cooperatives |
|   | Postal Savings and Insurance Services | Mutual Finance                                     |
| Securities companies & asset management companies | Postal Savings and Insurance Services | Postal Savings and Insurance Services              |
|   | Securities companies                  | Securities companies                               |
|   | Asset management companies            | Asset management companies                         |
|   | Futures companies                     | Futures companies                                  |
|   | Securities finance companies          | Securities finance companies                       |
| Investment advisory companies                     | Investment advisory companies         |  |

| Category                       | Subcategory 1  | Subcategory 2  |
|--------------------------------|--|--|
| Insurance companies            | Life insurance companies                                   | Life insurance companies                                   |
|                                | Non-life insurance companies                               | Non-life insurance companies                               |
|                                |  | Reinsurance companies                                      |
|                                |  | Guarantee insurance companies                              |
|                                | Postal savings and insurance services                      | Postal Savings and Insurance Services                      |
|                                | Provident institutions                                     | Provident institutions                                     |
|                                | Korean Trade Export Insurance Corporation                  | Korean Trade Export Insurance Corporation                  |
| Other financial institutions   | Credit-specialized financial companies                     | Leasing companies  |
|                                |  | Credit card companies                                      |
|                                |  | Installment financial companies                            |
|                                |  | New technology business investment Companies               |
|                                | Venture capital companies                                  | Small business investment companies                        |
|                                |  | Corporate restructuring companies                          |
| Trust companies                | Trust companies  |  |
| Financial support institutions | Financial supervisory service                              | Financial Supervisory Service                              |
|                                | Korea Deposit Insurance Corporation                        | Korea Deposit Insurance Corporation                        |
|                                | Korea Financial Telecommunications and Clearings Institute | Korea Financial Telecommunications and Clearings Institute |
|                                | Credit guarantee companies                                 | Korea Credit Guarantee Fund                                |
|                                | Credit rating agencies                                     | Korea Technology Finance Corporation                       |
|                                |  | Credit rating agencies                                     |
|                                | Korea Asset Management Corporation                         | Korea Asset Management Corporation                         |
|                                | Korea Housing Finance Corporation                          | Korea Housing Finance Corporation                          |
|                                | Korea Exchange   | Korea Exchange   |
| Financial intermediaries       | Financial intermediaries                                   |  |

## 2. Korea's Accounting System

Korea's accounting system was overhauled to meet international standards in the aftermath of the Asian financial crisis in 1997. Korean Financial Accounting Standards (KFAS) now comply with International Accounting Standards (IAS), as Korea has announced the adoption of the Korean International Financial Reporting Standards (K-IFRS). Korea's accounting and auditing system includes an external audit and an internal accounting control system. The external audit system involves an examination of a company's records and reports by an outside party. Under the internal accounting control system, internal standards are established, so that financial statements are drawn up and disclosed in line with accounting standards. One permanent director is designated to assume responsibility for internal accounting control.

- Business Accounting Standards
- Audit Policy

## 2-1 Business Accounting Standards

Following the 1997 Asian financial crisis, the Financial Services Commission (FSC) of Korea accepted the recommendations of the IMF and the World Bank to fully revise Korean business accounting standards to conform with international standards. This resulted in a shift from the legal provision-like form of the past to the current business accounting standards, which adhere to global standards. Commissioned by the FSC in July 2000 to set, revise and interpret business accounting standards, the Korean Accounting Institute (KAI) publishes new or revised business accounting standards with a designated serial number through the Statements of Korea Accounting Standards. The Statements of Korea Accounting Standards apply when corporations under the Act on the External Auditing of Stock Companies prepare financial statements for external users, and when external auditors conduct audits.

### ※ Business Accounting Standards and the Commercial Act and Tax Laws

In Korea, laws that regulate financial reports resulting from business activities include the Commercial Act, tax laws, the Financial Investment Services and Capital Markets Act, the Act on the External Auditing of Stock Companies, the Certified Public Accountant Act, business accounting standards, and the accounting auditing standards. Under the Commercial Act, financial statements are listed as the balance sheet, income statement, statement of appropriation of retained earnings and statement of disposition of deficit. However, under the business accounting standards, the statement of cash flow and annotations to financial statements are included as well. The tax laws are based on one major premise, namely the principle of obligation and equal taxation. Therefore, its standards differ from those of the financial reports required under the business accounting standards, which are based on the principles of accrual and realization. The difference between business accounting and tax accounting has been narrowed in recent legislations.

## 2-2 Audit Policy

### External Audit System

The external audit system refers to the auditing of a company by external accountants with no vested interests in that company. The system was established to ensure that external auditors conduct audits independently from internal auditors in order to protect interested parties such as shareholders, creditors, employees, etc. and to promote the sound development of companies. According to the Act on the External Auditing of Stock Companies, auditors who are certified public accountants inspect whether the financial statements prepared by businesses when settling their accounts comply with the business accounting standards.

Article 2 of the Enforcement Decree of the Act on the External Auditing of Stock Companies stipulates that companies subject to an external audit are corporations under certain categories as listed below. Thus, limited companies, etc. are not obligated to undergo an external audit, regardless of their size.

- A corporation whose total amount of assets at the end of the preceding business year comes to KRW 12 billion or more (as of the establishment of a new firm following the split of a corporation or a merger with another firm, if applicable).
- A stock-listed corporation (under the Financial Investment Services and Capital Markets Act) or a corporation planning to be listed in the corresponding or following business year.
- A corporation whose total liabilities come to KRW 7 billion or more at the end of the preceding business year and whose total assets come to KRW 7 billion or more (as of the establishment of a new firm following the split of a corporation or a merger with another firm, if applicable).
- A corporation whose total number of employees comes to 300 or more and whose total amount of assets comes to KRW 7 billion or more at the end of the preceding business year (as of the establishment of a new firm following the split of a corporation or a merger with another firm if applicable).



Companies subject to external audits should elect an auditor within four months of the start of each business year. Stock-listed corporations and association-registered corporations should elect the auditor within four months of the start of the first business year, and use the same auditor for three consecutive years. If the company prepares consolidated financial statements, then the same auditor must be used for the financial statement, consolidated financial statement, and combined financial statement. In electing an auditor, the company should obtain the approval of an auditor election committee (or an audit committee stipulated by the Commercial Act) endowed with expertise and independence. In particular, stock-listed corporations, association-registered corporations, and subsidiaries of business groups in which a member company has been notified by the Securities and Futures Commission to prepare a combined financial statement in the previous business year should obtain the approval of the auditor election committee. When the company elects an auditor under the said regulations, it should be reported at the first general shareholders' meeting after the election.

### Internal Accounting Control System

The internal accounting control system, which is part of the internal control system, is designed and operated to provide rational grounds for determining whether a company's financial statements have been prepared and disclosed according to the Generally Accepted Accounting Principles (GAAP). The internal control system has three purposes: operation, financial reporting, and compliance. Regarding these purposes, the internal accounting control system has been developed to meet the financial reporting requirements (to secure the reliability of financial statements in particular). Asset protection and corruption prevention programs are included, and when control procedures for operation or compliance are related to securing the reliability of financial statements, the relevant control procedure is included in the scope of the internal accounting control system.

The internal accounting control system provides basic guidelines for companies seeking to streamline their internal accounting management practices, allowing them to improve the reliability of their financial statements and other related materials. The representative of a company is responsible for managing the internal accounting control system, and should designate a full-time director as the internal accounting manager in charge of implementing the system. The internal accounting manager reports the operational status of the internal accounting control system to the board of directors and the auditor (or the audit committee) every six months, and the auditor (or the audit committee) reports its evaluation to the board of directors every year. In addition, review standards for the internal accounting control system is in place to provide clear standards for external auditors to review and report the establishment and operational status of a company's internal accounting control system.

#### < Good Practice Guidelines and Review Standards >

