Settlement of Accounts and External Audit

I. Companies subject to External Audit and Appointment of External Auditor

1. Companies subject to external audit

Under Article 4 of the Act on External Audit of Stock Companies (the “External Audit Act”), in case of (i) a stock-listed company, (ii) a company that is to be listed (if it wishes to become a stock-listed company during the relevant fiscal year or the following fiscal year), or (iii) a company that is an unlisted stock company or a limited liability company that meets one of the following requirements for total assets, sales or size, in principle, the company’s accounts must be audited by an independent external auditor (Article 4(1) of the External Audit Act, Article 5(1), (2) of the Enforcement Decree of the same Act).

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<th>Classification</th>
<th>Unlisted Stock Company</th>
<th>Limited Liability Company</th>
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<tr>
<td>Total Assets</td>
<td>KRW 50 billion or more (as of the end of the immediately preceding fiscal year)</td>
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<td>Sales</td>
<td>KRW 50 billion or more (in the immediately preceding fiscal year; however, if the company was established during the immediately preceding fiscal year, relevant sales would be calculated by dividing the sales in that fiscal year by the number of applicable months, then multiplying by 12.)</td>
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| Size           | Meeting at least two of the following requirements as of the end of the immediately preceding fiscal year:  
  1. Assets of at least KRW 12 billion
  2. Debt of at least KRW 7 billion
  3. Sales of at least KRW 10 billion
  4. At least 100 employees | Meeting at least three of the following requirements as of the end of the immediately preceding fiscal year:  
  1. Assets of at least KRW 12 billion
  2. Debt of at least KRW 7 billion
  3. Sales of at least KRW 10 billion
  4. At least 100 employees
  5. At least 50 members |
2. Timing and procedure for appointment of external auditor

Companies that were obligated to appoint an external auditor for the immediately preceding fiscal year must appoint an external auditor within 45 days from the start of the fiscal year. Companies that were not obligated to appoint an external auditor for the immediately preceding fiscal year must appoint an external auditor within 4 months from the start of the fiscal year. As an exception, companies that are required to establish an audit committee under applicable laws and regulations, such as the Korean Commercial Code (“KCC”), must appoint an external auditor before the start of the fiscal year. (Article 10(1), (2) of the External Audit Act)

When appointing an external auditor, a company must first cause its statutory auditor or audit committee, as applicable, to establish the criteria and procedures for selecting the external auditor (provided, however, that if an external auditor appointment committee must approve the selection of the external auditor, as discussed below, then the external auditor appointment committee must first approve the criteria and procedures for the external auditor’s selection). When appointing an external auditor, (i) the audit committee selects an external auditor if the company has an audit committee, and (ii) the statutory auditor selects an external auditor if the company does not have an audit committee. In the case of a stock-listed company, a large unlisted company (a stock company with total assets of KRW 100 billion or more as of the end of the immediately preceding fiscal year) or a financial company, an external auditor appointment committee must be separately formed, and the statutory auditor must select an external auditor upon approval by the committee. If a covered company does not have a statutory auditor, that company must still select an external auditor; among such companies, a limited liability company with capital of KRW 1 billion or more must select its external auditor after obtaining approval from the general meeting of its members (Article 10(4) of the External Audit Act).

The appointment of external auditor must be (i) reported to the ordinary general meeting of shareholders convened after the appointment of the auditor, (ii) notified to shareholders in writing, or (iii) posted on the website of the company until the termination of the audit contract with the external auditor (Article 12 of the External Audit Act). In addition, unless an exception applies, the appointment of external auditor must be electronically reported to the Securities and Futures Commission of the Financial Supervisory Service within 14 days from the execution of the contract with the external auditor.

II. Settlement of Accounts and External Audit Procedures

Directors of a company must prepare financial statements (balance sheet, income statement, supplementary statements, statement of changes in equity or statement of appropriation of retained earnings (or statement of disposition of deficit), statement of cash flows, notes, and consolidated financial statements) and business reports for approval by the board of directors each fiscal year. After the board meeting approving the fiscal year’s financial statements, etc., the board of directors must submit the financial statements and the business report to the company’s statutory auditor (or to its audit committee, as applicable) six weeks (or four weeks for a limited company) prior to the date set for the ordinary general meeting of shareholders under the KCC (Articles 447, 447-2, 447-3, 579 and 579-2 of the KCC). Under the External Audit Act, the board must also submit the individual financial statements to the company’s external auditor by no later than six weeks prior to the date set for the ordinary general meeting of shareholders, and the consolidated financial statements to the external auditor by no later than four weeks prior to such date (Article 6(2) of the External Audit Act and Article 8(1) of
the Enforcement Decree of the same Act).

The statutory auditor or the audit committee must submit an audit report to the board of directors within four weeks (three weeks for a limited liability company) from the date of receipt of the documents, pursuant to the procedures set forth in the KCC (Articles 447-4 and 579 of the KCC). Under the External Audit Act, an external auditor is required, in principle, to submit an external audit report to the company’s board by no later than one week prior to the ordinary general meeting of shareholders; provided, however, that the external auditor may submit the consolidated financial statements of a company not subject to the K-IFRS within 120 days from the end of the fiscal year (or 90 days from the end of the fiscal year, for a company not subject to the K-IFRS with total assets of KRW 2 trillion or more as of the end of the immediately preceding fiscal year) (Article 23(1) of the External Audit Act and Article 27(1) of the Enforcement Decree of the same Act).

As such, a company’s audited financial statements must be submitted to an ordinary general meeting of shareholders for approval under the KCC, and the company’s business report must be submitted to and reported to the ordinary general meeting of shareholders (Articles 449 and 583(1) of the KCC). A joint stock company may approve its financial statements by a resolution of its board of directors as set forth in its Articles of Incorporation (“AOI”), provided that (i) the company must obtain an external auditor’s opinion that the financial statements properly present the financial status and business performance of the company in accordance with applicable laws and regulations and the AOI, and (ii) the statutory auditor must consent (or audit committee members must unanimously consent), and if such approval is granted, the details of the financial statements must still be reported at a general meeting of shareholders (Article 449-2 of the KCC).

Under the KCC, a company’s board of directors is required to keep the company’s financial statements, business reports, and audit reports at the company’s head office for five years, and certified copies thereof at the company’s branch offices for three years, starting from one week before the ordinary general meeting of shareholders (however, a limited liability company must keep such documents at the head office for five years only); shareholders and creditors of the company may inspect such documents at any time during the company’s business hours, provided they pay the expenses determined by the company, and shareholders and creditors may request certified copies or abridged copies of such documents (Articles 448 and 579-3 of the KCC). In addition, if a listed company’s financial statements are approved at the ordinary general meeting of shareholders, its board must, without delay, give public notice of the balance sheet including the name of the external auditor and the full audit opinion (Article 449(3) of the KCC and Article 23(6) of the External Audit Act). Under the External Audit Act, a company must keep and disclose its financial statements and the external auditor’s audit report thereon in the same manner as provided in the KCC, and must keep and disclose consolidated financial statements and the external auditor’s audit report thereon at its head office and at its branches for five years from the date after the deadline for submission of the audit report to the board of directors (Article 23(5) of the External Audit Act and Article 27(7) of the Enforcement Decree thereof).

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* The opinions expressed in this article are the authors’ own and do not reflect the views of KOTRA.