The Korean Accountancy Market and Global Competition

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Among the professions, accountancy services play an especially critical role in the market economy today; thus, there have been many World Trade Organization (WTO) attempts, beyond the General Agreement on Trade in Services (GATS), to liberalize the market for accountancy services. In response to this international demand, the Korean government announced the liberalization of its accounting market from 2007 and its full opening by 2011. This paper begins with an overview of the Korean accountancy market, including a SWOT analysis focused on the post-financial-crisis era. Next, it shows how the WTO pacts – especially the GATS and the Disciplines on Domestic Regulation in the Accountancy Sector (Disciplines) – and ‘Revised Conditional Offer on the Schedule of Specific Commitments’ for WTO services negotiations submitted by Korea on May 31, 2005 are used to eliminate these domestic regulatory barriers to international trade in accountancy services. Finally, the paper anticipates both the positive and the negative implications of accountancy market liberalization in Korea following from the removal of existing obstacles to cross-border trade. As the first sector to be disciplined under the GATS, the liberalized accountancy sector is likely to become the model for other professional services such as law, health, engineering and architecture. Hence this study can have significant implications that extend beyond the field of accounting.

Keywords: Global accountancy services, WTO negotiations, Korean accountancy market, Globalization, Reliability of financial accounting information, Corporate governance

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I. INTRODUCTION

Among the professions, accountancy services play an especially critical role in the market economy today; thus, there have been many WTO attempts, beyond the GATS, to liberalize the market for accountancy services.¹ For example, the *Disciplines on Domestic Regulation in the Accountancy Sector* represent the WTO's first attempt to exercise its authority to impose disciplines on non-discriminatory domestic regulation under the GATS' Article VI.²

In response to the international demand, the Ministry of Finance and Economy (MOFE) of Korea announced on December 7, 2005 that the Korean government will open its accountancy and other professional-services sector markets³ to foreign companies in 2007,⁴ in order to increase its goals of attracting more foreign investors and making Korea the financial hub of Northeast Asia. Accordingly, it will overhaul financial regulations and related laws. This step is in line with the GATS and the timeline of the *Doha Development Agenda* (DDA) of the WTO. The government is stepping forward this year in planning to open up the market fully by 2011.⁵

The purpose of this paper is to critically examine the liberalization of the Korean accountancy market. As the first sector to be disciplined under the GATS, the (liberalized) accountancy sector is likely to become the model for other professional services such as law, health, engineering and architecture.⁶ The globalization of accountancy services might eventually lead to the restructuring not only of the market for accountancy services but also of that for other professional services as well.⁷ Hence, this study can have implications that extend beyond the field of accounting.

The paper first conducts a rudimentary SWOT analysis of the accountancy market in Korea, and documents the current liberalization of the Korean accountancy market. Next, it anticipates both the positive and negative implications of accountancy market liberalization in Korea. Finally, it suggests policy recommendations.

II. OVERVIEW OF THE KOREAN ACCOUNTANCY MARKET

As Korea is the third largest economy in Asia and 11th largest in the world, the size of the Korean accountancy market is also significantly large. Korea also boasts many talented professionals in the accountancy sector. According to the Financial Supervisory Service (FSS), the nation's total number of certified public accountants (CPAs), including 4,934 CPAs registered with 79 accounting firms, increased by 18.7 percent, from 7,148 in March 2004 to 8,485 in March 2005. The number of CPAs working at those 79 firms surged by 27.2 percent, from 3,880 to 4,934, over the same period.⁸ As of March 31, 2006, there

are 9,285 CPAs in total, according to the Korean Institute of Certified Public Accountants (KICPA). As the size of the Korean professional-services market grows with time and liberalization,⁹ it can be anticipated that the size of the Korean accountancy market will increase as well.

Under a general consensus that a deficiency in accounting standards, a lack of enforcement of the proper standards that did exist, and unsuccessful monitoring were three of the major causes of the financial crisis in Korea, the Korean government since 1997 has taken significant measures to improve accounting and auditing standards and practices and to strengthen the underlying institutions responsible for setting standards and ensuring compliance. As a result, there have been sweeping reforms in the overall accountancy system: (1) almost all of the financial accounting standards have been substantially rewritten to conform with the *International Accounting Standards* (IAS); (2) an independent private standards-setting organization, the Korea Accounting Institute (KAI)/the Korea Accounting Standards Board (KASB), which is largely consistent with the International Financial Reporting Standards (IFRS), was established; (3) as the auditing profession was on the verge of radical changes, and as independent directors were required to take a leading role in corporate governance, an audit committee was adopted to provide a formal vehicle for performing the monitoring function,¹⁰ and the *Korean Auditing Standards* (KAS), a translation of the ISA, was legislated by the KICPA.¹¹ Furthermore, the Korean government, in December 2003, enacted the *Act on External Audit of Stock Companies* (EAA) and amended the *Securities and Exchange Act* (SEA) to enhance the independence of external auditors.¹² These reforms are expected to contribute to a highly developed Korean accounting sector.

One of the most critical weaknesses in the Korean accountancy market is reflected by the outbreak of a string of accounting fraud scandals. For example, major conglomerates such as SK and Doosan were prosecuted for dressing up their accounting books to inflate profits. Even though the Korean government has fostered a tougher regulatory environment, accounting frauds are still being committed. The occurrence of such scandals calls into question the credibility and independence of the accounting profession. Strengthening sanctions or devising stricter regulations is ineffectual without the participation of both parties, the accountancy sector and the government. In the meantime, the existence of too many strict regulations is another weakness of the Korean accountancy market.

Accounting firms or joint audit teams in Korea cannot afford to hire all of the growing number of CPAs coming out of the universities, due to the low audit fees in Korea compared with other countries. The government has increased the number of candidates passing the CPA examination each year from about 500 in the past to at least 1,000 since 2001. Many of them have not been able to find positions at accounting firms or join audit teams. In order to ease this problem, the Certified Public Accountant Law, amended in December 2003,

shortened the period of practical experience that is required before an individual can register as a CPA, from 2 years to 1 year.¹³ However, the problem has not been much alleviated.

Unlike big accounting firms that already have an international affiliation with foreign accounting firms, such as Samil PwC, Deloitte Anjin LLC, and Samjong KPMG,¹⁴ small- and medium-sized accounting practices are not yet fully prepared for the liberalization of the accountancy market. When national regulations that protect the domestic accountancy market from globalization dismantled, those small- and medium-sized accounting practices will become vulnerable to consolidation by large professional-service conglomerates. Even for the large accounting firms, it will not be easy to survive amid tough international competition.

Although Korean accountancy market has its weaknesses, there are certain opportunities especially for foreign accountancy services firms. Northeast Asia today is rapidly becoming the most economically potent region in the world, contributing about 22 percent of world output. The region will make up about 30 percent of global GDP by 2020.¹⁵ This regional advantage works as an incentive for Korea to expand its market and induce more foreign direct investment (FDI). Recently the Korean government established the goal of becoming the financial hub of Northeast Asia, and to attract more foreign investors, it commenced negotiations on a free trade agreement (FTA) with the United States. As a first major step, the government aims to lay the essential foundation, that is, to upgrade the regulatory system, and to liberalize the professional-services market by 2007. This will be a challenge, but can also be an opportunity for Korea and its accountancy market.

Korea also has world-class information technology (IT) facilities. It is equipped with a hi-tech infrastructure and boasts high-quality IT manpower. Korean financial institutions are the most efficient in the world in the electronic transfer of funds and payment settlement.¹⁶ This technological factor is important, because IT is very directly relevant to accountancy services today, given the increasing traffic in electronic commerce, the development of the accounting information system (AIS) and the computer-assisted audit technique (CAAT), and other such improvements.

As mentioned previously, market liberalization can be both an opportunity for and a threat to the Korean accountancy market. The Korean accountancy market is now facing stiff competition from large Western accounting firms. One of the prospective negative effects of liberalization is the loss of the market share of domestic accounting firms. For small accounting firms, the competition will be more aggressive even at the level of penetrating the market. The second threat is the loss of CPA jobs due to the introduction of the paperless audit and generally increased dependence on IT.¹⁷ IT development will affect the employment prospects of CPAs as well as those of employees in other industries.

III. INCOMING LIBERALIZATION OF THE KOREAN ACCOUNTANCY MARKET

Regarding accountancy services as well as other professional services, the obstacles to international trade are predominately regulatory barriers, such as diverse national and sub-national licensing and qualification requirements, regulations limiting the scope of practice and the forms of business organization, and non-harmonized technical, educational and ethical standards.¹⁸ As a remedy to these ills, the liberalization of the accountancy market will mean that non-national accountants would be able to offer accountancy services under the same conditions as nationals, and thus foreign accounting firms might be able to establish offices without requiring locally approved professional accountants.¹⁹

With respect to accountancy, the GATS defines "trade in services" broadly to encompass accounting and audit services delivered across borders through electronic technologies, direct foreign investment in accounting and auditing firms, and the movement of professional workers across borders in order to practice as accountants and auditors. The GATS not only covers all types of services but also applies to all possible modes of delivering services. Those modes are: (1) cross-border delivery, (2) consumption abroad, (3) commercial presence, and (4) movement of natural persons. Nations can liberalize trade in accounting and auditing in any of the four modes of service by guaranteeing market access²⁰ and national treatment²¹ to all WTO Members on a most-favored-nation basis.²²

Market-access and national-treatment commitments are prescribed nationally through the "Schedules of Specific Commitments (Schedules)," which are annexed to the GATS. The Schedules also specify any limitations on market-access or national-treatment commitments that a country can apply. According to the "revised offer on the Schedule of Specific Commitments of Korea for the WTO Service Negotiations" on May 31, 2005,²³ Korea is open in Modes 1 and 2 except for auditing services that are unbound. Limitations apply to commercial presence, and special temporary entry is allowed under Mode 4 for foreign accountancy, training and transfer of technology.

In other words, the revised schedule accords market access and national treatment to foreign firms wishing to provide accounting and bookkeeping services through cross-border supply and consumption abroad, but leave unbound restrictions on the provision of auditing services through those modes. Korea permits the supply of accounting, bookkeeping, and auditing services through commercial presences provided that they are established as sole proprietorships, auditing task forces, joint accounting offices, or incorporated partnerships run by certified public accountants (CPAs) licensed under the Certified Public Accounting Law. In order to receive such a license, foreign accountants must have two years of experience in Korea after passing the CPA examination. Korea's limitations on the presence of foreign personnel are left untouched, although cross-industry

commitments provide for the entry and temporary stay of executives, senior managers, and specialists for periods of up to three years.

Although foreign accountants and firms cannot provide external audit services directly or externally, in fact such accountants and firms are already active in Korea in the form of international affiliation with Korean accounting firms or offices. The actual momentum was the financial crisis of 1997. During the post-crisis restructuring stage of the Korean corporate and financial communities, the International Monetary Fund (IMF) recommended to the Financial Supervisory Commission (FSC) of Korea that large Korean financial institutions with assets of over 800 billion won be audited by accounting firms that had entered into audit-quality-control contracts with recognized international accounting firms. As the recommendation followed the overall loss of international confidence in the reliability of the financial statements of Korean private enterprises and financial institutions, almost all of the large financial institutions in Korea have engaged in Korean member firms of the Big Five²⁴ to perform external audits.²⁵

Additionally, the Schedule permits a Korean accounting firm or office to gain membership in international accounting organizations having world-wide business networks by paying an annual membership fee. Through this membership contract, consultancy for foreign accounting standards and auditing, training of CPAs, transfer of auditing technology and exchange of information can be supplied to a Korean accounting firm or office. Also, because the Schedule approves accounting corporations – limited-liability companies (LLCs) – of CPAs licensed under the Certified Public Accountant Law, foreign accounting firms are participating in the Korean accountancy market by establishing LLCs with Korean accounting firms.

As of August 31, 2005, according to the FSS, three accounting firms – Samil PricewaterhouseCoopers (PwC), Deloitte Anjin and Ernst & Young Korea – dominate Korea's domestic auditing and consulting services market. The FSS stated that the number of CPAs working at the three major firms currently stands at 2,742, about 56 percent of the 4,934 CPAs registered with 79 accounting firms. About 30 percent of the 4,934 CPAs – 1,414 CPAs – at the 79 accounting firms nationwide worked for Samil PwC in March, 2005. Deloitte Anjin and Ernst & Young Korea employ 666 and 662 CPAs, respectively. As corporate clients' reliance on larger accounting firms has become a global trend, those large accounting firms affiliated with global players capture a greater portion of market share by offering high-quality auditing and consulting services. For example, Samil PwC posted 296 billion won in sales during the 2005 fiscal year, from April 2004 to March 2005, accounting for 33 percent of the total sales of the 79 firms.²⁶

According to the news released on April 2, 2006, the MOFE will suggest the amendment of the Certified Public Accountant Law from January 2007, in order to allow foreign accounting firms to open branch offices in Korea

and to permit Korean accounting firms to employ foreign accountants. This would be a significant change, if realized, because now, foreign accountants and accounting firms can work in Korea only under the satisfaction of the restricted conditions.²⁷ The amendment also includes direct consulting of foreign accounting firms to Korean corporate clients. Furthermore, the Korean government is now considering allowing FDI of foreign accounting firms that goes beyond simple international affiliation with a Korean accounting firm.²⁸ In the end, the Korean accountancy market will be fully liberalized – even allowing for Mode 4 of the GATS – by 2011.

Although the accountancy market seems to have adapted to global competition somewhat since 1997, accelerating liberalization would be prudent. Once a country undertakes commitments in the accounting sector, they become binding and cannot be altered easily. More precisely, WTO Members may schedule limitations on their market-access and national treatment commitments at the time those commitments are undertaken in order to preserve their right to maintain or adopt non-compatible domestic regulations. Scheduled limitations can be removed in the course of future negotiation to allow progressively higher levels of liberalization, but schedules may not be altered to modify or withdraw market access and national treatment commitments with impunity.²⁹

Therefore, the Korean government should be careful when revising the Schedule, and should be even more cautious in the case of accountancy services, because accountancy services deal in confidential client information. Moreover, considering that sales per Korean employee is only 36 percent of sales per American employee in accounting services,³⁰ radical liberalization might produce unexpected results.

IV. IMPLICATIONS OF LIBERALIZATION

The effects of liberalization can be evaluated either positively or negatively, depending on the domestic and international situations.

1. Prospective Positive Effects

Further liberalization of the accountancy market has the potential to restructure it by facilitating direct foreign investment, transfer of advanced skills and professional labor, cross-border delivery of services, connectivity to global networks, and mergers of local practices, all in the effort to compete with foreign joint-venture firms. Harmonized licensing and qualification standards with the GATS commitments to movement of natural persons (Mode 4) in service markets – Korea has not approved this provision of the commitments yet – will allow licensed accountants to move freely from one country to another. Accordingly, it becomes possible for accounting firms not only to move senior personnel around the

world more easily but also to bring accountants from lower-wage labor markets to perform temporary work assignments.³¹ The GATS commitments to cross-border trade (Mode 1), in combination with mutual recognition agreements, will also make it possible to “offshore” professional work – to electronically transmit work to accountants located in lower-wage markets.³²

(1) Enhancement of the Reliability of Financial Accounting Information

As previously mentioned, the 1997 financial crisis in Korea was partially due to the overall loss of international confidence in the reliability of the financial accounting information of Korean private enterprises and financial institutions. Since then, Korea has struggled to recover international confidence by pursuing fundamental reforms in the accountancy sector.

The reliability of financial accounting information cannot be achieved easily, because it results from a combination of high-quality accounting standards, rigorous interpretation and faithful application, and independent and professionally reliable external audits.³³ As the liberalization of the accountancy market can lead to the transfer of advanced skills necessary for improving auditing independence, audit quality, and reviews of audit engagement, Korea can learn methods of enhancing the reliability of financial accounting information more effectively and efficiently *through* liberalization. The enhancement of the reliability of financial accounting information promises more than what it minimally implies; that is, it promises the reinforcement of international competitive power. The level of the reliability of financial accounting information determines the level of risk on an investment. Therefore, the enhancement of the reliability of financial accounting information will spur foreign investment into the local Korean market and, finally, smooth the transition of Korean accounting firms into international markets.

(2) Promotion of Foreign Investment

One of main rationales for opening up the accountancy market is to attract more foreign investment.³⁴ This is why countries open their markets even at the risk of many negative effects. Because deregulation of markets makes it easier for foreign investors to access those markets, to invest, and to make profits, market liberalization typically induces foreign investment. As the liberalization of the accountancy market, as mentioned previously, will enhance the reliability of financial accounting information, the effect on the growth of foreign investment will be greater than that produced by the liberalization of other sectors.

(3) Export of Korean Accountancy Services

The liberalization of the accountancy market means that the Korean accountancy

marker has to compete with the global competition, which challenges will force domestic accounting firms to improve their operations. Through this process, the Korean accountancy market, in the end, will be restructured to meet the requirements of global competition and export.

It is true that the Korean accounting sector is relatively less developed than those of Western countries. However, it is also true that it is relatively highly developed compared with those of Southeast Asia or the Middle East or Africa. Korea has an absolute advantage over those underdeveloped countries in accountancy services as in professional services generally. Particularly in the GATS commitments to cross-border trade (Mode 1), Korea has the crucial comparative advantage of world-class IT facilities. An integrated global market for accountancy services means removal of national borders not only for foreign accounting firms but also for Korean firms. Korea can confidently take this risk as a chance to export its accountancy services to areas of the world where Korea has a comparative advantage and the opportunity, thereby, to earn significant profits.

2. Prospective Negative Effects

Efforts to eliminate regulatory barriers to trade in accounting and auditing services could have damaging repercussions for the public interest and consumer protections, the relations of exchange between developed and developing countries, and the ability of governments to regulate the conduct of business. The domestic regulations that are viewed as barriers to trade in accounting and auditing services are: (1) citizenship or residency requirements for professional licensure, (2) restrictions on ownership and forms of business organization (e.g. laws that limit ownership of accounting firms to licensed accountants, or prohibit corporate forms of accounting practice), (3) local hiring requirements or local equity requirements, (4) immigration laws restricting the mobility of personnel, (5) the scope of practice limitations, and (6) national standards that diverge from international standards.³³

(1) Loss of Accountancy Market Share

Elimination of these regulatory trade barriers would benefit major transatlantic accounting firms that export services, and would facilitate their ability to expand and consolidate their global operations through FDI and acquisition of local firms. However, the benefits would hardly be shared equally among developing countries, or across social and occupational groups within exporting countries. In other words, as these national regulations are dismantled, small – and medium-sized accounting practices become vulnerable to consolidation by large professional-services conglomerates.³⁶ Meanwhile, countries such as the United States, the EU, Canada and Australia, having highly developed accounting sectors

that are capable of expanding globally and exporting accounting and auditing services, receive a disproportionate share of the benefits from the deregulation of trade in accountancy services.³⁷

Korea, like other developing countries, employs measures such as local hiring requirements, local equity requirements, taxes on repatriation of profits, and citizenship or residency requirements in order to prevent indigenous accounting industries from being swallowed up by international firms. Local hiring requirements foster the development of local professional expertise and the requisite professional infrastructure for emerging economies. Similarly, equity requirements that domestic accountants hold some share of the ownership of accounting firms are a viable strategy for economic development.³⁸

Without those means to protect and foster domestic accounting sectors, developing countries would find their accounting sectors dominated by large Western accounting firms that would likely be more concerned with servicing their multinational clients than with developing local economies.³⁹ The elimination of such protectionist measures could ultimately limit development strategies and perpetuate inequitable relations of exchange between developing and developed countries.⁴⁰

(2) Infringement of Public Interest and Consumer Protections

Citizenship or residency requirements for accounting licensure run counter to accountancy market liberalization because they discriminate against foreign accountants. However, such requirements protect consumers from malpractice by making disciplinary control more practicable and by facilitating the ability of injured parties to sue for negligence.⁴¹ Hence, residency requirements can be a legitimate means of protecting consumers against non-performance, malpractice, incompetence and breach of confidence. Restrictions on forms of ownership, forms of business organization, and scope of practice, likewise, serve prudential purposes.⁴²

In sum, these types of domestic regulations not only constitute barriers to market access by foreign accounting firms that operate as multi-practice, limited-liability corporations, but also effectively regulate auditing practices and stem abuses in financial reporting. Therefore, the elimination of regulatory obstacles to trade in accounting and auditing services has deregulatory effects that could impair audit quality and the integrity of financial reporting in both developing and developed nations.⁴³

(3) Conflicts with Domestic Governance

Many of the perceived regulatory barriers to trade in accounting and auditing services touch upon delicate domestic policy issues. The mobility of professional workers involves sensitive immigration issues that have implications for labor

markets in both developed and developing nations, and the decision to adopt international accounting and auditing standards has implications for the integrity of financial reporting.⁴⁴

If WTO Members agree to undertake market access or national treatment commitments in the accountancy sector, they may not maintain or adopt domestic regulations that are incompatible with those commitments. Restrictive immigration laws are incompatible with market-access commitments regarding the movement of natural persons (Mode 4), while residency and citizenship requirements conflict with national treatment commitments that guarantee that foreign suppliers are treated “no less favorably” than domestic suppliers. Local equity requirements and prohibitions of corporate forms of ownership also violate the GATS market-access commitments, which stipulate that nations may not limit “the participation of foreign capital in terms of maximum percentage limits on foreign shareholding” or maintain “measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service.”⁴⁵

The GATS not only limits discriminatory laws such as citizenship and residency requirements but also affects non-discriminatory domestic regulations. Under the GATS market access provisions, nondiscriminatory domestic laws can be deemed discriminatory if they inadvertently preclude foreign firms from competing in domestic markets. Furthermore, the GATS controls on domestic regulation can apply to non-discriminatory domestic regulations.⁴⁶

Limitations on practice scope and restrictions on corporate forms of ownership are potentially illegal according to GATS – even when applied equally to foreign and domestic firms – because the effect of such laws is to exclude foreign accounting firms that operate as multi-practice, limited-liability corporations. Some analysts have even interpreted bans on advertising as discriminatory on the grounds that they disadvantage foreign firms that are new to the market and reliant on advertisement to establish their business presence.⁴⁷ Because the GATS can infringe on an array of non-discriminatory domestic regulations, it does more than merely create a level playing field for foreign competitors in domestic markets. It potentially limits the ability of governments to effectively govern the practice of accounting within their own borders.⁴⁸

V. POLICY RECOMMENDATIONS

Some people portray globalization as natural and inevitable, as an impersonal and immutable force that workers and companies must adapt to and accommodate, and that nations are powerless to control or subordinate it to goals such as a sustainable economic development or greater social equity. Others, especially analysts writing in recently published papers, argue that global markets are

politically constructed institutions that are shaped by non-market actors – including multinational corporations and industry trade lobbies – by means of international trade agreements.⁴⁹

Considering the formation process of international agreements, the latter seems more reasonable. However, for Korea, which is still in the position of a standard-taker, not a standard-maker, it is also true that globalization is the inevitable trend. Hence, for Korea, the international convergence of accounting standards⁵⁰ and the liberalization of the accountancy market are irreversible trends under economic globalization. Given these circumstances, what is left for Korea is to take this risk and make the most of its opportunities. The following are recommendations for how Korea – government, industry, and entities – can cope with the situation.

1. Recommendations for the Public Sector: Government and the Accountancy Industry as a Whole

Accountancy services have been a sector in which foreign professionals have not been allowed to freely operate in Korea. Thus, the announcement of the Korean government that it will open up its accountancy market to foreign companies in 2007 and even allow all modes of the GATS by 2011 has significant implications for the Korean economy. Therefore, first, the Korean government should try to minimize the prospective negative effects of accountancy market liberalization on the Korean domestic market by taking strategically tailored approaches to the negotiations. Second, because internal negotiations are as important as external ones in facilitating globalization and market liberalization, internal negotiations should entail the promotion of the advantages of an open market, the establishment of a two-way communication channel between the government and various interest groups, and the coordination of differing views on liberalization.

Third, in order to prepare for external liberalization in accounting services, it is imperative to establish a system for recognizing the competence of foreign accounting professionals. That is, it is necessary to provide an objective evaluation mechanism for the education and training of foreign license holders. Fourth, the government needs to upgrade the domestic licensing system by introducing continuing education for license holders.

Fifth, Korea should promote structural reforms that increase market liberalization. Adopting the IFRS can advance a country's economic growth and provide a platform for companies to provide more transparent financial reporting. Thus, the Korea Accounting Standards Board (KASB) needs to make additional efforts to remove discrepancies between local accounting standards and the IFRS.⁵¹ After all, the KFAS has to be the one conforming to global standards, not the other way around. In other words, it is important to keep the KFAS consistent

and in harmony with the best global practices and standards.

Sixth, the Korean Institute of Certified Public Accountants (KICPA) needs to issue additional best-practices guidance to help implement auditing standards to restore public confidence, since the outbreak of a string of accounting fraud scandals – the dressing up of accounting books to inflate profits at such major conglomerates as SK and Doosan – calls into question the credibility and independence of the accounting service. The audit committee needs to be mandated for smaller listed companies, and its role needs to be strengthened. The statutory regulator should consider strengthening sanctions against violators of standards and rules, and should put in place improved arrangements for efficient and effective oversight of auditors of public companies and for monitoring of accounting firms.⁵²

Seventh, what is more important even than the rigorous application of tougher standards for accounting transparency is the willingness of each player in the accountancy market to pursue best practices. The occurrence of those scandals prompted the Korean government to devise a tougher regulatory environment that was modeled on the Sarbanes-Oxley Act of the United States (see Table 1 for the comparison).⁵³ However, as the fact that other accounting scandals occurred even after those regulations were instituted indicates, strengthening sanctions or toughening regulations is futile without the willing compliance of each player.

TABLE 1. COMPARISON BETWEEN SARBANES-OXLEY ACT OF 2002 AND RECENT LEGISLATION IN KOREA

Sarbanes-Oxley Act of 2002	Recent Legislation in Korea
Sec. 101-107 Establishment of the Public Company Accounting Oversight Board	<ul style="list-style-type: none"> - No equivalent provision for the Oversight Board - The Act on External Audit of Stock Companies amended in December 2003 increased a period that a statutory auditor should maintain audit work papers from 5 years to 8 years
Sec. 108, 109 Accounting standards and funding	<ul style="list-style-type: none"> - No equivalent provision - Korea Accounting Institute, a private standard-setter, has a responsibility to establish Korean accounting standards
Sec. 201 Prohibit non-audit services	<ul style="list-style-type: none"> - The CPA Act amended in December 2003 prohibits the statutory auditor from providing certain types of non-audit services contemporaneously with the audit. Non-audit services prohibited by the amended CPA Act are as follows: Bookkeeping or other services related to the accounting records of the audit client; preparation of financial statements of the audit client; financial information systems design and implementation; internal audit outsourcing services; other non-audit services that can cause conflicts of interest, as prescribed by the Presidential Decree.
Sec. 203 Audit partner rotation	<ul style="list-style-type: none"> - The Act on External Audit of Stock Companies mandates the rotation of the coordinating audit partner of an accounting firm every 5 years (3 years if the client is a listed company)

Sarbanes-Oxley Act of 2002	Recent Legislation in Korea
Sec. 206 Conflicts of interest	<ul style="list-style-type: none"> - The Decree on the CPA Act amended in January 27, 2004, prohibits an accounting firm from performing audit services for a company if any of the company's officers (or the spouse of the officer) was employed by that accounting firm and participated in audit of the company during the 1-year period preceding the date of the initiation of the audit.
Sec. 207 Study of mandatory rotation of registered public accounting firms	<ul style="list-style-type: none"> - The Act of External Audit of Stock Companies amended in December 2003 requires a mandatory rotation of a statutory auditor in every 6 consecutive years from the fiscal years beginning after December 31, 2005, with a few exceptions
Sec. 302 Corporate responsibility of financial reports	<ul style="list-style-type: none"> - The Securities and Exchange Act amended in December 2003 requires that the principal executive officer and chief financial officer or officers performing similar functions certify documents periodically filed with the FSC, such as annual reports, semiannual reports, and quarterly reports.
Sec. 402 Enhanced conflict of interest provisions	<ul style="list-style-type: none"> - The Securities and Exchange Act amended in December 2003 prohibits a listed company from making a personal loan or lending securities to, and providing collateral or debt guarantee for principal shareholders, directors, statutory internal auditor officer, and members of the audit committee.
Sec. 403 Disclosures of transactions involving management and principal stockholders	<ul style="list-style-type: none"> - The Securities and Exchange Act amended in December 2003 clarifies prohibition on personal loans to executives and requires disclosures of management compensation in annual reports.
Sec. 404 Management assessment of internal controls	<ul style="list-style-type: none"> - The Act on External Audit of Stock Companies amended in December 2003 mandates companies subject to the statutory audit requirement to maintain an internal accounting control system. The Act also requires the statutory internal auditor to assess internal control system and the statutory external auditor to attest to, and report on, the assessment made by the statutory internal auditor.
Sec. 407 Disclosure of audit committee financial expert	<ul style="list-style-type: none"> - The Securities and Exchange Act amended in December 2003 requires that at least one member of the audit committee of a company has expertise in the accounting or finance area and that the audit committee of a security company with stock listed on the KSE or KOSDAQ be chaired by an independent member of the board of directors.
Sec. 806 Protection for employees of publicly traded companies who provide evidence of fraud	<ul style="list-style-type: none"> - The Act on External Audit of Stock Companies amended in December 2003 stipulates protection for a whistleblower who provided the SPC, external auditor, or statutory internal auditor with information about violations of established standards, rules, and regulations
	<ul style="list-style-type: none"> - The Security-related Class Action Lawsuit Act enacted in December 2003 strengthened investor protection by allowing minority shareholders collectively to bring a lawsuit for accounting irregularities, untruthful disclosures in prospectus, annual reports, and quarterly reports, and illegal insider trading, or stock price manipulation, provided that the shareholders are qualified to file a lawsuit. The new Act also restricts the number of lawsuits that any person can file or an attorney can represent to 3 lawsuits in 3 years in order to minimize frivolous lawsuits.

Last but not least, English translation of the relevant regulations is requisite, given that the one main purpose of liberalization is to induce more foreign investment. The Certified Public Accountant Law is significant for its liberalization of the Korean accountancy market, and so it is quite surprising that there is no English translation of the law. Because language, obviously, is the most important tool used in establishing cross-cultural understanding, it is clearly crucial to translate the relevant regulations into the international language of commerce – English – in improving clarity.

2. Recommendations for the Private Sector: Individual Accounting Firms

In order to survive and thrive amid stiff global competition, each accountancy firm needs to have a creative vision. Mergers between small local accounting firms would be a good countermeasure against accountancy market liberalization. However, such horizontal integration or even vertical integration might not be enough to compete with the big Western firms. Hence one recommendation suggested here is to pursue conglomeration, especially with law firms. The areas of business of a law firm are broad. It not only practices litigation and arbitration but also deals in corporate and M&A, capital markets, banking, projects, asset finance, real estate & construction, pensions & incentives, financial markets, investment management and tax.⁵⁴ As this shows, the interests of a law firm are overlapped somewhat with those of an accounting firm. Therefore, if those two professional-services industries – the legal and accountancy services industries – work together, the improvement in productivity, efficiency and effectiveness will be more than two-fold, and clients will be able to receive one-stop service. This one-stop service is already provided in Thailand by firms such as KPMG Tax & Legal, PricewaterhouseCoopers Legal & Tax Consultants Ltd., and SCM International Law Office Ltd.⁵⁵

The other recommendation is to explore new niche markets by operating a back office. An accounting firm works with lots and lots of paper, as well as electronic copies of documents. The firm needs to store those materials for both short-term and the long-term periods. It also needs to have a low-cost, efficient means of editing documents, so that when a client has a document needing to be created or edited, the work can be turned around almost instantly, even if hundreds of pages long. Traditionally, there was a secretarial or word-processing pool of hundreds of secretaries working simultaneously on one document, if necessary, in order to get the work done. Now, with word processing software, it can be accomplished with considerably fewer people. Nevertheless, document production needs to continue to grow, exponentially.

Such back offices are already in operation in India, but not yet in Northeast Asia. For example, Unisoft Datatech is a data entry and processing services provider from India offering services to clients across the globe and within India.

What they do is data entry and processing, data conversion, scanning, optical character reading with editing and indexing services, form processing, web research, bookkeeping and accounting services, as well as financial services.⁵⁶ Since Korea has an excellent IT infrastructure, this kind of back office operation would work well in Korea and help Korea become the financial hub – or at least the financial information center – of Northeast Asia. A back office operation can even include document storage or archiving functions. Moreover, the launch of a global training center could also be considered.⁵⁷

If the upgrading of the domestic accountancy market is delayed due to concerns about difficulties arising from such reforms, the growth potential of the Korean economy will be diminished. External liberalization should be viewed as an opportunity to achieve internal reforms and economic growth, because the advanced availability, transparency and verifiability of financial information that would result from successful reforms would undoubtedly attract additional investment. The critical success factors for achieving a world-class accounting system include IFRS-compatible accounting standards, rigorous implementation by preparers of financial statements, independent monitoring by external auditors, and an effective market response to deficiencies of players.⁵⁸ However, the steps taken to liberalize the accountancy market should be prudential, because once the Schedule is revised or the market is liberalized, it is very hard to go back.

VI. CONCLUSION

Because the accounting industry has been a fundamental infrastructure in the capitalist market economy, performing an efficient function of distributing scarce economic resources through the capital market,⁵⁹ there have been ongoing international efforts, under the leadership of the WTO, to create a global market for accounting and auditing services. In response to the international demand, the Korean government announced plans to liberalize its accounting market and other sectors from 2007 and to fully open the market by the year 2011. The liberalization of the Korean accountancy market will be obligatory under the WTO pacts – especially the GATS and ‘Revised Conditional Offer on the Schedule of Specific Commitments’ for the WTO services negotiations submitted by Korea on May 31, 2005. The amendment of the Certified Public Accountant Law will follow soon to allow foreign accounting firms to open branch offices in Korea.

The liberalization of the accountancy market means that non-nationals and even non-residents of a nation state would be able to offer accounting services under the same conditions as nationals, and foreign accounting firms might also be able to establish offices without involving locally approved professional

accountants. The effects of the liberalization can be both positive and negative depending on the market and economic situations inside and outside the country, as the SWOT analysis of the Korean accountancy market indicates. On the one hand, the liberalization of the accountancy market has the potential to restructure the market by facilitating FDI, the transfer of advanced skills, the mobility of professional labor, the cross-border delivery of services, connectivity to global networks, and the merger of local practices to compete with foreign joint-venture firms. On the other hand, efforts to eliminate regulatory barriers to trade in accounting and auditing services could have harmful side effects for the public interest, consumer protections, the relations of exchange between developed and developing countries, and the ability of governments to intervene in the conduct of business.

Arnold Toynbee once wrote that history moves according to challenge and response. Sometimes the challenge is too great and a society declines, breaks down or lies stagnant. Sometimes the challenge inspires a reaction that changes history.⁶⁰ Whether the result of liberalization is the former or the latter utterly depends on Korea and Koreans. The Korean government should undertake to minimize the prospective negative effects and maximize the prospective positive effects caused by accountancy market liberalization. To reap the full benefits of accountancy market liberalization, Korea should strengthen cooperation at the global level in the field of accounting services, create greater harmonization in accounting and auditing standards, improve the independence of CPAs, enhance the supervision and monitoring of accounting services, and reinforce corporate governance. Also, the importance of English translation of the relevant regulations can never be ignored in this era of globalization. By overcoming all difficulties and challenges, someday Korea could at last escape the position of standard-taker and achieve the status of standard-maker.

The theme of this paper – the liberalization of the Korean accountancy market – is an ongoing issue. Subsequently, the situation changes day by day. Therefore, this is not the end of the study, but rather, constant and continuous attention to this issue is required. The possibilities for future studies are wide open.

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ENDNOTES

- ¹ The attempts reflect the demands of large accounting firms and professional associations in the United States, the EU, Australia and Canada (Christine Cooper (2003). *Discussions' Comments on Governing Accounting Beyond the State: The WTO and the Construction of a "World without Walls" for Accounting Services* by Caroline Aggestam and Anne Loft. *The 11th Interdisciplinary Perspectives on Accounting Conference* (July 13-16, 2003), p.1).
- ² GATS Article VI:4 grants the WTO authority to develop disciplines on domestic regulation to ensure that licensing, qualification and technical standards are not more trade restrictive than necessary (Patricia J. Arnold (2003). *Disciplining domestic regulation: The World Trade Organization and the market for professional services*. *Accounting, Organizations and Society* 30: 300).
- ³ Under the finalized second offer to the WTO for service market opening, 10 service sectors to bring more foreign professionals are services related to the installment, management or repair of industrial equipment or machinery; consultancy services related to the technical knowledge or skill concerning the natural sciences; architectural services; consultancy services for foreign accounting standards and auditing; management consulting services; consultancy services related to the installation of computer hardware, software research & development-based implementation services; data management services; data system services and specialty engineering design services for automobiles (Seo, Jee-yeon. *More foreign professionals to work in Korea from 2007*. *The Korea Times* (May 23, 2005).
- ⁴ Foreign Press Spokesperson's Office at MOFE (2005). *Accounting Market to Open in 2007* (December 7, 2005).
- ⁵ Park, Hyun Jin. The legal-accountancy market will be opened fully by the year 2011. *The Dong-A Ilbo* (May 3, 2006).
- ⁶ The accountancy disciplines and the outcome of ongoing negotiations on domestic regulation are of enormous significance both within and outside the accounting profession. Accounting is likely to become the model for GATS disciplines in other professional services such as law, engineering, architecture, and medicine. The WTO Working Party on Domestic Regulation (WPDR) has considered using the accounting disciplines as a model for disciplines in other fields and/or for developing horizontal disciplines that would apply to all professional services (Arnold, 2005:308).
- ⁷ Patricia J. Arnold (2003). International trade law and the political construction of professional service markets: A case study of corporate led globalization. *GMS* 3(7): 5.
- ⁸ Kim, Yon-se. Accounting firms dominate market. *The Korea Times* (August 31, 2005).
- ⁹ According to the statistics of the Korea National Statistical Office, the number of establishments in legal, accounting and tax preparation services has steadily increased from 14,162 in 2000 to 17,793 in 2004, the number of workers from 78,351 in 2000 to 100,922 in 2004, and annual sales from 2,764,477 million won in 2000 to 4,839,884 million won in 2004.
- ¹⁰ Il-Sup Kim (2000). Financial crisis and its impact on the accounting system in Korea. *Korean Accounting Journal* 9(3): 105-106.
- ¹¹ World Bank and International Monetary Fund (2004). *Report on the Observance of Standards and Codes (ROSC): Accounting and Auditing of the Republic of Korea* (June 30, 2004), p.1.
- ¹² The recent reforms, however, did not include establishment of a Public Company Accounting Oversight Board (PCAOB) to oversee auditors of public companies and issuance of auditing standards (*Ibid.*:2-5).
- ¹³ World Bank and International Monetary Fund (2004), p.5.
- ¹⁴ As of December 19, 2005, there were 22 Korean accounting firms making international affiliation with foreign accounting firms through membership contracts, such as Samil PwC, Deloitte Anjin LLC, and Sanjong KPMG (Park, Hae Young. Accounting industry is already in the global competition. *The Korean Economic Daily* (December 19, 2005)).
- ¹⁵ Iglauer, Philip Dorsey. Financial hub is Korea's future. *The Korea Times* (February 20, 2006).
- ¹⁶ Lee, Jang-yung. Regulatory reform and the road to financial hub. *The Korea Herald* (May 9, 2006).
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- ¹⁸ Patricia J. Arnold (2003). International trade law and the political construction of professional service markets: A case study of corporate-led globalization. *GMS* 3(7): 1.
- ¹⁹ Cooper (2003), p.1.
- ²⁰ In sectors where market-access commitments are undertaken, WTO Members may not maintain

- or adopt laws that (1) limit the number of services suppliers via quotas, monopolies, or exclusive service suppliers, (2) limit the total value of service transactions, (3) limit the total number of service operations or the total quantity of service output, (4) limit the total number of natural persons that may be employed in a particular service sector, (5) restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service, or (6) limit the participation of foreign capital according to maximum percentage limits on foreign shareholding or the total value of individual or aggregate foreign investment (GATS, Article XVI). Cited in Arnold (2005), p.305.
- ²¹ National treatment means that treatment given a foreign service supplier is no less favorable than that accorded to domestic service suppliers (United States International Trade Commission (USITC) (1988). *US Schedules of Commitments under the General Agreement on Trade in Services*, Investigation No. 332-354 (August 1988), p.E-2). Cited in *Ibid.* p.305.
- ²² Most-favored nation (MFN) is a trading status accorded to a nation wherein the terms and conditions of trade with that nation are as favorable as those with any other nation (USITC, 1988:E-2). Cited in *Ibid.* p.305.
- ²³ TN/S/O/KOR/Rev.1, a revision of GATS/SC/48, pressed on June 14, 2005 by Special Session of Council for Trade Services, WTO. The Original Schedules of Specific Commitments of Korea was made on April 10, 1995.
- ²⁴ Now it is the Big Four: Deloitte Touche, Ernst & Young, KPMG and PriceWaterhouseCoopers. The Big Four is a group of international accountancy firms that handle the vast majority of audits for publicly traded corporations. Arthur Andersen, the smallest member firm of what was then known as the Big Five, was indicted in the wake of the 2001 Enron scandal for falsifying the financial statements of Enron. Further information is available at the homepage of Wikipedia, s.v. "Accountancy."
- ²⁵ Kim (2000), pp.92-104.
- ²⁶ Kim, Yon-se (2005).
- ²⁷ Under the present legislation, Korean accounting firms can employ foreign accountants only after receiving both the recommendation of the Finance Economy minister and the approval of the Ministry of Justice in the form of international affiliation for a period not exceeding one year. (Kim, Young Gi. Approval of the branch office establishment of foreign accounting firms in Korea. *The Seoul Economic Daily* (April 2, 2006)).
- ²⁸ *Ibid.*
- ²⁹ Arnold (2005), p.313.
- ³⁰ Yoon, Ja-young. US FTA to hit service industry hard. *The Korea Times* (April 21, 2006).
- ³¹ C. Roberts (2000). Promoting international trade in services: A priority for Europe. *European Business Journal*, 12, 199-206. Cited in Arnold (2005), p.324.
- ³² Arnold (2005), p.324.
- ³³ Kim (2000), p.92.
- ³⁴ According to the Foreign Press Spokesperson's Office of MOFE, Korea (2005), the Korean government opens its accounting market to attract more foreign investors for its financial hub goal.
- ³⁵ Arnold (2005), p.312. This part deals generally in the prospective negative effects of the liberalization of the accountancy market. Therefore, it can be applied beyond Korea.
- ³⁶ *Ibid.*, p.324.
- ³⁷ In the United Kingdom, exports of accounting services increased nearly fourfold from £178 million in 1996 to £701 million in 2002 after rising slowly in the first half of the 1990s. Net exports rose from £50 to £461 during the same time period (International Financial Services, London (IFSI). (2003). *Accounting Services Update: City Business Series* (October 2003)). Cited in Arnold (2005), p.312.
- ³⁸ Arnold (2005), p.312.
- ³⁹ D. J. Cooper, R. Greenwood, and J. L. Brown (1998). Globalization and nationalism in a multinational accounting firm: The case of opening markets in Eastern Europe. *Accounting, Organizations and Society* 23: 513-548. Cited in Arnold (2005), p.313.
- ⁴⁰ Arnold (2005), p.12.
- ⁴¹ Canadian Bar Association (2000). *Submission to the House of Commons Subcommittee on International Trade, Trade Disputes and Investment on the General Agreement on Trade in Services and the Legal Profession: The Accountancy Disciplines as a Model for the Legal Profession* (November 2000), p.11. Cited in Arnold (2005), p.313.
- ⁴² Prior to deregulation in the 1990s, the United States and United Kingdom prohibited corporate forms of organization that limited accountants' professional liability for malpractice. In the wake of the Enron scandal, the United States enacted the Sarbanes-Oxley Act of 2002 to restrict auditing firms from engaging in consulting services that breached auditing independence (Arnold 2005, 313).
- ⁴³ *Ibid.*
- ⁴⁴ *Ibid.*
- ⁴⁵ *Ibid.*
- ⁴⁶ For instance, sub-national regulation of professional accounting (e.g. state level regulation in the United States) has been construed as a barrier to trade because the need to comply with licensing

regimes in multiple sub national jurisdictions makes it difficult for foreign firms to enter the national market (*Ibid.*, 314).

⁴⁷ L. J. White (1999). Reducing the barriers to international trade in accounting services: Why it matters, and the road ahead. *The Conference on Service 2000: New Directions in Services Trade Liberalization*, Washington, D.C. (June 1-2, 1999), and *The American Enterprise Institute*, Washington, D.C. (October 5, 1999), p.22. Cited in Arnold (2005), p.314.

⁴⁸ Arnold (2005), p.314.

⁴⁹ Arnold (2005), p.300.

⁵⁰ China, Japan and Korea agreed on this fact at the 5th Three Countries' Accounting Setters' Meeting between China, Japan and Korea (P. R. Xiao (2005). *Memorandum of Understanding (MoU) of the 5th Three Countries' Accounting Setters' Meeting between China, Japan and Korea* (September 1, 2005).

⁵¹ World Bank and International Monetary Fund (2004), p.1.

⁵² *Ibid.*

⁵³ Kim, Ji-hyun. Deloitte CEO gives high marks to Korean accounting industry. *The Korea Herald* (September 5, 2005).

⁵⁴ These are business areas of Linklaters, a prominent international law firm with headquarters in the United Kingdom. More information on Linklaters is available at: <http://www.linklaters.com>.

⁵⁵ The SCM International Law Office is an international law and accounting firm, established in Thailand since 1997. More information on SCM International Law Office Ltd is available at: <http://www.thailandlaw.com>.

⁵⁶ Further information on Unisoft Datatech is available at: <http://www.unisoftdatatech.com>.

⁵⁷ This is the idea of Prof. Son-U Michael Paik. The author would like to thank him for his kind help.

⁵⁸ Kim (2000), p.106.

⁵⁹ Hoyik Lee. 2005. *The role of accounting standards in the Asian economic crisis: the Korean experience*, p.2.

⁶⁰ Pfaff, William. 20th century wrecked European, but not U.S., zest for war. *The Se-Gye Ilbo* (January 25, 2005).