

Legal Update

PCAOB Secures Complete Access to Inspect and Investigate Chinese Audit Firms, but SEC Signals Must Remain Vigilant

Yesterday, the U.S. Public Company Accounting Oversight Board (“PCAOB”) announced it had secured complete access to inspect and investigate issuer engagements of audit firms headquartered in China and Hong Kong, marking the first time in history that Chinese authorities allowed complete access for inspections and investigations meeting U.S. standards.¹

Under the Sarbanes-Oxley Act, the PCAOB is responsible for inspecting and investigating registered public accounting firms around the world. However, its access to inspect and investigate such firms in Mainland China and Hong Kong has been impeded.² In 2020, Congress unanimously passed the Holding Foreign Companies Accountable Act (“HFCAA”) to ensure all issuers with securities trading in the United States comply with U.S. investor protection regulations.³ Under the HFCAA, if the SEC determines that the PCAOB has not been able to undertake a complete inspection and investigation of a PCAOB registered firm for three consecutive years, the Securities and Exchange Commission (“SEC”) must prohibit the issuer’s securities from being traded in the United States, including on any U.S. national securities exchanges and over-the-counter trading. Due to the inability of the PCAOB to undertake inspections and investigations in Mainland China and Hong Kong, approximately 200 China-based issuers were in danger of being delisted under the HFCAA.⁴

On August, 26, 2022, the PCAOB signed a Statement of Protocol Agreement (“SOP Agreement”) with the China Securities Regulatory Commission and the Ministry of Finance of the People’s Republic of China which established a framework for the PCAOB to conduct inspections and investigations of PCAOB-registered public accounting firms in China and Hong Kong.⁵ In the months following the execution of the SOP Agreement, Chinese authorities allowed the PCAOB to achieve each of the four criteria laid out under this framework: PCAOB inspectors and investigators (1) had sole discretion to select the PCAOB registered firms and clients they wanted to examine; (2) could see and retain all audit work papers and information they wanted to review without any redaction; (3) were able to interview or take testimony from all related personnel of the audit firms; and (4) could transfer information to the SEC.⁶

SEC Chair, Gary Gensler, noted the PCAOB’s determination yesterday as a positive development, but reiterated his hawkish view of continued compliance by Chinese authorities, stating, “the SEC and PCAOB remain vigilant to critical issues regarding ongoing access for inspections and investigations, audit quality, and disclosures by Chinese-based issuers.” He further noted that, “this determination addresses only the PCAOB’s ability to access audit firms for inspections and investigations, not the quality of the audits. PCAOB inspectors identified

numerous deficiencies at audit firms in China and Hong Kong, as has been the case in other jurisdictions in the first year of PCAOB inspection.”⁷

Similarly, PCAOB Chair, Erica Williams, hailed the PCAOB’s determination as a historic moment but tempered her statements with the following words of caution:

I want to be clear: this is the beginning of our work to inspect and investigate firms in China, not the end. The PCAOB is continuing to demand complete access in mainland China and Hong Kong moving forward. Our teams are already making plans to resume regular inspections in early 2023 and beyond, as well as continuing to pursue investigations.⁸

In light of these statements by U.S. regulators, the PCAOB’s determination should not be viewed as a clean bill of health for audit firms in Mainland China and Hong Kong, but rather, a recognition of the first time the PCAOB was able to perform full and thorough inspections and investigations of audit firms headquartered in Mainland China and Hong Kong. Moreover, other aspects of the HFCAA remain in place regarding disclosure requirements for China-based issuers. The PCAOB’s determination yesterday resets the three-year clock for compliance under the HFCAA, but the SEC and PCAOB continue to signal that if the PCAOB does not receive continued and complete access in the future, the three-year clock to mandatory delisting will simply restart.⁹ Despite the PCAOB’s announcement, however, Congress is still considering a provision in its end-of-year appropriation bill to shorten the three-year compliance period to two years.¹⁰

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ENDNOTES

¹ See the Press Release: [PCAOB Secures Complete Access to Inspect, Investigate Chinese Firms for First Time in History](#)

² See the PCAOB [Fact Sheet: PCAOB Secures Complete Access to Inspect, Investigate Chinese Firms for First Time in History](#)

³ See the [Holding Foreign Companies Accountable Act](#)

⁴ See the SEC Fact Sheet: [china-sop-fact-sheet.pdf](#)

⁵ See the Press Release: [PCAOB Signs Agreement with Chinese Authorities Taking First Step Toward Complete Access for PCAOB to Select, Inspect and Investigate in China](#)

⁶ See the [2022 HFCAA Determination Report](#)

⁷ See the SEC [Statement on PCAOB’s Determinations Regarding Public Accounting Firms in China](#)

⁸ See the Press Release: [PCAOB Secures Complete Access to Inspect, Investigate Chinese Firms for First Time in History](#)

⁹ See the SEC [Statement on PCAOB’s Determinations Regarding Public Accounting Firms in China and Hong Kong](#)

¹⁰ See [S.2184 - 117th Congress \(2021-2022\): A bill to amend the Sarbanes-Oxley Act of 2002 to institute a trading prohibition for certain issuers that retain public accounting firms that have not been subject to inspection by the Public Company Accounting Oversight Board, and for other purposes](#)

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