

PCAOB Agreement with China on Audit Inspections and Investigations



The Public Company Accounting Oversight Board (PCAOB) signed a Statement of Protocol (SOP) Agreement with the China Securities Regulatory Commission and China's Ministry of Finance regarding cooperation in the oversight of PCAOB-registered public accounting firms in China and Hong Kong.

- The agreement establishes a **specific and accountable framework** for the PCAOB to conduct inspections and investigations of PCAOB-registered public accounting firms in China and Hong Kong.
- While this is a step forward, it is **just a step in a process**. Now PCAOB inspectors and investigators can travel to Hong Kong to start their work and inspect and investigate completely as required by the Holding Foreign Companies Accountable Act of 2020 (HFCAA).
- **Compliance with the agreement is what matters**. If the PCAOB continues to be prohibited from conducting complete inspections and investigations of PCAOB-registered public accounting firms in China and Hong Kong, roughly 200 China-based issuers will face trading prohibitions in the U.S. Currently, such issuers comprise a market capitalization of about \$1 trillion to \$2 trillion.

Why This Matters

If foreign issuers want to access U.S. capital markets, they must comply with our laws. Investor protection and trust in public company filings should not depend on where an issuer is located. Further, all issuers seeking capital formation in our markets should have a level playing field.

Currently, more than 50 jurisdictions around the world comply with the PCAOB's requirements relating to audit inspections and investigations, while two have not: China and Hong Kong.

What's Required

The HFCAA requires, among other things, that the PCAOB determine whether it is unable to inspect or investigate completely PCAOB-registered public accounting firms because of a position taken by an authority in that jurisdiction. The SOP includes commitments from Chinese authorities on four issues that have historically impeded the PCAOB's ability to inspect and investigate completely:

- **Engagement Selection.** The PCAOB will be able, in its sole discretion, to select the audit firms and clients it will examine.
 - **No Redaction.** PCAOB inspectors and investigators can see all audit workpapers *without any redaction*.
 - For a limited set of “Restricted Data,” including Personally Identifiable Information, the SOP Agreement creates a “view only” process for PCAOB inspectors and investigators to view the data *in camera*. The PCAOB has used an *in camera* approach in other jurisdictions for inspections and investigations.
 - The PCAOB is entitled to retain any of the information it reviews, including Restricted Data, as needed to support the findings of its inspections and investigations.
 - **Testimony.** The PCAOB can interview and obtain testimony from audit firm personnel in China and Hong Kong.
 - **Onward Sharing.** The PCAOB can transfer information, including Restricted Data, to the SEC, and the SEC can use the information for all SEC purposes, including administrative or civil enforcement actions.
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Next Steps

PCAOB inspectors will be on-the-ground in Hong Kong in mid-September 2022 to begin their work, and, shortly thereafter, *all* audit work papers requested by the PCAOB must be made available to them. The PCAOB will need to determine whether it can complete inspections and investigations in China and Hong Kong by the end of 2022.

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