



Will the new China-U.S. audit deal resolve a decade-long dispute?

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September 15, 2022

A presentation for the Peterson Institute for International Economics' Financial Statements series

The Punchline

After 15 years of negotiations, last month the U.S. audit oversight authority, the PCAOB, announced signing an agreement with Chinese authorities to enable the PCAOB's oversight of registered audit firms in mainland China and Hong Kong

“On paper, the agreement signed today grants the PCAOB complete access to the audit work papers, audit personnel, and other information we need to inspect and investigate any firm we choose, with no loopholes and no exceptions.”
(PCAOB Chair Erica Williams)

“While significant, the [agreement] is only a first step. The real test comes next, as the PCAOB prepares to have inspectors on the ground by mid-September and begin conducting on-site inspections and investigations of firms headquartered in mainland China and Hong Kong.

“Whether the PCAOB can make a determination that China is no longer obstructing access depends on whether China abides by this agreement and allows for full and timely access to information.” *(PCAOB Fact Sheet: China Agreement)*

Agenda

Background

HFCAA
and the
PCAOB's 2021
China and Hong
Kong
Determinations

Observations on
the August 2022
U.S.-China
Agreement

Looking Ahead



Background

Key Players

Who does what on the U.S. side

- **PCAOB** (a nonprofit corporation established by Congress): *inspects registered audit firms* that prepare audit reports on U.S. issuer (hereafter, “public company”) financial statements
- **PCAOB** and **SEC**: each may *investigate and take enforcement actions* against audit firms and their “associated persons”
- **SEC**: regulates *U.S. public companies* (e.g., financial reporting and disclosure)

Relevant authorities on the Chinese side

- **CSRC** (securities regulator) and **MOF** (finance ministry) each have authorities over audits of mainland China-based operations, and *must approve provision of documents to foreign regulators* by mainland companies or their auditors
- **Others** involved with respect to *state secrets, personal information*, and other data deemed *sensitive* (e.g., National Administration of State Secrets Protection, National Archives Administration of China)

What Does the PCAOB Need?

Inspections

- Regular frequency as required by law: maximum three-year interval between inspections of active audit firms
 - As of December 2021, seven mainland China firms and eight Hong Kong firms were overdue for inspection
- Access to audit documentation
 - Review of firm systems for quality control over audits
 - Review of individual audit engagement work papers (*i.e.*, documentation of U.S. public company audits)
 - PCAOB retains select documents that support any findings included in the inspection report)
- Access to firm personnel (interviews)

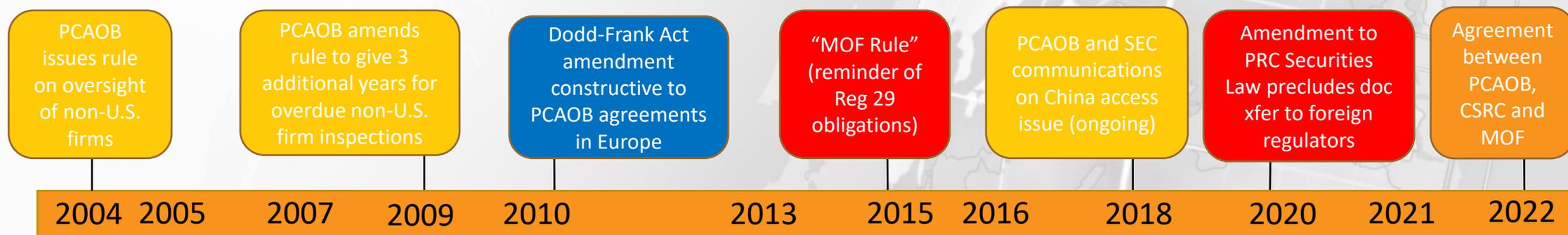
Investigations

- Timely production of documents relevant to matters under investigation
- Testimony

For more information, see Section III.A. of [PCAOB Release No. 2021-004](#) (September 22, 2021)

HFCAA and the PCAOB's 2021 Determinations
Observations on the August 2022 U.S.-China Agreement
Looking Ahead

How We Got Here



PCAOB issues rule on oversight of non-U.S. firms

PCAOB amends rule to give 3 additional years for overdue non-U.S. firm inspections

Dodd-Frank Act amendment constructive to PCAOB agreements in Europe

“MOF Rule” (reminder of Reg 29 obligations)

PCAOB and SEC communications on China access issue (ongoing)

Amendment to PRC Securities Law precludes doc xfer to foreign regulators

Agreement between PCAOB, CSRC and MOF

2004 2005

2007

2009

2010

2013

2015

2016

2018

2020

2021

2022

Non-U.S. firm inspections begin

PCAOB and Chinese authorities begin negotiations

Regulation 29 adopted (precludes auditors from providing docs to foreign regulators without approval); CSRC comment letter that “PCAOB is not allowed to perform any form of ... inspection” in China

Enforcement cooperative agreement signed

Agreement on one “pilot” inspection

HFCAA passed unanimously, enacted

PCAOB issues determinations as to mainland China and Hong Kong firms

As of 2009 cumulatively: PCAOB inspections conducted in 33 non-U.S. jurisdictions

As of 2021 cumulatively: PCAOB inspections conducted in 53 non-U.S. jurisdictions and sanctions of firms/individuals in 24 non-U.S. jurisdictions

Key:

- PCAOB
- PCAOB-CSRC-MOF
- U.S. Congress
- Chinese authorities



HFCAA
and the PCAOB's 2021 China
and Hong Kong Determinations

How the HFCAA Works



4. If the SEC identifies a public company (step 2) for three consecutive years, the **SEC prohibits trading of that company's securities** in the United States.

Then ... delisting??? Not mandated by the HFCAA or addressed in SEC rules.

Three Factors for PCAOB Determinations

(steps 1 and 3 in the prior slide)

Assessment of the PCAOB's:

- 1) ability to **select engagements, audit areas, and potential violations** to be reviewed or investigated;
- 2) **timely access to, and the ability to retain and use**, any document or information (including through conducting interviews and testimony) ... relevant to an inspection or investigation; and
- 3) ability to conduct inspections and investigations in a manner consistent with applicable legal provisions and rules.

For more information, see Section IV.B. of [PCAOB Release No. 2021-004](#) (September 22, 2021)

Outcome of First PCAOB Assessment

The Board determined it is unable to inspect or investigate completely audit firms headquartered in

- Mainland China
- Hong Kong

because of positions taken by PRC authorities.

See PCAOB Release No. 104-HFCAA-2021-001, [HFCAA Determination Report](#) (December 16, 2021)



Observations on the August 2022 U.S.-China Agreement

How does it address issues cited in the December 2021 assessment of the
three factors?

Caveat: As the agreement is not publicly available, the observations in this section are based solely on statements published by PCAOB, SEC, and CSRC.

Factor 1: the PCAOB's ability to select ...

Issues cited in December 2021 report:

- Absence of an agreement
- In negotiations, CSRC sought limitations on issuer selection
- Withholdings and redactions in “pilot” inspection “nullified” selections
- Non-performance under enforcement cooperative agreement “nullified” selections

August statements relevant to Factor 1

PCAOB Fact Sheet:

- “The PCAOB has sole discretion to select the firms, audit engagements and potential violations it inspects and investigates – without consultation with, nor input from, Chinese authorities.”
- “Procedures are in place for PCAOB inspectors and investigators to view complete audit work papers with all information included.”

August statements relevant to Factor 1 (cont'd)

SEC Fact Sheet:

- “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 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.”

CSRC published response to reporter questions:

- “The main function of audit work papers is to document whether or not an auditor has fulfilled its due diligence in verifying the accuracy of the financial records of a company ... based on applicable audit standards. Therefore, **audit work papers generally do not contain state secrets, individual privacy, companies’ vast user data or other sensitive information.**” (*emphasis added*)
- “The two sides will communicate and coordinate in advance to plan for inspections and investigations,” and, “Both sides will have thorough communications in advance.”

Factor 2: timely access to, and the ability to retain and use, documents or information

Issues cited in December 2021 report:

- Absence of an agreement for inspections
- Withholdings and redactions in “pilot” inspection
- Non-performance under enforcement cooperative agreement
- No protocols for testimony

August statements relevant to Factor 2

PCAOB Fact Sheet:

- “Procedures are in place for PCAOB inspectors and investigators to view complete audit work papers with all information included and for the PCAOB to retain information as needed.”
- “The PCAOB has direct access to interview and take testimony from all personnel associated with the audits the PCAOB inspects or investigates.”

August statements relevant to Factor 2 (cont'd)

SEC Fact Sheets:

- “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.”
- “PCAOB investigators will be able to question witnesses directly and use its own stenographers to create an official, English-language transcript.”

CSRC published response to reporter questions:

“The Chinese side will also take part in and assist in the interviews and testimonies of relevant personnel of audit firms requested by the U.S. side.”

Factor 3: the PCAOB's ability to conduct oversight (catch-all)

Issues cited in December 2021 report:

- Absence of an agreement and non-performance under enforcement cooperative agreement prevent inspections / investigations, thereby impairing other activities (including referring matters to SEC)

August statements relevant to Factor 3

SEC Fact Sheets:

- “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.”
- “The SOP, together with two protocol agreements governing inspections and investigations..., establishes a specific, accountable framework to make possible complete inspections and investigations by the PCAOB of audit firms based in China and Hong Kong, as required under U.S. law.”



Looking Ahead

What to Expect this Year

Performance under the new agreement to be put to the test in coming months:

- “The real test comes next, as the PCAOB prepares to have inspectors on the ground by mid-September and begin conducting on-site inspections and investigations of firms headquartered in mainland China and Hong Kong.” (PCAOB Fact Sheet)
- “The PCAOB has issued document requests to audit firms in China, and the testimony notifications have been sent to witnesses. These audit firms must provide the requested documents to the PCAOB, through the CSRC, on a timely basis such that PCAOB inspectors may conduct inspections of audit documentation and investigators will be able to conduct the interview of witnesses and collect testimony in Hong Kong.” (SEC Fact Sheet)

PCAOB reassessment of its HFCAA determination as to China and Hong Kong by the end of 2022

Abbreviations

CSRC	China Securities Regulatory Commission
HFCAA	Holding Foreign Companies Accountable Act
MOF	Ministry of Finance of the People's Republic of China
PCAOB	Public Company Accounting Oversight Board
PRC	People's Republic of China
SEC	U.S. Securities and Exchange Commission

Resources

PCAOB:

- [News release](#), [Fact Sheet: China Agreement](#), and [PCAOB Chair's statement](#) on August agreement (August 26, 2022)
- [HFCAA Determination Report](#) on firms headquartered in China and Hong Kong (December 16, 2021)
- Release No. 2021-004, [Rule Governing Board Determinations Under the Holding Foreign Companies Accountable Act](#) (September 22, 2021)
- Webpage with [data about China related access challenges](#), updated quarterly

SEC:

- [Fact Sheet: PCAOB Agreement with China on Audit Inspections and Investigations](#), [Fact Sheet: Statement of Protocol - Questions & Answers](#), and [SEC Chair's statement](#) (August 26, 2022)
- List of [Identified Issuers](#)
- [Sample letter to China-based U.S. public companies](#) on disclosure of risks and use of variable interest entity (VIE) structures
- SEC and PCAOB Chairs' [Statement](#), *Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China* (December 7, 2018)

CSRC:

- [Press release](#) and [Officials Answered Reporter Questions regarding China-U.S. Audit Oversight Cooperation Agreement](#) (August 25, 2022)