



## A Robinson+Cole Legal Update

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### PCAOB Confirms Complete Access to Inspect and Investigate Chinese Auditing Firms

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On December 15, 2022, the Public Company Accounting Oversight Board (PCAOB), the U.S. independent regulator of public company auditing work, [announced](#) that it has completed a test inspection of two selected auditing firms in mainland China and Hong Kong and has voted to vacate its previous Determination Report, which concluded in December 2021 that the PCAOB could not inspect or investigate completely registered public accounting firms based in mainland China or Hong Kong.[1]

The Holding Foreign Companies Accountable Act (HFCAA) mandates that securities of public companies listed on a U.S. exchange or traded on the over-the-counter market will be delisted or deregistered if the PCAOB determines that they could not inspect such companies' auditors for three consecutive years beginning in 2021.[2]

Pursuant to the HFCAA, the PCAOB issued a Determination Report on December 16, 2021, which found that the PCAOB was unable to inspect or investigate completely registered public accounting firms headquartered in: (1) mainland China and (2) Hong Kong.[3] As a result, since March 2022 the staff of the Securities and Exchange Commission (SEC) has maintained a list of Chinese companies on its watchlist for potential delisting, which could expose up to 200 Chinese firms to delisting risks.[4]

On August 26, 2022, the PCAOB announced a statement of protocol with Chinese securities regulators under which the PCAOB would enjoy independent discretion to select any auditing firm, audit engagements and potential violations for inspection or investigation, and have the unfettered ability to transfer information to the SEC.[5] However, many questions arose due to the inconsistencies between the announcements by the PCAOB and Chinese regulators and the lack of detail on how the inspections would be accomplished with the participation of the Chinese regulators.[6] At that time, the PCAOB announced that it would conduct a test inspection in Hong Kong before making its new determination by the end of 2022.[7]

The PCAOB dispatched 30 staff members to spend nine weeks beginning in September 2022 in Hong Kong conducting inspections of audit work provided by the mainland China affiliate of KPMG and the Hong Kong affiliate of PwC for eight state-owned Chinese companies and companies in sensitive industries.[8] The inspections included reviewing documents, conducting interviews and gathering testimony.

Following its work, the PCAOB [announced](#) that:

1. PCAOB has secured complete access to inspect and investigate registered public accounting firms headquartered in mainland China and Hong Kong. Based upon the foregoing, the PCAOB Board had voted to vacate the previous December 2021 determination.
2. PCAOB has uncovered numerous deficiencies in the work of the local auditing firms.
3. PCAOB maintains that this is the beginning of PCAOB's work to inspect and investigate firms in China, not the end. Moving forward, the PCAOB will continue to demand complete access in mainland China and Hong Kong.
4. PCAOB cautions that should PRC authorities obstruct or otherwise fail to facilitate the PCAOB's access – in any way and at any point in the future – the Board would act expeditiously to consider the need to issue a new determination.

Despite the PCAOB's announcement, the statement released by SEC Chair Gary Gensler cautioned that Chinese authorities will need to ensure that the PCAOB continues to have full access for inspections and investigations in 2023 and beyond. The announcement also does not diminish the importance for the registered public accounting firms in mainland China and Hong Kong to strengthen their auditing qualities, nor for the China-based public companies to provide specific and prominent disclosures about the heightened operational and legal risks they face in China.

While the PCAOB announcement relieves the immediate threat for Chinese companies listed on U.S. stock exchanges, the continued functioning of the inspection process, including allowing inspectors to visit mainland China, will remain important for the system to work for years to come.

#### ENDNOTES

[1] <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-secures-complete-access-to-inspect-investigate-chinese-firms-for-first-time-in-history>.

[2] 15 U.S. Code § 7214(i)(3).

[3] <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-makes-hfcaa-determinations-regarding-mainland-china-and-hong-kong>.

[4] <https://www.sec.gov/hfcaa>.

[5] <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-signs-agreement-with-chinese-authorities-taking-first-step-toward-complete-access-for-pcaob-to-select-inspect-and-investigate-in-china#:~:text=%E2%80%9CThe%20Statement%20of%20Protocol%20grants,nor%20input%20from%2C%20Chinese%20authorities>.

[6] *Compare* <http://www.csrc.gov.cn/csrc/c100028/c5572300/content.shtml> with <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-signs-agreement-with-chinese-authorities-taking-first-step-toward-complete-access-for-pcaob-to-select-inspect-and-investigate-in-china#:~:text=%E2%80%9CThe%20Statement%20of%20Protocol%20grants,nor%20input%20from%2C%20Chinese%20authorities>.

[7] <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-signs-agreement-with-chinese-authorities-taking-first-step-toward-complete-access-for-pcaob-to-select-inspect-and-investigate-in-china#:~:text=%E2%80%9CThe%20Statement%20of%20Protocol%20grants,nor%20input%20from%2C%20Chinese%20authorities>; <https://www.sec.gov/files/china-sop-fact-sheet.pdf>.

[8] <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-secures-complete-access-to-inspect-investigate-chinese-firms-for-first-time-in-history>.

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