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RE: **Summary of "Holding Foreign Companies Accountable Act" Passed by U.S. Senate**

The United States Senate, on May 20, 2020, approved a bill that would require Chinese companies have its auditors submit to inspection by the Public Company Accounting Oversight Board (PCAOB) and to establish that they are not owned or controlled by a foreign government.

The bill, short titled the "Holding Foreign Companies Accountable Act," seeks to amend Section 104 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7214) by adding more stringent disclosure requirements. It would apply to public companies that have retained an accounting firm in a branch or office that, first, is located in a foreign jurisdiction and, second, cannot be inspected by the PCAOB. Generally, if the issuer goes more than three years in a row without its accounting firm being inspected by the PCAOB, then that firm will be unable to sell securities on any national exchange. This prohibition would continue until the issuer retains an accounting firm that the PCAOB has inspected. If it then switches back to another firm outside the PCAOB's reach, the prohibition would be re-imposed by the United States Securities and Exchange Commission (the "SEC") for potentially up to five years.

The bill would also require that companies submit documentation establishing that they are not owned or controlled by a governmental entity in the foreign jurisdiction (despite the difficulties of proving a negative). Specifically, an issuer must make this certification if the PCAOB is unable to audit specified reports because the issuer has retained a foreign public accounting firm not subject to inspection by the PCAOB. If they fail to do this, they would be barred from trading on a national stock exchange or an "over-the-counter" or OTC market.

Notably, by expressly naming it, the Senate-backed legislation would require the covered foreign issuers to disclose its relationship with the Chinese Communist Party (the "CCP") in their disclosure in connection with the foreign government entities. Such disclosures include but are not limited to the name of the CCP officials serving as the members of the board of directors and whether the major organizational documents contain the text of any charter of the CCP.

As background, in 2013 China had entered into a memorandum of understanding (MOU) that would permit the PCAOB to perform investigations in cooperation with Chinese regulators. At that time, the PCAOB was optimistic that it could reach an agreement to perform auditor inspections as well. However, since then the PCAOB has stated that "Chinese cooperation has not been sufficient for the PCAOB to obtain timely access to relevant documents and testimony necessary to carry out our mission."

Chinese audit firms, including the Chinese affiliates of the Big Four, are currently prohibited from producing their work papers to U.S. regulators unless it is done in cooperation with Chinese authorities under the MOU. The China-based affiliates of the Big Four also audit the Chinese operations of most of the largest multinational firms.

The proposed law would provide three years to resolve the issue of enabling the PCAOB to inspect audit firms based in China and Hong Kong. The issue of inspections is not controlled by issuers, given that the PCAOB has jurisdiction only over audit firms.

The bill would also need to pass the Democratic-controlled House of Representatives before reaching the President's desk to be signed into law. A similar measure to end the Chinese oversight exemption was introduced in the House and Senate last year but did not make it out of committee.