

## MEMORANDUM

**To:** EGS Clients

**From:** Ellenoff Grossman & Schole LLP

**Subject:** SEC's Interim Final Rule to Implement the Holding Foreign Companies Accountable Act

**Date:** April 22, 2021

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We are writing to inform our clients of recent regulatory activity regarding implementing Holding Foreign Companies Accountable Act ("HFCA Act"). On March 24, 2021, the Securities and Exchange Commission (the "SEC") adopted interim final amendments to Forms 20-F, 40-F, 10-K, and NCSR to implement the disclosure and submission requirements of the HFCA Act, which became law on December 18, 2020.

The interim final amendments will apply to registrants that the SEC identifies ("Commission-Identified Issuers") as having filed an annual report that includes an audit report issued by a registered public accounting firm that has a branch or office that is located in a foreign jurisdiction and that the Public Company Accounting Oversight Board ("PCAOB") is unable to inspect or investigate completely because of a position taken by an authority in that jurisdiction. The amendments also require the submission of documentation to the SEC establishing that such a registrant is not owned or controlled by a governmental entity in that foreign jurisdiction and also require disclosure in a foreign issuer's annual report regarding the audit arrangements of, and governmental influence on, such registrants.

The interim final amendments will become effective on May 5, 2021. However, no action by a registrant will be required until it has been identified by the SEC as having a "non-inspection year" (defined below) pursuant to a process that has not yet been established by the SEC.

### **Disclosure Requirement (applies only to foreign issuers)**

Commission-Identified Issuers that are foreign issuers, as defined in Exchange Act Rule 3b-41 ("Commission-Identified Foreign Issuers"), are subject to additional specified disclosure requirements under Section 3 of the HFCA Act. A Commission-Identified Foreign Issuer will be required to provide the following disclosure in its annual report for the year that the SEC so identifies the issuer:

- (i) that, during the period covered by the form, the registered public accounting firm issued

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<sup>1</sup> Under Exchange Act Rule 3b-4, the term "foreign issuer" means any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country.

an audit report for the issuer;

(ii) the percentage of the shares of the issuer owned by governmental entities in the foreign jurisdiction in which the issuer is incorporated or otherwise organized;

(iii) whether governmental entities in the applicable foreign jurisdiction with respect to that registered public accounting firm have a controlling financial interest with respect to the issuer;

(iv) the name of each official of the Chinese Communist Party (“CCP”) who is a member of the board of directors of the issuer or the operating entity with respect to the issuer; and

(v) whether the articles of incorporation of the issuer (or equivalent organizing document) contains any charter of the CCP, including the text of any such charter.

While the disclosures apply to all foreign companies, the references to the CCP make clear that the primary objective of the requirements is to remedy the problem of the PCAOB's inability to inspect audits of Chinese companies.

### **Submission Requirement**

A registrant that is a Commission-Identified Issuer that is not owned or controlled by a governmental entity in the described foreign jurisdiction will be required to electronically submit documentation to the SEC on a supplemental basis (through EDGAR) that establishes that the registrant is not so owned or controlled. Such submissions will be made on or before the due date of the relevant annual report form. The submission requirements do not apply to a registrant that is owned or controlled by a foreign governmental entity. As an initial matter, registrants will have flexibility under the interim final amendments to determine how best to satisfy this requirement. However, the SEC is requesting comment as to whether it should require specific types of documentation or whether additional guidance would be necessary or useful.

### **Timing**

To identify Commission-Identified Issuers, the following needs to take place:

- First, the PCAOB will need to develop a process for determining which registered public accounting firms it is unable to inspect or investigate because of a position taken by an authority in a foreign jurisdiction.
- Then, the SEC will use PCAOB’s determination, along with information in a registrant’s annual reports, to compile a list of registrants that are Commission-Identified Issuers. Any year in which the SEC has identified a registrant as having retained a registered public accounting firm meeting the criteria described above for the audit report in its annual report will be deemed a “non-inspection year”.

The first step, PCAOB determination process has not been established yet. **In other words, the SEC cannot move forward with implementation of these new rules until the PCAOB has completed its implementation of the HFCA Act.**

### **Conclusion**

The rule is targeting companies whose auditors are not subject to PCAOB inspections. The SEC is requesting public comment regarding implementation of the HFCA Act disclosure and submission requirements mentioned above before it becomes effective, as well as the appropriate mechanics for determining Commission-Identified Issuers. **A registrant will not be required to comply with the amendments until the Commission has identified it as having a “non-inspection year” under a process to be subsequently established by the SEC with appropriate notice.** Once identified, a registrant will be required to comply with the amendments in its annual report for each fiscal year in which it is identified. Note that if a registrant is determined to be a Commission-Identified Issuer for three consecutive years, Section 2 of the HFCA Act directs SEC to prohibit trading of the registrant’s securities. The SEC plans to separately address implementation of the trading prohibitions in a future notice and comment process.

We would be happy to discuss with you the rule and its impact upon your firm. Please contact Richard Anslow ([ranslow@egsllp.com](mailto:ranslow@egsllp.com)), Barry I. Grossman ([bigrossman@egsllp.com](mailto:bigrossman@egsllp.com)), or Lijia Sanchez ([lsanchez@egsllp.com](mailto:lsanchez@egsllp.com)) for additional information.

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