COMPLIANCE WEEK

Congress passes bill forcing Chinese companies to comply with U.S. audit rules

Aaron Nicodemus

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In a bipartisan and unanimous vote, the House passed a bill Wednesday that could kick publicly traded Chinese-based companies off U.S. exchanges.

The bill would force foreign-based companies to submit to oversight by the U.S. Public Company Accounting Oversight Board (PCAOB). The bill is meant to rein in accounting abuses by Chinese-based organizations like **Luckin Coffee** that improperly inflate earnings and profits without the usual audit scrutiny required of other public companies listed on U.S. exchanges.

Called the "Holding Foreign Companies Accountable Act," the bill (**S.945**) would delist a foreign-owned company that refused to comply with the PCAOB's audit requirements for three consecutive years. Foreign-owned companies would also have to certify they are not owned or controlled by a foreign government.

The bill, which passed by voice vote of the House after unanimously passing the Senate in May, proposes to amend a section of the Sarbanes-Oxley Act of 2002 (**15 U.S.C. 7214**). The bill now heads to President Donald Trump, whose administration had previously pushed the Securities and Exchange Commission (SEC) to enact a similar rule, **according to Fortune**.

Should Trump sign the measure into law, the SEC and the PCAOB would be tasked with enforcing it.

The bill's sponsors, Sens. Chris Van Hollen (D-Md.) and John Kennedy (R-La.), **say the bill will protect American investors** from "dishonest companies" that should abide by the "same independent audit requirements that apply to their competitors in America and other countries."

"Communist China is right now using U.S. stock exchanges to exploit American workers and families—people who put their retirement and college savings in public companies. U.S. policy is letting China flout rules that American companies play by, and it's dangerous," Kennedy said.

The bill evens the playing field, Van Hollen said, "ensuring that all companies on the U.S. exchanges abide by the same rules."

According to the PCAOB, audit firms in China and Hong Kong **issued audit reports** for 188 public companies in 2019, with a combined global market capitalization (U.S. and non-U.S. exchanges) of approximately $1.9 trillion. Some of the companies potentially affected include Alibaba Group and Baidu, and future listing plans of major private Chinese corporations could also be prevented.

The positions taken by regulators in China and Hong Kong "impair our ability to conduct inspections and investigations of the audits of public companies with China-based operations," the PCAOB said, affecting two specific types of audit work: audit work performed by the

principal, signing author certifying the audit complied with PCAOB standards and referred work, which is signed and issued by a separate firm and made public through the PCAOB's online database, **AuditorSearch**.

The China Securities Regulatory Commission (CSRC) issued a **statement** before the bill was passed, saying Chinese companies "follow the U.S. laws and regulations for financial reporting and information disclosure" and could not be listed on U.S. exchanges otherwise.

The CSRC said it is making steady progress with U.S. regulators on a deal that would allow for joint inspection of the auditors that audit Chinese companies. However, these negotiations have been going on for some time. The Chinese Communist government refuses to allow American regulators to perform audits of Chinese companies, claiming such audits would unveil state secrets.

Reaction to the bill in the business community was mixed. Some wondered whether the measure would actually hurt U.S. investors, whose investments might be lost when Chinese companies chose to leave U.S. markets for alternatives in London and Hong Kong or go private.

Others wondered whether the SEC was being forced into an untenable position.

"Chinese companies, and their auditors, should play by the same basic ground rules that apply to any other company accessing U.S. markets. But by subjecting China to special rules, including requiring disclosures about the Chinese government's role in the company, the legislation places the SEC in a geopolitical minefield that has little relation its mission," said Jennifer Schulp, director of financial regulation studies at the Cato Institute, a think tank that supports limits on government intervention.

President-elect Joe Biden—who will take office in January and choose someone aligned with his policies to replace outgoing SEC Chairman Jay Clayton—will have considerable sway on how the rule is enforced. As a result, the bill might prove toothless, said Peter Cohan, a lecturer in strategy and entrepreneurship at Babson College in Wellesley, Mass.

"Given that a new administration should be coming into office next month and the three-year implementation period, I would not be surprised if the Chinese delisting bill has very little effect," Cohan said.