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# President's Working Group Attempts To Increase Transparency In Chinese Investments

September 2, 2020 | [The GEE Blog, SEC](#)



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After a long-running dispute with the Chinese government over whether the Public Company Accounting Oversight Board (PCAOB) can inspect the Chinese accounting firms that audit companies with stock trading in United States public markets, the President's Working Group on Financial Markets (PWG) recently announced that Chinese companies will either have to get a transparent auditor or be delisted from United States markets. The PWG's recommendations – which the administration has indicated the Securities and Exchange Commission will adopt, making them requirements – are intended to ensure that Chinese accounting firms are meeting audit standards equivalent to those in the United States under the Sarbanes-Oxley Act of 2002. These standards are intended to drive transparency in financial disclosures and to expose risks in investing in Chinese companies (as well as in companies from other countries with similar limitations on transparency).

It has long been recognized that investors in Chinese companies were at a potential disadvantage insofar as the Chinese government views much of the behind-the-scenes work [necessary to audit Chinese companies](#) to be state secrets. In 2013, China and the United States reached an [agreement by which the PCAOB](#) could obtain audit work papers for accounting firms it was

investigating. However, this “diplomatic solution” [never afforded the PCAOB](#) the type of access it needed.

Indeed, as the PWG commented [in its July 24, 2020, report](#) (disclosed to the public on Aug. 6, 2020), “[t]he PCAOB has been unable to fulfill its statutory mandate under Sarbanes-Oxley to inspect audit firms in [non-cooperating jurisdictions], including those in China, potentially exposing investors in U.S. capital markets to significant risks. The PCAOB has been unable to fulfill this mandate meaningfully with respect to audit firms based in China for more than a decade.”

Now, the PWG has recommended, companies that are publicly listed in the United States must either ensure their auditor can and does provide audit work papers on demand to the PCAOB or provide “a co-audit from an audit firm with comparable resources and experience where the PCAOB determines it has sufficient access to audit work papers and practices to conduct an appropriate inspection of the co-audit firm.” Currently listed companies will have until Jan. 1, 2022, to meet these strictures. For newly listed companies, the restrictions would become immediately effective.

In addition to this requirement, the PWG recommended ensuring additional disclosures intended to protect United States investors from risks attendant to investing in countries like China. These include enhanced risk disclosures from issuers of stock on United States markets and funds registered in the United States, enhanced due diligence by funds that track indexes into index providers, and issuing guidance to investment advisers offering investments in non-cooperating jurisdictions like China. These recommendations address many of the risks discussed at a recent [public forum hosted by the Securities and Exchange Commission](#), as discussed in an earlier post on this blog.

It is too early to say how the PWG’s recommendations will impact investors in the United States or foreign companies that trade in United States public markets, but the recommendations certainly appear likely to increase transparency.