

[Securities Regulation Daily Wrap Up, ACCOUNTING AND AUDITING— Proposed legislation would allow delisting of foreign companies that dodge U.S. audit rules, \(Jun. 7, 2019\)](#)

Securities Regulation Daily Wrap Up

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Bipartisan legislation would amend the securities laws to provide for the delisting of foreign companies from U.S. exchanges if U.S. regulators cannot inspect the work of those companies' auditors.

Recently introduced legislation sponsored by Sen. Marco Rubio (R-Fla) and Rep. Mike Conaway (R-Texas) would allow for the delisting of foreign companies whose auditors cannot be inspected by the PCAOB. Although the bill comes at a time of rising trade tensions between the U.S. and China, one of the main targets of the bill, the inability of U.S. regulators to obtain foreign company audit papers has been a long-simmering issue. The proposed legislation is backed by a cadre of four Republican Senate and House sponsors and has bipartisan support from a group of three Democratic senators and representatives, including presidential candidate Sen. Kirsten Gillibrand (D-NY).

Name and shame provisions. The [Ensuring Quality Information and Transparency for Abroad-Based Listings on our Exchanges \(EQUITABLE\) Act](#) (S. 1731; H.R. 3124) would curb listings by some foreign issuers in several ways. First, the Commission would be required to publish a list of foreign issuers for whom a foreign public accounting firm prepared an audit report but the PCAOB is unable to inspect the accounting firm because of positions taken by local authorities in that country. The Commission also would have to list each covered foreign public accounting firm that prepared an audit subject to the bill's requirements and list the jurisdiction in which each covered foreign public accounting firm is organized or operating. The PCAOB would provide data on at least an annual basis for the Commission to compile the list.

Moreover, the bill would mandate annual disclosures by foreign issuers on Forms 10-K and 20-F. Specifically, an issuer would have to disclose: (1) the fact that it is audited by a covered foreign public accounting firm; (2) the percentage of its shares owned by governmental entities in a covered jurisdiction; (3) whether governmental entities in the covered jurisdiction have a controlling financial interest in the issuer; and (4) the names of Chinese Communist Party officials who sit on the issuer's board of directors.

The bill also contains related disclosures that broker-dealers would have to make to investors seeking to trade shares of foreign issuers. The SEC would have to adopt rules to implement the bill within 270 days after enactment with the bill's name and shame provisions becoming effective upon the Commission finishing its rulemaking.

Exchange listing standards. The EQUITABLE Act also would require exchanges to amend their rules to prohibit some foreign issuers from listing shares in the U.S. For one, the bill would ban such listings if an issuer is audited by a covered foreign public accounting firm, although this provision would apply only to listings sought after enactment.

Second, beginning in 2025, U.S. exchanges would be barred from listing shares of an issuer that has thrice appeared (in consecutive years) on the SEC's list of foreign issuers for whom a foreign public accounting firm prepared an audit report and which firm the PCAOB is unable to inspect. This second ban, however, would be relaxed if an issuer submits to the Commission an audit report prepared by a registered public accounting firm the PCAOB can inspect. Exchanges would be required to finish changes to their rulebooks, with Commission approval, within one year of enactment.

Long-running access issue. The PCAOB has [noted](#) on its website that it often seeks to enter into cooperative arrangements with overseas audit regulators, although these arrangements are not always possible to achieve. As a result, the PCAOB sometimes is unable to access foreign jurisdictions for purposes of conducting inspections. The PCAOB has [listed](#) countries where it has conducted inspections of registered firms. The PCAOB, however, has also noted that it generally cannot inspect firms based in Hong Kong that have audit clients with operations in mainland China.

The sponsors of the EQUITABLE Act cited a [joint statement](#) by top SEC and PCAOB officials issued in December 2018 that acknowledged progress in obtaining access to audit papers in some jurisdictions, but cautioned that access remained problematic regarding PCAOB-registered auditing firms in China. The bill's sponsors also cited data from the U.S.-China Economic and Security Review Commission that [identified](#) 156 Chinese companies (among them 11 state-owned enterprises) listed on three U.S. exchanges that accounted for \$1.2 trillion in market capitalization (the study deemed a company state-owned if it had 30 percent or more state ownership).

"If China-based companies want to list on stock exchanges or access capital markets in the U.S., we should make them comply with American laws," [said](#) Sen. Rubio. "The EQUITABLE Act makes it clear that there is a price for the Chinese government and Communist Party's disregard for the rules of responsible economic and financial engagement in international capital markets."

Presidential contender Gillibrand echoed the call for greater transparency regarding foreign companies. "Chinese firms should not be allowed to play by a different set of rules than American companies, yet they are currently allowed to operate on our stock exchanges without the same oversight that American companies have to comply with," said Sen. Gillibrand.

Representative Conaway [emphasized](#) his view that the Chinese government "manipulates" legal requirements to insulate Chinese companies from global accounting best practices: "Beijing shows no apprehension while obstructing attempts to audit Chinese companies or breaking U.S. law. Without the EQUITABLE Act, the Chinese government will only escalate this malicious pattern of conduct."

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