

SEC Reporting & Compliance Alert

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SEC Approves PCAOB Rule Establishing Framework for Determinations Under the Holding Foreign Companies Accountable Act

On November 5, 2021, the U.S. Securities and Exchange Commission (SEC) approved the Public Company Accounting Oversight Board's (PCAOB) Rule 6100 — Board Determinations Under the Holding Foreign Companies Accountable Act. Rule 6100 provides a framework for the PCAOB to determine, pursuant to the Holding Foreign Companies Accountable Act (HFCAA), whether the board is unable to inspect or investigate completely registered public accounting firms located in a foreign jurisdiction because of a position taken by one or more authorities in that jurisdiction.

Background

Registrants with securities listed on a U.S. securities exchange must comply with the registration and reporting provisions of the Securities Exchange Act of 1934. These requirements include annually filing audited financial statements with the SEC. The auditor of those financial statements — whether a U.S. auditor or a non-U.S. auditor — must be registered with, and therefore subject to inspection by, the PCAOB.

The HFCAA, which was enacted in December 2020, directs the SEC to prohibit securities of a registrant from being listed on any U.S. securities exchanges if the PCAOB determines it was unable to inspect the auditor of the registrant's financial statements for three consecutive years. In addition, the HFCAA also requires a foreign registrant to provide certain disclosures if the registrant files a Form 10-K or 20-F that includes an audit report from an auditor that was not subject to PCAOB inspection.

PCAOB Rule 6100

On September 22, 2021, the PCAOB adopted Rule 6100 to establish a framework for making determinations under the HFCAA. Rule 6100, which was subject to SEC approval, establishes the manner of the PCAOB's determinations; the factors the PCAOB will evaluate and the documents and information the PCAOB will consider when assessing whether a determination is warranted; the form, public availability, effective date and duration of such determinations; and the process by which the PCAOB will reaffirm, modify or vacate any such determinations.

SEC Reporting & Compliance Alert

Two Types of Determinations

Rule 6100 provides that the PCAOB may make two types of determinations: (i) determinations as to a particular foreign jurisdiction; and (ii) determinations as to a particular registered accounting firm. The PCAOB anticipates that most determinations made under Rule 6100 will be jurisdiction-wide determinations.

- **Headquartered in a Particular Jurisdiction.** The PCAOB may determine that it is unable to inspect or investigate completely registered public accounting firms “headquartered” in a particular foreign jurisdiction because of a position taken by one or more authorities in that jurisdiction. Headquartered is defined as the firm’s principal place of business (*i.e.*, where the firm’s management directs, controls and coordinates the firm’s activities). The PCAOB would presume that a firm is headquartered at the physical address reported by the firm as its headquarters to the PCAOB in its required filings. Absent an indication that the headquarters address reported by a firm may not be its principal place of business, the PCAOB would use that address to determine where the firm is “headquartered” for purposes of the rule.¹

Historically, the types of positions taken by foreign authorities that have impaired the PCAOB’s ability to conduct inspections or investigations in a jurisdiction include gatekeeper laws (which provide that an auditor can transfer its audit work papers to the PCAOB only via a local non-U.S. regulator), personal data protection laws, state secrecy laws, banking secrecy laws, commercial secrecy laws and other laws.

- **Particular Registered Firm With an Office in a Foreign Jurisdiction.** The PCAOB may determine that it is unable to inspect or investigate completely a particular registered public accounting firm that has an office located in a foreign jurisdiction because of a position taken by one or more authorities in that jurisdiction.² The PCAOB’s approach in determining where a firm’s offices are located is similar to its approach in determining where a firm is headquartered: The PCAOB will look principally to the firm’s PCAOB filings, but if any uncertainty arises as to whether a firm has an office in a jurisdiction, the PCAOB may consider other information regarding the firm and may request additional information from the firm.

¹ With respect to a member firm of an international firm network, if it is a separate legal entity from the other member firms in the network and signs audit reports in its own name, the PCAOB would not treat other member firms in the network as being “located” or having an “office” in that jurisdiction merely because they are part of the same network as a member firm subject to the jurisdiction-wide determination.

² Similar to the jurisdiction-wide approach, if a member firm of an international firm network becomes subject to a PCAOB determination under Rule 6100(a)(2), and is a separate legal entity from the other member firms in the network and signs audit reports in its own name, the PCAOB would not treat it as an “office” of other member firms within the network, and accordingly the other member firms would not be subject to that PCAOB determination.

Now that the SEC has approved Rule 6100, the PCAOB will promptly make determinations under the rule. Thereafter, the PCAOB will consider, at least annually, whether changes in the facts and circumstances support any additional determinations. If so, the PCAOB will make such additional determinations, as and when appropriate, to allow the SEC on a timely basis to identify covered issuers in accordance with the SEC’s rules.

Factors for PCAOB Determinations

In determining whether it is able to “inspect or investigate completely,” the PCAOB will consider whether it:

- can select the audits and audit areas it will review during inspections and the potential violations it will investigate;³
- has timely access to firm personnel, audit work papers, and other documents and information relevant to its inspections and investigations, and the ability to retain and use such documents and information; and
- can otherwise conduct its inspections and investigations in a manner consistent with the provisions of the Sarbanes-Oxley Act of 2002 and the PCAOB’s rules.⁴

Basis for PCAOB Determinations

The PCAOB may consider any documents or information it deems relevant to make its determinations, including, but not limited to:

- laws, statutes, regulations, rules, ordinances and other legal authorities of the foreign jurisdiction;
- the entirety of the PCAOB’s efforts to reach and secure compliance with agreements with foreign authorities in the jurisdiction, including whether an agreement was made, the terms of any such agreement, and the foreign authorities’ interpretation of and performance under such agreement; and
- the PCAOB’s experience with the foreign authorities’ other conduct and positions taken relative to PCAOB inspections or investigations.

³ This factor encompasses situations in which a foreign authority takes the position that certain engagements, or certain parts of engagements, cannot be reviewed during an inspection, or that the PCAOB cannot decide when (*i.e.*, in which inspection year) certain engagements will be reviewed. It also encompasses situations in which a foreign authority takes the position that the PCAOB cannot decide what potential violations it will investigate.

⁴ This factor includes the PCAOB’s ability to satisfy inspection frequency requirements, to identify violative acts during inspections, to impose sanctions for noncooperation with an investigation and to share information with the SEC and other regulators.

SEC Reporting & Compliance Alert

In addition, a PCAOB determination need not depend on the PCAOB's commencement of, but inability to complete, an inspection or investigation of a registered public accounting firm located in the foreign jurisdiction. Rule 6100 notes that the PCAOB should not be expected to attempt to initiate inspections or investigations in a foreign jurisdiction that rejects the guiding principles for international cooperation, which would render the PCAOB's efforts futile.

Publication and Effective Date of PCAOB Determinations

The PCAOB will issue determinations under Rule 6100 in the form of a report to the SEC. This report will describe the PCAOB's assessment of whether the position taken by the foreign authority (or authorities) impairs the PCAOB's ability to execute its mandate with respect to inspections or investigations. The report also will analyze the relevant factor(s) set forth in Rule 6100, describe the basis for the PCAOB's conclusions and identify in an appendix to the report the registered public accounting firm(s) to which the determination applies. The PCAOB's determinations will become effective on the date such report is issued.

The PCAOB will make a copy of the report publicly available on the board's website (on or about the same day the board issues the report to the SEC) and will email the report to the registered public accounting firms listed in the report's appendix. In limited circumstances, the public report may be redacted if it contained proprietary, personal or other information protected by applicable confidentiality laws.

Reaffirming, Modifying or Vacating PCAOB Determinations

A PCAOB determination will remain effective until it is reaffirmed, modified or vacated by the PCAOB. At least annually, the PCAOB will reassess each determination that is in effect. In addition, at any time, on its own initiative or at the SEC's request, the PCAOB may reassess a prior determination. If the PCAOB reaffirms, modifies or vacates its prior determination, the board will issue a report to the SEC and make the report publicly available on the PCAOB's website.

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