

# Liza Mark and Han Liang in Bloomberg Law: U.S.-Listed Chinese Companies: Regulatory Scrutiny & Strategic Options

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China has become the largest emerging market economy and the second largest economy in the world. As a result, many Chinese companies have elected to access the U.S. capital markets for their financing needs. As of June 2020, there are over 200 China-based issuers listed on U.S. exchanges with a collective market capitalization of over \$1.15 trillion. With the rising geopolitical tensions between China and the U.S., long standing regulatory concerns, and the recent fraud scandals surrounding these “China Inc.” companies, U.S. regulators are increasing their focus on U.S.-listed Chinese companies.

## Long-Standing Regulatory Concerns

On the regulatory side, there have been long standing concerns regarding China-based issuers. China-based audit firms—including the Chinese branches of the “Big Four” accounting firms—have long been unable to comply with the U.S. Public Company Accounting Oversight Board (PCAOB) inspections required under the Sarbanes-Oxley Act of 2002 (SOX Act), arguing that the production of audit papers would violate Chinese law due to the potential disclosure of state secrets in the audit materials.

In 2012, the Chinese branches of several audit firms were barred by the U.S. Securities and Exchange Commission from auditing companies listed on U.S. exchanges for six months for refusing to produce work papers. The matter was settled after the China Securities Regulatory Commission provided copies of the audit firms’ work papers to the SEC.

In 2013, the PCAOB negotiated a memorandum of understanding with CSRC allowing the PCAOB to obtain audit work papers of China-based audit firms, with several exceptions where Chinese government approval was needed. However, both the SEC and PCAOB have noted that “progress has been slow and satisfactory resolution remains uncertain.” Since then, the PCAOB has long complained about the lack of Chinese cooperation for it to obtain timely access to relevant documents and information necessary for it to carry out its oversight function.

On April 21, 2020, the SEC and PCAOB jointly issued a statement warning investors about investing in “emerging market” companies given the absence of PCAOB inspections. In this statement, the SEC and PCAOB chairs both expressed serious concerns regarding the SEC and the PCAOB's inability to promote and enforce disclosure standards for U.S.-listed companies operating in emerging markets, particularly China. They warned financial professionals and investment funds to consider the risks posed by issuers in emerging markets when constructing funds, making investments and providing investment recommendations, and make appropriate disclosures to investors.

Excerpted from *Bloomberg Law*. To read the full article, click on the PDF linked below:

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