
STAFF QUESTIONS AND ANSWERS

AUDITS OF MAINLAND CHINA ISSUERS BY REGISTERED FIRMS OUTSIDE OF MAINLAND CHINA

December 30, 2016

In 2015, the Chinese Ministry of Finance put into effect *Interim Provisions on Auditing Operations Conducted by Accounting Firms Concerning the Overseas Listing of Domestic Chinese Companies* (the “MOF Rule”). The MOF Rule includes provisions related to the conduct of auditors based outside of Mainland China that perform audit work in Mainland China.

The Public Company Accounting Oversight Board (“PCAOB” or “Board”) has received questions from registered public accounting firms about the application of certain PCAOB requirements when a PCAOB-registered firm based outside of Mainland China (in the Q&A below, “the Firm”) provides audit services in Mainland China that the Firm understands to be subject to those MOF Rule provisions. PCAOB staff has prepared the following answers to questions that have arisen or may arise in this context. These staff answers do not constitute Board rules, nor have they been approved by the Board.

Q1. Does the MOF Rule have any effect on the Firm’s obligations to provide its audit documentation and other information to the PCAOB in PCAOB inspections and investigations?

A1. No, the MOF Rule has no effect on those obligations. If the PCAOB makes a demand on the Firm for its work papers or other information in an inspection or investigation, the PCAOB will expect the Firm to ensure that the materials are completely and unconditionally produced to the PCAOB by the PCAOB-prescribed deadline. (Whether the Firm also discloses the demand to foreign authorities is up to the Firm.)

The Board has stated that non-U.S. legal obstacles do not create an exception to a registered firm’s obligation to provide documents and other information to the Board, and they are not a defense to Board disciplinary action for noncooperation, including potentially revocation of a firm’s PCAOB registration.

See PCAOB Release No. 2009-003 (June 25, 2009) at 14 (“[A] registered firm’s failure or refusal to provide requested information is a violation of Rule 4006” and “the Board does not view non-U.S. legal restrictions or the sovereignty concerns of local authorities as a sufficient defense in a Board disciplinary proceeding instituted under Section 105(c) of the Sarbanes-Oxley Act (“the Act”) for failing or refusing to provide information requested in an inspection.”). The Securities and Exchange Commission (“Commission”) has affirmed that finding a violation of Rule 4006 does not depend on establishing a particular state of mind and that “impossibility” is not a defense. See *Gately & Associates*, Exchange Act Release No. 62656 at 12-13 (August 5, 2010). In addition, the Board has revoked a firm’s registration because of the firm’s refusal, based on asserted MOF restrictions predating the MOF Rule, to provide information in a PCAOB investigation. See *PKF [Hong Kong]*, PCAOB Release No. 105-2016-001 (January 12, 2016).

A firm should not anticipate any form of relief from the obligation to comply with any PCAOB demand for documents or other information, whatever the circumstances. Firms should bear this in mind when considering accepting or continuing engagements.

Q2. If the Firm carries out an audit in cooperation with a non-U.S. accounting firm (“the Participating Non-U.S. Auditor”), must the Participating Non-U.S. Auditor be registered with the PCAOB?

A2. It depends. Whether the Participating Non-U.S. Auditor must be registered with the PCAOB depends on the role that the Participating Non-U.S. Auditor plays in the audit. For the Participating Non-U.S. Auditor to play a role that meets or exceeds the “substantial role” threshold defined in PCAOB Rule 1001(p)(ii), the Act and PCAOB rules require that the Participating Non-U.S. Auditor be registered with the PCAOB.

Q3. In carrying out an audit, what PCAOB auditing standards govern the Firm’s conduct with respect to the role of the Participating Non-U.S. Auditor?

A3. PCAOB rules and standards allow for the possibility of conducting an audit with the participation of another accounting firm. Depending on the nature of the other firm’s participation, the situation would be governed either by PCAOB Auditing Standard (“AS”) 1201 [previously AS No. 10], *Supervision of the Audit Engagement*, or AS 1205 [previously AU sec. 543], *Part of the Audit Performed by Other Independent Auditors*.

In all circumstances, the Firm should be mindful of compliance with other applicable PCAOB auditing standards (including AS 1215, *Audit Documentation*, among others) and independence requirements, including with respect to the independence of the Participating Non-U.S. Auditor.

More detailed guidance on these points can be found in PCAOB Staff Audit Practice Alert No. 6, *Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants from Outside the Firm* (July 12, 2010) (available at pcaobus.org/Standards/QandA/2010-07-12_APA_6.pdf).

Q4. Would the retention of the Firm's audit documentation by the Participating Non-U.S. Auditor satisfy the Firm's audit documentation retention obligation under PCAOB standards?

A4. No. AS 1215 [previously AS No. 3], *Audit Documentation*, provides that "[t]he auditor must retain audit documentation for seven years" from the report release date (paragraph 14). To satisfy this requirement, documentation supporting the work performed by the office issuing the auditor's report must be retained by that office of the Firm; it is not sufficient for the documentation to be merely accessible to that office. This also applies to the documentation specified in paragraph 19 of AS 1215 that the issuing office of the Firm must obtain, review, and retain concerning the work performed by auditors from other than the issuing office.

Other documentation – *i.e.*, documentation that supports the work performed by other offices of the Firm or by other firms and that is not specified in paragraph 19 of AS 1215 – must be retained by or be accessible to the issuing office (paragraph 18).

The Firm must also comply with the retention requirements set out in Rule 2-06 of Commission Regulation S-X, 17 C.F.R. § 210.2-06.

Q5. Does the Firm have any other reporting or document production obligations arising from the participation of the Participating non-U.S. Auditor in the audit?

A5. Yes. As explained below, the participation of any other firm, whether U.S. or non-U.S., gives rise to reporting obligations. In addition, the participation of a non-U.S. firm in the audit gives rise to statutory obligations under the federal securities laws concerning the production of documents to the Board and the Commission.

Reporting Obligations

PCAOB Rule 3211 requires firms that issue audit reports for issuers to disclose certain information about the audit in a filing on PCAOB Form AP. Among other things, for audit reports issued on or after June 30, 2017, a firm must disclose on Form AP whether any other accounting firm participated in the audit. With respect to any such other accounting firm with which the firm has not divided responsibility (within the meaning of that concept in AS 1205), the firm must also affirm on Form AP that it is responsible for the audits or audit procedures performed by the other accounting firm and that it supervised or performed procedures to assume responsibility for the other firm's work in accordance with PCAOB standards. If the hours attributable to the work of another accounting firm with which the firm has not divided responsibility total 5 percent or more of the total audit hours, the firm must also identify the other firm on Form AP and report the percentage of the total audit hours that was attributable to the other accounting firm's work.

Document Production Obligations

A registered public accounting firm is also subject to certain obligations under the Act when it relies to any extent on the work of a non-U.S. public accounting firm (including an unregistered firm) in issuing an audit report, performing audit work, or conducting an interim review. In those circumstances, section 106(b)(2) of the Act, as amended by the Dodd-Frank Act requires the registered firm –

- to produce, in response to any request by the Board or the Commission, the non-U.S. firm's work papers and all other documents related to any such work, and
- to secure – as a condition of being able to rely on the non-U.S. firm's work – the non-U.S. firm's agreement to such production by the firm.

Separately, section 106(b)(1) of the Act also imposes certain obligations on a non-U.S. firm (including an unregistered firm) that performs material services upon which a registered public accounting firm relies in the conduct of an audit or interim review. Section 106(b)(1) requires any such non-U.S. firm to produce its work papers and related documents to the Board or the Commission upon request, and it subjects any such firm to the jurisdiction of the courts of the United States for purposes of enforcement of any such request. Section 106(d) also requires such non-U.S. firms to designate an agent in the U.S. to accept service of process.