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# SEC's Interim Final Rules Under Holding Foreign Companies Accountable Act Become Effective

The Securities and Exchange Commission (the "SEC") has adopted interim final rules<sup>1</sup> to implement the Congressionally-mandated document submission and disclosure requirements of the Holding Foreign Companies Accountable Act (the "HFCA Act"), which became effective on May 5, 2021.

The HFCA Act was enacted to address certain concerns over registrants listed on U.S. securities exchanges whose audit reports are issued by registered public accounting firms with offices in foreign locations in which local authorities may prohibit complete inspection by the Public Company Accounting Oversight Board (the "PCAOB"). In particular, the HFCA Act is concerned with influence by Chinese authorities over accounting firms and contains specific references and disclosure requirements related to the Chinese Communist Party.

The HFCA Act requires, among other things, that the SEC identify these registrants (each, a "Commission-Identified Issuer"). Once identified, Commission-Identified Issuers are required to submit certain documents and make certain disclosures. If a foreign issuer is identified as a Commission-Identified Issuer (a "Commission-Identified Foreign Issuer"), then it is subject to additional disclosure requirements. In addition, if a registrant is identified as a Commission-Identified Issuer for three consecutive years, the HFCA Act directs the SEC to prohibit trading of the registrant's securities on U.S. exchanges.

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## I. Identification

Section 2 of the HFCA Act (which amended Section 104 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley")) requires the SEC to identify each "covered issuer" that has "filed an annual report ... with an audit report issued by a registered public accounting firm that is located in a foreign jurisdiction." In addition, the HFCA Act requires the PCAOB to determine which branches or offices of registered public accounting firms it is "unable to inspect or investigate completely because of a position taken by an authority in the foreign jurisdiction."

The SEC will only identify registrants as Commission-Identified Issuers and Commission-Identified Foreign Issuers once the PCAOB has established its process for determining that it is "unable to inspect or investigate completely." Once the PCAOB has done so, the SEC will use the PCAOB's determination about which firms it is unable to inspect or investigate completely, along with information in a registrant's annual reports, to identify and

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<sup>1</sup> For the full text of the final interim amendments, see Securities and Exchange Commission, Holding Foreign Companies Accountable Act Disclosure, Release No. 34-91364, available at <https://www.sec.gov/rules/interim/2021/34-91364.pdf> (March 24, 2021) [hereinafter the "Adopting Release"]. Unless otherwise specified, quoted statements in this memorandum are taken from the Adopting Release.

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compile a list of such Commission-Identified Issuers. Per the Adopting Release, the SEC “will issue appropriate notice once it has established the process by which it will begin to identify registrants pursuant to the HFCA Act.”

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## II. Disclosure and Submission Requirements

### A. Disclosure Requirements

Commission-Identified Foreign Issuers must disclose the following items in their annual reports (the “Disclosure Requirements”):

- “That, during the period covered by the form, the registered public accounting firm has prepared an audit report for the issuer;
- The percentage of the shares of the issuer owned by governmental entities in the foreign jurisdiction in which the issuer is incorporated or otherwise organized;
- Whether governmental entities in the applicable foreign jurisdiction with respect to that registered public accounting firm have a controlling financial interest with respect to the issuer;
- The name of each official of the Chinese Communist Party (“CCP”) who is a member of the board of directors of the issuer or the operating entity with respect to the issuer; and
- Whether the articles of incorporation of the issuer (or equivalent organizing document) contains any charter of the CCP, including the text of any such charter.”

Although technically not required to do so by the HFCA Act, in order to help registrants comply with the HFCA Act, the SEC has amended certain forms (Forms 10-K, 20-F, 40-F, and N-CSR) to reflect these disclosure requirements. These disclosures are required for each year in which the registrant is identified as a Commission-Identified Foreign Issuer, which will impact disclosures that look back at previous years even if the registrant subsequently files an audit report by an accounting firm that the PCAOB is able to inspect or investigate completely.

### B. Submission Requirements

All Commission-Identified Issuers are required to submit “documentation establishing the issuer is not owned or controlled by a governmental entity in the foreign jurisdiction of the registered public accounting firm that the PCAOB is unable to inspect or investigate completely” (the “Submission Requirements”). Documentation is to be submitted electronically (through EDGAR) on a supplemental basis on or prior to the due date of the relevant annual report. Although the Disclosure Requirements only apply to Commission-Identified Foreign Issuers, the Submission Requirements apply to all Commission-Identified Issuers.

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## III. Timing Considerations

The HFCA Act requires disclosure by Commission-Identified Issuers in their annual reports that cover “non-inspection years,” as defined in Section 104(i)(1)(B) of Sarbanes-Oxley (as amended by the HFCA Act). A “non-inspection year” means any year during which “(1) [the SEC] identifies an issuer as having retained a registered public accounting firm for the audit report on its financial statements; (2) [t]hat registered public accounting firm has a branch or office that is located in a foreign jurisdiction; and (3) [t]he PCAOB is unable to inspect or investigate completely the registered public accounting firm because of a position taken by an authority in that foreign jurisdiction.” It is important to note that clause (1) above refers to the year in which the SEC makes its identification. Consequently, a Commission-Identified Foreign Issuer identified as such in 2022 (based on its annual report for 2021) will be subject to the Submission Requirements and Disclosure Requirements for 2022. On the other hand, the HFCA Act only requires the SEC to identify registrants “after the date of enactment” and, therefore, a registrant will

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not be subject to a non-inspection year determination, the Submission Requirements, or the Disclosure Requirements for any fiscal year ending on or prior to December 31, 2020.

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#### IV. What's Next

Notwithstanding their designation as “final,” the SEC in the Adopting Release requested public comment on many aspects of the interim final rules, including not only the identification process but also the Disclosure Requirements and the Submission Requirements. Some commentators expressed concern that, as drafted, the Disclosure Requirements will not adequately identify Chinese government ownership of registrants,<sup>2</sup> implying that the interim final rules may not meet some of their stated goals. Although the comment period is now closed, it remains to be seen how extensive any additional details, further amendments or other modifications based on the comments received may be. In the meantime, any immediate next steps will depend on the details of the PCAOB's process for determining that it is “unable to inspect or investigate [the registrant's registered public accounting firm] completely because of a position taken by an authority in that jurisdiction.”

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Geoffrey E. Liebmann (partner) at 212.701.3313 or [gliebmann@cahill.com](mailto:gliebmann@cahill.com) or Michael Chaia (associate) at 212.701.3335 or [mchaia@cahill.com](mailto:mchaia@cahill.com) or email [publications@cahill.com](mailto:publications@cahill.com).

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<sup>2</sup> <https://www.sec.gov/comments/s7-03-21/s70321-8587637-230902.pdf> .

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