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## PCAOB Developments: Board Proposes HFCA Rule; SEC to Replace Its Members

The Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) has released proposed Rule 6100<sup>1</sup> to establish a framework for determining if it “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” under the Holding Foreign Companies Accountable Act (the “HFCA Act” or the “Act”). Under the Act, once such a determination is made, the rules of the Securities and Exchange Commission (the “SEC” or the “Commission”) will require issuers covered by the Act that retain such accounting firms to make certain disclosures or submissions and may ultimately prohibit trading in such issuers’ securities.<sup>2</sup>

Subsequently, incoming SEC Chair Gary Gensler removed PCAOB Chair William Duhnke, and the Commission announced its intention to seek to replace all five positions on the Board, creating, among other things, a degree of uncertainty regarding adoption of the rule as proposed.

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### I. Proposed Rule 6100

As proposed, Rule 6100 addresses “the manner of the Board’s determinations; the factors the Board will evaluate and the documents and information it 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 Board can modify or vacate its determinations.”<sup>3</sup>

Under the proposed rule, the PCAOB would make two types of determinations: (1) those as to a particular foreign jurisdiction and (2) those as to a particular registered firm.

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<sup>1</sup> For the full text of the proposed rule, see Public Company Accounting Oversight Board, Proposed Rule Governing Board Determinations Under the Holding Foreign Companies Accountable Act, Release No. 2021-001 (May 13, 2021), available [here](#) [hereinafter the “Proposing Release”]. Unless otherwise specified, quoted statements in this memorandum are taken from the Proposing Release.

<sup>2</sup> For a discussion of the SEC’s interim final rules under the HFCA Act, see our memorandum available [here](#). For the full text of the final interim amendments, see Securities and Exchange Commission, Holding Foreign Companies Accountable Act Disclosure, Release No. 34-91364 (March 24, 2021), available [here](#).

<sup>3</sup> Although the Act does not explicitly require the PCAOB to adopt a formal rule regarding its determinations, the PCAOB stated in the Proposing Release that it believed doing so will inform the relevant parties, as well as the public, regarding how it will perform its statutory obligations and will promote consistency in the Board’s approach.

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## A. Particular Foreign Jurisdictions

Proposed Rule 6100(a)(1) “provides that the Board may determine that it is unable to inspect or investigate completely registered firms headquartered in a foreign jurisdiction because of a position taken by one or more authorities in that jurisdiction.” Because the PCAOB believes that audit firms that are headquartered in foreign jurisdictions necessarily have a branch or office located in that jurisdiction, the PCAOB is proposing that a jurisdiction-wide determination “would apply to all firms *headquartered* in that jurisdiction.” “A firm is ‘headquartered,’ as that term is used in the proposed rule, at its principal place of business (i.e., where the firm’s management directs, controls, and coordinates the firm’s activities).”<sup>4</sup>

The Proposing Release also addresses the application of Rule 6100(a)(1) on member firms of an international firm network that are subject to a jurisdiction-wide determination. “In such a circumstance, if that member firm is a separate legal entity from the other member firms in the network and signs audit reports in its own name, the Board 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.”

## B. Particular Registered Firms in a Foreign Jurisdiction

Proposed Rule 6100(a)(2) would allow the PCAOB to “determine that it is unable to inspect or investigate completely a particular registered firm that has an office located in a foreign jurisdiction because of a position taken by one or more authorities in that jurisdiction.” According to the Proposing Release, this will allow the PCAOB to make “a more tailored determination” in circumstances where a jurisdiction-wide determination would be “inappropriately broad,” such as when a foreign authority obstructs an investigation of a particular firm, but not all firms, in a jurisdiction. This proposed provision would also allow the Board to make determinations regarding firms that are located, but not necessarily headquartered, in a jurisdiction.

## C. Factors for Making Determinations

The proposed rule sets forth the following factors the Board may use in making its determination:

- “the Board’s ability to select engagements, audit areas, and potential violations to be reviewed or investigated,” essentially testing whether the PCAOB can decide what potential violations it can/will investigate;
- “the Board’s access, and the ability to retain and use, any document or information (including through conducting interviews and testimony) in the possession, custody, or control of the firm(s) or any associated persons thereof that the Board considers relevant to an inspection or investigation,” which reflects the PCAOB’s belief that access to the firms is built into its mandate; and
- “the Board’s ability to conduct inspections and investigations in a manner consistent with the provisions of the Act and [the Board’s rules], as interpreted and applied by the Board,” which is a catch-all consideration designed to capture all other aspects of the PCAOB’s inspection and investigation mandate.

The Proposing Release notes that each factor is not a separate prerequisite; impairment of any one of these factors could be sufficient on its own to support a PCAOB determination.

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<sup>4</sup> Proposing Release, p. 18 (citing *Hertz Corp. v. Friend*, 559 U.S. 77, 92-93 (2010) (“in practice it should normally be the place where the corporation maintains its headquarters—provided that the headquarters is the actual center of direction, control, and coordination, i.e., the ‘nerve center,’ and not simply an office where the corporation holds its board meetings”).

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## D. Basis for PCAOB Determinations

The proposed rule provides that, in making its determinations, the PCAOB may consider: a foreign jurisdiction's black-letter law and relevant interpretations of those laws; the entirety of the PCAOB's efforts to "reach and secure agreements with foreign authorities in the jurisdiction"; and the PCAOB's past experiences with a foreign authority. Together, these provisions would allow the PCAOB to "consider any relevant information" when making its determinations.

Lastly, the Proposing Release 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, because such futile efforts would not advance the PCAOB's mission of protecting investors and furthering the public interest...."

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## II. What's Next

Proposed Rule 6100 is open to public comment, and the comment deadline is July 12, 2021. Once effective, the PCAOB will start making determinations under Rule 6100, and those determinations will be provided to SEC in a report and then made public on the PCAOB's website.

As noted above, however, any understanding of the adoption of Proposed Rule 6100 and its final terms is complicated to some extent by the impending personnel changes at the PCAOB. SEC Chair Gensler gave no specific reason for his removal of Board Chair Duhnke, although Gensler did note his intention "to set [the Board] on a path to better protect investors...."<sup>5</sup> The Commission also announced that it "intends to seek candidates to fill all five board positions," noting it will provide additional information "in the coming weeks."<sup>6</sup> At the same time, SEC Commissioners Hester Peirce and Elad Roisman have expressed their disapproval of the Commission's decision, acknowledging that the SEC has the authority to remove Board members without cause but noting that the SEC's actions are "unmoored from any practical standard that could be meaningfully applied in the future" and "undermine the PCAOB's important mission by suggesting that it is subject to the vicissitudes of politics."<sup>7</sup> Clearly, the adoption of proposed Rule 6100 is in flux, at least with regard to its timing if not its final terms.

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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>5</sup> Press Release, "SEC Announces Removal of William D. Duhnke III from the Public Company Accounting Oversight Board; Duane M. DesParte to Serve as Acting Chair," June 4, 2021, available [here](#).

<sup>6</sup> *Ibid.*

<sup>7</sup> Public Statement, "Statement on The Commission's Actions Regarding the PCAOB," SEC Commissioners Hester M. Peirce and Elad L. Roisman, June 4, 2021, available [here](#).

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