

## CHINA UPDATE FEBRUARY 2015: SETTLEMENT OF THE SEC ACTION AGAINST CHINESE AUDITORS REGARDING PRODUCTION OF WORKPAPERS, AND EB-5 VISA UPDATE

### SETTLEMENT OF THE SEC ACTION AGAINST CHINESE AUDITORS REGARDING PRODUCTION OF WORKPAPERS

*Chinese audit firms pay a fine to the SEC but may continue to withhold workpapers on State Secrecy grounds.*

Earlier this month the US Securities and Exchange Commission (SEC) agreed to “stay” the administrative action (meaning the SEC stopped prosecuting the action, but did not dismiss it) that was pending against four Chinese accounting firms who had refused to turn over documents related to investigations of potential fraud involving US-listed Chinese companies. The firms faced a potential 6-month bar from representing clients before the SEC. Under the settlement, the firms each agreed to pay \$500,000 and admit that they did not produce documents before the proceedings were instituted against them in 2012. They agreed to the settlement without admitting or denying other findings in the order. The China-based firms are members of large international networks associated with the “Big Four” accounting firms and are registered with the US Public Company Accounting Oversight Board (PCAOB), a US regulatory body.

Andrew Ceresney, Director of the SEC’s Enforcement Division, stated that “... obtaining an audit firm’s workpapers is critical to enforcement staff’s ability adequately to protect investors from the dangers of accounting fraud.” The settlement also holds four of the firms accountable for previously violating U.S. rules, and makes clear that should production of documents cease, the SEC can restart the administrative proceeding.”

Throughout the administrative proceeding, the Chinese firms argued that they were caught between two opposing legal regimes -- if they produced audit workpapers directly to the SEC, they could be subject to civil and/or criminal action in China for divulging state secrets, and if they did not produce the requested documents, they could be barred from appearing before the SEC and effectively lose their ability to audit U.S.-listed Chinese companies.

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A year ago an administrative law judge issued an initial decision finding that the four firms – Deloitte Touche Tohmatsu Certified Public Accountants Limited, Ernst & Young Hua Ming LLP, KPMG Huazhen (Special General Partnership), and PricewaterhouseCoopers Zhong Tian CPAs Limited Company – willfully refused to provide the SEC with workpapers and related documents in connection with their audit work for nine China-based companies that had securities registered in the U.S. The initial decision found that the firms willfully violated Section 106 of the Sarbanes-Oxley Act, which requires foreign public accounting firms to provide such workpapers to the SEC upon request. After the hearing, the SEC received multiple productions of workpapers from the firms through assistance provided by the China Securities Regulatory Commission (CSRC). As these productions were being made, the four firms petitioned the Commission to review the January 2014 initial decision. The SEC's Enforcement Division also sought review of aspects of that decision.

The terms of the settlement now require the audit firms to respond to the SEC's future document requests within 90 days. However, the firms will produce documents to the CSRC, not the SEC. Both the firms and the CSRC will then be permitted to make redactions to the documents before providing them to the SEC. Additionally, the audit firms may refuse production altogether if they determine, along with the CSRC, that the requested documents should be withheld under China's state secrets regulations.

The SEC's position is that "the settlement is an important milestone in the SEC's ability to obtain documents from China," said Antonia Chion, Associate Director of the Enforcement Division, and that "the settlement provides a path forward for obtaining productions and enhanced future cooperation from the Big Four firms." However, compliance with an SEC demand for workpapers is still subject to the consent of Chinese regulators. Under the settlement, if future document productions fail to meet specified criteria, the Commission retains authority to impose a variety of additional remedial measures on the firms depending on the nature of the failure, including an automatic six-month bar on a single firm's performance of certain audit work, commencement of a new proceeding against a firm, or the resumption of the current proceeding against all four firms.

The proceeding continues against a fifth China-based accounting firm, Dahua CPA Ltd.

## **EB-5 VISAS, FOR US INVESTMENTS, ARE STILL AVAILABLE FOR CHINESE NATIONALS**

The US State Department's monthly report for February regarding visa availability states that EB-5 visas are still available to Chinese applicants for the 2014-2015 fiscal year that ends 30 September, 2015. China is theoretically allocated 7% of the total 10,000 EB-5 visas issued annually, however in past years China has been allowed to take up allocations designated for other countries that were undersubscribed. Given China's large uptake of EB-5 visas, last year the State Department stopped accepting applications from China in August, and industry predictions are that China will reach its quota earlier this year, perhaps as early as May. The number of EB-5 visas issued to wealthy Chinese nationals increased nearly 50% in the last three years, and indeed in the fiscal year that ended 30 September 2014, Chinese nationals accounted for 70% of total EB-5 visa applications.

EB-5 visas provide wealthy foreigners with access to permanent US residency. In exchange for the visa, the foreign national must invest \$1 million in a new commercial enterprise (or \$500,000 if the investment is in a high unemployment or rural area) that creates at least 10 full-time jobs. EB-5 visas have been used substantially in the real estate industry, particularly for new hotels and commercial buildings.



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