

A Possible Solution to the Dispute on Audit Working Papers of Overseas Listing - Brief comment on the new rules re confidentiality and archives administration in overseas listing

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On April 2, 2022, the China Securities Regulatory Commission, together with the Ministry of Finance, the State Secrecy Administration, and the State Archives Administration, proposed amendments to the "Provisions on Strengthening Confidentiality and Archives Administration in Overseas Issuance and Listing of Securities" (CSRC Announcement [2009] No. 29) (hereinafter referred to as "Announcement No. 29") and issued the "Provisions on Strengthening Confidentiality and Archives Administration in Overseas Issuance and Listing of Securities by Domestic Enterprises (Draft for Comment)" (hereinafter referred to as the "Draft for Comment"). This is undoubtedly a substantial step towards resolving the dispute with the U.S. PCAOB regarding the inspection of the auditors for Chinese enterprises listed overseas.

In general, the Draft for Comments has sorted out and optimized the confidentiality obligations of sensitive information that may be involved in the process of overseas listing. It intends to implement the confidentiality and archives administration requirements at the time of provision of such information by domestic enterprises to securities service agencies, overseas institutions, and individuals, so as to avoid sensitive information from entering the audit working papers, thereby paving the way for cross-border cooperation with and inspection by overseas regulators such as PCAOB.

When implementing confidentiality and archives administration requirements at the information provision stage, the Draft for Comments first requires domestic enterprises to perform different approval, filing, or other corresponding procedures for the provision of different types of information, specifically:

- a) Documents and materials involving state secrets and work secrets of departments and units shall be reported to the competent authority with the approval authority for approval according to law, and shall be reported to the secrecy administrative department at the same level for the record (Article 3);
- b) For other documents and materials that will adversely affect national security or public interests after being leaked, the corresponding procedures shall be strictly followed in accordance with relevant state regulations (Article 4);
- c) Accounting archives or copies that are of great preservation value to the state and society shall be subject to corresponding procedures in accordance with relevant state regulations (Article 8).

At the same time, the Draft for Comments also proposes behavioral guidelines on the cooperation between domestic enterprises and securities service agencies: first, domestic enterprises are required to make written explanations to securities service agencies regarding the above-mentioned confidentiality and archives administration requirements, which will help both parties to reach a common understanding of the scope and method of information provision to avoid future disputes; second, it clarifies that if domestic enterprises provide confidential information after performing corresponding procedures, they shall sign a non-disclosure agreement with securities service agencies; third, it further requires that domestic enterprises and securities services agencies shall take remedial measures and report to relevant government agencies when state secrets are leaked or may be leaked.

The Draft for Comments also stipulates that foreign accountants engaged in the overseas listing of domestic enterprises should “perform the corresponding procedures”, otherwise domestic enterprises may not provide them with accounting files. This is in line with Article 15 of the “Provisions of the State Council on the Administration of the Overseas Issuance and Listing of Securities by Domestic Enterprises (Draft for Comment)” (hereinafter referred to as “Provision on the Administration of Overseas Listing (Draft)”), which provides that “[S]ecurities companies and securities service agencies that conduct overseas issuance and listing of domestic enterprises in China shall be subject to supervision and management in accordance with the law.”

After implementing the above substantive approval and behavioral guidance requirements for information provision, with respect to the request of inspection and evidence collection by overseas regulatory authorities, the Draft for Comments reiterates that this should be conducted by way of cross-border regulatory cooperation, manifests a candid and cooperative attitude, and no longer requires that “on-site inspections should be mainly conducted by Chinese regulatory agencies, or rely on the inspection results of Chinese regulatory agencies.”

In general, during a time when the requirements for data and information protection and national security are becoming more and more prominent, the Draft for Comments represents a practical and creative venture to balance security with openness, and to provide systematic assurance for domestic companies to continue actively making use of both domestic and overseas capital markets. We hope that the haze of the audit and inspection dispute that has loomed over China concepts stocks for a long time will dissipate in the near future.

2022-04-04