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BANKING
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FINANCE
JUDICIARY
RULES

United States Senate

WASHINGTON, DC 20510

November 22, 2011

The Honorable James R. Doty
Chairman
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006

Dear Chairman Doty,

I write today to express my concern about the Public Company Accounting Oversight Board's continued failure to inspect Chinese audit firms. Close to 100 Chinese auditors, or China-based affiliates of U.S. auditors, have registered with the Board to perform audit work for over 300 U.S. public companies with operations in China. The Board's failure to inspect means that American investors have no independent assurance that Chinese accounting firms' audits on U.S. public companies' operations in China comply with U.S. law. This is a serious problem that threatens to undermine public confidence in the companies' financial statements.

It goes without saying that the integrity of public companies' financial statements is critical to confidence in U.S. markets – whether those financial statements are prepared in the United States or in other countries. Yet, despite six years of Chinese audit firms' refusals to cooperate in inspections, the Board has taken no disciplinary actions with respect to any of those firms. I recognize that the Chinese government is acting to obstruct the Board's inspection of registered Chinese audit firms, but this standoff has gone on long enough. I respectfully urge the Board to take immediate disciplinary actions against Chinese audit firms that continue to refuse to cooperate.

In just a two-month span earlier this year, more than 24 companies doing business in China reported auditor resignations and accounting irregularities. Moreover, the Board itself has expressed concern about the danger lack of inspection of Chinese audit firms poses for U.S. investors. Yet the Board has done nothing more than list the Chinese auditors that have never been inspected, along with the names of their client companies, and issue an audit alert to remind registered audit firms of their obligations. The alert appears to have been prompted by the increasing numbers of companies based in China and Hong Kong accessing the U.S. markets via reverse mergers. These recent reverse merger scandals are case-in-point that failure to scrutinize Chinese audits can cost U.S. investors billions. More problematic is that the reverse merger collapses might just be the tip of the iceberg.

It has been ten years since the wave of corporate accounting scandals that began with the sudden and unexpected collapse of Enron Corp. In the wake of those scandals, Congress established an independent watchdog – the Public Company Accounting Oversight Board – specifically to regulate independent auditors of public companies. To ensure corporate financial statements are subject to tough, outside scrutiny, Congress also gave the Board explicit legal authority to take disciplinary action if auditors refuse to cooperate in inspections. Those sanctions include suspending or revoking an audit firm's registration, which would preclude the firm from preparing or issuing any audit reports concerning any issuer. Despite this enforcement authority, and despite six years of Chinese audit firms' refusals to cooperate in inspections, the Board has taken no disciplinary actions on any Chinese auditors. The Board's failure to do what it was created to do – particularly in the face of Chinese corporate accounting scandals that have already cost U.S. investors billions – is deeply troubling.

I understand the Board has been negotiating the auditor inspection issue with China for over six years. However, as we have seen on other issues, years of discussions with the Chinese government generally fail to produce meaningful results. The Board was not created to merely alert the public to problems. Rather, the Board was set up as a watchdog to protect investors – to inspect and assess compliance with applicable securities laws to protect the interests of investors and further the public interest in the preparation of accurate audit reports. In the case of Chinese audit firms, the Board is failing to do its job.

Mr. Chairman, you recently conceded publicly that it is not tenable to continue indefinitely to allow Chinese audit firms to remain registered if the PCAOB cannot inspect their U.S.-related audit work. I agree. Six years with no resolution on this critical issue is unacceptable, and it is time for the Board to exercise its enforcement authority against Chinese audit firms that have not submitted to independent regulatory review. In a separate letter, I am asking the Securities and Exchange Commission to require upfront disclosure by public companies that use China-based audit firms while we wait for the Board to do its job. The longer the Board countenances this impasse, the greater the danger to American investors and U.S. markets.

Thank you for your attention to this important matter. I ask that you please keep me apprised of developments.

Sincerely,

Charles Schumer

Charles E. Schumer
United States Senator