



Capital Markets and the Holding Foreign Companies Accountable Act—S. 945 and H.R. 7000

September 18, 2020

In May 2020, the Senate passed S. 945, [the Holding Foreign Companies Accountable Act \(HFCAA\)](#), and the House introduced H.R. 7000, [a companion bill](#). These bills would require that foreign companies listed in U.S. stock exchanges be subject to the same accounting and audit oversight as listed domestic companies. This Insight explains the importance of reliable financial statements and disclosures for efficient capital markets and discusses the role of the [Public Company Accounting Oversight Board \(PCAOB\)](#) in ensuring reliable audits of financial statements. It also discusses the specific requirements of the HFCAA and other related legislation.

Capital Markets

[Capital markets](#) are global, and they generally function most efficiently when investors and creditors have a high degree of trust in the quality of information firms communicate. Capital investments have increasingly flowed [internationally to and from the United States](#). Both U.S.-based and many foreign companies rely on U.S. financial markets to raise capital and establish a reliable and consistent trading presence for their securities. Financial reports and disclosures are the primary means by which firms communicate about their performance with investors, creditors, regulators, and the public. Reliable financial statements can provide economy-wide benefits to firms and investors by disseminating accurate information. These benefits are often realized through a more efficient allocation of capital between investors and firms.

Investors rely on financial statements to make informed decisions on how best to invest their savings. Investors and other stakeholders, arguably, need to have reasonable assurance that a firm's financial statements are [free of material misstatement](#), whether caused by error or fraud.

Congressional Research Service

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IN11507

Financial Reporting and Disclosures

Federal securities laws require public companies, both domestic and foreign, listed in the United States to [share critical information about their performance](#) on an ongoing basis. Domestic companies are required to submit to the Securities and Exchange Commission (SEC) annual reports on [Form 10-K](#), which includes the audited financial statements. Investors rely on Form 10-K and other SEC filings, such as Form 10-Q and Form 8-K, for a comprehensive overview of a company's performance. Foreign companies participating in the U.S. capital markets are [required to file](#) a different but comparable set of financial reports and disclosures (e.g., instead of Form 10-K, they file [Form 20-F](#)). Foreign firms that file the 20-F follow the financial reporting and disclosure requirements that are native to their countries. Foreign firms do not follow U.S. accounting or disclosure requirements, and the auditing requirements in those countries might also differ.

A qualified external party—an auditor—provides independent assurance to shareholders and other stakeholders that a firm's annual reports and financial statements are free of [material errors](#). The auditor is engaged to give an unbiased [professional opinion](#) on whether the financial statements and related disclosures are fairly stated in all material respects for a given period of time in accordance with [Generally Accepted Accounting Principles](#) (GAAP). As a consequence of widespread financial accounting fraud in the early 2000s, Congress passed the [Sarbanes-Oxley Act of 2002](#) (SOX; P.L. 107-204). SOX created the PCAOB as a nonprofit self-regulatory organization to provide independent oversight of accounting firms that audit public companies. The PCAOB also oversees [audits of registered brokers and dealers](#). The [SEC has oversight authority](#) over the PCAOB, including the approval of the board's rules, standards, and budget.

Foreign firms accessing U.S. capital markets use [auditors from their home countries](#) to audit their financial reports. This poses challenges for PCAOB oversight. Over the past decade, the SEC and PCAOB have [entered into various agreements](#) either multilaterally or bilaterally with various foreign regulators to inspect the audit workpapers of accounting firms that audit multinationals, but they [face limitations with certain regulators](#). Some foreign authorities, including [China](#), prevent or impair the PCAOB's ability to inspect non-U.S. accounting (audit) firms, even when these firms are [registered with the PCAOB](#). The PCAOB has been restricted from inspecting the audit workpapers of PCAOB-registered accounting firms based in China, including Hong Kong, even though the related securities are listed on U.S. exchanges. The PCAOB has identified [188 unique Chinese issuers with \\$1.9 trillion in combined market capitalization](#).

Proposed Requirements

S. 945 and H.R. 7000 would place certain requirements on U.S. regulators and foreign firms listed in the United States. These requirements can be divided into two broad categories:

Disclosure Requirements. The SEC and PCAOB would be required to identify firms that have U.S. listed securities but retain foreign accounting firms to audit their financial statements, whose audit workpapers cannot be inspected by the PCAOB. If the PCAOB is unable to inspect the audit workpapers, then the foreign firm would be required to document to the SEC that they are not owned or controlled by a governmental entity in a foreign jurisdiction.

Trading Restrictions. The SEC would be required to prohibit an issuer's trading of securities if the PCAOB is unable to inspect its audit firm's workpapers for three consecutive years. The proposals allow listed companies that are able to resolve the underlying audit inspection issues with the PCAOB to be listed again. The bills also address subsequent violations by the listed companies.

In addition to S. 945 and H.R. 7000, other bills with similar provisions—S. 1731, [H.R. 3124](#), and H.R. 7181—have also been introduced in the 116th Congress. Some Members have also introduced legislation—S. 2791, H.R. 5018, and H.R. 6614—requiring that, if PCAOB is unable to inspect the audit workpapers of foreign accounting firms of foreign companies listed in the United States, then the [Thrift Savings Plan](#) would be required to divest from such foreign companies. Although these bills would limit foreign firms’ abilities to raise funds through listing on the exchanges, foreign firms could still raise funds in the United States through [other means](#), such as through [private equity](#) and qualifying as an [emerging growth company](#).

The President’s Working Group on Financial Markets issued a [report](#) with specific recommendations. Among those recommendations are enhanced initial and continued listing standards on U.S. exchanges where PCAOB has ongoing access to a listed company’s principal audit firm’s workpapers.

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