

**Bills Committee on
Financial Reporting Council Bill**

**Funding Arrangement for the
Financial Reporting Council**

PURPOSE

This paper provides information on the revised funding arrangement for the Financial Reporting Council (FRC).

BACKGROUND

2. As the Bills Committee was briefed at the meetings on 27 September and 7 October 2005, the Hong Kong Exchanges and Clearing Limited (HKEx), Hong Kong Institute of Certified Public Accountants (HKICPA), Securities and Futures Commission (SFC) and the Administration had previously agreed to contribute to the funding of the FRC on the following basis -

- (a) Each of the four funding parties would contribute an amount of \$2.5 million *per annum* (i.e. a total of \$10 million *per annum*) as the recurrent funding for the first three years of the operation of the FRC;
- (b) On top of (a) above, each party would contribute a maximum amount of \$2.5 million (i.e. a total of \$10 million) as the contingency funding for the FRC for the first three-year period; and
- (c) The funding requirements from the fourth year onwards would be reviewed later on, in the light of actual operational experience.

In this respect, the Administration's contribution would come from the Companies Registry Trading Fund (CRTF) which would, in addition to the aforesaid monetary contribution, provide free accommodation to the FRC.

3. Noting the proposed arrangement as set out in paragraph 2 above, some Members stressed that sufficient funding should be made available to the FRC. In this connection, the Bills Committee invited the Administration to -

- (a) elaborate on the basis on which the funding arrangement was formulated; and
- (b) discuss with the relevant parties whether additional resources should be injected to the FRC.

RELEVANT CONSIDERATIONS

4. We agree with the Bills Committee that sufficient funding should be available to the FRC for performance of its functions. In meeting this objective, the concerned parties have taken into account the following considerations -

- (a) As a matter of principle, it is important to ensure that a lean structure comprising competent personnel will be devised for effective operation of the FRC;
- (b) The caseload of the FRC after its establishment may fluctuate from time to time depending on many factors, such as the business cycle and the enhancement of the regulatory framework. Nevertheless, the number of investigations, in relation to listed entities, instigated by the Hong Kong Society of Accountants (HKSA)/HKICPA's Investigation Committees since 1998 (see table below) may shed some light on the matter -

Year	New cases instigated by the HKSA/HKICPA's Investigation Committees in the year
1998 ¹	1
1999	5
2000	1
2001	1
2002	0
2003	5
2004	1
2005	0
Total	14

- (c) The FRC will take the place of the Investigation Committees of the HKICPA to conduct investigations and make findings to enable the HKICPA to institute disciplinary proceedings under the Professional Accountants Ordinance (Cap. 50). In this connection, according to the HKICPA, the Institute has incurred about \$3 million *per annum* in the past five years in respect of its *investigation* function.
- (d) The FRC is empowered to recover investigation costs from cases where the complaints are proven (c.f. **clauses 37, 71 and 80**); and
- (e) Contingency funding shall be available for the FRC to cover any shortfall in the recurrent funding and meet the exigencies of circumstances (for instance, an unexpected heavier caseload, the need to recruit additional employees to deal with certain complex cases, legal fees, etc.).

¹ Since the introduction of investigatory powers in the Professional Accountants Ordinance in 1994, no cases were filed for investigation until 1998.

REVISED FUNDING ARRANGEMENT

5. In response to the request of the Bills Committee, the Administration and the other relevant funding parties have carefully reviewed the funding arrangement. We consider that the proposed recurrent funding of \$10 million *per annum* should be sufficient to cover the operating expenses of the FRC in the first three years and cater for some future fluctuations in price levels and occasional rise of investigation costs as a result of, say, any upsurge of caseload and complexity of individual cases.

6. While it may not be prudent for us to make changes just based on developments which may be cyclical in nature or whose impact has yet to be ascertained, the Administration and the other relevant funding parties have agreed to **double the amount of the contingency funding for the FRC**. In this regard, the *revised* funding arrangement, as agreed among the four parties, will be as follows -

- (a) Each of the four parties is to contribute an amount of \$2.5 million *per annum* (i.e. a total of \$10 million *per annum*) as the recurrent funding for the first three years of the operation of the FRC;
- (b) On top of (a), each party is to undertake to contribute an amount of **\$5 million** (i.e. **a total of \$20 million**) as the contingency funding for the FRC for the first three-year period;
- (c) The CRTF is to provide free accommodation to the FRC. According to the latest estimate, the annual accommodation cost (including all notional rent and rates, overhead costs and depreciation of the fitting-out cost) will amount to about \$2.9 million *per annum*; and
- (d) The funding requirements from the fourth year onwards are to be reviewed later on, in the light of actual operational experience.

The four parties intend that the agreement shall be signified in the form of a memorandum of understanding among them. Moreover, as regards the detailed budget allocation, **clause 17** of the Bill provides that the FRC shall submit to the Secretary for Financial Services and the Treasury, for his approval, estimates of the income and expenditure of the FRC. We consider that it is best for the FRC to draw up such allocation upon its establishment.

7. Furthermore, the four parties have agreed that they will seriously consider any justified request made by the FRC for additional funding beyond the current commitments.

Financial Services and the Treasury Bureau
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