

**For information**

**Legislative Council Panel on Financial Affairs**

**Financial Reporting Council  
Budget for the Financial Year 2022-23**

**PURPOSE**

This paper highlights the main features of the budget of the Financial Reporting Council (“FRC”) for 2022-23.

**BACKGROUND**

2. Section 17(3) of the Financial Reporting Council Ordinance (“FRCO”) requires the FRC to submit the estimates of its income and expenditure for each financial year to the Financial Secretary (“FS”) for approval. In line with the practice of other financial regulators, the Government has prepared this paper to brief Members on the main features of the FRC’s budget for 2022-23.

3. The Legislative Council passed the Financial Reporting Council (Amendment) Bill 2021 (“Amendment Bill”) in October 2021 to enhance the regulatory regime of the accounting profession in Hong Kong. Under the new regime, the FRC will become a full-fledged independent regulator of the accounting profession and be renamed as the Accounting and Financial Reporting Council, which will be vested with powers to regulate Public Interest Entities (“PIE”)<sup>1</sup> auditors as well as practice units<sup>2</sup> and certified public accountants (“CPA”). The current target is to commence

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<sup>1</sup> A PIE refers to a corporation with issued shares or stocks listed in Hong Kong or a collective investment scheme with interests listed in Hong Kong.

<sup>2</sup> A practice unit is defined in the Amendment Bill as (i) a certified public accountant (practising) who practises accountancy on the accountant’s own account under the accountant’s own name; (ii) a certified public accountant (practising) who practises accountancy on the accountant’s own account under a firm name; (iii) a firm of certified public accountants (practising); or (iv) a corporate practice.

the new regime by the end of 2022<sup>3</sup>.

## FUNDING OF THE FRC

4. A seed capital of \$400 million was injected to the FRC in 2019 to help it migrate to the PIE auditor regulatory regime and to exempt the relevant levies<sup>4</sup> for the first two years of implementation of the regime. Since 1 January 2022, the FRC has started collecting the levies pursuant to the FRCO to fund the operating expenditure arising from the PIE auditors regulatory functions (to be referred to as “PIE-related functions” below).

5. The unspent balance of the seed capital will help cover the expenses arising from the expanded functions of the FRC under the prospective new regulatory regime of the accounting profession, including the regulation of practice units and CPAs, i.e., registration of practice units, and inspection, investigation and discipline of the entire profession (to be referred to as “non-PIE-related functions” below). Upon the transfer of powers for issuance of practising certificates and registration of practice units to the FRC, the FRC will collect the relevant application fees which are currently payable to the Hong Kong Institute of Certified Public Accountants (“HKICPA”), while the Government has committed to exempt these fees in the first year of implementation of the new regime.

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<sup>3</sup> We will separately brief Members on the progress of the preparatory work in April 2022.

<sup>4</sup> The three levies are:

- (1) the levies payable for a sale and purchase of securities –
  - (a) for the seller – 0.00015% of the consideration for the sale; and
  - (b) for the purchaser – 0.00015% of the consideration for the purchase;
- (2) the levies payable by a PIE for a calendar year – 4.2% of the prepaid annual listing fee; and
- (3) the levies payable by a PIE auditor for a calendar year –
  - (a) \$6,155 × the number of PIEs for which the auditor is carrying out, as at 31 December of the preceding calendar year, a specified engagement; and
  - (b) 0.147% of the total remuneration paid to the auditor, in the preceding calendar year, by the PIEs for which the auditor carried out specified engagements.

## **BUDGET FOR 2022-23**

6. Based on the target to commence the new regime within this year, the FRC has prepared its 2022/23 budget at Annex, the main features of which are set out in paragraphs 7 to 20 below.

### **Income**

7. The total estimated income for 2022-23 is about \$242.22 million, including \$179.35 million from the levies collected since 1 January 2022, \$6.32 million of Grant income<sup>5</sup>, and interest and other incomes for funding the PIE-related functions; while \$56.24 million is from the Grant income for funding the implementation of the new non-PIE-related functions starting from this year.

8. In projecting the estimated levies income, the FRC has adopted the following assumptions –

- (a) an average securities market turnover of \$147 billion per day;
- (b) an estimated annual 1% increase in the number of PIEs with unchanged average annual listing fee per PIE; and
- (c) the annual increase of engagements will be in line with the increase in the number of PIEs.

### **Operating Expenditure**

9. The total estimated operating expenditure for 2022-23 is about \$237.97 million for implementing the PIE-related functions and the new non-PIE-related functions.

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<sup>5</sup> According to the FRC's financial reporting method, the amount of seed capital (i.e. Government Grant) disbursed in the financial year is recognised as "Grant income" in the financial statement for offsetting the operating expenditure funded by the seed capital. Upon the collection of levies which will be used to fund the operating expenditure incurred for the PIE-related functions, the seed capital will continue to be disbursed to cover the capital expenditure for the PIE-related functions.

10. The largest expenditure item is “staff salaries, bonuses, variable pay and Mandatory Provident Fund contributions” which is estimated at about \$152.51 million in total, of which –

- (a) around \$116.84 million is attributed to the 59 existing headcount and 30 new headcount for the PIE-related functions with a provisional average salary increment of 3% factored in; and
- (b) around \$35.67 million is for the 26 new headcount for the non-PIE-related functions.

### **Manpower Plan**

11. The FRC proposes a total of 56 new headcount in the budget for 2022-23. This will bring the FRC’s total headcount from 59 at present to 115.

12. For the PIE-related functions, the FRC is currently understaffed as a result of the budgetary and headcount freeze in 2021-22, as well as unforeseen increase in workload<sup>6</sup>. The 30 new headcount is proposed to cope with the phasing-in of the PIE auditor regulatory regime, and a majority of the new headcount will be deployed to extend the inspection work to cover audits of larger and more complex PIE; to process the increase in case intake as a result of complaints, whistle-blower reports and referrals from other regulators; and to start handling the first batch of disciplinary cases under the PIE regime.

13. As for the new non-PIE-related functions, the FRC needs to build up a new establishment to cope with the duties. When drawing up the manpower plan, the FRC has made reference to the existing setup and establishment in the HKICPA for similar functions (e.g. registration and inspection); the synergy with headcount for comparable functions under the PIE auditor regulatory regime; and the relevant regulatory experience under the PIE auditor regulatory regime for new functions that are unique to the FRC. The 26 new headcount proposed by the FRC is mainly for taking up the issuance of practising certificates and registration of practice units from the HKICPA, following up on the investigation and disciplinary

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<sup>6</sup> For instance, the case intake as a result of complaints, whistleblower reports and referrals from other regulators from January to October 2021 has increased by about 70%.

cases handed over by the HKICPA or newly arising, as well as gearing up for the inspection function.

14. The FRC will adopt a progressive approach to implement its non-PIE-related functions. The new headcount for the relevant functions will gradually increase across the coming three financial years.

### **Capital Expenditure**

15. The estimated total capital expenditure for 2022-23 is about \$32.91 million, covering expenses on IT equipment and development of IT systems, office equipment, and office renovation and furniture, including those required to accommodate the new non-PIE-related functions.

### **Reserve Funds**

16. The total sum of reserve funds of the FRC by 31 March 2023 is estimated at about \$192.58 million, with about \$70.06 million of general reserve mainly comprising operating surplus from the PIE-related functions, and about \$122.52 million of unspent Government Grant.

17. According to Part 4A of the FRCO on the levies, the FRC may, after consultation with the FS, recommend to the Chief Executive-in-Council that the rate or amount of levies be reduced if the reserves of the FRC are more than twice its estimated operating expenses for that financial year. Since around \$122.52 million of the estimated reserve funds of the FRC is the unspent Government Grant which will be used to compensate the deficit arising from the exemption of fees for the non-PIE-related functions, it is considered that no adjustment to the rate or amount of levies is required.

## **COMPARISON OF THE 2021-22 APPROVED BUDGET WITH THE UPDATED FORECAST**

### **Income**

18. The forecast income for 2021-22 is \$111.16 million, comprising about \$41.79 million of levies income, \$66.99 million of Grant income, and \$2.38 million of interest and other incomes and recovery of investigation costs. It is \$10.41 million (8.56%) below the approved

budget of \$121.57 million, mainly due to a smaller-than-budgeted amount of Government Grant needed to be disbursed before the collection levies and thus recognised as Grant income.

### **Operating Expenditure**

19. The forecast operating expenditure is \$99.76 million, which is \$4.81 million (4.6%) lower than the approved budget of \$104.57. The underspending is mainly due to time lag in filling vacancies, and lower expenses on items including conference and duty visits, corporate communication and depreciation, etc. The savings were partially offset by an increase in expenses on staff recruitment and training, legal and professional services and information and systems services.

### **Capital Expenditure**

20. The forecast capital expenditure is about \$4.08 million, which is \$2.21 million (35.14%) below the approved budget of \$6.29 million.

## **THE GOVERNMENT'S VIEWS**

21. We have studied in detail the FRC's proposed budget for 2022-23 and note that the FRC will adopt a progressive approach for the implementation of the new regime so as to facilitate a smooth transition for the profession.

22. We also note that the application fees for issuance of practising certificates and the registration of practice units will be exempted in the first year of the new regime. Thereafter, the FRC will collect the relevant fees which will initially be set at a level no higher than that currently collected by the HKICPA. The FRC will be short of income to cover the expenses arising from the non-PIE-related functions over a period, and therefore will need to continue to deploy the Government Grant to fill the gap. We encourage the FRC to effectively utilise the available resources to attain as far as possible synergy with the resources for different functions and prioritise its work properly. We will keep the FRC's financial position in the next few years under review.

## **ADVICE SOUGHT**

23. Members are invited to note the proposed budget of the FRC for 2022-23.

**Financial Services Branch  
Financial Services and the Treasury Bureau  
March 2022**

## Financial Reporting Council

## Budgeted Income and Expenditure Statement

For the period from 1 April 2022 to 31 March 2023 (the "Period")  
(Expressed in Hong Kong dollars)

	Note	Proposed budget			Forecast	Approved budget
		Apr 2022 to Mar 2023			Apr 2021 to Mar 2022	Apr 2021 to Mar 2022
		PIE	Non PIE	Total	PIE only	PIE only
	HK\$	HK\$	HK\$	HK\$	HK\$	
<b>Income</b>						
<b><u>PIE</u></b>						
Levies income	1	179,352,000	-	179,352,000	41,788,000	41,788,000
Grant income	2	6,318,000	-	6,318,000	66,994,000	77,993,000
Interest & other incomes	3	303,000	-	303,000	1,133,000	1,789,000
Recovery of costs of investigation	4	-	-	-	1,244,000	-
<b><u>NON-PIE</u></b>						
Grant income	2	-	56,244,000	56,244,000	-	-
		185,973,000	56,244,000	242,217,000	111,159,000	121,570,000
<b>Expenditure</b>						
Staff salaries, bonuses, variable pay and MPF	5	(116,836,000)	(35,672,000)	(152,508,000)	(67,929,000)	(77,392,000)
Other staff related expenses	6	(9,234,000)	(3,810,000)	(13,044,000)	(7,027,000)	(3,602,000)
Premises expenses	7	(23,697,000)	(6,923,000)	(30,620,000)	(11,848,000)	(11,912,000)
Legal fees (FRC)	8	(4,200,000)	(1,800,000)	(6,000,000)	(2,150,000)	(500,000)
Legal fees (enforcement)	8	(7,000,000)	(3,000,000)	(10,000,000)	-	-
Conference and duty visits	9	(1,547,000)	(393,000)	(1,940,000)	-	(770,000)
Corporate communication expenses	10	(3,485,000)	(1,018,000)	(4,503,000)	(576,000)	(1,106,000)
Information and systems services	11	(3,627,000)	(957,000)	(4,584,000)	(2,766,000)	(852,000)
Other operating expenses	12	(2,873,000)	(752,000)	(3,625,000)	(1,250,000)	(1,452,000)
Depreciation	13	(6,533,000)	(1,132,000)	(7,665,000)	(2,853,000)	(3,503,000)
Total recurring operating expenditure		(179,032,000)	(55,457,000)	(234,489,000)	(96,399,000)	(101,089,000)
Non-executive directors' fees		(2,693,000)	(787,000)	(3,480,000)	(3,360,000)	(3,480,000)
Total expenditure		(181,725,000)	(56,244,000)	(237,969,000)	(99,759,000)	(104,569,000)
<b>Operating Surplus</b>		4,248,000	-	4,248,000	11,400,000	17,001,000
Headcount		89	26	115	59	59



## 1. Levies Income

1.1 Details of the levies payable by sellers and purchasers of securities, PIEs, and PIE auditors to the FRC are set out in Section 50A of the Financial Reporting Council Ordinance (FRCO). The collection of the levies will commence on 1 January 2022. The levies will be recorded as income on an accrual basis. Levies payable by sellers and purchasers of securities will be collected on behalf of the FRC by Hong Kong Stock Exchange and Clearing Limited (HKEX) and those payable by local PIE auditors will be collected on behalf of the FRC by the Hong Kong Institute of Certified Public Accountants (HKICPA).

### 1.2 Levies payable by sellers and purchasers of securities

1.2.1 Under Section 1 of Schedule 7 of the FRCO, the levy payable for a sale and purchase of securities is calculated based on the consideration for the sale and purchase (Market Turnover) by the seller and purchaser, each at a rate of 0.00015% of the Market Turnover.

1.2.2 Same as last year, when determining the assumed market turnover, we have referred to the estimate adopted by SFC in estimating the market turnover in the budget. SFC estimates the average securities market turnover for the preparation of its budget based on the average securities market turnover per day in the current year and the market outlook for the budget year.

1.2.3 The average securities market turnover of Main Board and GEM is HK\$147.0 billion / day based on the SFC adopted estimate provided to us on 23 December 2021.

1.2.4 For the preparation of the budget, HK\$147.0 billion per day has been used as the assumed average rate of securities market turnover in 2022/23.

1.2.5 The unpredictable nature of market turnover leads to an unavoidable degree of uncertainty in the annual budget compilation. Any fluctuation of HK\$10 billion in average daily rate of securities market turnover will have an impact of around HK\$7.4 million on our income.

### 1.3 Levies payable by PIEs

1.3.1 Under Section 1 of Schedule 7 of the FRCO, the levy payable by a PIE for a calendar year is calculated at 4.2% of the prepaid annual listing fee which is determined by reference to the nominal value of the securities which are or are to be listed on the HKEX Exchange.

1.3.2 In 2020, the total annual listing fee income of the HKEX was HK\$768 million and the number of PIE was 2,538 (average annual listing fee per PIE was HK\$302,600). In 2020, there were 165 new listings and 76 delistings or other departures from the market for listed entities, resulting in a net increase of 89 from 2,449 to 2,538 PIEs during the year (a net rate of increase of 3.6%).

1.3.3 However, given the recent lower level of new listings and increase in the number of delistings by HKEX (the net increase for the 9 months to 30 September 2021 was 21), for budgeting purposes, it has been assumed that the number of PIEs will continue to increase by 26 per year (representing a 1% growth rate) and that the average annual listing fee per PIE will remain at HK\$300,000.

### 1.4 Levies payable by PIE auditors

1.4.1 The levy payable by a PIE auditor for a calendar year is the sum of (a) HK\$6,155 x N; and (b) 0.147% of TR. N is the number of PIEs for which the auditor is carrying out a specified engagement as of 31 December of the preceding year, and TR is the total remuneration paid to the auditor in the preceding calendar year by the PIE for which the auditor carried out the specified engagements.

1.4.2 We have assumed that the number of PIE engagements in 2022/23 is equal to the number of listed companies in the year (see paragraph 1.3.2). Accordingly, there are 2,590 specified engagements (N) in 2022 and the average total remuneration (TR) per specified engagement is approximately HK\$5.6 million (which is assumed to be the same as in 2021).

1.5 Levies income assumption

The following key assumptions have been used in calculating the levies income estimates:

	FY2022/23
<b>Levy payable by:</b>	
<b>Sellers and purchasers of securities</b>	
•Average daily market turnover	\$147.0 billion
•Levy rate on sellers	0.00015%
•Levy rate on purchasers	0.00015%
<b>PIEs</b>	
•Average annual listing fee / PIE	\$300K
•No. of PIEs	2,590
<b>PIE auditors</b>	
•No. of specified engagements (N)	2,590
•Average total remuneration (TR) per specified engagement	\$5.6 million

1.6 The budgeted levies income is determined as follows:

	FY2022/23 \$ million
Payable by	
•Sellers and purchasers of securities	109.0
•PIEs	33.0
•PIE auditors (\$6,155 x N)	16.0
•PIE auditors (0.147% x TR)	21.4
<b>Total</b>	<b>179.4</b>

**Non-PIE Levies and Licence fees income assumption**

1.7 Licence fees are assumed to be waived for 2022-23 but to commence being collected by FRC from 2023-24. The assumed amount to be collected is based on the amount reported in the HKICPA Annual Report for 2020 of HK\$45,136,000.

## **2. Grant income**

- 2.1 In August 2019, the FRC received a grant of \$400 million from the Government of HKSAR to be utilised, during the period of migration to the New Regime, to cushion the FRC against short-term fluctuations in the levy income, to fund one-off capital and non-recurrent expenses, to allow the FRC to gradually expand its manpower taking into account its actual operational needs, and to provide a buffer for other exigencies of circumstances. There were no unfulfilled conditions or other contingencies attaching to the grant.
- 2.2 The grant is recognised as deferred income in the statement of financial position initially and is recognised as income on a systematic basis in the statement of comprehensive income over the periods in which the FRC recognises as expenses the related costs, including depreciation on capital expenditure, for which the grant is intended to compensate.
- 2.3 The FRC's operating expenditure will be financed by levies from 1 January 2022. Any shortfall in the PIE Levies would also be funded by the grant, to the extent not fully utilized. For 2022-23 the PIE functions are budgeted to be generating a surplus.
- 2.4 It is also assumed that the operating and capital expenditure relating to the FRC's Non-PIE functions would be funded by the grant in 2022-23 and subsequent years to the extent that there is a shortfall in funding from licence fees and that there is a balance of the Grant available. Any remaining shortfall in funding is assumed to be provided from other sources.

## **3. Interest Income and Other Income**

- 3.1 Cash held by the FRC not for immediate use, including the general fund, the balance of government grant and operating surplus if any, will be placed in fixed deposits to generate interest income.
- 3.2 Other income represents application fees received for recognition of overseas auditors.

#### 4. Recovery of Costs of Investigation

4.1 Auditing irregularities in relation to PIE engagements completed before 1 October 2019 would be referred to the HKICPA for disciplinary action. Provisions under sections 37 and 50 of the FRCO as in force immediately before 1 October 2019 and section 35 of the Professional Accountants Ordinance for the award of costs and expenses to the FRC by the Magistracy, the Court and the Disciplinary Committees (of the HKICPA) continue to apply to these cases.

4.2 Given the low levels of recovery in past years, and the fact that the timing and amounts of any recoveries are dependent on the HKICPA timetable and success of prosecution, no income in relation to the award of costs and expenses has been included in the budget, which is consistent with prior year budgets.

#### 5. Staff Salaries, Bonuses, Variable Pay and MPF

5.1 Budgeted salaries, bonuses, variable pay and MPF are analyzed in terms of headcount and by functions below:

Department	Headcount	\$
<b>Corporate functions:</b>		
CEO Office	2	5,964,473
Legal	4	6,447,319
Finance & Administration	16	12,138,444
	<b>22</b>	<b>24,550,236</b>
<b>Regulatory functions:</b>		
Investigation & Compliance	33	39,411,978
Inspection	30	35,485,021
Oversight, Policy & Governance	11	17,303,840
Discipline	19	30,215,222
	<b>93</b>	<b>122,416,061</b>
<b>Total</b>	<b>115</b>	<b>146,966,297</b>
Contract staff and interns		5,541,690
<b>Total</b>		<b>152,507,987</b>

5.2 Salaries bonuses and variable pay are calculated based on the existing remuneration level and bonus scheme of the FRC, with an average salary increment of 3% p.a. in 2022-23. In addition, as in prior years, a cash incentive bonus pool is provided at 2.5% of the annual salary for all staff other than the CEO and other staff eligible for variable pay. Any actual

payment will be determined at the discretion of the Board.

- 5.3 The amount of MPF contributions is based on 5% of the budgeted amount of salaries and bonuses.

## 6. Other Staff Related Expenses

	\$
Staff recruitment expenses	6,820,126
Staff training and development	1,869,550
Other staff expenses	4,354,587
<b>Total</b>	<b>13,044,263</b>

### Staff Recruitment Expenses

- 6.1 The 2022-23 Budget projected recruitment expenses are HK\$6,820,126 (including HK\$6.6 million for the recruitment of 27 new staff and the replacement of a Head of Department through the use of a recruitment agency). In addition to recruitment of new staff, it is assumed that there will be a need to recruit replacement staff and a staff turnover rate of 10% has been assumed. For the Non-PIE function, recruitment due to staff turnover is assumed to commence from 2023-24 onwards.

- 6.1.1 It is assumed that the FRC will use an external recruitment agency to recruit part of the 56 new staff for 2022-23, taking into account that the FRC's existing resources will also be preparing for a smooth transition of functions from the HKICPA and that the market conditions for recruiting professional staff are tight. It is assumed that the total headcount of 56 staff will be as follows:

- (i) Direct recruitment by the FRC of up to 29 HKICPA staff currently involved in the performance of the functions to be transferred to the FRC, without use of an external recruitment agency; and
- (ii) Use of a recruitment agency to recruit 27 headcounts.

- 6.1.2 The estimated recruitment cost for the headcounts to be recruited with recruitment agency support is estimated to be HK\$9 million. As Management needs to commence the recruitment of these staff in 2021-22 in order to meet the budgeted phased timing of on-boarding of the new staff, it is estimated that HK\$3 million will be incurred in 2021-22 with the remaining HK\$6 million incurred in 2022-23.

## Staff Training and Development

- 6.2 Staff training and development includes professional training in financial reporting, auditing, legal, inspection, and investigation skills. It also includes development of broader management and leadership skills, including report writing skills and other communication skills to ensure the FRC can maintain a highly proficient team to discharge its statutory functions. Team building will also be crucial to maintain cohesiveness and avoid silo behaviours as our headcount increases significantly in transforming the FRC to deliver the Further Reforms.
- 6.3 Effective recruitment, development and retention of staff will be a critical strategic goal in implementing the integration of the Non-PIE functions. Learning and development is an important enabler of that goal and will require investment.
- 6.4 As a regulator of the accounting profession, the focus of our regulatory work is on the professional competence and behaviours of accountants. It is critical to the effective performance of these functions that our staff maintain their competence at an appropriately high level.
- 6.5 We aim to instill a culture of learning not only in relation to technical competence but also competence in management and leadership. This culture is a key ingredient underpinning our drive to deliver high performance and effective outcomes with efficient use of our resources.
- 6.6 In 2019, Willis Towers Watson assisted the FRC to develop a Competency Framework for staff. In order to effectively recruit, retain and develop the FRC staff, the development of staff competencies including core competencies (e.g. time management, stress management, and communication skill) and leadership competencies under the Competency Framework are needed.
- 6.7 The budgeted amount of staff training and development expenses are analyzed below.

	\$
Maintaining technical competence	649,550
Development management and leadership skills	575,000
Team building	345,000
Technical update and other reference materials	300,000
Total	<u>1,869,550</u>

- 6.8 We have budgeted for team-building activities at an assumed cost of HK\$3,000 for each staff member. This will be an important aspect of our approach to on-boarding and quickly integrating the significant new headcounts budgeted, which will see the organisation reach a headcount of 115 staff in 2022-23.

**Other staff expenses**

- 6.9 The budgeted estimate of other staff expenses for 2022-23 is HK\$4,354,587, of which 79.1% relates to staff life, medical and dental insurance, and an annual health check subsidy. The budgeted insurance premium amount is determined with reference to the premium rates of the existing insurance policies plus 5% per annum for medical and dental insurance and 2% per annum for other benefits.

	\$
Medical insurance and dental plan	2,356,836
Life insurance	487,843
Employees' compensation insurance	82,343
Health check subsidy	600,000
Professional membership fee	312,000
Staff welfare	430,333
Market information on employee compensation	50,232
Others	35,000
	<u>4,354,587</u>



## 7. Premises Expenses

7.1 The current office of the FRC comprises a single floor of the Hopewell Centre that could accommodate 72 staff members based on the existing office layout.

7.2 Additional premises equivalent to 1.5 further floors of Hopewell Centre would be required to accommodate the proposed increase of staff to 115 in 2022-23 and allowing for future growth in headcount in 2023-24.

	\$
Rental	
Interest on the lease liability	4,096,563
Depreciation charge – Right-of-use asset	<u>20,871,678</u>
	24,968,241
Property management fee	1,713,312
Air-conditioning charge	1,944,828
Government rates	1,161,270
Office cleaning	<u>831,875</u>
	<u><u>30,619,526</u></u>

7.3 The budgeted premises expenses are summarized as follows.

7.4 The FRC entered into the lease agreement for the office premises on 24/F Hopewell Centre with fixed rental for 4 years. The lease term is from 1 September 2019 to 31 August 2023 with an option to extend for a further term of 2 years at a negotiable rent.

7.5 The monthly rental for the first 4-year term is HK\$747,348, which is equivalent to HK\$49 per sq. ft. based on the lettable floor area of 15,252 sq. ft. It is assumed that the option to extend will be exercised in 2023-24 and that the rental cost will be increased to HK\$50 per sq. ft. per month, which is the current asking rent for two vacant floors at the Hopewell Centre.

7.6 The total rental payments to the Landlord are allocated for accounting purposes between the asset representing the right to use the property during the lease term and the interest cost as if the asset was purchased with notional borrowings (the lease liability). The right of use asset is amortised over the period of the lease. The interest cost is recognised as an expense at a constant rate of return on the reducing balance of the notional borrowing. As a result, interest costs recognised in the earlier period of the lease are higher than those recognised in later periods.

7.7 The budgeted amounts of the property management fee, air-conditioning charge, Government rates, and office cleaning cost are assumed to remain at the current levels per sq. ft. with a 2% per annum increase due to inflation.

## **8. Legal Fees**

### 8.1 Legal and professional fees (FRC)

8.1.1 The legal and professional fees (FRC) represent the budgeted costs for obtaining external legal advice (such as advice from Senior Counsel) for operational matters. With the expanded functions, additional legal support would be required. A budget of HK\$6m is provided for 2022-23.

### 8.2 Legal and professional fees (enforcement)

8.2.1 These represent the budgeted costs for engagement of Case Advisers and expert witnesses, for cases that may result in legal proceedings at the PIE Auditor Review Tribunal or the Court of Appeal. The first batch of disciplinary cases is assumed to be handled in 2021-22. It will take time for disciplinary cases to go through different stages of the disciplinary process. A budget of HK\$10m is provided for 2022-23.

8.2.2 The amount of costs for legal proceedings at PIE Auditor Review Tribunal and the Court of Appeal would depend on the number of disciplinary cases going to the PIE Auditor Review Tribunal and the Court of Appeal and the complexity of these cases.

## **9. Conference and Duty Visits**

9.1 The budgeted conference and duty visits are analyzed below:

	\$
Conferences:	
International conferences	240,000
Other duty visits:	
Liaison with overseas regulators	140,000
Liaison with Mainland authorities	360,000
Overseas visits for CEO/Chairman	<u>1,200,000</u>
	<u>1,940,000</u>

## 10. Corporate Communications Expenses

10.1 The budgeted corporate communications expenses are analyzed below:

	\$
FRC Annual Report and quarterly e-news	259,400
Departmental progress reports	421,400
Events	
- Regional Forum	1,500,000
- Other stakeholder engagements	66,200
Website maintenance	106,000
Website revamp	800,000
New logo design	500,000
New Corporate video	550,000
Press and other events relating to Further Reforms	300,000
Total	<u>4,503,000</u>

10.2 Following the Further Reforms, engagement with our existing and new stakeholders will be crucial in establishing public awareness of our expanded functions and public confidence in our regulatory approach. In addition to our regular market communications, including our Annual report, quarterly e-news bulletins and Departmental progress reports, we plan to hold a Regional Forum in 2022-23.

10.3 As a result of the Further Reforms, we also plan to undertake a major revamp of our website, develop a new corporate video, update our logo design given the proposed change in name of the FRC and to hold more conferences to engage with stakeholders on the Further Reforms. These costs will be one-off costs for 2022-23.

## 11. Information and System Services

11.1 The budgeted expenses for information and system services are summarized below:

	\$
Data connection fees	486,930
IT infrastructure and software system maintenance fees	675,631
Data services	1,241,021
Computer peripherals, accessories, user licenses	503,760
Biennial IT security review	350,000
IT sub-contractor fees	1,000,000
Development & implementation cost	326,667
	<u>4,584,009</u>

- 11.2 Budgeted information and system services expenses primarily relate to:
- 11.2.1 Data connection fees represent the costs for broadband connections at the FRC office and our offsite backup server, our telephone service, VPN user license, and video conferencing software license fees.
  - 11.2.2 IT infrastructure and software system maintenance fees relate to annual maintenance fees payable to the vendors or external developers of our infrastructure and application systems following the end of the warranty periods.
  - 11.2.3 Data services include subscriptions to e-magazines and other news search services, data analysis services and online legal research platforms.
  - 11.2.4 Computer peripherals, accessories and user licenses include end-user computer software and hardware, and other software licenses relating to our infrastructure.
  - 11.2.5 We plan to commission an IT security review once in every two years, as recommended by the Office of Government Chief Information Officer. The last review was carried out in 2020-21.
  - 11.2.6 We plan to sub-contract our IT systems development, including supporting our departments to provide design input for those systems and monitoring progress of the development on behalf of the FRC. In addition to the operating costs of HK\$1 million per annum assumed for such support and management, the related capital expenditure estimates are included in Note 18.
  - 11.2.7 By way of benchmarking total IT expenditure included in the budget estimate for 2022-23, we have made a comparison with other financial regulators of IT expenditure as a percentage of total operating expenses. The comparison shows that, despite the proposed increases, the estimate of total IT expenditure for 2022-23 is still on the low side compared with other regulators. The estimate of HK\$11.1 million for total IT expenditure for 2022-23 includes information and system services expenditure of HK\$4.6 million (see paragraph 11.1 above) plus estimated salaries and related staff costs for IT staff of HK\$3.2 million and depreciation of IT capital expenditure of HK\$3.3 million.

This represents 4.7% of total operating expenditure of HK\$238.0 million. Based on our research, this compares with estimates of 7.0% for the UK FRC, 5.4% for the US PCAOB and 5.8% for the SFC, based on information in their most recent annual reports. In the case of the UK FRC, we understand that substantially all their IT services are outsourced. In the case of the US PCAOB, there is no disclosure of the components of their total IT expenditure. In the case of the SFC, their IT staff costs are not disclosed separately and are not included in the above estimate.

## 12. Other Operating Expenses

12.1 The budgeted other operating expenses are summarized below:

	\$
Professional liability and office insurance	596,800
Utilities	324,000
Postage, printing and stationery	1,005,255
Other office supplies and consumables	304,068
Maintenance fees for office equipment	131,110
Small items of office equipment	86,400
Stakeholder engagement activities	428,068
IFIAR membership fee	180,000
IOSCO membership fee	250,000
Annual levy collection fee from HKEX	50,000
Reorganisational costs relating to the Further Reforms	100,000
Other expenses	169,357
Total	<u>3,625,058</u>

12.2 Other expenses include company search services, records management services and bank charges.

### **13. Depreciation**

13.1 Depreciation charge represents the amounts calculated to write off the carrying values of leasehold improvements, office equipment and furniture and fixtures on a straight-line basis over their estimated useful lives as follows:

Leasehold improvements	6 years (over the assumed lease period of 6 years) or over the remaining lease term
Furniture	10 years
Office equipment	7 years
IT equipment	3 years
IT infrastructure & database systems	5 years

13.2 The significant increase in depreciation is due to capital expenditure planned for 2022-23. A substantial portion of the depreciation will be offset by accounting credits for grant income, when the capital expenditure has been funded by the grant, details of which are set out in Note 17 (see paragraph 17.2).

### **14. Non-executive directors' fees**

14.1 It is assumed that there will be no change to the non-executive directors' fee for 2022-23.

### **15. Contingency**

15.1 No contingency provision has been set aside in the budget.

### **16. Cost increase**

16.1 It is assumed that general cost increases will be a rate of 2% per annum. Despite increasing shortages and high turnover rates for accounting and legal professionals, our current assumption is that increases in salaries costs for 2022-23 could be restricted to a rate of only 3% (see paragraph 5.2). No increase in property costs is assumed as the extension of the current lease and new floor space are currently available at a similar rate to the existing lease (see Note 7 for basis of assumptions).

## 17. Funds

### 17.1 General Fund

	HK\$
Balance as at 1 April 2021	48,813,476
Budget operating surplus for 2021-22 (PIE)	<u>17,001,000</u>
Estimated balance as at 31 March 2022	65,814,476
Budget operating surplus for 2022-23 (PIE)	<u>4,248,022</u>
Estimated balance as at 31 March 2023	<u><b>70,062,498</b></u>

### 17.2 Government Grant

HK\$

Grant received from the HKSAR Government (8/8/19)	400,000,000
<u>FY2019/21</u>	
Actual capital expenditure for the new regime	(14,720,479)
Actual operating expenditure (Net of depreciation)	<u>(105,901,259)</u>
<b>Estimated balance as at 31 March 2021</b>	<u><b>279,378,262</b></u>
<u>FY2021/22</u>	
Forecast capital expenditure	(4,075,000)
Forecast operating expenditure (Net of depreciation)	<u>(64,760,747)</u>
<b>Estimated balance as at 31 March 2022</b>	<u><b>210,542,515</b></u>
<u>FY2022-23</u>	
Budget capital expenditure	(32,909,000)
Budget Non-PIE Operating expenditure (Net of depreciation)	<u>(55,111,636)</u>
<b>Estimated balance as at 31 March 2023</b>	<u><b>122,521,879</b></u>

## 18. Capital Expenditures

18.1 The budgeted capital expenditures for IT equipment, system development and office renovation are as follows:

	PIE \$	Non-PIE \$	Total \$
IT Computer software costs	8,303,315	2,425,685	10,729,000
IT Infrastructure costs	3,018,261	881,739	3,900,000
IT related costs	564,500	335,500	900,000
<b>Sub-total for IT costs</b>	<b>11,886,076</b>	<b>3,642,924</b>	<b>15,529,000</b>
Leasehold improvements	9,867,391	2,882,609	12,750,000
Office furniture and fixtures	3,018,261	881,739	3,900,000
Office equipment	605,652	124,348	730,000
<b>Total</b>	<b>25,377,380</b>	<b>7,531,620</b>	<b>32,909,000</b>

18.2 Leasehold improvements of HK\$12.8 million are based on the need to increase our office space to accommodate the increase in headcount. The amount is estimated based on the cost previously incurred for the 24th Floor Hopewell Centre. The split between PIE and Non-PIE is based on the Headcount of each function.

18.3 Budgeted IT software development expenditure for 2022-23 comprises:

	\$
Human Resources Management System	1,729,000
Database system and case management system to automate regulatory functions work	3,000,000
System for maintenance of declarations of conflicts of interests	1,500,000
Staff schedule software, secure documents exchange platform and e-Discovery platform	1,500,000
IT system for registration and licensing	1,500,000
Finance and Accounting system	1,500,000
Total	<u>10,729,000</u>

18.4 IT Infrastructure costs relate to the extending access to the IT infrastructure the additional office space that are required to accommodate the increase in staff Headcount. The amount is estimated based on the cost previously incurred for the 24th Floor Hopewell Centre. The split between PIE and Non-PIE is based on the Headcount of each function.



- 18.5 IT-related costs are personal computers and notebooks for new staff and related computer software. It also covers replacement of older items.
- 18.6 Office furniture and fixtures represent costs for fitting out the additional office space that are required to accommodate the increase in staff Headcount. The amount is estimated based on the cost previously incurred for the 24th Floor Hopewell Centre. The split between PIE and Non-PIE is based on the Headcount of each function.
- 18.7 Office equipment relates to copiers for the additional office space that are required to accommodate the increase in staff Headcount. The amount is estimated based on the cost previously incurred for the 24th Floor Hopewell Centre.