

**For discussion  
on 17 March 2023**

**Legislative Council Panel on Financial Affairs**

**Accounting and Financial Reporting Council  
Budget for the Financial Year 2023-24**

**PURPOSE**

This paper highlights the main features of the budget of the Accounting and Financial Reporting Council (“AFRC”) for 2023-24 (at Annex).

**BACKGROUND**

2. Section 17(3) of the Accounting and Financial Reporting Council Ordinance (“AFRCO”) requires the AFRC 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 AFRC’s budget for 2023-24.

3. The new regulatory regime of the accounting profession was launched on 1 October 2022. Under the new regime, the AFRC has become a full-fledged independent regulator of the accounting profession with expanded powers to regulate Public Interest Entities<sup>1</sup> (“PIE”) auditors as well as practice units<sup>2</sup> and certified public accountants (“CPA”). It also promotes development of the accounting profession as well as oversees the Hong Kong Institute of Certified Public Accountants (“HKICPA”)’s performance of various statutory professional functions.

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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 AFRCO 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) which practises accountancy in partnership; or (iv) a corporate practice.

## FUNDING OF THE AFRC

4. The Government injected a seed capital of \$400 million to the AFRC in 2019 for the launch of the PIE auditors regulatory regime and exempted the relevant levies<sup>3</sup> for the first two years of implementation of the regime. Since 1 January 2022, the AFRC has started collecting the levies pursuant to the AFRCO to fund the operating expenditure arising from the PIE auditors regulatory functions (to be referred to as “PIE-related functions” below).

5. The AFRC is responsible for discharging expanded functions under the new regulatory regime of the accounting profession, including the regulation of practice units and CPAs, i.e., issuance of practising certificates, registration of practice units, and inspection, investigation and discipline of practice units and CPAs (to be referred to as “non-PIE-related functions” below). The AFRC will start collecting application fees for issuance of practising certificates and registration of practice units from 1 October 2023 upon the end of the one-year exemption period. The fees have initially been set at the same levels as those adopted by the HKICPA immediately before the launch of the new regime. The AFRC will therefore need to make use of the unspent balance of the seed capital (around \$212.02 million at the beginning of 2022-23) to cover the expenses arising from the expanded functions.

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<sup>3</sup> The relevant 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 is 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.

## **COMPARISON OF THE 2022-23 APPROVED BUDGET WITH THE UPDATED FORECAST**

### **Income**

6. The forecast income for 2022-23 is \$196.17 million, which is \$46.04 million (19.01%) below the approved budget of \$242.22 million. The lower income is mainly due to the lower-than-budgeted market turnover and total remuneration of PIE auditors for PIE engagements.

### **Operating Expenditure**

7. The forecast operating expenditure is \$221.62 million, which is \$16.35 million (6.87%) lower than the approved budget of \$237.97 million. The underspending is mainly due to time lag in filling vacancies, and lower expenses on items including premises and depreciation, etc. The savings were partially offset by an increase in expenses on corporate communication and information and systems services.

### **Capital Expenditure**

8. The forecast capital expenditure is \$13.81 million, which is \$19.1 million (58.04%) below the approved budget of \$32.91 million. The underspending is mainly due to the postponement of the IT software development project to 2023-24.

## **BUDGET FOR 2023-24**

### **Income**

9. The total estimated income for 2023-24 is about \$263.45 million, among which around \$135.22 million is from levies for funding the PIE-related functions; while around \$111.39 million is from the grant income<sup>4</sup> for funding the non-PIE-related functions during the application fee exemption period and around \$9.1 million is from the application fees

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<sup>4</sup> According to the AFRC'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.

collected from October 2023 to March 2024. The AFRC has adopted the following assumptions in projecting the estimated income –

- (a) **for the levies income:** the average securities market turnover will be \$107 billion per day, and the number of PIEs, average annual listing fee per PIE as well as number of PIE engagements will remain unchanged in 2023-24; and
- (b) **for the fee income:** the numbers of practising CPAs, partners of CPA firms and directors of corporate practices will increase by 2%.

### **Operating Expenditure**

10. The total estimated operating expenditure for 2023-24 is about \$340.49 million, of which around \$219.03 million arises from PIE-related functions and \$121.46 million from non-PIE-related functions.

11. The largest expenditure item is “staff salaries, bonuses, variable pay and Mandatory Provident Fund contributions” which is estimated at about \$210.92 million in total, of which –

- (a) around \$134.66 million is attributed to the 89 existing headcount and 4 new headcount for the PIE-related functions;
- (b) around \$76.26 million is for the 26 existing headcount and 26 new headcount for the non-PIE-related functions; and
- (c) a provisional average salary increment of 3.7% has been factored in.

12. The estimated premises expenses in 2023-24 is about \$39.11 million. The AFRC has secured a four-year lease agreement for new office premises with effect from 1 April 2023 to accommodate its

expanding establishment<sup>5</sup>. The estimated premises expenses include the rental as well as the relevant cost for the concurrent occupancy of its existing and new premises between April and August 2023 for the necessary fitting-out prior to the planned relocation in August 2023.

### **Manpower Plan**

13. The AFRC proposes a total of 30 new headcount in the budget for 2023-24. This will bring the AFRC's total headcount from 115 at present to 145.

14. For the PIE-related functions, 4 new headcount will be allocated to cope with the increase in investigation cases due to a rise in number of complaints and referrals. Meanwhile, the AFRC will continue to discharge other PIE-related functions through effective deployment of its existing staff, including the 30 additional headcount approved and filled in 2022-23.

15. For the new non-PIE-related functions, as foreseen in the last budget, the AFRC will adopt a progressive approach in the implementation as well as the corresponding expansion of establishment in the initial years of the new regime. In 2022-23, 26 new headcount has been approved and filled in full for taking up the functions of issuance of practising certificates and registration of practice units upon the commencement of the new regime. As the AFRC has been gradually taking over investigation and disciplinary matters from the HKICPA as well as delivering other functions of the new regime, it needs to increase its manpower and correspondingly proposed 26 additional headcount for 2023-24.

### **Capital Expenditure**

16. The estimated total capital expenditure for 2023-24 is about \$44.08 million, mainly covering expenses on development of IT systems and office relocation and fitting out.

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<sup>5</sup> The AFRC entered into a 4-year lease for the current office premises with effect from September 2019, and further entered into a short-term lease for additional office space in the same building with effect from April 2022 to accommodate additional headcount for the launch of the new regulatory regime. In view of the upcoming expiry of both leases in August 2023, the AFRC resolved to relocate to a new office premises instead of seeking lease renewal for the existing premises taking into account its long-term operational and manpower needs.

## **Reserve Funds and Estimated Cash Shortfall**

17. The AFRC expected that an operating deficit of about 77.04 million will be recorded in 2023-24. The unspent balance of the Government Grant injected in 2019 will be depleted by the end of 2023-24, while there will be a negative general fund balance, i.e., net liabilities. Accordingly, the AFRC envisaged that cash shortfall will arise at the beginning of 2024-25. Given the uncertainty in market situation leading to the lower-than-expected levy income of the AFRC, and that the application fees for practice which the AFRC will start collecting from 1 October 2023 will be frozen in the initial years of the new regime, the funding shortfall of the AFRC arising in 2024-25 is expected to reoccur in ensuing financial years.

18. According to Part 4A of the AFRCO on the levies, the AFRC 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 AFRC are more than twice its estimated operating expenses for that financial year. Given the projected negative fund balance in 2023-24, the above mechanism for adjustment to the rate or amount of levies will not be triggered.

19. The AFRC needs additional funding injection to tide over its projected cash shortfall in early 2024-25.

## **THE GOVERNMENT'S VIEWS**

20. As the AFRC pointed out in the budget, its income has decreased under the prevailing securities market situation and the exemption of new registration fees in the first 6 months of 2023-24, and its future income will remain short due to the market situation and freeze on the fee levels. Having studied the AFRC's budget and with reference to the arrangements in the last reform, we plan to consult the Panel on Financial Affairs on the proposed funding injection and long-term funding mechanism of the AFRC within this year.

21. In the meantime, we have tasked the AFRC to continue to exercise strict control over its expenditure, appropriately prioritise its work, and leverage synergy between different functions to effectively deploy its resources, thereby continuing to implement various functions under the

new regulatory regime in a progressive manner. In parallel, the AFRC will continue to monitor and review its resource needs and explore new income source with the Government, with a view to ensuring financial stability for the effective discharge of its regulatory objectives in the long run.

## **ADVICE SOUGHT**

22. Members are invited to note the proposed budget of the AFRC for 2023-24.

**Financial Services Branch  
Financial Services and the Treasury Bureau  
March 2023**

**Accounting and Financial Reporting Council**  
**Budgeted Income and Expenditure Statement**  
**For the period from 1 April 2023 to 31 March 2024**  
**(Expressed in Hong Kong dollars)**

	Note	Proposed budget Apr 2023 to Mar 2024			Forecast Apr 2022 to Mar 2023			Approved budget Apr 2022 to Mar 2023		
		PIE	Non PIE	Total	PIE	Non PIE	Total	PIE	Non PIE	Total
		HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000	HK\$ '000
<b>Income</b>										
<b>PIE</b>										
Levies income	1	135,216	-	135,216	141,535	-	141,535	179,352	-	179,352
Grant income	2	5,246	-	5,246	-	-	-	6,318	-	6,318
Interest & other income	3	2,493	-	2,493	2,701	-	2,701	303	-	303
<b>Non-PIE</b>										
Grant income	2	-	111,394	111,394	-	51,938	51,938	-	56,244	56,244
Licence fees	1	-	9,101	9,101	-	-	-	-	-	-
		<b>142,955</b>	<b>120,495</b>	<b>263,450</b>	<b>144,236</b>	<b>51,938</b>	<b>196,174</b>	<b>185,973</b>	<b>56,244</b>	<b>242,217</b>
<b>Expenditure</b>										
Staff salaries, bonuses, variable pay and MPF	4	134,663	76,261	210,924	108,913	32,657	141,570	116,837	35,671	152,508
Other staff related expenses	5	11,726	9,868	21,594	9,480	2,770	12,250	9,234	3,810	13,044
Premises expenses	6	25,087	14,027	39,114	16,637	4,860	21,497	23,697	6,923	30,620
Legal and professional fees	7	21,016	4,746	25,762	11,200	4,800	16,000	11,200	4,800	16,000
Conference and duty visits	8	4,927	2,754	7,681	1,501	439	1,940	1,547	393	1,940
Corporate communication expenses	9	954	533	1,487	7,099	2,074	9,173	3,485	1,018	4,503
Information and systems services	10	8,872	4,961	13,833	4,454	1,301	5,755	3,627	957	4,584
Other operating expenses	11	3,341	1,693	5,034	2,583	755	3,338	2,873	752	3,625
Depreciation	12	6,216	5,366	11,582	5,246	1,532	6,778	6,532	1,133	7,665
Total recurring operating expenditure		<b>216,802</b>	<b>120,209</b>	<b>337,011</b>	<b>167,113</b>	<b>51,188</b>	<b>218,301</b>	<b>179,032</b>	<b>55,457</b>	<b>234,489</b>
Non-executive directors' fees	13	2,232	1,248	3,480	2,569	750	3,319	2,693	787	3,480
Total expenditure		<b>219,034</b>	<b>121,457</b>	<b>340,491</b>	<b>169,682</b>	<b>51,938</b>	<b>221,620</b>	<b>181,725</b>	<b>56,244</b>	<b>237,969</b>
<b>Operating Surplus/ (Deficit)</b>		<b>(76,079)</b>	<b>(962)</b>	<b>(77,041)</b>	<b>(25,446)</b>	<b>-</b>	<b>(25,446)</b>	<b>4,248</b>	<b>-</b>	<b>4,248</b>
<b>Headcount</b>		<b>93</b>	<b>52</b>	<b>145</b>	<b>89</b>	<b>26</b>	<b>115</b>	<b>89</b>	<b>26</b>	<b>115</b>



## **1. Levies Income**

1.1 Details of the levies payable by sellers and purchasers of securities, PIEs, and PIE auditors to the AFRC are set out in Sections 50A to 50C of the Accounting and Financial Reporting Council Ordinance (AFRCO). The collection of the levies commenced on 1 January 2022. The levies are recorded as income on an accrual basis. Levies payable by sellers and purchasers of securities and by PIEs are collected on behalf of the AFRC by the Hong Kong Stock Exchange and Clearing Limited (HKEX). Levies payable by local PIE auditors as from 1 January 2022 for the 2021 calendar year were collected on behalf of the AFRC 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 AFRCO, 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 Market Turnover, we adopted the respective SFC estimates on the average securities market turnover per day of the Main Board and GEM in the current year and the market outlook for the budget year.

1.2.3 For the preparation of the budget, HK\$107 billion per day has been used as the assumed average rate of securities market turnover in 2023/24, based on the SFC estimate provided to us on 24 November 2022.

1.2.4 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 reduce our income by around HK\$7.2 million.

### 1.3 Levies payable by PIEs

1.3.1 Under Section 2 of Schedule 7 of the AFRCO, 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 2021, the total annual listing fee income of the HKEX was HK\$771 million and the number of PIEs was 2,572 (average annual listing fee per PIE was HK\$300,000). There were 98 new listings and 64 delistings or other departures from the market for listed entities, resulting in a net increase of 34 of PIEs from 2,538 to 2,572 (a net rate of increase of 1.3%).

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 10 months to 31 October 2022 was 8 and the total number of PIE was 2,580), for budgeting purposes, we have assumed that both the number of PIEs and the average annual listing fee per PIE will remain the same.

### 1.4 Levies payable by PIE auditors

1.4.1 Under Section 3 of Schedule 7 of the AFRCO, 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 was carrying out a “specified engagement” (i.e. an annual audit) 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 specified engagements in 2023/24 is equal to the number of PIEs in the year (see paragraph 1.3.3), i.e. 2,580 (N) in 2023. We have also assumed that the average total remuneration (TR) per specified engagement for 2023 is the same as the previous year, i.e. approximately HK\$2.6 million.

1.4.3 For the PIE auditor levy income, a shortfall of HK\$12.6 million is expected when compared to the provisional amounts submitted to FSTB for FY2023-24 in February 2022. This is mainly due to (i) the shortfall of HK\$3 million between the estimated group audit fees used in the budget and the actual group audit fees disclosed in the PIE annual reports, and (ii) the shortfall of HK\$9 million between the actual group audit fees disclosed in the annual report and the total remuneration (TR) reported by PIE auditors in their submitted levy returns. The main cause of the shortfall of HK\$9 million stems from the legal definition of TR which does not include

significant amounts of audit fees that were paid directly to component auditors.

1.5 Levies income assumption

In summary, the following key assumptions have been used in calculating the levies income estimates:

	FY2023/24
<b>Levy payable by:</b>	
<b>Sellers and purchasers of securities</b>	
• Average daily market turnover	\$107.0 billion
• Levy rate on sellers	0.00015%
• Levy rate on purchasers	0.00015%
<b>PIEs</b>	
• Average annual listing fee per PIE	\$300K
• No. of PIEs	2,580
<b>PIE auditors</b>	
• No. of specified engagements (N)	2,580
• Average total remuneration (TR) per specified engagement	\$2.6 million

1.6 The budgeted levies income is determined as follows:

	FY2023/24 \$ million
<b>Payable by</b>	
• Sellers and purchasers of securities	77.0
• PIEs	33.0
• PIE auditors (\$6,155 x N)	16.1
• PIE auditors (0.147% x TR)	9.1
<b>Total</b>	<b>135.2</b>

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

1.7 Under Sections 23 and 24 of the Legco Brief on Accounting and Financial Reporting Council (Amendment) Bill 2021, AFRC will be the authority for the issuance of practising certificates and registration of CPA firms and corporate practices. As per the government, the respective licence fees and annual renewal fee have been waived. From 1 October 2023, AFRC will collect the registration and licence fees and the estimated amount to be collected is HK\$9,101,000.

1.8 As at 31 December 2022, there were 5,243 practising members, 1,260 firms and 707 corporate practice.

## **2. Grant income**

2.1 In August 2019, the AFRC received a seed capital of \$400 million (Grant) from the Government of HKSAR. The Grant should be utilized as follows: (i) during the period of migration to the 2019 Regime, (ii) to cushion the AFRC against short-term fluctuations in the levy income, (iii) to fund one-off capital and non-recurrent expenses, (iv) to allow the AFRC to gradually expand its manpower taking into account its actual operational needs, and (v) 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 AFRC recognises as expenses the related costs, including depreciation on capital expenditure, for which the Grant is intended to compensate.

2.3 The AFRC'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.

2.4 For 2023-24 the PIE functions are budgeted with a deficit, which would be set off against general reserves when the Grant has been fully utilized. We have assumed that: (i) ongoing capital expenditure relating to transition to the PIE functions will be financed from the Grant, and (ii) the operating and capital expenditure relating to the AFRC's Non-PIE functions would be funded by the Grant in 2023-24 and subsequent years to the extent that if there is a shortfall in funding from licence fees, there is a balance of the Grant available.

2.5 For FY2023-24, an amount of HK\$111.4 million will be utilized from the Grant for Non-PIE functions. The Grant will be fully depleted by the end of March 2024 (i.e. FY2023-24).

2.6 AFRC does not have any controls over our levy income, especially regarding the level of transaction levies (given the volatility of market turnover) which represents 56.9% of our total levies income. More expenditure is expected in the budget as AFRC undertakes its new roles and responsibilities under the Further Reform.

### 3. Interest Income and Other Income

- 3.1 Cash held by the AFRC, including the general fund and the balance of Grant, will be placed in fixed deposits to generate interest income.
- 3.2 Other income represents application fees received for recognition of overseas auditors and recovery of costs of investigation undertaken under the old regime.
- 3.3 Auditing and reporting irregularities in relation to relevant engagements completed before 1 October 2019 are still governed by legislative provisions as in force immediately before that date, under which an award of the costs of investigation could be made in favour of the AFRC in disciplinary or court proceedings.
- 3.4 Given the low levels of recovery in past years, and the fact that the timing and amounts of any recoveries are difficult to predict and dependent on the outcomes of the proceedings, no income in relation to the award of costs and expenses has been included in the budget, which is consistent with prior year budget  $\$$  assumption.

### 4. Staff Salaries, Bonuses, Variable Pay and MPF (“Staff costs”)

- 4.1 The following table provides a breakdown of the sum of Staff costs by functions and headcount:

Department	Headcount	\$'000
<b>Corporate functions:</b>		
CEO Office	2	6,056
Legal	6	10,959
Finance & Administration	19	15,939
	<b>27</b>	<b>32,954</b>
<b>Regulatory functions:</b>		
Investigation & Compliance	36	53,810
Inspection	40	49,264
Policy, Registration and Oversight	18	26,530
Discipline	24	40,899
	<b>118</b>	<b>170,503</b>
<b>Total</b>	<b>145</b>	<b>203,457</b>
Contract staff	28 <sup>1</sup>	7,467
<b>Total</b>		<b>210,924</b>

<sup>1</sup> The contract staff are needed for extra support during the peak period of registration and licensing.

- 4.2 Salaries, 13<sup>th</sup> month year-end bonuses and variable pay are calculated based on the existing remuneration level of the AFRC, with an average salary increment of 3.7% p.a. in 2023-24.
- 4.3 Similar to the accounting and legal profession, the then AFRC experienced a high staff turnover rate of 20.8% in FY2020-21 and 29.4% in FY2021-22. In order to enable AFRC to attract and retain staff, it will be important for the AFRC to ensure that its pay levels are appropriate for such purpose.
- 4.4 The amount of MPF contributions is based on 5% of the budgeted amount of salaries and bonuses.

## 5. Other Staff Related Expenses

	\$'000
Staff recruitment expenses	11,366
Staff training and development	3,684
Other staff expenses	6,544
<b>Total</b>	<b>21,594</b>

### Staff Recruitment Expenses

- 5.1 The 2023-24 Budget projected recruitment expenses are HK\$11.4 million (including HK\$11 million for the recruitment of 27 new staff 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 5% has been assumed.

### Staff Training and Development

- 5.2 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 communication skills to ensure the AFRC can maintain a highly proficient team to effectively discharge its statutory functions.

- 5.3 Breakdown of the budgeted amount of staff training and development expenses are as below.

	\$'000
Development management and leadership skills	1,393
Team building	625
Maintaining technical competence	955
Technical update and other reference materials	711
Total	<u>3,684</u>

#### **Other staff expenses**

- 5.4 The budgeted estimate of HK\$6.5 million for other staff expenses for 2023-24 mainly comprises staff insurance for life, medical, dental and maternity, 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 4% per annum for other benefits.

	\$'000
Medical insurance, dental plan and maternity coverage	3,956
Life insurance	642
Employees' compensation insurance	120
Health check subsidy	765
Professional membership fee	418
Staff welfare	545
Market information on employee compensation	52
Others	46
Total	<u>6,544</u>

## 6. Premises Expenses

- 6.1 The current office of the AFRC comprises two floors of the Hopewell Centre (24/F and 43/F) which currently accommodate 115 staff members. The net area (with lettable area multiplied by efficiency ratio) and rental expenses are 24,000 square feet and HK\$1,420,000 per month, respectively.
- 6.2 On 11 August 2022, the Board approved the office relocation to new premises in Two Taikoo Place upon expiry of the current leases in August 2023. The new premises are expected to accommodate the proposed increase of staff to 145 in 2023-24 with further allowance for growth in the medium future.

	<u>Hopewell</u> <u>Centre</u> \$'000	<u>Two Taikoo</u> <u>Place</u> \$'000	<u>Total</u> \$'000
Rental			
Interest on the lease liability	52	4,709	4,761
Depreciation charge			
– Right-of-use asset	6,462	16,593	23,055
	6,514	21,302	27,816
Property management fee and			
Air-conditioning charge	976	3,237	4,213
Government rates	294	1,037	1,331
Office cleaning	184	830	1,014
Estimated dismantling and			
removing cost	3,690	-	3,690
Office and furniture moving			
costs	-	1,050	1,050
Total	11,658	27,456	39,114

- 6.3 The budgeted premises expenses are summarized as follows.
- 6.4 The AFRC entered into the lease agreement for the office premises on 10/F (whole floor) and 1101-03 (half floor) of Two Taikoo Place with a fixed rental for 4 years. The lease term is from 1 April 2023 to 30 March 2027 with an option to extend for a further term of 3 years at a market rent subject to a cap. The net area is 28,925 square feet in total.
- 6.5 The monthly rental for the first 4-year term is HK\$1,729,000, which is equivalent to HK\$50 per sq. ft. based on the lettable floor area of 34,580 sq. ft. It is assumed that the option to extend will be exercised in 2027-28



and the rent for the renewed term will be, at a capped market rate, HK\$2,074,800 per month.

- 6.6 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.
- 6.7 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. of Hopewell Centre, with a 4% per annum increase due to inflation.
- 6.8 AFRC will have an overlapping period of occupying 2 offices from April 2023 to August 2023.<sup>2</sup> Therefore, the revised budget for 2023-24 will be higher than the previously submitted budget.

## **7. Legal Fees and professional fees**

- 7.1 The legal and professional fees represent the budgeted costs for (i) external legal advice (such as advice from Senior Counsel) for operational matters; (ii) engagement of external law firms, barristers and expert witnesses, for cases which are expected to progress to legal proceedings at the Accounting and Financial Review Tribunal and the Court of Appeal; (iii) investigation costs and (iv) commission of external bodies (e.g. universities and consultants) for the conduct of policy and governance projects.
- 7.2 It will take time for disciplinary cases to go through different stages of the disciplinary process. The costs for legal proceedings at the Accounting and Financial Reporting Review Tribunal and the Court of Appeal will depend on the number of disciplinary cases progressing to those stages and the complexity of these cases. Hence, actual legal fees for the disciplinary function may be different from the budgeted amounts.

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<sup>2</sup> The lease of Two Taikoo Place will commence from 1 April 2023. The renovation of new office will start from that time and is expected to be finished in July 2023. Besides, reinstatement of existing office will be carried out before the end of lease in August 2023. Therefore, there will be an overlapping period of occupying 2 offices from April to August 2023.

## 8. Conference and Duty Visits

8.1 The budgeted conference and duty visits are analyzed below:

	\$'000
<b>Conferences:</b>	
International conferences	1,218
Regional forum	3,290
<b>Other duty visits:</b>	
Liaison with Mainland authorities	435
Inspection in Mainland China	706
Liaison with overseas regulators	143
Overseas visits for departments	1,224
Others	665
Total	<u>7,681</u>

8.2 There will be a need to renew attendance at conferences and workshops with international peers in 2023-24 to re-engage when COVID-19 travel restrictions have been relaxed. Besides, there will also be a need to renew face to face engagement with Mainland and overseas regulators.

8.3 It is proposed to have a regional forum in 2023-24 to (i) promote the importance of audit quality in investor protection; (ii) provide high quality training and sustainable development to accounting professions; (iii) establish a regional platform for peer regulators to learn and share with each other, and (iv) promote and sustain Hong Kong as a competitive international financial market.

## 9. Corporate Communications Expenses

9.1 Breakdown of the budgeted corporate communications expenses are as below:

	\$'000
AFRC Annual Report and quarterly reports	224
Departmental progress reports	563
Events	
- Other stakeholder engagements	400
Website maintenance	300
Total	<u>1,487</u>

9.2 Following the Further Reform, it is crucial for us to engage and establish closer collaboration with our existing and new stakeholders, so as to deliver our functions efficiently and effectively.

## 10. Information and System Services

10.1 Breakdown of the budgeted expenses for information and system services are as below:

	\$'000
IT infrastructure and software system maintenance fees	3,291
Software licence fees payable to HKICPA for Member Activity System	4,166
Computer peripherals, accessories, user licences	746
Data connection fees	450
Data services	1,504
Development & implementation cost	326
IT sub-contractor fees	3,000
Biennial IT security review	350
	<u>13,833</u>

10.2 Budgeted information and system services expenses primarily relate to:

10.2.1 IT infrastructure and software system maintenance fees relate to (i) annual maintenance fees payable to the vendors or external developers of our infrastructure and application systems following the end of the warranty periods; (ii) IT solutions implementation, enhancement, support and maintenance systems for new HR and finance management systems.

10.2.2 We have signed a Member Activity System (the "MAS system") Implementation contract with HKICPA for taking up the registration

functions.

- 10.2.3 Computer peripherals, accessories and user licences include end-user computer software and hardware, and other software licences relating to our infrastructure.
- 10.2.4 Data connection fees represent the costs for broadband connections at the AFRC office and our offsite backup server, our telephone service, VPN user licence, and video conferencing software licence fees.
- 10.2.5 Data services include subscriptions to e-magazines and other news search services, data analysis services and online legal research platforms.
- 10.2.6 We plan to sub-contract our IT systems development for case management system, HR system and finance management system, for enhancing efficiency of our administration functions. IT sub-contractors could provide design input for those systems and monitor progress of the development on behalf of the AFRC. In addition to the operating costs of HK\$3 million per annum assumed for such support and management, the related capital expenditure estimates are included in Note 17.
- 10.2.7 We plan to commission a biennial IT security review as recommended by the Office of Government Chief Information Officer. The last review was carried out in 2020-21.

## 11. Other Operating Expenses

11.1 Breakdown of the budgeted other operating expenses are summarized below:

	\$'000
Professional liability and office insurance	876
Postage, printing and stationery	1,053
Other office supplies and consumables	604
Maintenance fees for office equipment	206
Utilities	337
Stakeholder engagement activities	475
Annual levy collection fee from HKEX	52
Relocation expenses	700
Other expenses	731
Total	<u>5,034</u>

11.2 The professional liability is assumed to be increased at a rate of 20% per year.

11.3 Other expenses include company search services, records management services, travelling, meeting expenses, bank charges and sundry expenses.

## **12. Depreciation**

12.1 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	7 years for premises at Two Taikoo Place (over the assumed lease period of 7 years)
Furniture	10 years
Office equipment	7 years
IT equipment	3 years
IT infrastructure & database systems	5 years

12.2 The increase in depreciation is due to capital expenditure planned for 2023-24. 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 16 (see paragraph 16.2).

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

13.1 It is assumed that the non-executive directors' fee for 2023-24 will remain at HK\$3.48 million per year.

## **14. Contingency**

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

## **15. Cost increase**

15.1 It is assumed that cost will increase generally at 4% per annum, which is reference to the CPI Index in November 2022.

15.2 Despite the increasing shortages and high turnover rates for accounting and legal professionals, we assume a 3.7% increase in salaries costs for 2023-24.

## 16. Funds

### 16.1 General Fund

	HK\$'000
Balance as at 1 April 2022	56,234
Operating surplus for April to November 2022 (PIE)	11,798
Budget operating deficit for December 2022 to March 2023 (PIE)	(37,244)
Estimated balance as at 31 March 2023	30,788
Budget operating deficit for 2023-24 (PIE)	(76,079)
Budget operating deficit for 2023-24 (Non-PIE)	(962)
Estimated balance as at 31 March 2024	<b>(46,253)<sup>3</sup></b>

### 16.2 Government Grant

The Grant is represented in the budget on an accounting basis. Operating expenditure that is eligible to be claimed under the Grant will be claimed as a Grant income. However capital expenditure that is eligible to be claimed under the Grant will be capitalized as an asset in the balance sheet and expensed on a monthly basis through depreciation expense. Therefore, there is a timing difference between cash balance available from the Grant and the Grant income in the budget. The cash balance available from the Grant (HK\$400m) is expected to be depleted by March 2024.

In order to reflect the actual status of the Grant, we present the forecast as follows.

<u>CASH FLOW BASIS</u>	HK\$'000
Grant received from the HKSAR Government (8/8/19) <u>FY2019/21</u>	400,000
Actual capital expenditure for the new regime	(18,115)
Actual operating expenditure (Net of depreciation)	(167,316)
<b>Balance as at 31 March 2021</b>	<b>214,569</b>

<sup>3</sup> General fund is a reserve account, with total assets minus total liabilities in the statement of financial statement. It is a kind of accounting treatment. As at 31 March 2024, the estimated amounts of cash will be approximately HK\$20 million.

FY2021/22

Actual capital expenditure	(2,547)
Actual operating expenditure (Net of depreciation)	-
<b>Balance as at 31 March 2022</b>	<b>212,022</b>

Actual capital expenditure (Apr to Nov 2022)	(5,919)
Actual operating expenditure (Net of depreciation) (Apr to Nov 2022)	(16,957)
Budgeted capital expenditure (Dec 2022 to Mar 2023)	(7,893)
Budgeted operating expenditure (Net of depreciation) (Dec 2022 to Mar 2023)	(31,893)
<b>Estimated Balance as at 31 March 2023</b>	<b>149,360</b>

Budgeted capital expenditure	(43,331)
Balancing of budgeted operating expenditure (Net of depreciation)	(106,029)
<b>Estimated Balance as at 31 March 2024</b>	<b>-</b>

The seed money is expected to be utilised by March 2024.



## 17. Capital Expenditures

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

	PIE \$'000	Non-PIE \$'000	Total \$'000
IT Computer software costs and systems	4,572	2,556	7,128
IT related costs	787	871	1,658
<b>Sub-total for IT costs</b>			<b>8,786</b>
Leasehold improvements			26,945
Office furniture and fixtures			1,750
Office equipment			2,850
Others and Contingency			3,750
<b>Sub-total for new premises</b>			<b>35,295</b>
<b>Total</b>			<b>44,081</b>

17.2 Leasehold improvements of HK\$26.9 million are based on the need to rent the new premises at Two Taikoo Place. The amount is estimated based on the preliminary cost provided by our contractor. The split between PIE and Non-PIE is based on the Headcount of each function.

17.3 Budgeted IT software development expenditure for 2023-24 comprises:

	\$'000
Database system and case management system to automate regulatory functions work	5,804
IT system for registration and licensing	1,324
Total	<u>7,128</u>

17.4 IT Computer software costs and systems are the database systems updates for Inspection and Investigation & Compliance Department and case management system for Discipline Department to automate the regulatory functions work.

17.5 IT-related costs are personal computers and notebooks for new staff and related computer software. It also covers replacement of obsolete items.

17.6 Office furniture and fixtures represent costs for fitting out the new office that are required to accommodate the increase in staff Headcount. The

amount is estimated based on the preliminary cost provided by our contractor.

- 17.7 Office equipment relates to copiers and other necessary equipment for the new office that are required to accommodate the increase in staff Headcount. The amount is estimated based on the preliminary cost provided by our contractor.