



The Hong Kong Standard on Auditing for Audits of Financial Statements of Less Complex Entities (HKSA for LCE)

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This Q&As should be read in conjunction with the Institute's *The Hong Kong Standard on Auditing for Audits of Financial Statements of Less Complex Entities* (HKSA for LCE), its Basis for Conclusions, and other regulations, standards or guidance published and issued by the HKICPA.

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The Standard Setting Department welcomes your comments and feedback, which should be sent to commentletters@hki CPA.org.hk.

Question 1: When can the HKSA for LCE be used?

The Authority of the standard in Part A sets out the intended scope of the HKSA for LCE. Limitations for using the standard are designated into three categories:

- (a) Specific classes of entities for which the use of the HKSA for LCE is prohibited (i.e., specific prohibitions);
- (b) Qualitative characteristics that describe a less complex entity which, if not exhibited by an entity, would ordinarily preclude the use of the HKSA for LCE for the audit of the financial statements of that entity; and
- (c) Quantitative thresholds to be determined by legislative or regulatory authorities or relevant local bodies with standard-setting authority in each jurisdiction.

In determining the appropriate use of the HKSA for LCE, all three categories are to be considered.

The HKSA for LCE includes additional details and specifics on when an auditor can use the standard. These details and specifics are included in the Authority (Part A) of the standard and include specific prohibitions, qualitative characteristics, and quantitative thresholds.

Question 2: Are there any quantitative thresholds that must be met to determine the appropriate use of the HKSA for LCE?

Yes. To determine the appropriate use of the HKSA for LCE, an entity or a group of entities must not only comply with the requirements regarding the specific prohibitions in paragraph A.1. and meet the qualitative characteristics in paragraph A.3. of the standard, but also not exceed any two of the following quantitative thresholds specified in paragraph A.4-1:

- (a) Total revenue of HK\$200 million
 - (b) Total assets of HK\$200 million at the end of the reporting period
 - (c) 100 employees
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- **Meeting the size tests in the first financial year:** A newly established entity is eligible to use the HKSA for LCE in the audit of its first financial year if it meets the quantitative thresholds and other requirements for using the HKSA for LCE in that year. Likewise, for a group of entities with a newly established holding entity, the group is eligible to use the HKSA for LCE in the audit of its first financial year if it meets the quantitative thresholds and other requirements for using the HKSA for LCE in that year (paragraph A.4-3.).
 - **Meeting the size tests in subsequent financial years:** For an existing entity or a group of entities, in addition to complying with the specific prohibition and qualitative requirements for the year under consideration, it will need to meet the quantitative thresholds for two consecutive reporting periods before it is eligible to use the HKSA for LCE in the audit of the following year, regardless of its size in that period (paragraph A.4-3.). Further illustrations are provided in Scenarios 1 to 3 below.
 - **Evaluating the quantitative thresholds:** To evaluate the quantitative thresholds, an entity or a group of entities should use the financial information of the two financial years immediately before the year that the auditor plans to use the HKSA for LCE (paragraph A.4-3.). Illustrations are provided in scenarios 2 to 3 below.

An entity or a group of entities that already qualifies for and is already using the HKSA for LCE in its audit can continue to use it until it fails the quantitative thresholds for two consecutive financial years. In that case, it will only lose the eligibility to use the HKSA for LCE in the reporting period after not meeting the quantitative thresholds for the two immediately preceding financial years (“two-year grace period”) (paragraph A.4-4.). Illustrations are provided in scenarios 1 to 2 below.

- **Exception to the two-year rule:** If a new entity or business unit enters the group and causes the group to exceed the quantitative thresholds in paragraph A.4-1. in the financial year it joins the group, the group will lose the eligibility to use the HKSA for LCE in that year right away, without the two-year grace period mentioned above (paragraph A.4-5.). Scenario 4 below illustrates this.

The following scenarios assume that the HKSA for LCE is effective for the audits of financial statements beginning on or after 15 December 20X3. These scenarios only illustrate the assessment of the quantitative thresholds for the application of the HKSA for LCE, assuming the entity or group of entities meets all other criteria for the application of the HKSA for LCE.

Scenario 1

- The entity or group of entities met the quantitative thresholds for two consecutive financial years in 20X2 and 20X3. Therefore, it is eligible to use the HKSA for LCE in its audit of financial statements in the next reporting period in 20X4.
- Having met the quantitative thresholds, the auditor decided to use the HKSA for LCE in the audit for 20X4.
- The entity fails the quantitative thresholds for the 20X4, 20X6 and 20X8 financial years but meets the quantitative thresholds for the intervening years, i.e., 20X5 and 20X7. As the entity has met the quantitative thresholds in 20X2 and 20X3 (and so it is eligible to use the HKSA for LCE for its 20X4 audit), and it has not failed the quantitative thresholds for at least two consecutive financial years during 20X4 to 20X8 (see Scenario 2 below), the auditor can continue to apply the HKSA for LCE for those reporting periods.

Financial reporting period	20X2	20X3	20X4	20X5	20X6	20X7	20X8
Meets the quantitative thresholds	✓	✓	✗	✓	✗	✓	✗
Eligibility to adopt the HKSA for LCE			✓	✓	✓	✓	✓
Decision to adopt the HKSA for LCE			✓	✓	✓	✓	✓

Scenario 2

- The entity or group of entities met the quantitative thresholds for two consecutive financial years in 20X2 and 20X3. Having met the quantitative thresholds, the auditor decided to use the HKSA for LCE in the audit of the financial statements in the next reporting period in 20X4.
- Later, the entity does not meet the quantitative thresholds for two consecutive financial years in 20X4 and 20X5. It continues to be eligible for and the auditor continues to use the HKSA for LCE for the audit, until the auditor becomes ineligible to do so in 20X6.
- Being not eligible to use the HKSA for LCE on the grounds of its size, it will need to meet the quantitative thresholds for two consecutive financial years again in 20X6 and 20X7, before it will be eligible for the use of the HKSA for LCE in its audit of financial statements in the next reporting period in 20X8.

Financial reporting period	20X2	20X3	20X4	20X5	20X6	20X7	20X8
Meets the quantitative thresholds	✓	✓	✗	✗	✓	✓	✗
Eligibility to adopt the HKSA for LCE			✓	✓	✗	✗	✓
Decision to adopt the HKSA for LCE			✓	✓	NA	NA	✓

Scenario 3

- The entity or group of entities met the quantitative thresholds for two consecutive financial years in 20X2 and 20X3. Therefore, it is eligible to use the HKSA for LCE in the audit of the financial statements in the next reporting period in 20X4.
- Despite being eligible, the auditor decided not to use the HKSA for LCE in the audit in 20X4.
- In 20X5, the auditor wishes to adopt the HKSA for LCE in the audit. To be eligible, the entity must meet the quantitative thresholds for two consecutive years immediately preceding 20X5, i.e., 20X3 and 20X4.
- Since the entity does not meet the quantitative thresholds consecutively in 20X3 and 20X4, the auditor cannot use the HKSA for LCE in their audit in 20X5. The auditor will only be eligible to do so when the entity subsequently meets the quantitative thresholds for two consecutive years (e.g., in 20X5 and 20X6) and then use it in the next reporting period (i.e., 20X7).

Financial reporting period	20X2	20X3	20X4	20X5	20X6	20X7	20X8
Meets the quantitative thresholds	✓	✓	✗	✓	✓	✓	✓
Eligibility to adopt the HKSA for LCE			✓	✗	✗	✓	✓
Decision to adopt the HKSA for LCE			✗	NA	NA	✓	✓

Scenario 4

- The entity or group of entities meeting the quantitative thresholds for two consecutive financial years in 20X2 and 20X3 is eligible to use the HKSA for LCE in 20X4. Once it is eligible, it can continue using the HKSA for LCE unless it fails the quantitative thresholds for two consecutive years (see Scenario 2 above).
- An exception to this two-year grace period is when a new entity or business unit enters the group (e.g., in 20X5) where that new entity or business unit is of such a size that causes the group to fail the quantitative thresholds in that year. In this case, the group

will no longer be eligible for the use of the HKSA for LCE in the financial year in which the new entity or business unit enters the group in 20X5. Its auditor will be eligible to use the HKSA for LCE again if, subsequently, the group meets the quantitative thresholds for two consecutive financial years again (e.g., in 20X6 and 20X7) and then use it in the next reporting period (say in 20X8).

Financial reporting period	20X2	20X3	20X4	20X5	20X6
Meets the quantitative thresholds	✓	✓	✓	✗ (a new co or business unit joins the group)	✓
Eligibility to adopt the HKSA for LCE			✓	✗	✗
Decision to adopt the HKSA for LCE			✓	NA	NA

Question 3. What key areas should I be aware of when applying the HKSA for LCE in an audit engagement?

- ***Standalone nature of the HKSA for LCE.*** The HKSA for LCE is a standalone, self-contained standard, with no intended need to reference back to the Hong Kong Standards on Auditing (“HKSAs”). Auditors applying the HKSA for LCE must exercise caution from inadvertently reverting to HKSA requirements in areas not covered by the HKSA for LCE. Therefore, it is essential for auditors to conduct a thorough and comprehensive assessment of eligibility for using the HKSA for LCE to ensure that the relevant audit engagement will be adequately addressed by requirements in the HKSA for LCE.
- ***Needing to navigate different sections for the same topic.*** The HKSA for LCE is designed to align with the flow of an audit engagement. In contrast to the HKSAs, which typically address a single topic—from risk assessment procedures and evaluation to auditor conclusions and reporting—within one standard, the HKSA for LCE organizes its requirements into distinct parts corresponding to the various stages of an audit. This structure requires auditors to refer to different parts for requirements related to the same topic.

For example, when addressing “going concern,” auditors must refer to different parts in the HKSA for LCE for relevant requirements and Essential Explanatory Material:

- Risk identification and Assessment: Part 6
- Responding to Assessed Risks of Material Misstatement: Part 7
- Concluding: Part 8
- Forming an Opinion: Part 9

- **Qualitative characteristics relating to accounting estimates.** Paragraph A.3. of the HKSA for LCE describes an LCE in the context of accounting estimates as:
 - (a) Having few accounts or disclosures in the financial statements that necessitate the use of significant management judgment in applying the requirements of the financial reporting framework.
 - (b) The financial statements ordinarily do not include accounting estimates that involve the use of methods, models, assumptions, or data, that are complex.

For instance, fair value accounting estimates that use unobservable inputs to measure the fair value of the asset or liability, known as Level 3 inputs under International Financial Reporting Standards, are commonly not associated with LCEs.¹

Meanwhile, the International Auditing and Assurance Standards Board (IAASB) has clarified that the presence of one or a small number of accounting estimates with a higher degree of complexity may not be indicative of the complexity of the entity as a whole. The standard's focus is not on the isolated or "one-off" accounting estimates or transactions that do not otherwise increase the complexity of the entity as a whole".²

In Hong Kong, it is common for non-regulated private entities, without substantial businesses and/or operations, to hold investment properties with fair values determined using unobservable inputs. These entities would otherwise qualify for using the HKSA For LCE in their audits. Following the IAASB's clarification outlined above, auditors must exercise professional judgment in determining whether an entity's accounting estimate with unobservable inputs is isolated or "one-off", or relates to the entity's main business activities which would be likely to be an indicator of complexity more pervasively and thus preclude the use of the HKSA for LCE.

- **No illustration on modified opinions.** The HKSA for LCE does not provide illustrative examples of modified opinions. Auditors are to refer to separate publications, such as the [ISA for LCE Authority Reporting Supplemental Guidance](#) published by the IAASB, for relevant guidance and illustration when and as necessary.
- **Timing differences with HKSA updates.** The HKSA for LCE is converged with the *International Standard on Auditing for Audits of Financial Statements of Less Complex Entities* (ISA for LCE). Any maintenance of the HKSA for LCE, other than local refinements and guidance, will follow the updates made to the ISA for LCE.

After the ISA for LCE/HKSA for LCE becomes effective on 15 December 2025, there will be an initial period of stability of at least three years. This means that any possible future revisions to the ISA for LCE would not become effective before 15 December 2028. This initial period of stability provides stakeholders time to adopt and implement the standard before introducing any possible revisions.³ However, it also means that the new and revised requirements in the ISAs/HKSAs that become effective between 2025 and 2028

¹ ISA for LCE Authority Supplemental Guidance (<https://www.iaasb.org/publications/isa-lce-authority-standard-supplemental-guidance>) published by the IAASB.

² IAASB [Basis for Conclusions: ISA for LCE](#), paragraph 53

³ IAASB [Basis for Conclusions: ISA for LCE](#), paragraph 142

may diverge from those in the ISA for LCE/HKSA for LCE. Consequently, auditors must apply different requirements across audit engagements of the HKSA's and the HKSA for LCE on the same topic. This divergence may include, but is not limited to, the following ISAs and their corresponding HKSA's:

Standard	Effective Date
ISA 570 (Revised 2024), <i>Going Concern</i>	Audits of financial statements for periods beginning on or after 15 December 2026
ISA 240 (Revised), <i>The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements</i>	Audits of financial statements for periods beginning on or after 15 December 2026 (tentative)

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