17 September 2024

To: Members of the Hong Kong Institute of CPAs
All other interested parties

INVITATION TO COMMENT ON *PROPOSED HONG KONG STANDARD ON AUDITING FOR AUDITS OF FINANCIAL STATEMENTS OF LESS COMPLEX ENTITIES (HKSA FOR LCE)*

Comments to be received by 17 November 2024

The Hong Kong Institute of Certified Public Accountants' ("Institute") Auditing and Assurance Standards Committee ("AASC") is seeking comments on the *Proposed Hong Kong Standard on Auditing for Audits of Financial Statements of Less Complex Entities* ("HKSA for LCE").

In December 2023, the International Auditing and Assurance Standards Board ("IAASB") issued the *International Standard on Auditing for Audits of Financial Statements of Less Complex Entities* ("ISA for LCE" or the "standard"), which is tailored to meet the specific audit needs of smaller and less complex businesses and organizations. The Authority of the standard in Part A sets out the intended scope of the ISA for LCE. Decisions about the required or permitted use of the ISA for LCE rest with legislative or regulatory authorities or relevant local bodies with standard-setting authority in individual jurisdictions.

To help users in determining the appropriate situations to use the standard, the IAASB has also issued "The ISA for LCE – Authority of the Standard Supplemental Guidance" which further explains matters and circumstances that may be relevant in determining the appropriate use of the ISA for LCE in accordance with Part A of the standard.

In February 2024, the Institute's AASC approved in principle the adoption of the ISA for LCE as the HKSA for LCE. Consequently, the AASC proposes to modify Part A, Authority of the standard concerning the scope of the proposed HKSA for LCE in a local context. The proposed modifications include:

- Refining the classes of entities prohibited from using the proposed HKSA for LCE to entities having public interest characteristics within a Hong Kong context.
- Establishing quantitative thresholds to determine the appropriate use of the proposed HKSA for LCE within a Hong Kong context.

This exposure draft ("ED") includes only the proposed Part A, *Authority of the proposed HKSA for LCE*, which has incorporated the AASC's proposed modifications outlined above, for public consultation. Notably, this ED does not encompass the Preface, Parts 1 to 10, and Appendix 1 to 7 of the proposed HKSA for LCE, on which the Institute requested feedback from HKICPA members and interested parties in July 2021 and January 2023 during the IAASB consultation period. Consequently, the Institute will converge the Preface, Parts 1 to 10 and Appendix 1 to 7 from the ISA for LCE into the corresponding sections of the HKSA for LCE following the Institute's due process with minimal alterations.

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The ED should be read along with the Explanatory Memorandum ("EM") that accompanies it which have been posted on the Institute's website at:
https://www.hkicpa.org.hk/en/Standards-setting/Standards/Open-for-comment-documents/Auditing-and-Assurance

Questions for respondents have been included in Section IV "Guide for Respondents" of the EM to solicit specific feedback on the proposals in this ED.

In accordance with the Institute's due process, comments are invited from any interested party and the Institute would like to hear from both those who do agree and those who do not agree with the contents of the ED.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the ED to be considered, comments are requested by the due date shown above.

Comments may be sent by mail, fax or e-mail to:

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Fax number (+852) 2865 6603
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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

Proposed HKSA for LCE
Issued September 2024

Exposure Draft

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

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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FOREWARD

This exposure draft, accompanied by an explanatory memorandum, is developed and approved by the Auditing and Assurance Standards Committee ("AASC") of the Hong Kong Institute of Certified Public Accountants ("HKICPA" or the "Institute"). It explains the background and the proposed local amendments for adoption in the proposed *Hong Kong Standard on Auditing for Audits of Financial Statements of Less Complex Entities* ("HKSA for LCE").

EXPLANATORY MEMORANDUM

I. Reasons for issuing this exposure draft

1. In December 2023, the International Auditing and Assurance Standards Board ("IAASB") issued the *International Standard on Auditing for Audits of Financial Statements of Less Complex Entities* ("ISA for LCE" or the "standard"). The standard is effective for audits of financial statements of less complex entities ("LCEs") for periods beginning on or after 15 December 2025 with early adoption permitted.

2. The Authority of the standard in Part A sets out the intended scope of the ISA for LCE. Limitations for using the standard are designated into three categories:
   (a) Specific classes of entities for which the use of the ISA for LCE is prohibited (i.e., specific prohibitions);
   (b) Qualitative characteristics that describe an LCE which, if not exhibited by an entity, would ordinarily preclude the use of the ISA 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 ISA for LCE, all three categories are to be considered.[1]

3. Paragraph A.1. of the standard sets out the classes of entities for which the use of this standard is specifically prohibited:

A.1. The ISA for LCE shall not be used if: (a) Law or regulation prohibits the use of the ISA for LCE or specifies the use of auditing standards other than the ISA for LCE for the audit of the financial statements in that jurisdiction. (b) The entity is a listed entity. (c) The entity falls into one of the following classes: (i) An entity one of whose main functions is to take deposits from the public; (ii) An entity one of whose main functions is to provide insurance to the public; or

[1] In August 2024, the IAASB issued "The ISA for LCE - Authority Supplemental Guidance" which further explains matters and circumstances that may be relevant in determining the appropriate use of the ISA for LCE in accordance with Part A of the standard.

(iii) A class of entities where use of the ISA for LCE is prohibited for that specific class of entity by a legislative or regulatory authority or relevant local body with standard-setting authority in the jurisdiction. (d) The audit is an audit of group financial statements (group audit) and: (i) Any of the group's individual entities or business units meet the criteria as described in paragraph A.1.(b) or A.1.(c); or (ii) Component auditors are involved, except when the component auditor's involvement is limited to circumstances in which a physical presence is needed for a specific audit procedure for the group audit (e.g., attending a physical inventory count or physically inspecting assets or documents).

4. The classes in paragraph A.1.(a), (b) and (d) are outright prohibitions and cannot be modified. Legislative or regulatory authorities or relevant local bodies with standard-setting authority can modify each class described in paragraph A.1.(c) but a class cannot be removed.

5. According to paragraph A.4. of the standard, determining quantitative thresholds would assist in the consistent and appropriate use of the ISA for LCE in a jurisdiction.

6. Decisions about the required or permitted use of the ISA for LCE rest with legislative or regulatory authorities or relevant local bodies with standard-setting authority in individual jurisdictions. As part of the local adoption and implementation process, the IAASB anticipates that legislative or regulatory authorities or relevant local bodies with standard-setting authority:
   (a) May add or modify the classes of entities prohibited from using the standard under paragraph A.1.(c).
   (b) Determine quantitative thresholds described in paragraph A.4. of the ISA for LCE.

   In doing so, the specific prohibitions and qualitative characteristics should be considered, as well as other specific needs that may be relevant in the jurisdiction.

7. Paragraph A.1.(c) of the standard sets out some classes of entities that may exhibit public interest characteristics. Entities that have public interest characteristics could embody a level of complexity in fact or appearance and are specifically prohibited from using the ISA for LCE. Modifications can be made by adding a class of entities to the list of prohibited entities, permitting specific sub-sets within a class to be able to use this standard or using quantitative thresholds to prohibit use of this standard. Legislative or

regulatory authorities or relevant local bodies with standard-setting authority may subsequently remove or amend modifications that they have made.[2]

II. Local adoption of ISA for LCE

8. The HKICPA is the only statutory body in Hong Kong that sets auditing and assurance standards for professional accountants in Hong Kong.

9. In February 2024, the Institute's Auditing and Assurance Standards Committee ("AASC") approved in principle the adoption of the ISA for LCE as the HKSA for LCE given local circumstances. The AASC noted that regulators in Sweden, Norway and Finland are very supportive to the local application of the ISA for LCE, while other jurisdictions have taken or may take a different perspective. For instance, the Auditing and Assurance Standards Board of the Australian Government concluded that the limited benefits of the ISA for LCE are outweighed by the public interest considerations, such as the perception that an LCE standard is a lesser quality.[3] Similarly, the Financial Reporting Council in the UK considered that "there is insufficient grounds for adoption in the UK", citing the UK Government's effort to address regulatory burdens on small and less complex entities by removing auditing requirements for certain categories of businesses.[4]

10. When the IAASB consulted on the proposed ISA for LCE, some stakeholders expressed concerns that the proposed ISA for LCE may not achieve reasonable assurance because certain requirements from the ISAs were omitted, and due to the lack of comprehensive application materials to support the implementation of requirements.[5] The IAASB addressed these concerns by making changes to the ISA for LCE based on the specific comments received during its consultation. For example, being more specific about the scope of entities for which the standard can be used.[6]

11. The AASC thoroughly deliberated the concerns mentioned in paragraphs 9 and 10 regarding the adoption of the ISA for LCE. The AASC concluded that if the ISA for LCE is appropriately applied to audits of entities falling under its Authority, the standard contains all the necessary requirements to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. The AASC also considered that the ISA for LCE is proportionate and

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[2] Essential Explanatory Material ("EEM") to paragraph A.2, ISA for LCE

[3] Auditing and Assurance Standards Board of the Australian Government Feedback Statement (December 2023)

[4] Financial Reporting Council UK response to the IAASB's exposure draft (April 2023)

[5] Paragraph 20, Basis for Conclusions to the ISA for LCE (December 2023)

[6] Paragraph 23, Basis for Conclusions to the ISA for LCE (December 2023)

tailored to the specific needs of an audit of a LCE.[7] The AASC therefore considered that appropriate use of the HKSA for LCE following the requirements and essential explanatory materials ("EEM") of the standard would not result in a lesser audit quality.

12. Consideration is also given to the mandatory audit regime in Hong Kong. In contrast to certain jurisdictions which implement an audit exemption regime to relieve companies meeting specific thresholds from audit, all companies incorporated under the Companies Ordinance ("CO") in Hong Kong are required to undergo an annual audit of their financial statements by independent auditors. An exemption from the auditing requirement is granted only to dormant companies.[8]

13. Hong Kong has a large number of CPA practices which vary in terms of size and kinds of services they offer. As of August 2024, there were 1,957 CPA firms or corporate practices registered with the Accounting and Financial Reporting Council ("AFRC") in Hong Kong;[9] only 44 of them had issued auditor's opinions for listed companies for the financial year ended 2022.[10] This implies that most of the CPA practices in Hong Kong mainly concentrate on providing audit services to non-listed entities.

14. With the CO's mandatory audit regime (paragraph 12), the vast number of practitioners in Hong Kong play a significant role in assisting SMEs in meeting their regulatory requirements. Therefore, the AASC's decision to adopt the ISA for LCE as the HKSA for LCE aims to support practitioners in Hong Kong to audit the large number of SMEs consistently, effectively and with high-quality, thereby maintaining confidence in their financial reporting.

III. Proposed local refinement to the use of the HKSA for LCE

15. In adopting the ISA for LCE, the AASC evaluated the need to modify the scope of using the HKSA for LCE in a local context described in paragraph 6, to:
    (a) Add or modify the classes of entities prohibited from using the HKSA for LCE under paragraph A.1.(c).
    (b) Determine quantitative thresholds described in paragraph A.4. of the ISA for LCE.

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7 Introduction to the ISA for LCE, IAASB (December 2023)

8 Question 9, FAQ – Companies Ordinance – Accounts and Audits, Companies Registry

9 Find a CPA Firm / Corporate Practice, AFRC (accessed on 20 August 2024)

10 Paragraph 3.2, Report on the Analysis of the Public Interest Entity Audit Market in Hong Kong, AFRC (March 2024)

Definition of a public interest entity in the HKICPA Code of Ethics for Professional Accountants

16. In April 2022, the International Ethics Standards Board for Accountants ("IESBA") issued *Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code* ("PIE Provisions") to Part 4A of the *International Code of Ethics for Professional Accountants (Including International* Independence Standards) (the "IESBA Code"). The revisions include an expanded definition of a PIE in the IESBA Code by specifying a broader list of PIE categories. The PIE Provisions also recognize the essential role local bodies responsible for the adoption of the IESBA Code play in delineating the specific entities that should be scoped in as PIEs in their jurisdictions, encouraging them to further refine the PIE categories in the expanded definition and adding any other categories relevant to their environments.

17. The IAASB aligned the classes of specific prohibited entities in the ISA for LCE with the PIE classes in the IESBA's PIE Provisions. The IAASB noted that the IESBA's PIE definition for the purposes of the IESBA Code serves a different purpose than the description of classes of entities that may exhibit public interest characteristics in the ISA for LCE. The former imposes differential independence requirements that apply to the audit firm or auditor for audits of financial statements of PIEs, and the latter describes classes of entities for which the use of ISA for LCE may not be appropriate. Notwithstanding that they serve a different purpose, the IAASB acknowledged respondents' comments that regardless of the purpose, having differing descriptions may cause confusion, and therefore noted the importance of alignment to the greatest extent possible between the Authority of the ISA for LCE and the IESBA Code.[11]

18. The Institute adopts and converges the IESBA Code with Chapter A of the Institute's *Code of Ethics for Professional Accountants* (the "HKICPA Code"). Following the discussion in paragraph 16, the Institute's Ethics Committee has tailored the mandatory PIE categories in the Hong Kong context for adoption in Chapter A of the HKICPA Code. The amendments use sub-sets to specify distinct types of PIE within the IESBA's mandatory PIE categories, and are undertaken in two phases:
    - Phase 1 focused on refining the IESBA's mandatory PIE categories in a local context as well as deliberating on whether to expand the categories of entity that should be PIEs. The final pronouncement and basis for conclusions of Phase 1 were issued on 15 July 2024.

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[11] Paragraph 46, Basis for Conclusions to the ISA for LCE, IAASB (December 2023)

- Phase 2 involves further research on any potential additional PIE categories and may lead to another round of local amendments to further refine the definition of a PIE in Chapter A of the HKICPA Code.

19. The IESBA's mandatory PIE categories in the PIE Provisions, along with the Ethics Committee's Phase 1 local amendments to refine them (shaded), are set out below:

- A publicly traded entity
- An entity one of whose main functions is to take deposits from the public
    - Licensed banks as defined under the Banking Ordinance ("BO") except where there is no statutory requirement for audit to be performed.
- An entity one of whose main functions is to provide insurance to the public
    - Authorized insurers as defined under the Insurance Ordinance ("IO") except for (i) captive insurers; (ii) special purpose insurers; and (iii) insurers where there is no statutory requirement for audit to be performed.
- An entity specified as such by law, regulation or professional standards to meet the purpose described in paragraph 400.10.
    - Mandatory Provident Fund ("MPF") Schemes, as registered under the Mandatory Provident Fund Schemes Ordinance.
    - Occupational Retirement Schemes ("ORSO schemes"), as registered under the Occupational Retirement Schemes Ordinance and are exempted under section 5 of the Mandatory Provident Fund Schemes Ordinance with total assets exceeding HK$100 million by reference to the most recent set of audited financial statements.

20. In line with the IAASB's decision to align the categories of specific prohibited entities in the Authority of the ISA for LCE with the PIE definition in the IESBA Code (paragraph 17), the AASC has proposed that the specific prohibited entities in the Authority of the HKSA for LCE be aligned with the PIE definition in Chapter A of the HKICPA Code, including any future local amendments made to the PIE definition in Chapter A of the HKICPA Code that may arise over time. Under this proposal, the HKSA for LCE would not be applicable for audit engagements of entities that are defined as PIEs in Chapter A of the HKICPA Code.

Question for Respondent
Do you agree that entities falling within the definition of a PIE in Chapter A of the HKICPA Code, including any future local amendments made to the PIE definition in Chapter A of the HKICPA Code, should be prohibited from applying the HKSA for LCE in their audit of financial statements? If not, why not?

Entities prohibited from using the CO's reporting exemption

21. Although Hong Kong does not have a statutory SME definition, one would often refer to the eligible criteria of the reporting exemption in Part 9 of the CO (the "reporting exemption") to a SME.

22. Part 9 of the CO came into effect in 2014. Private entities or groups of private entities meeting the criteria and size tests specified in Part 9 are eligible for the reporting exemption: they have the option to prepare their financial statements using the *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard* ("SME-FRS & SME-FRF"), which is the accounting standard to be followed under section 380(4)(b) of the CO by those Hong Kong incorporated companies which are entitled to, and decide to, take advantage of the reporting exemption as set out in section 359 of the CO.

23. SME-FRF & SME-FRS was developed by the Institute in 2005 to better meet the needs of users of SME financial statements.[12] It contains simpler measurement and fewer disclosure requirements than that of the Hong Kong Financial Reporting Standards ("HKFRS") or HKFRS for Private Entities ("HKFRS for PE"). Financial statements complying with the SME-FRS & SME-FRF would not achieve a true and fair view of the financial position, performance and cash flows of the entity. Instead, they would achieve a proper presentation appropriate for SMEs.[13]

24. One of the objectives of the CO's reporting exemption is to facilitate SMEs' preparation of financial statements through simplified accounting and reporting requirements.[14] Thus, the reporting exemption criteria under the CO were developed with a SME-focus and generally reflect the characteristics and sizes associated with SMEs in Hong Kong.

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[12] Paragraph 3, Setting Hong Kong Financial Standards, HKICPA (June 2006)

[13] Paragraph 1.2, SME-FRS

[14] Paragraph 7, Legislative Council Brief, Companies Bill, Financial Services and the Treasury Bureau ("FSTB") (12 January 2011)

25. Under section 359(4) of the CO, companies that carry out certain lines of business are not permitted to adopt simplified reporting,[15] even if they are private companies:
    (a) One that carries on any banking business and holds a valid banking licence granted under the BO;
    (b) One that is a corporation licensed under Part V of the Securities and Futures Ordinance (Cap. 571) ("SFO") to carry on a business in any regulated activity within the meaning of that Ordinance;
    (c) One that carries on any insurance business, otherwise than solely as an agent; or
    (d) One that accepts, by way of trade or business (other than banking business), loans of money at interest or repayable at a premium, other than on terms involving the issue of debentures or other securities.

26. The classes of prohibited entities that are not eligible to use the reporting exemption were brought forward from the predecessor CO for public interest or regulatory reasons.[16] Consequently, these classes are similar to the definition of a PIE in Chapter A of the HKICPA Code, although they may not be entirely identical.

27. As discussed in paragraph 7, the IAASB is explicit that entities that have public interest characteristics could embody a level of complexity in fact or appearance and so they are specifically prohibited from using the ISA for LCE.

28. The AASC is of the view that, with the exception of non-bank entities engaged in the money lending business (paragraph 25 (d)), the remaining three categories of entities that are prohibited from applying the CO's reporting exemption set out in paragraph 25(a) to (c) (i.e., banks, corporations licensed by the Securities and Futures Commission ("SFC") and insurance companies) exhibit a high level of public interest because they hold assets in a fiduciary capacity for a broad group of stakeholders as one of their primary businesses. Therefore, they could "embody a level of complexity in fact or appearance" (paragraph 27) and so in line with the objective of the ISA for LCE, the AASC has proposed that these entities be specifically prohibited from applying the HKSA for LCE in their audit engagements.

29. For non-bank entities engaged in the money lending business in Hong Kong, they are regulated under the Money Lenders Ordinance ("MLO"). The MLO stipulates that non-bank money lenders must apply for a license before running a money lending business.

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15 In this Explanatory Memorandum, the terms "simplified reporting" and "reporting exemption" are used interchangeably.

16 Paragraph 7.6(f), Consultation Paper: Accounting and Auditing Provisions, CO Rewrite, FSTB (March 2007)

The license has a validity period of twelve months. Licensed money lenders are required to adhere to the licensing conditions imposed on them and apply for license renewal on an annual basis. As of December 2023, a total of 2,270 money lenders were licensed under the MLO in Hong Kong.[17]

30. The AASC observed that the public interest in non-bank lenders is relatively limited. Unlike banks, insurance companies and SFC-authorized corporations, money lenders do not accept deposits or handle assets from the public.

31. In addition, while the other three categories of entities that are prohibited from applying the CO's reporting exemption generally align with the definition of a PIE in the IESBA's PIE Provisions (paragraph 19), or are being considered by the IESBA in its PIE-related activities,[18] money lenders have not been included nor considered as a potential PIE category during any of the IESBA's deliberations on the definition of a PIE.

32. Given the above, the AASC does not propose prohibiting audit engagements of money lenders from applying the HKSA for LCE. However, the audit of a money lending business would not be eligible to apply the HKSA for LCE if the entity does not fulfill the relevant qualitative criteria in paragraph A.3. (for example, the entity's business activities, operations or transactions involve complex matters or circumstances) and the quantitative criteria (see discussions in paragraphs 35 to 60 below) set out in the HKSA for LCE.

Question for Respondent
Do you agree with not specifically prohibiting a non-bank money lender within the meaning of the MLO from using the HKSA for LCE in its audit of financial statements? If not, why not?

33. While deposit-taking companies and insurance companies are already prohibited from applying the ISA for LCE in their audit of financial statements, the AASC has proposed to tailor the prohibition in paragraph A.1.(c)(i) and (ii) in the ISA for LCE for adoption in the HKSA for LCE in the local context:

- For the purpose of A.1.(c)(i), the HKSA for LCE shall not be used if the entity carries on any banking business and are authorized institutions as defined under the BO.

[17] Number of Licenesed Money Lenders, Companies Registry

[18] See the discussion on collective investment vehicles ("CIVs") in paragraphs 90 to 104 in the Basis for Conclusions to IESBA's PIE Provisions.

- For the purpose of A.1.(c)(ii), the HKSA for LCE shall not be used if the entity carries on any insurance business and are authorized insurers as defined under the IO.

34. For the prohibition against SFC-licensed corporations (paragraph 28) and entities defined as PIEs in Chapter A of the HKICPA Code (paragraphs 19 to 20), the AASC has proposed to include them as prohibited entities through modifying paragraph A.1.(c)(iii) as follows:

- For the purpose of A.1.(c)(iii), the HKSA for LCE shall not be used if:
  - The entity is a licensed corporation under Part V of the SFO to carry on a business in any regulated activity within the meaning of that Ordinance.
  - The entity is a public interest entity defined in Part 4A, Chapter A of the HKICPA *Code of Ethics for Professional Accountants*.

Question for Respondent
Do you agree to modify the specific prohibition in paragraph A.1.(c) to prohibit the following entities from using the HKSA for LCE in their audit of financial statements? If not, why not? • Entities that carry on any banking business and are authorized institutions as defined under the BO; • Entities that carry on any insurance business and are authorized insurers as defined under the IO; • Entities that are licensed corporations under Part V of the SFO to carry on a business in any regulated activity within the meaning of the SFO; and • Public interest entities defined in Part 4A, Chapter A of the HKICPA Code.

Establishing quantitative thresholds

35. Paragraph A.4. of the standard states that determining quantitative thresholds would assist in the consistent and appropriate use of the ISA for LCE in a jurisdiction. The Institute is the local body with standard setting authority and is responsible for determining the quantitative threshold for the use of the HKSA for LCE.

36. The EEM to paragraph A.4. of the standard states that:
    - *Guidance on setting quantitative thresholds is described further in the Authority Supplemental Guide. Quantitative thresholds may be set, for example, for all applicable entities within the jurisdiction in general, or different thresholds may be set for entities within specific or certain industries or for certain classes of entities. In doing so, consideration is to be given to the specific prohibitions for use of the*

ISA for LCE and the qualitative characteristics of an LCE, as set out in this Part, as well as other specific circumstances or needs that may be relevant in the jurisdiction. While complexity is not always directly relative to the size of an entity or its activities, complexity often increases when key quantitative measures (e.g., revenue, total assets, employee numbers etc.,) increase.

- *When determining quantitative thresholds for the use of the ISA for LCE, existing definitions or thresholds in a jurisdiction, developed for different purposes, may be considered for example:*
    - *European Commission's definition of a "small enterprise." A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover or annual balance sheet total does not exceed EUR 10 million.*
    - *The South African Department of Small Business Development's definition of "small enterprise." This definition includes the size category, 'small', which is an enterprise with 50 or fewer full-time equivalent paid employees and a total annual turnover not exceeding a specific threshold depending on the enterprise's sector or subsector of the economy.*

  The IAASB considered that the above definitions or thresholds may be appropriate examples for a jurisdiction to consider when determining quantitative thresholds, adjusted for the economic and other circumstances of the jurisdiction.

  When the auditor is determining whether the ISA for LCE is appropriate to use, quantitative thresholds established in a jurisdiction are to be considered in addition to the specific prohibitions in paragraph A.1. and the qualitative characteristics in paragraph A.3.

37. While the IAASB noted that complexity is not directly linked to size, it acknowledged that the use of quantitative thresholds may serve as an additional "safeguard" to limit the range of entities perceived to be within the scope of the standard.[19]

38. Considering the aforementioned points, the AASC explored the definition of SMEs in various jurisdictions, including the examples provided by the IAASB (paragraph 36). Generally, SME definitions across jurisdictions encompass a combination of criteria, such as the number of employees, annual turnover, and total assets. Meanwhile, it is important to recognize that the definition of SMEs in different jurisdictions may serve specific purposes and objectives that may go beyond a mere focus on size, such as differentiating the types of entities for different types of governmental support.

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[19] Paragraph 55, Basis for Conclusions to the ISA for LCE

Definition	Criteria
Medium Enterprise, the People's Republic of China ("PRC")[20]	Thresholds vary among industries: • Revenue ranges between RMB 50 million and 2,000 million (approximately HK$56 million to HK$2,200 million). • Employees range between 200 and 2,000. Some industries could qualify for the definition by meeting the revenue criterion alone, while others would need to meet both the revenue and employee criteria.
Small Enterprise, PRC[20]	Thresholds vary among industries: • Revenue ranges between RMB 5 million and 60 million (approximately HK$6 million to HK$67 million). • Employees range between 20 and 300. Some industries could qualify for the definition by meeting the revenue criterion alone, while others would need to meet both the revenue and employee criteria.
Small & Medium Enterprises, Singapore[21]	Operating revenue not more than SGD 100 million (approximately HK$587 million) ***or*** employing not more than 200 workers.
Small Enterprise, European Commission[22]	• Fewer than 50 employees; and • Turnover not exceeding €10 million (approximately HK$86 million) ***or*** balance sheet total not exceeding €10 million (approximately HK$86 million).
Small Enterprise, South African Department of Small Business Development[23]	Thresholds vary among industries: • Total number of full-time equivalent of paid employees between 11 and 50; and • Total annual turnover between R15 million and R80 million (approximately HK$6 million to HK$33 million), depending on the industry engaged.

20 统计上大中小微型企业划分办法, National Bureau of Statistics of the PRC

21 The Singapore Department of Statistics

22 SME Definition, European Commission

23 Revised Schedule 1 of the National Definition of Small Enterprise in South Africa

39. The thresholds mentioned above exhibit significant variation across jurisdictions. In addition, as discussed in paragraph 38, the definition of SMEs in some jurisdictions is influenced by multiple factors and purposes beyond just size considerations. Hence, the quantitative thresholds mentioned above may not provide relevant insights into the relative sizes of SMEs in Hong Kong, given the diverse nature of economies and the multifaceted aspects encompassed by SME definitions.

40. For instance, in Hong Kong, one of the initial listing requirements for a Main Board applicant on The Stock Exchange of Hong Kong ("SEHK") is to have at least HK$500 million revenue for the most recent audited financial year.[24] Accordingly, the operating revenue threshold of SGD 100 million (approximately HK$587 million) used in Singapore's SME definition is regarded as excessively high when it comes to defining a SME in Hong Kong.

Companies Ordinance: A size-test approach

41. As discussed in paragraph 22, eligible private companies fulfilling the CO's size test could opt for the simplified reporting regime to prepare simplified financial and directors' reports. The CO's size limits are classified into various categories based on the types of companies or groups, which are detailed in Schedule 3 of the CO.

42. In summary, a private company or a group of entities qualifies for the CO's reporting exemption if the following conditions are met:
    - The company, or each company in the group, does not fall within the ineligible lines of business under section 359(4) of the CO (paragraph 25 above);
    - The company or the group fulfills the relevant size tests specified in Schedule 3 of the CO; and
    - Where applicable, the company or the group obtains the necessary shareholders' approval to adopt the reporting exemption as required by the CO.

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[24] Chapter 8 Qualification for Listing, Main Board Listing Rules, SEHK

43. Size tests specified in Schedule 3 of the CO and relevant requirements for shareholders' approval are summarized below:

<table>
<tr><th rowspan="2">Eligible categories</th><th colspan="3">Size criteria</th><th rowspan="2">Approval from shareholders</th></tr>
<tr><th>Annual revenue</th><th>Total assets</th><th>No. of employees</th></tr>
<tr><td>1. A private company which has no subsidiary and is not a subsidiary of another company</td><td colspan="3">No size test is required</td><td>• 100% written approval from shareholders is required for each year.
• Note: If the private company also qualifies under category 2 below, shareholders' approval would not be required.</td></tr>
<tr><td>2. Small private company or group: Must not exceed two of the size criteria (Note 1)</td><td>≤ HK$100 million</td><td>≤ HK$100 million</td><td>≤ 100</td><td>Not required</td></tr>
<tr><td>3. Small guarantee company or group (Note 1)</td><td>≤ HK$25 million</td><td>No limit</td><td>No limit</td><td>Not required</td></tr>
<tr><td>4. Eligible private company or group: Must not exceed two of the size criteria (Note 1)</td><td>≤ HK$200 million</td><td>≤ HK$200 million</td><td>≤ 100</td><td>At least 75% of all the members of the company/ holding company of the group must pass a resolution at a general meeting that the company/ holding company is to fall within the reporting exemption for the financial year; and none of the members holding the remaining voting rights objects.</td></tr>
</table>

5. Mixed group comprising a mix of different company types which may include non-Hong Kong body ***(Note 2)***	Size tests and approval criteria for the group as a whole depend on the nature of the holding company in that group.

Note 1: For groups, size tests must be met for each company in the group and for the group as a whole.

Note 2: In the case of mixed groups, the relevant tests for the group as a whole depend on the nature of the holding company in that group:

- If the holding company in that mixed group is a small private company, the aggregate amounts for the mixed group in total must not exceed 2 out of 3 of the size tests for a group of small private companies as set out in the table above.
- If the holding company in that mixed group is an eligible private company, the aggregate amounts for the mixed group in total must not exceed 2 out of 3 of the size tests for a group of eligible companies as set out in the table above.
- If the holding company in that mixed group is a small guarantee company, the aggregate annual revenue of the mixed group must not exceed HK$25 million.

44. On the other hand, the Support and Consultation Centre for SMEs under the Trade and Industry Department of the Government of the Hong Kong Special Administrative Region ("HKSARG") describes SMEs as manufacturing enterprises with employees fewer than 100 persons, and non-manufacturing enterprises with employees fewer than 50 persons. Although it does not take into account the financial criteria of an entity, its threshold for the number of employees is similar to that used in the size test for the reporting exemption of the CO discussed in paragraph 43 above.

45. One of the purposes of the CO's simplified reporting is to save the compliance and business costs of SMEs.[25] Therefore, it may be submitted that the CO's size tests for the reporting exemption were designed for SMEs and are generally commensurate with the sizes associated with the different types of SMEs in Hong Kong.

[25] Paragraph 7, Legislative Council Brief, Companies Bill, FSTB (12 January 2011)

46. The CO's size criteria have been effective since 2014. Over the last ten years, Hong Kong's GDP grew by 32% from HK$2,260 billion in 2014 to HK$2,982 billion in 2023,[26] whereas the Consumer Price Index ("CPI") during the same period grew by 20%.[27]

47. Despite the growth in Hong Kong's GDP and CPI over the past decade, the size criteria of the CO have remained unchanged. The AASC observed that it is uncommon for a government or regulator to raise a quantitative threshold within a short time frame or in response to non-significant changes in underlying factors. For instance, the European Commission's definition of SMEs, introduced in 2003, has remained the same at the time of this memorandum despite significant global changes in prices and economies over the last 20 years. As such, the growth of Hong Kong's GDP and CPI since 2014 (paragraph 46) in isolation may not be deemed as a substantive reason enough to warrant a revision of the size tests for the reporting exemption in the CO.

48. It is important to highlight that the reporting exemption and the ISA for LCE share common objectives, despite their different focuses on financial reporting and auditing requirements. Both frameworks were designed to cater to the needs of smaller entities and the ultimate aims are similar: to reduce the operational burdens of SMEs[28] and helping auditors of LCEs to undertake a consistent, effective and proportionate approach to producing high-quality audits .[29]

49. Currently, the size criteria of the reporting exemption in the CO are the only quantitative and representative measures relevant to SMEs in Hong Kong. The AASC believes that these quantitative thresholds serve as an appropriate reference for determining the quantitative thresholds for the use of the HKSA for LCE.

50. Considering that both frameworks share common objectives, it would be appropriate for the HKSA for LCE to have a size test similar to that in the reporting exemption.

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[26] GDP, implicit price deflator of GDP and per capita GDP, Census and Statistics Department, HKSARG

[27] CPI, Census and Statistics Department, HKSARG

[28] Paragraph 7, Legislative Council Brief, Companies Bill, FSTB (12 January 2011)

[29] Paragraph 5, Basis for Conclusions to the ISA for LCE, IAASB (December 2023)

51. Consequently, the AASC has proposed to incorporate the following size criteria, making reference to the CO's size test for reporting exemption (paragraph 43), as the quantitative thresholds in the HKSA for LCE:

	Size criteria in determining the use of the HKSA for LCE		
	Annual revenue	**Total assets**	**No. of employees**
An eligible entity or a group of entities - *Must not exceed two of the size criteria*	≤ HK$200 million	≤ HK$200 million	≤ 100

The proposed approach for calculating the annual revenue, total assets and number of employees of an eligible entity or a group of entities to determine their use of the HKSA for LCE in their audits is set out in paragraph 71.

52. In its deliberation, the AASC considered the possibility of applying a lower quantitative threshold of HK$25 million in annual revenue or HK$100 million in total assets, which are the CO's reporting exemption size criteria for a guarantee company/group of guarantee companies and a small private company/group of small private companies (paragraph 43). However, after careful consideration, the AASC agreed on HK$200 million in annual revenue and/or total assets as the quantitative threshold in the HKSA for LCE for the following reasons:

- The quantitative threshold of the HKSA for LCE is not intended to be a "copy" of the size criteria of the CO's reporting exemption; instead, the latter is used as a basis for the AASC's deliberation. Consequently, entities or groups that are eligible for the CO's reporting exemption (hence eligible to use the SME-FRF & SME-FRS in their financial reporting) would not automatically be eligible for the HKSA for LCE in the audit of their financial statements. To be eligible to use the HKSA for LCE in their audits, an entity or a group of entities must meet the layers of requirements: the specific prohibition, qualitative criteria and the proposed quantitative criteria.
- The CO's threshold of HK$25 million for guarantee companies was developed from the perspective of public interest.[30] It is important to note that the AASC has proposed explicitly prohibiting PIEs as defined in Chapter A of the HKICPA Code from applying the HKSA for LCE in their audit engagements, regardless of their revenue, assets, and employee size (paragraph 20). Given the AASC has already taken the public interest element into account separately, it is deemed not

[30] Paragraph 18, Consultation Conclusions on the Accounting and Auditing Provisions of the Companies Ordinance, FSTB (March 2008)

necessary to incorporate the public interest aspect when establishing the quantitative threshold for limiting the use of the HKSA for LCE, which was the reporting exemption's intention to apply HK$25 million revenue as a size criterion for guarantee companies.

53. The AASC also noted that the CO's reporting exemption criteria uses HK$100 million and HK$200 million in annual revenue and/or total assets to differentiate between small private companies or groups (category 2 in paragraph 43) and eligible private companies or groups (category 4 in paragraph 43) respectively for their size test. In addition, eligible private companies or groups must obtain 75% approval from their members in order to adopt the simplified reporting regime of the CO.

54. The requirement for shareholders' approval was brought forward from section 141D of the predecessor CO. Under section 141D of the predecessor CO, a private company with members' approval irrespective of its size would be allowed to prepare simplified reports. At the time of the CO rewrite, the Financial Services and the Treasury Bureau ("FSTB") and Companies Registry ("CR") noted that such a regime had not created any problems. Therefore, there was a case for allowing larger private companies or groups with members' approval to adopt the simplified reporting without undermining members' interest.[31]

55. If the quantitative threshold to use the HKSA for LCE serves as an additional "safeguard" to ensure the appropriate use of the standard (as stated in paragraph 37), the AASC concurred that if an entity already meets the specific, qualitative criteria and quantitative thresholds set out in the HKSA for LCE, obtaining further approval from shareholders should not be required in order for its audit engagement to apply the HKSA for LCE. In addition, while management is responsible for preparing financial statements and thus determines which set of financial reporting standards to use, the determination of the appropriate auditing standard for an audit engagement is the professional judgment of auditors based on the facts and circumstances of the entity, rather than a decision by management or the entity's shareholders. Therefore, it is determined that the need for shareholders' approval on the use of the HKSA for LCE is not necessary.

[31] Paragraph 15, Companies Bill, Consultation Paper on the Qualifying Criteria for Private Companies to Prepare Simplified Financial and Directors' Reports, FSTB and CR (6 December 2011)

56. The AASC has proposed to adopt the reporting exemption's highest size threshold of HK$200 million in annual revenue and/or total assets as the quantitative thresholds for evaluating the use of the HKSA for LCE in an audit engagement.

57. The AASC also discussed whether category 1 of the CO's reporting exemption set out in paragraph 43, i.e., a private company which has no subsidiary and is not a subsidiary of another company, should be able to apply the HKSA for LCE without any quantitative thresholds, as is the case with the CO's reporting exemption.

58. The IAASB anticipates local standard-setting bodies to develop quantitative thresholds as a safeguard on the appropriate use of the standard (paragraph 37). Therefore, when evaluating the use of the HKSA for LCE, the AASC considered that this category would not be necessary because having a category without any size criteria would not align with the purpose of developing a quantitative threshold. In addition, category 1 of the CO's reporting exemption requires 100% written approval from shareholders each year for the entity to be eligible for the CO's reporting exemption. As mentioned in paragraph 55, auditors should be responsible for determining the appropriate use of the HKSA for LCE in an audit engagement based on the specific circumstances of an entity, as opposed to it being a decision by shareholders. Furthermore, as discussed in paragraph 52, the AASC does not intend to align the quantitative thresholds in the HKSA for LCE (which applies to audits of financial statements) with those in the CO's reporting exemption (which relates to the use of the SME-FRF & SME-FRS in preparing financial statements).

59. In certain situations, entities or groups that qualify for the reporting exemption may not opt for the simplified reporting regime but prepare their financial statements in accordance with the HKFRS or HKFRS for PE as appropriate. In such cases, if the entity or group fulfills other criteria stated in the Authority of the HKSA for LCE (i.e., in addition to meeting the quantitative thresholds, it does not fall within the specific prohibitions and meets the qualitative characteristics), their auditors have an option to perform the audit engagements using the HKSA for LCE, even if the financial statements are not prepared using SME-FRF & SME-FRS.

60. In summary, it is the responsibility of the auditors to conduct a thorough assessment and maintain comprehensive documentation to justify their selection and appropriateness of the audit framework to be used.

Question for Respondent
In determining the appropriate use of the HKSA for LCE, in addition to the specific prohibitions in paragraph A.1. and meeting the qualitative characteristics in paragraph A.3., do you agree that an entity or a group of entities should not exceed any two of the following? If not, why not? (a) Annual revenue of HK$200 million (b) Total assets of HK$200 million at the end of the reporting period (c) 100 employees

Evaluating an entity's size for the eligible use of the HKSA for LCE

Meeting the size tests in the first financial year[32]

61. The AASC has proposed that a new entity could use the HKSA for LCE in the audit of its first financial year if it meets the quantitative thresholds and other requirements for the use of the HKSA for LCE in that year. This mirrors the approach in the CO's reporting exemption for a newly established company[33] and allows it to adopt the HKSA for LCE immediately without waiting for another two years as in the case of an existing entity (paragraph 63) to determine its eligibility.

62. Likewise, for a group of entities with a newly established holding company, the AASC has proposed that the group could use the HKSA for LCE in the audit of its first financial year if it meets the quantitative thresholds and other requirements for the use of the HKSA for LCE in that year.

Meeting the size tests in subsequent financial years

63. For an existing entity or a group of entities, the AASC has proposed that in addition to the specific prohibition and qualitative characteristics, it will need to meet the quantitative thresholds for two consecutive financial years before it is eligible for the use of the HKSA for LCE in the audit of the following financial year. This is illustrated in Scenario 1 and 3 below.

64. 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. Scenario 2 below illustrates this.

[32] In this explanatory memorandum, the terms "financial year" (or year) and "financial reporting period" (or period) are used interchangeably.

[33] Section 361(1) and 362(2) of the CO.

65. 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"). Scenario 3 below illustrates this.

66. However, there is an exception to the rule in paragraph 65. If a new entity becomes part of the group and results in the group exceeding the quantitative thresholds 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 in paragraph 65. Scenario 4 below illustrates this.

67. The proposed approach in paragraphs 63 to 65 is consistent with the timeframe for an existing entity or a group of entities to assess its size criteria under the CO's reporting exemption. Applying them as the timeframe to assess the use of the HKSA for LCE would ensure stability and avoid frequent switching between the use of the HKSA for LCE and HKSAs. It also enables auditors to assess an entity's characteristics and financial performance over a more extended period, allowing for a more informed determination of the suitability of using the HKSA for LCE in subsequent periods. In cases where an entity's size exceeds the quantitative thresholds for a particular reporting period, the approach allows a buffer and time for the auditor to determine and prepare for the transition to the HKSAs in the third reporting period, rather than having the transition immediately in the subsequent financial year. Nevertheless, an auditor can transit from using the HKSA for LCE to HKSAs or other relevant auditing standards as needed or appropriate, even if an entity or a group still meets the requirements to apply the HKSA for LCE for auditing purposes and is entitled to the two-year grace period in paragraph 65.

68. The exception to the two-year grace period in paragraph 66 also mirrors the approach in the CO's reporting exemption.[34] The AASC observed that adding a new, large entity to an existing group may change the fundamental attributes of that group in a way that undermines the original eligibility criteria, including the quantitative thresholds. If this new, large entity had been part of the group from the start, the entire group would not have been eligible for the quantitative thresholds initially. Furthermore, the breach of the thresholds is not due to fluctuations in the sizes or business activities of the existing

[34] Section 364(4), 365(4) and 366(4) and 366A(6).

member entities. Rather, it is directly attributable to the addition of the new, large entity and its size was not considered in the initial size assessment when determining the eligibility to use the HKSA for LCE. Therefore, the AASC has proposed following the CO's reporting exemption approach that a group should not be eligible for the HKSA for LCE in its audit in the financial year that the new entity enters the group, if that new entity is of such a size that the group fails the quantitative thresholds in that year, in which case the two-year grace period would not be applicable.

69. During its deliberations, the AASC noted a different timeframe criterion is used in the HKICPA Ethics Committee's local refinement to the definition of PIE in the HKICPA Code, i.e., in evaluating whether a MPF-exempted ORSO registered scheme is a PIE, reference is made to the scheme's total assets based on the most recent audited financial statements.[35] If a similar approach were adopted for the quantitative threshold assessment in the HKSA for LCE, auditors of an existing company or a group of entities would not need to wait for two years (if applicable) to adopt the HKSA for LCE in the next financial year as shown in Scenario 3 below. Although this may be an advantage, the AASC has placed greater emphasis on maintaining stability by using the same auditing standard consistently, rather than making frequent switches from year to year. Therefore, the AASC has proposed to mirror the timeframe approach in the CO for the quantitative threshold assessment in the HKSA for LCE.

70. The timeframe criteria discussed in paragraphs 63 to 66, i.e., measuring the quantitative thresholds over a two-year period, are only relevant to the assessment of the proposed quantitative thresholds. To use the HKSA for LCE in an audit of financial statements, an entity or a group of entities must also meet the proposed specific prohibitions (paragraph A.1.(c)) and qualitative characteristics (paragraph A.3.) of the HKSA for LCE in the year of application.

[35] Paragraph 400.18 A3, HKICPA Exposure Draft *Revisions to the Definitions of Listed Entity and PIE in the Code* (February 2024)

Illustration: Eligibility of an existing entity or a group of entities for applying the HKSA for LCE in its audit engagement

The following scenarios assume that the HKICPA issues the HKSA for LCE in January 20X4. These scenarios only illustrate the assessment of the proposed 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 proposed size criteria	✓	✓	✗	✓	✗	✓	✗
Eligibility to adopt the HKSA for LCE			✓	✓	✓	✓	✓
Decided 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 proposed size criteria	✓	✓	×	×	✓	✓	×
Eligibility to adopt the HKSA for LCE			✓	✓	×	×	✓
Decided 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 proposed size criteria	✓	✓	×	✓	✓	✓	✓
Eligibility to adopt the HKSA for LCE			✓	×	×	✓	✓
Decided 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 enters the group (e.g., in 20X5) where that new entity 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 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 proposed size criteria	✓	✓	✓	× (a new co joins the group)	✓
Eligibility to adopt the HKSA for LCE			✓	×	×
Decided to adopt the HKSA for LCE			✓	NA	NA

Question for Respondent

Do you agree with the following in applying the proposed quantitative thresholds to assess the use of the HKSA for LCE? If not, why not?

(a) The general principle is that an entity or a group of entities will need to meet the proposed quantitative thresholds for the two immediately preceding reporting periods in order to be eligible to use the HKSA for LCE in that reporting period (subject to meeting all the other conditions), regardless of its size in that period. An exception applies to an entity which is a newly established entity, or a group of entities whose holding company is a newly established entity. In this case, the entity or group could use the HKSA for LCE in the audit of its first financial year if the entity or group meets the proposed quantitative thresholds and other requirements for using the HKSA for LCE in its first financial year.

(b) An entity or a group of entities that already meets the criteria of and is using the HKSA for LCE in its audit of financial statements can continue using it until it fails the proposed quantitative thresholds for two consecutive financial years. It will only lose the eligibility to use the HKSA for LCE in the reporting period following the two immediately preceding financial years in which it has failed to meet the proposed quantitative thresholds.

(c) A group of entities that meets the criteria of using the HKSA for LCE and has been using it in its audit of financial statements will lose the eligibility to use it in the financial year when a new entity enters the group and causes the group to exceed the proposed quantitative thresholds in that year. As a result, the group will lose its eligibility to use the HKSA for LCE immediately in its audit of financial statements in the year that the new entity enters the group, without the two-year grace period in (b).

(d) To evaluate the proposed quantitative thresholds, an auditor should use the entity's or the group's financial information of the two consecutive financial years immediately preceding the year that the auditor plans to use the HKSA for LCE in the audit of the entity or group financial statements. This is the case except for a newly established entity or a group of entities whose holding company is a newly established entity which intends to apply the HKSA for LCE in its first financial year (see (a) above).

<u>Other considerations</u>

71. In assessing the quantitative thresholds for the eligible use of the HKSA for LCE, the AASC has proposed mirroring the CO's interpretative guidance in Schedule 3 as follows:
   (a) The annual revenue and total assets are those reflected in the entity financial statements or group financial statements for the financial year;
   (b) In the case where the reporting period is shorter or longer than a year, the amount of annual revenue for a financial year is to be calculated on a pro-rata basis as if the length of the financial year was 12 months;
   (c) The number of employees is the average number of persons employed by the entity or group of entities during the reporting period (irrespective of whether in full-time or part-time employment) determined on a monthly basis as follows:
      (i) Determine the number of employees as at the end of each calendar month.
      (ii) Add together all the monthly numbers in (i).
      (iii) Divide the number in (ii) by the number of months in the reporting period.

Question for Respondent

Do you agree to apply the following bases to determine the quantitative thresholds for the eligible use of the HKSA for LCE? If not, why not?

(a) The annual revenue and total assets are those reflected in the entity financial statements or group financial statements for the financial year;

(b) In the case where the reporting period is shorter or longer than a year, the amount of annual revenue for a financial year is to be calculated on a pro-rata basis as if the length of the financial year was 12 months;

(c) The number of employees is the average number of persons employed by the entity or group of entities during the reporting period (irrespective of whether in full-time or part-time employment) determined on a monthly basis as follows:
   (i) Determine the number of employees as at the end of each calendar month.

(ii) Add together all the monthly numbers in (i).

(iii) Divide the number in (ii) by the number of months in the reporting period.

Interaction with other pronouncements of the HKICPA

72. The IAASB decided not to develop requirements to address the ISA 800-series within the ISA for LCE at this time. However, the IAASB explored the possibility of an interim solution to allow the use of the standard for such engagements and added wording to the Preface (paragraph P.2.) to allow the use of the standard, to be adapted as necessary, to an audit of:
    (a) A complete set of special purpose financial statements; or
    (b) An audit of a single financial statement or of a specific element, account or item of a financial statement.

73. The following AASC's guidance was previously developed to cater for the special purpose reporting under HKSA 800:
    - Circular on Reporting to Grantees of the Language Fund
    - Circular on Reporting to Grantees of the Quality Education Fund
    - Circular on Reporting on the Audit of Schools

74. With the rollout of the HKSA for LCE, the AASC has acknowledged the need to update the above pronouncements to cater for the special purpose reporting under the HKSA for LCE.

75. Likewise, the AASC noted the need to update PN 900 (Revised), *Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard* to include example auditor's reports on financial statements prepared in accordance with SME-FRS based on HKSA for LCE.

76. Subject to the release of the HKSA for LCE, the AASC will develop the updates mentioned in paragraphs 73 and 75 in due course.

IV. Guide for Respondents

77. The AASC welcomes comments on all matters addressed in this exposure draft, but especially those identified in the *Request for specific comments* below. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed

changes to wording. When a respondent agrees with proposals in this exposure draft, it will be helpful for the AASC to be made aware of this view.

78. Comments should be supported by specific reasoning and should be submitted in written form.

79. The proposals in this exposure draft may be modified in light of the comments received. For the issuance of the final pronouncement, the AASC will deliberate the stakeholders' views in its meetings after the end of the comment period.

Request for specific comments

1. Do you agree that entities falling within the definition of a PIE in Chapter A of the HKICPA Code, including any future local amendments made to the PIE definition in Chapter A of the HKICPA Code, should be prohibited from applying the HKSA for LCE in their audit of financial statements? If not, why not?

2. Do you agree with not specifically prohibiting a non-bank money lender within the meaning of the MLO from using the HKSA for LCE in its audit of financial statements? If not, why not?

3. Do you agree to modify the specific prohibition in paragraph A.1.(c) to prohibit the following entities from using the HKSA for LCE in their audit of financial statements? If not, why not?
   - Entities that carry on any banking business and are authorized institutions as defined under the BO;
   - Entities that carry on any insurance business and are authorized insurers as defined under the IO;
   - Entities that are licensed corporations under Part V of the SFO to carry on a business in any regulated activity within the meaning of the SFO; and
   - Public interest entities defined in Part 4A, Chapter A of the HKICPA Code.

4. In determining the appropriate use of the HKSA for LCE, in addition to the specific prohibitions in paragraph A.1. and meeting the qualitative characteristics in paragraph A.3., do you agree that an entity or a group of entities should not exceed any two of the following?
   (a) Annual revenue of HK$200 million
   (b) Total assets of HK$200 million at the end of the reporting period
   (c) 100 employees

5. Do you agree with the following in applying the proposed quantitative thresholds to assess the use of the HKSA for LCE? If not, why not?
   (a) The general principle is that an entity or a group of entities will need to meet the proposed quantitative thresholds for the two immediately preceding reporting periods in order to be eligible to use the HKSA for LCE in that reporting period (subject to meeting all the other conditions), regardless of its size in that period. An exception applies to an entity which is a newly established entity, or a group of entities whose holding company is a newly established entity. In this case, the entity or group could use the HKSA for LCE in the audit of its first financial year

if the entity or group meets the proposed quantitative thresholds and other requirements for using the HKSA for LCE in its first financial year.

(b) An entity or a group of entities that already meets the criteria of and is using the HKSA for LCE in its audit of financial statements can continue using it until it fails the proposed quantitative thresholds for two consecutive financial years. It will only lose the eligibility to use the HKSA for LCE in the reporting period following the two immediately preceding financial years in which it has failed to meet the proposed quantitative thresholds.

(c) A group of entities that meets the criteria of using the HKSA for LCE and has been using it in its audit of financial statements will lose the eligibility to use it in the financial year when a new entity enters the group and causes the group to exceed the proposed quantitative thresholds in that year. As a result, the group will lose its eligibility to use the HKSA for LCE immediately in its audit of financial statements in the year that the new entity enters the group, without the two-year grace period in (b).

(d) To evaluate the proposed quantitative thresholds, an auditor should use the entity's or the group's financial information of the two consecutive financial years immediately preceding the year that the auditor plans to use the HKSA for LCE in the audit of the entity or group financial statements. This is the case except for a newly established entity or a group of entities whose holding company is a newly established entity which intends to apply the HKSA for LCE in its first financial year (see (a) above).

6. Do you agree to apply the following bases to determine the quantitative thresholds for the eligible use of the HKSA for LCE? If not, why not?

(a) The annual revenue and total assets are those reflected in the entity financial statements or group financial statements for the financial year;

(b) In the case where the reporting period is shorter or longer than a year, the amount of annual revenue for a financial year is to be calculated on a pro-rata basis as if the length of the financial year was 12 months;

(c) The number of employees is the average number of persons employed by the entity or group of entities during the reporting period (irrespective of whether in full-time or part-time employment) determined on a monthly basis as follows:

(i) Determine the number of employees as at the end of each calendar month.

(ii) Add together all the monthly numbers in (i).

(iii) Divide the number in (ii) by the number of months in the reporting period.

7.	Are there any other matters you would like to raise in relation to this exposure draft? If so, please clearly indicate the requirement(s) or material, or the theme or topic, to which your comment(s) relate.

EXPOSURE DRAFT

This exposure draft comprises only Part A, *Authority of the HKSA for Audits of Financial Statements of Less Complex Entities*, of the proposed HKSA for LCE. In this exposure draft, proposed local amendments to Part A of the ISA for LCE are marked in **red**.

This exposure draft does not encompass the Preface, Parts 1 to 10, and Appendix 1 to 7 of the proposed HKSA for LCE. They will be adopted from the corresponding sections of the ISA for LCE following the Institute's due process with minimal alterations.

A. Authority of the HKSA for Audits of Financial Statements of Less Complex Entities

Content of this Part

Part A sets out the Authority for determining the appropriate use of the HKSA for LCE.

The HKSA for LCE is designed to enable the achievement of the overall objectives of the auditor, given the typical nature and circumstances of an LCE as described in this Part. There are limitations to the use of the HKSA for LCE that are designated into three categories: specific prohibitions, qualitative characteristics, and quantitative thresholds. Part A also describes the responsibilities for legislative or regulatory authorities or relevant local bodies with standard-setting authority to support the appropriate use of this standard. The use of "LCE" or "entity" also refers to a group (i.e., where the audit is an audit of group financial statements).[36]

The requirements in this HKSA for LCE have been designed to be proportionate to the typical nature and circumstances of an audit of an LCE (i.e., they do not address complex matters or circumstances). If the HKSA for LCE is used for an audit outside the intended scope of this standard, compliance with the requirements of the HKSA for LCE will not be sufficient for the auditor to obtain sufficient appropriate audit evidence to support a reasonable assurance opinion.

The Supplemental Guidance for the Authority of the Standard (the Authority Supplemental Guide) provides further guidance for legislative or regulatory authorities or relevant local bodies with standard-setting authority when addressing their respective responsibilities as described in this Part. In addition, the Authority Supplemental Guide further explains matters that may be relevant for firms and auditors in determining whether the use of the HKSA for LCE is appropriate.

Limitations for Using the HKSA for LCE

Limitations for using the HKSA for LCE are designated into three categories:

- *Specific classes of entities for which the use of the HKSA for LCE is prohibited (i.e., specific prohibitions);*

[36] A "group" is a reporting entity for which group financial statements are prepared and "group financial statements" are financial statements that include the financial information of more than one entity or business unit through a consolidation process. The term "consolidation process" as used in the HKSA for LCE is not intended to have the same meaning as "consolidation" or "consolidated financial statements" as defined or described in financial reporting frameworks. Rather, the term "consolidation process" refers more broadly to the process used to prepare group financial statements. The Glossary of Terms (**Appendix 1**) describes the meanings attributed to certain terms for the purpose of the HKSA for LCE, including the meaning of group and group financial statements.

- *Qualitative characteristics that describe an LCE, and 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*
- *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.

Specific Prohibitions

Paragraph A.1. sets out the classes of entities for which the use of this standard is specifically prohibited.

A.1. The HKSA for LCE shall not be used if:

(a) Law or regulation prohibits the use of the HKSA for LCE or specifies the use of auditing standards other than the HKSA for LCE for the audit of the financial statements in that jurisdiction.

(b) The entity is a listed entity.

(c) The entity falls into one of the following classes:

(i) An entity one of whose main functions is to take deposits from the public;

(ii) An entity one of whose main functions is to provide insurance to the public; or

(iii) A class of entities where use of the HKSA for LCE is prohibited for that specific class of entity by a legislative or regulatory authority or relevant local body with standard-setting authority in the jurisdiction.

For the purpose of A.1.(c)(i), the HKSA for LCE shall not be used if the entity carries on any banking business and is an authorized institution as defined under the Banking Ordinance.

For the purpose of A.1.(c)(ii), the HKSA for LCE shall not be used if the entity carries on any insurance business and is an authorized insurer as defined under the Insurance Ordinance.

For the purpose of A.1.(c)(iii), the HKSA for LCE shall not be used if:

- The entity is a licensed corporation under Part V of the Securities and Futures Ordinance to carry on a business in any regulated activity within the meaning of that Ordinance.
- The entity is a public interest entity defined in Part 4A, Chapter A of the HKICPA Code of Ethics for Professional Accountants.

(d) The audit is an audit of group financial statements (group audit) and:

(i) Any of the group's individual entities or business units meet the criteria as described in paragraph A.1.(b) or A.1.(c); or

(ii) Component auditors are involved, except when the component auditor's involvement is limited to circumstances in which a physical presence is needed for a specific audit procedure for the group audit (e.g., attending a physical inventory count or physically inspecting assets or documents).

A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a store with multiple branches. When those business units have characteristics such as separate locations, separate management, separate general ledger and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of group financial statements because they include the financial information of more than one entity or business unit through a consolidation process.

In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (e.g., in a sub-ledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (e.g., divisions) for purposes of this HKSA for LCE.

Component Auditors

A component auditor is an auditor who performs audit work related to a component[37] *for purposes of the group audit. A component auditor is a part of the engagement team for a group audit. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (e.g., another office within the group auditor's firm).*

In some circumstances, the group auditor may perform centralized testing on classes of transactions, account balances or disclosures, or may perform audit procedures related to a component. In these circumstances, the group auditor is not considered a component auditor.

Part 3 contains requirements in relation to engagement quality, including relevant ethical requirements, and the direction and supervision of the members of the engagement team, and the review of their work.

A.2. The classes in paragraph A.1.(a) (b) and (d) are outright prohibitions and cannot be modified. Legislative or regulatory authorities or relevant local bodies with standard-setting authority can modify each class described in paragraph A.1.(c) but a class cannot be removed.

A.1.(c) sets out some classes of entities that may exhibit public interest characteristics. Entities that have public interest characteristics could embody a level of complexity in fact or appearance and are specifically prohibited from using the HKSA for LCE. Modifications can be made by adding a class of entities to the list of prohibited entities, permitting specific sub-sets within a class to be able to use this standard or using quantitative thresholds to prohibit use of this standard. Legislative or regulatory authorities or relevant local bodies with standard-setting authority may subsequently remove or amend modifications that they have made.

Qualitative Characteristics

The requirements in this HKSA for LCE have been designed to be proportionate to the typical nature and circumstances of an audit of an LCE.

The HKSA for LCE has not been designed to address:

[37] A component is an entity, business unit, function or business activity, or some combination thereof, determined by the group auditor for the purposes of planning and performing audit procedures in a group audit.

- *Complex matters or circumstances relating to the nature and extent of the entity's business activities, operations and related transactions and events relevant to the preparation of the financial statements.*
- *Topics, themes and matters that increase, or indicate the presence of, complexity, such as those relating to ownership of the entity, corporate governance arrangements of the entity, or policies, procedures or processes established by the entity.*

Also, the HKSA for LCE does not include any requirements addressing:

- *Procedures or matters typically relevant to listed entities, including reporting on segment information or key audit matters.*
- *When the auditor intends to use the work of internal auditors, as this would ordinarily not be applicable to an audit of an LCE.*
- *When the auditor intends to use a report provided by a service auditor of a service organization either as audit evidence about the design and implementation of controls at the service organization (i.e., a type 1 or type 2 report), or as audit evidence that controls at the service organization are operating effectively (i.e., a type 2 report), as this would ordinarily not be applicable to an audit of an LCE.*

A.3. The following list describes characteristics of an LCE for the purpose of determining the appropriate use of the HKSA for LCE. The list is not exhaustive nor intended to be absolute (including numerical indicators), and other relevant matters may also need to be considered. Each of the qualitative characteristics may not, on its own, be sufficient to determine whether the HKSA for LCE is appropriate or not in the circumstances. Therefore, the matters described in the list are intended to be considered both individually and in combination. For the purpose of group audits, these considerations shall apply to both the group and each of its individual entities and business units.

Business Activities, Business Model & Industry	The entity's business activities, business model, or the industry in which the entity operates, do not give rise to significant pervasive business risks. There are no specific laws or regulations that govern the business activities that add complexity (e.g., prudential requirements). The entity's transactions result from few lines of business or revenue streams.
Organizational Structure and Size	The organizational structure is relatively straightforward, with few reporting lines or levels and a small key management team (e.g., 5 individuals or less).
Ownership Structure	The entity's ownership structure is straightforward and there is clear transparency of ownership and control, such that all individual owners and beneficial owners are known.
Nature of Finance Function	The entity has a centralized finance function, including centralized activities related to financial reporting. There are few employees involved in financial reporting roles (e.g., 5 individuals or less).

Information Technology (IT)	The IT environment of the entity, including its IT applications and IT processes, is straightforward. The entity uses commercial software and does not have the ability to make any program changes other than to configure the software (e.g., the chart of accounts, reporting parameters or thresholds). Access to the software is generally limited to one or two designated individuals for the purpose of making the configurations. Few formalized general IT controls are needed in the entity's circumstances.
Application of the Financial Reporting Framework and Accounting Estimates	Few accounts or disclosures in the financial statements of the entity necessitate the use of significant management judgment in applying the requirements of the financial reporting framework. The entity's financial statements ordinarily do not include accounting estimates that involve the use of methods, models, assumptions, or data, that are complex.
Additional Characteristics Relevant for Group Audits For group audits, the following qualitative characteristics are to be considered in addition to those above:	
Group Structure and Activities	The group has few entities or business units (e.g., 5 or less). Entities or business units within the group operate in jurisdictions with similar characteristics, for example laws or regulations and business practices.
Access to Information or People	Group management will be able to provide the engagement team with access to information and unrestricted access to persons within the group as determined necessary by the group auditor.
Consolidation Process	The group has a simple consolidation process. For example: • Intercompany or other consolidation adjustments are not complex; • Financial information of all entities or business units has been prepared in accordance with similar accounting policies applied to the group financial statements; and • All entities or business units have the same financial reporting period-end as that used for group financial reporting.

Notwithstanding that professional judgment is applied in determining whether this standard is appropriate to use, if there is uncertainty about whether an audit meets the criteria as set out in this Authority, the use of the HKSA for LCE is not appropriate.

Quantitative Thresholds

A.4. Determining quantitative thresholds assists in the consistent and appropriate use of the HKSA for LCE in a jurisdiction. This section anticipates that legislative or regulatory authorities or relevant local bodies with standard setting authority will determine quantitative threshold(s) for use of the HKSA for LCE in their respective jurisdictions.

A.4.1. In determining the appropriate use of the HKSA for LCE, in addition to the specific prohibitions in paragraph A.1. and meeting the qualitative characteristics in paragraph A.3., an entity or a group of entities should not exceed any two of the following:

(a) Annual revenue of HK$200 million

(b) Total assets of HK$200 million at the end of the reporting period

(c) 100 employees

A.4.2. When determining the sizes in paragraph A.4.1.,

(a) The annual revenue and total assets are those reflected in the entity financial statements or group financial statements for the financial year;

(b) In the case where the reporting period is shorter or longer than a year, the amount of annual revenue for a financial year is to be calculated on a pro-rata basis as if the length of the financial year was 12 months;

(c) The number of employees is the average number of persons employed by the entity or group of entities during the reporting period (irrespective of whether in full-time or part-time employment) determined on a monthly basis as follows:

(i) Determine the number of employees as at the end of each calendar month.

(ii) Add together all the monthly numbers in (i).

(iii) Divide the number in (ii) by the number of months in the reporting period.

A.4.3. When evaluating the quantitative thresholds in paragraph A.4.1., the general principle is that an entity or a group of entities will need to meet the quantitative thresholds for the two immediately preceding reporting periods in order to be eligible to use the HKSA for LCE in that reporting period (subject to meeting all the other conditions), regardless of its size in that period. An exception applies to an entity which is a newly established entity, or a group of entities whose holding company is a newly established entity that intends to use the HKSA for LCE in the audit of its first financial year. The entity or group is eligible to do so if it meets the quantitative thresholds in paragraph A.4.1. and other requirements for using the HKSA for LCE in that first financial year.

A.4.4. An entity or a group of entities that already meets the criteria of and is using the HKSA for LCE in its audit can continue using it until it fails the quantitative thresholds in paragraph A.4.1. for two consecutive financial years. It will only lose the eligibility to use the HKSA for LCE in the reporting period immediately after the two consecutive periods where it does not meet the quantitative thresholds.

A.4.5. However, a group that meets the criteria of using the HKSA for LCE and has been using it in its audit of financial statements will lose the eligibility to use it in the financial year when a new entity enters the group and causes the group to exceed the quantitative thresholds in paragraph A.4.1. in that year. The group will lose its eligibility to use the HKSA for LCE immediately in its audit of financial statements in the financial year that the new entity enters the group, without the two-year grace period in paragraph A4.4..

A.4.6. To evaluate the quantitative thresholds in paragraph A.4.2,, the financial information of the two reporting periods immediately preceding the reporting period that the audit plans to use the HKSA for LCE should be used.

Guidance on setting quantitative thresholds is described further in the Authority Supplemental Guide. Quantitative thresholds may be set, for example, for all applicable entities within the jurisdiction in general, or different thresholds may be set for entities within specific or certain industries or for certain classes of entities. In doing so, consideration is to be given to the specific prohibitions for use of the HKSA for LCE and the qualitative characteristics of an LCE, as set out in this Part, as well as other specific circumstances or needs that may be relevant in the jurisdiction. While complexity is not always directly relative to the size of an entity or its activities, complexity often increases when key quantitative measures (e.g., revenue, total assets, employee numbers etc.,) increase.

When determining quantitative thresholds for the use of the HKSA for LCE, existing definitions or thresholds in a jurisdiction, developed for different purposes, may be considered for example:

- *European Commission's definition of a "small enterprise."[38] A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover or annual balance sheet total does not exceed EUR 10 million.*
- *The South African Department of Small Business Development's definition of "small enterprise."[39] This definition includes the size category, 'small', which is an enterprise with 50 or fewer full-time equivalent paid employees and a total annual turnover not exceeding a specific threshold depending on the enterprise's sector or subsector of the economy.*

The IAASB considered that these definitions or thresholds may be appropriate examples for a jurisdiction to consider when determining quantitative thresholds, adjusted for the economic and other circumstances of the jurisdiction.

When the auditor is determining whether the HKSA for LCE is appropriate to use, quantitative thresholds established in a jurisdiction are to be considered in addition to the specific prohibitions in paragraph A.1. and the qualitative characteristics in paragraph A.3.

Responsibilities of Legislative or Regulatory Authorities or Relevant Local Bodies

Decisions about the required or permitted use of the HKICPA's standards (including the Hong Kong Standards on Auditing and the HKSA for LCE) rest with legislative or regulatory authorities or relevant local bodies with standard-setting authority (such as regulators or oversight bodies, jurisdictional / national auditing standard setters, professional accountancy organizations or others as appropriate) in individual jurisdictions.

As part of the local adoption and implementation process, it is anticipated that legislative or regulatory authorities or relevant local bodies with standard-setting authority:

- *May add or modify the classes of entities in paragraph A.1.(c) as set out in paragraph A.2.*

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[38] This definition was derived from the European Commission's website (https://single-market-economy.ec.europa.eu/smes/sme-definition_en) at the time of finalizing the ISA for LCE (September 2023). This Authority will not be further revised for subsequent changes to this definition.

[39] This definition was derived from the South African Department of Small Business Development's website (https://www.gov.za/sites/default/files/gcis_document/201903/423041gon399.pdf) at the time of finalizing the ISA for LCE (September 2023). This Authority will not be further revised for subsequent changes to this definition.

- *Determine quantitative thresholds described in paragraph A.4.*

In doing so, the specific prohibitions and qualitative characteristics should be considered, as well as other specific needs that may be relevant in the jurisdiction.