

# Audit Focus for 2025 year-end audits

## Financial Services Sector

Inspection

3 October 2025



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## **About the Accounting and Financial Reporting Council**

The Accounting and Financial Reporting Council (**AFRC**) is an independent body established under the Accounting and Financial Reporting Council Ordinance. As an independent regulator, the AFRC leads the accounting profession by upholding professional standards, safeguarding the public interest, and promoting the profession's healthy development.

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# Introduction

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## Importance of the financial services sector and quality audits

The financial services (**FS**) sector is one of Hong Kong's key pillar industries, contributing to 24.9% of Gross Domestic Product in 2023 and reinforcing Hong Kong's position as a leading international financial centre. This sector consists of various sub-sectors, including Banking, Insurance, Asset and Wealth Management and Broker-dealers.<sup>1</sup> They play a critical role in facilitating capital flows, managing risks, and providing investment opportunities. In doing so, they support economic growth, employment, foster investor confidence, and contribute to financial stability.

High-quality audits are the foundation upon which trust in financial reporting is built. They enhance the reliability of financial statements and regulatory disclosures, strengthen accountability, and safeguard the public interest. In the FS sector, these responsibilities carry added significance: the scale, complexity, and systemic importance of financial institutions demand heightened professional scepticism, judgement, and deep technical expertise to effectively address sector-specific risks.

## Market and macroeconomic developments

As auditors head into their 2025 year-end audits, they face an increasingly complex landscape as market volatility, fluctuating interest and exchange rates, and ongoing geopolitical uncertainties and regulatory shifts are creating uncertainties for all kinds, including financial institutions. Against this backdrop, liquidity pressures, heightened credit risk, valuation uncertainty, and the rapid growth of alternative investments are increasing the risks of material misstatements — whether due to error or fraud.

## Purpose of this publication

Market trends and macroeconomic development vary across the FS sub-sectors. Drawing on our inspection experience, Section 2 of this publication highlights sector-specific risks and audit considerations relevant to the 2025 environment.

Auditing financial institutions presents unique challenges due to the complexity and scale of the businesses involved, as well as the specialised expertise required. In this regard, firms intending to provide audit services to such entities should critically assess their competence and capabilities to deliver high-quality audits before accepting a client or an engagement. Section 3 of this publication outlines considerations for firms to gauge their readiness to undertake FS audit and assurance engagements and provide guidance on meeting the high expectations associated with this sector.

Recognising the significance of these entities to the Hong Kong economy, the AFRC will continue to place a strong focus on this sector to promote audit quality and safeguard the investing public.

<sup>1</sup> *Asset and Wealth Management* sub-sectors include collective investment schemes in various forms, such as funds and retirement schemes (MPF schemes / ORSO schemes). *Broker-dealers* sub-sector includes licensed corporations regulated by the SFC and insurance broker companies regulated by the IA.

# Table of contents

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	Page
<b>Section 1 Key macroeconomic and market development</b>	<b>1</b>
<b>Section 2 Industry-specific focus areas</b>	<b>2</b>
I. Banking	3
II. Insurance	4
III. Asset and wealth management	5
IV. Broker-dealers	6
<b>Section 3 Firm-specific key considerations</b>	<b>7</b>
I. Competence and capabilities in specific FS sectors	7
II. Understand the business, industry, and regulatory environment	8
III. Test of internal controls	8
IV. Accounting estimates and use of auditor's experts	9
V. Regulatory reporting	9
<b>Glossary</b>	<b>10</b>

## Section 1

# Key macroeconomic and market development



Challenging market and economic conditions create an environment where companies may experience extended financial pressures, increasing their susceptibility to management bias or fraud. This section highlights key factors that can considerably impact financial institutions.



### Geopolitical and economic uncertainties

Ongoing geopolitical and economic uncertainties not only shape business and market sentiment of retail and institutional customers, but also directly impact financial institutions themselves, influencing capital flows, cross-border investment activities, market volatility, and elevating credit, liquidity, and operational risks.

### Volatility in interest rates and exchange rates

Volatility in interest and exchange rates poses challenges for banks and insurers in managing balance sheet exposures, as well as for funds and broker-dealers in maintaining stable returns. In Hong Kong, the linked exchange rate system anchors stability, however, continued shifts in US monetary policy exerts significant pressure on funding costs and exchange rate movements.



### Liquidity pressures

Liquidity remains a key concern despite the general decline in interest rates. The 1-month HIBOR, which stood at 4.2% at the start of 2025, has eased to around 3.6% at the end of Q3 2025. While this represents some relief, rates remain elevated, and institutions must carefully manage the cost of financing and maintain adequate liquidity buffers to mitigate potential stress on their funding and solvency positions.

### Persistent headwinds in the retail and real estate sectors

Hong Kong's retail sector faces weak domestic consumption and a shift to online shopping, with provisional total retail sales values down 2.6% year-on-year for the first seven months of 2025. The property market has also softened, with the provisional price indices for private offices and retail decreasing by 9.1% and 7.3% since December 2024. Persistent soft demand, high interest rates, and developer leverage pressures heighten risks for financial institutions. Banks are exposed through loan books, insurers through investment portfolios, and funds through direct holdings, raising broader credit and market risks concerns across the financial ecosystem.



### Market sentiment of alternative investments

Growing interests in virtual assets and stablecoins introduces both opportunities and risks for financial institutions. While regulators have advanced frameworks for custody, licensing, and investor protection, concerns around volatility, systemic exposure, and risk management remain significant, particularly for funds and broker-dealers engaging these products.

## Section 2

# Industry-specific focus areas



This section outlines the key focus areas for the financial services sector in 2025. Auditors should pay particular attention to the risks and considerations highlighted, as these are amplified by current market, macroeconomic, and regulatory developments.

In performing risk assessments for 2025 audits, auditors should evaluate how evolving conditions may influence financial reporting and control environments. Key considerations include, but are not limited to: the broader business and regulatory environment and its impact on operations and performance; management's incentives and pressures that may affect judgements; areas involving significant accounting estimates; and the implications of these factors for the design of the audit approach.

### Business and regulatory environment

Consider recent changes in the client's business and its environment, including but not limited to:

- Business performance and strategy
- New business model / new product offerings
- Changes in regulations
- IT system changes / implementation / migration / integration

### Management's incentive

Consider management incentives in fraud risk assessment, in particular, potential changes due to market and regulatory development:

- KPIs of the entity / management
- How changes in business environment may impact their incentives
- Fraud risk indicators

### Areas involving significant accounting estimates

Inherent risks of significant accounting estimates can be elevated due to changes in an entity's business, and its business environment. Auditors should duly consider:

- Governance and controls in significant accounting estimates
- Magnitude of potential misstatements arising from estimation uncertainties
- Whether actual results deviate from the auditor's independent expectation or market practice

### Design an appropriate audit approach



Taking the above and other implications into account, design an appropriate audit approach that:

- Adequately respond to the risks identified, including fraud risks
- Sufficiently and appropriately evaluate management judgement and accounting estimations considered to have a higher degree of estimation uncertainty

Considering the implications of the above factors, auditors should place particular attention to the following key areas of focuses for each FS sub-sector.

## I. Banking



### Recoverability of loans and advances to customers

A challenging macroeconomic environment may weaken borrowers' repayment capacity and drive declines in collateral values, increasing uncertainty around asset recoverability. Industries such as real estate and retail are facing heightened challenges and difficulties, and forward-looking assumptions involve greater uncertainty under current macroeconomic conditions. These factors heighten the audit risks associated with Expected Credit Losses (**ECL**) and reinforce its significance as a key audit focus area in 2025.

### ECL model



#### Appropriateness of methodology and model

Evaluation of the ECL methodology and model typically requires expertise in credit risk. In particular, the segmentation of the loan portfolio, the methodologies applied for PD and LGD modeling amid evolving credit behaviours, and the heightened challenges in identifying relevant macroeconomic variables arising from shifting correlations between the macroeconomic environment and the bank's credit exposures.



#### Appropriateness of key assumptions

- ✓ Given the heightened uncertainty in the macroeconomic outlook and its correlation with the bank's loan portfolio, auditors should critically evaluate:
  - The selection of macroeconomic variables and their respective weighting
  - The probability weightings assigned to forward-looking scenarios

### Credit review



#### Comprehensiveness in the identification of risk factors in credit review

- ✓ Identify borrowers with less favourable prospects, considering both borrowers' behaviours and external market information, among other criteria:
  - Overdue repayment and other indicators signaling borrowers' financial difficulties or financial distress
  - Industries / sectors with unfavourable outlook
  - Negative news, for example, downgrade of credit agencies' rating



#### Appropriateness of staging application

- ✓ Amid the challenging economic environment, quantitative factors alone are insufficient to determine the appropriateness of staging. Auditors should:
  - Evaluate both quantitative and qualitative factors, including whether the criteria for SICR are met
  - Validate the appropriateness and assignment of ICR, taking into account the HKFRS 9 accounting framework and relevant HKMA guidance and manuals



#### Reasonableness of cash flow analysis

- ✓ For credit-impaired loans, recovery is typically through asset realisation or borrower restructuring, both of which require detailed cash flow analysis:
  - Assess probability of adopted asset recovery scenarios
  - Evaluate the timing and source of expected cash flows
  - Evaluate the reasonableness of collateral valuation, considering market information, FSV under distressed conditions, and disposal costs

## II. Insurance



### Valuation of insurance contract liabilities

While the insurance sector has remained resilient amid recent market volatility, ongoing changes in areas such as underwriting and claims management, product offerings, and regulatory requirements warrant auditors' attention in audits and regulatory reporting for 2025.

### Reserving model

#### Appropriateness of methodology and model

Auditors typically engage actuaries as their experts to evaluate methodologies and models in estimating insurance contracts liabilities. Particular emphasis should be placed on the following for the 2025 audits:



##### ✓ **Changes** in methodology and model, which could arise from:

- Implementation of GL 34, particularly regarding surplus distribution mechanisms and dividend policies
- New or revised reinsurance arrangements, reflecting the growing importance of risk management under HKRBC
- Introduction of new products, such as IUL in the life insurance market
- Revisions to SAA driven by investment strategy and portfolio management

#### Relevance, appropriateness and accuracy of key data

Ensure the key data (e.g., claims, lapse, investment return) used in assumption-setting adequately reflect both potential macroeconomic development and entity-specific claims experience in 2025, taking into account how the current economic conditions may change customer behaviour and claims experience.



#### Appropriateness of key assumptions

- ✓ Consider the need for an auditor's expert in reviewing key assumptions. For example:
  - Persistency assumption: monitor and evaluate the impact of the wider economy on policyholder behaviours (e.g. lapse and surrenders) in the experience study and assumption-setting
- ✓ Challenge management for possible bias in the projection of FCF and CSM (e.g. future management actions, calibration of LTIR and illiquidity premium)
- ✓ Challenge management on assumptions which deviate from experience study or market-consistent practice, paying additional attention to future expectations on claims, premium rates, and investment returns



### Compliance with HKRBC regulatory requirements

**Appropriateness of valuation methodology** on compliance with regulatory requirements and evaluate the impact of differences between HKFRS 17 and HKRBC reporting bases.



#### Valuation of Technical Reserves and PCA, including:

- Compliance with IA's prescribed assumptions and risk factors
- Portfolio look-through: Identification and classification of underlying risks
- Determination of Matching Adjustments (**MA**)





### III. Asset and wealth management



#### Valuation of investments

Interest and exchange rates volatility, and the growth of virtual assets heighten valuation risks. Real estate headwinds and weak market sentiment leave illiquid assets especially exposed, thus appropriateness of valuation methodologies and assumptions is a key audit focus.

#### Valuation model



##### Appropriateness of methodology and model

Market developments in 2025 amplify estimation risk, particularly for models used to value illiquid assets or those sensitive to macroeconomic factors, such as investments in real estate, private equity, or private credit in industries experiencing downturns. These conditions increase estimation uncertainty, highlighting the need for specialised expertise, and firms should ensure they have adequate resources to support the reasonableness of methodologies and models.



##### Appropriateness of key assumptions

- ✓ Consider the need of valuation expert in assessing:
  - Choice of comparable companies / transactions
  - Key assumptions, including discount rates, DLOM, growth rates and cash flows
- ✓ Recent transaction considerations:
  - Consider if a transaction of the same investment indicates the fair value
  - Assess proximity of transaction date and whether it reflects fair value at period-end

#### Fee allocation

Amid the current economic uncertainty, management may face pressure to reduce costs, which could incentivise shifting excessive expenses onto the funds and investors as management fees.



#### Management fees



##### Comprehensiveness in identification of fee structure

Fund fee structures, as set out in various agreements or documents, directly affect investor costs and may create incentives for cost-shifting. Engagement team should ensure all fee arrangements are identified and assess their implications by reviewing:

- Limited partnership agreement, fund offering documents, side letters and special arrangements
- Advisory / service contracts



##### Appropriateness of fees

- Perform risk assessment where incentives for overcharging fees are higher and design appropriate audit responses
- Identify differences in fee structure that may exist in different fund classes

#### Retirement schemes - regulatory updates



##### Appropriateness of Fund Expense Ratio (FER)

The eMPF platform became effective in June 2024, with one of its objectives to create room for MPF fee reductions. Consequently, the FER must be disclosed in the audited financial statements of MPF schemes onboarded to eMPF. Auditors should thoroughly understand the regulatory requirements and design appropriate procedures to ensure FER accuracy.

## IV. Broker-dealers



### Revenue recognition

The recovery in IPOs and the stock markets is expected to increase placing activities and broking volumes by licensed corporations. Auditors should assess its potential impact on revenue recognition and ensure related internal controls over transaction recording are operating effectively.

### Placing services



#### Appropriateness of revenue recognition

- ✓ Evaluate whether the entity is a principal or agent
- ✓ Obtain contracts and evaluate whether performance obligations have been fulfilled in recognising revenue:
  - Consider commitment vs best-effort basis
  - Assess homogeneity of revenue contracts for audit sampling, given the diversity of issuers and their specific performance obligations

### Use of IT



#### Adequacy of IT dependencies

Given the high transaction volumes and the widespread use of web-based and mobile applications for broking services, auditors should critically evaluate IT dependencies for audit and assurance reporting:

- ✓ Volume of transactions
  - The higher the volume, the more unlikely that an audit approach without reliance on IT can provide sufficient appropriate audit evidence
- ✓ Extent of digital channels may indicate the needs of IT dependencies
  - Distribution channels such as websites and mobile applications with financial reporting impact should be thoroughly assessed

### Virtual assets and related activities

With the growth of licensed virtual asset trading platforms (VATPs) and the introduction of the stablecoin regime, VA-related activities are expected to grow. Auditors should carefully assess and evaluate the associated risks in these engagements.



### Assessment on competence and capabilities



#### VATP related activities

Given the complexity and rapid evolution of VA-related activities, audits in this sector require highly specialised expertise, supported by appropriate audit tools and programs, to effectively address the unique risks inherent in such businesses.

- Availability of VA and IT specialists with relevant experiences and qualifications
- Availability of specialised audit tools and audit programs
- Assessment of the reliability of third-party blockchain explorers



The 2024 Audit Focus, issued in October 2024, and the Checkpoint – Reminders for Auditors' Reporting on Licensed Corporations (**Checkpoint - LCs**), issued in March 2025, highlight key considerations for auditing VATPs and related activities. Auditors should refer to these publications for detailed guidance.

2024 Audit Focus

Checkpoint - LCs



## Section 3

### Firm-specific key considerations



As the financial services sector continues to operate amid evolving risks, changing regulatory expectations, and heightened market scrutiny, it is critical for audit firms to assess their readiness to undertake FS audit and assurance engagements. Five key areas have been identified that warrant particular attention.

Audits of financial institutions are distinguished by their heightened public interest significance, reflecting the critical role these entities play in the stability of financial markets and the broader economy. The scale and complexity of their operations, coupled with increasingly sophisticated products, diverse business models, and rapidly evolving technology, demand specialised knowledge and sector-specific expertise from audit firms. As regulated entities, financial institutions are subject to heightened regulatory expectations, making it critical for auditors to perform their work properly in ensuring the audits and assurance engagements meet high standards of quality and compliance.

In recognition of these factors, the AFRC will continue to place audits of the financial services sector under greater scrutiny, with an emphasis on promoting audit quality, enhancing market confidence, and safeguarding the public interest. This section highlights key areas that serve as indicators of audit firms' readiness to undertake financial services audit and assurance engagements effectively and consistently.

01



#### Competence and capabilities in specific FS sectors



Due to the complexity and industry-specific specialty in FS audits and assurance, audit firms should possess **sufficient resources** to deliver a quality engagement performance.

Before acceptance of engagements and throughout the audit, audit firms should consider:

- ✓ **Firm's resources and training** in specific FS industries
- ✓ Experience and expertise of **engagement quality reviewers, engagement partners, and managers** in specific industries, with sufficient involvement and oversight throughout the engagements, including the **ability to challenge** management's assessments and engagement team's conclusions.
- ✓ **Availability of auditor's experts**, such as an actuary, a valuation specialist, a credit risk expert, a virtual assets expert, or an IT auditor

02



## Understand the business, industry, and regulatory environment

**Risk assessment** should be performed regularly to keep abreast of the entity's business, industry and regulatory environment, including the following considerations:

- ✓ **Regulatory compliance** as financial institutions are subject to various regulatory reporting, capital, liquidity, and disclosure requirements
- ✓ **Key regulatory changes** which may have wider audit and regulatory reporting implications
- ✓ **Multi-locations implications** as larger financial institutions are likely to have presence across different geographical locations, and subject to **group-level & local-level** policies, processes, and controls
- ✓ **Year-on-year changes** in business strategies, processes and controls
- ✓ **IT systems and applications** across business cycles and the financial reporting process



03



## Test of internal controls



Due to the risks involved and volume of transactions in the FS sector, substantive procedures alone are unlikely to sufficiently and appropriately address the RoMM of key financial statements line items. Auditor should:

- ✓ Sufficiently test the **design and operating effectiveness** of controls
 

GITCs and ITACs	EUC controls	Manual and review controls
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- ✓ Critically evaluate whether the **objectives** of the internal controls correspond to the auditor's reliance on **specific assertions**
- ✓ **Perform reliability testing of IPE** used by control operators/owners in operating the controls
- ✓ Commonly used controls in FS:



Examining signatures of a "preparer" and a "reviewer" is not sufficient to conclude operating effectiveness of internal controls.

### Reconciliations

commonly used in data inputs and outputs between systems

### Management review controls

commonly used in the review of financial information and accounting estimates

### Use of service organisations

Obtain ISAE 3402 reports to evaluate the effectiveness of controls

04



### Accounting estimates and use of auditor's experts

Significant accounting estimates subject to estimation uncertainty often necessitate the involvement of auditor's experts. Auditors should:

- ✓ Agree with the auditor's experts their **scope of work, roles and responsibilities**, and assess their competence and capabilities
- ✓ **Evaluate the work performed** by the auditor's experts, including:
  - ⇒ Validate key data inputs significant to the expert's work
  - ⇒ Understand the procedures performed and the testing approach adopted by experts
  - ⇒ Evaluate observation / findings and caveats reported by experts
  - ⇒ Review and assess the reasonableness of the overall results



Auditors should not merely place reliance on experts without proper evaluation.

05



### Regulatory reporting



A solid understanding and knowledge of the regulatory requirements lays the foundation for auditors' work on regulatory reporting. Auditors should:

- ✓ **Obtain sufficient up-to-date knowledge** about regulatory reporting requirements
- ✓ **Design control testing procedures** that are relevant to address the regulatory reporting requirements
- ✓ Adequately test relevant IT dependencies, including general IT controls and application controls **specific to regulatory reporting**
- ✓ Sufficiently test **IPE** used for the preparation of regulatory returns / statements
- ✓ **Assess misstatements and adjustments** in financial reporting and evaluate the impact on regulatory reporting

## Glossary

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This glossary provides definitions of the acronyms, abbreviations, and key terms used in this publication:

CSM	Contract service margin
DLOM	Discounts for lack of marketability
EUC	End-user computing
FCF	Fulfilment cash flows
FS	Financial Services
FSV	Forced sale value
GITC	General IT controls
GL 34	<i>Guideline on Establishment and Maintenance of Fund(s) In Respect of Participating Business</i>
HIBOR	Hong Kong Interbank Offered Rate
HKFRS 9	Hong Kong Financial Reporting Standard 9 <i>Financial Instruments</i>
HKFRS 17	Hong Kong Financial Reporting Standard 17 <i>Insurance Contracts</i>
HKMA	Hong Kong Monetary Authority
HKRBC	Hong Kong Risk-Based Capital
IA	Insurance Authority
ICR	Internal credit rating
IPE	Information produced by the entity
IPO	Initial public offering
ISAE 3402	International Standard on Assurance Engagements 3402
IT	Information technology
ITAC	IT application controls
IUL	Indexed Universal Life
KPI	Key Performance Indicator
LGD	Loss given default
LTIR	Long-term investment return
MPF	Mandatory Provident Fund
MPF schemes	Mandatory Provident Fund schemes
ORSO schemes	Occupational Retirement schemes
PCA	Prescribed capital amount
PD	Probability of default
RoMM	Risk of material misstatements
SAA	Strategic asset allocation
SFC	Securities and Futures Commission
SICR	Significant increase in credit risk
US	United States
VA	Virtual assets

## Contacts

**If you have any enquiries or comments, please feel free to contact us.**

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