Accounting and Financial Reporting Council
會計及財務匯報局

afrc.org.hk

2025-26 Annual Inspection Report

14 July 2026

Regulation Governance Development

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 (**AFRCO**). 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.

For more information about the statutory functions of the AFRC, please visit www.afrc.org.hk.

Highlights of 2025-26 Inspections

PIE auditors

Category A firms[1]

All 5
firms inspected

These firms audit

1,400
listed entities

87%
listed entities by market capitalisation[2]

Category B firms[1]

A total of 26 firms audit 1,015 listed entities or 4% of listed entities by market capitalisation[2]

16
firms inspected

These firms audit

626
listed entities

2%
listed entities by market capitalisation[2]

Category C firms[1]

A total of 19 firms audit 62 listed entities or 0.1% of listed entities by market capitalisation[2]

4
firms inspected

These firms audit

19
listed entities

0.1%
listed entities by market capitalisation[2]

Non-PIE auditors

41
firms inspected
(27 firms were only subject to AML/CTF compliance monitoring inspections)

Less than 1%
by number of practice units

1 Annex 1 provides details on the categorisation of public interest entity (**PIE**) auditors.

2 The figures represent percentages of the total market capitalisation of all equity securities as at 31 December 2024. As at that date, overseas auditors recognised under the AFRCO audit approximately 9% of listed entities by market capitalisation.

Executive Summary

Independent audit oversight – Advancing sustainable audit quality

2025-26 marks the completion of our second three-year inspection cycle, which began on 1 April 2023 and concluded on 31 March 2026 (**Second Inspection Cycle**). Over the past six years, Hong Kong's audit oversight regime has undergone a profound transformation. Regulatory reforms and rising expectations have driven a significant commitment to improvement across the profession. Since the introduction of the PIE auditor regulatory regime in 2019 and the expansion of our mandate to include non-PIE auditors in 2022, the regulatory framework has become more independent, transparent, and aligned with global standards. This transformation has strengthened the AFRC's ability to assess audit firms objectively, hold them accountable for audit quality outcomes, and promote a culture in which high-quality audits are recognised as fundamental to public trust, investor confidence, and the integrity of Hong Kong's capital markets.

Progress observed, but challenges remain

The completion of our Second Inspection Cycle provides a valuable opportunity to assess how audit quality has evolved across the profession. The results indicate that firms have continued to strengthen their systems of quality management (**SQM**s) and have generally become more responsive to inspection findings. Follow-up inspections also demonstrated that firms were typically able to implement effective remedial actions to address previously identified findings.

However, inspection outcomes across the profession remain uneven. While a number of engagements were assessed as requiring no more than limited improvements, significant findings continued to be identified across various inspections. Findings were particularly prevalent in complex and judgment-intensive areas of auditing, including revenue recognition, asset impairment assessments, going concern assessments, and fraud risk identification.

The results also varied across firm categories. Category A firms, which audit approximately half of all listed entities and around 87% of total market capitalisation, generally demonstrated established SQMs and strong technical capabilities. Nevertheless, inspection findings continued to arise in complex and higher-risk engagements. Category B firms continued to face challenges in maintaining audit quality while managing growth and undertaking first-year audit engagements. By contrast, the small number of engagements inspected at Category C firms indicated notable areas for improvement within this group, which collectively audited fewer than 100 listed entities, all with insignificant market capitalisation.

Understanding this year's results

The 2025 inspections focused on higher-risk engagements selected through our risk-based inspection methodology. These included larger listed companies, complex group structures, financial services (**FS**) audits, specialised industries, and audits conducted within sophisticated information technology (**IT**) environments.

Executive Summary

Many of these engagements involved significant management judgment, estimation uncertainty, cross-border operations, or extensive reliance on information systems. Accordingly, inspection findings should be interpreted in the context of the heightened complexity and risk profile of the engagements selected for review.

Remediation – progress and remaining challenges

Firms have demonstrated a growing ability to remediate findings at the engagement level. During the Second Inspection Cycle, follow-up inspections of previously rated 3 or 4 engagements confirmed that most firms (involving three Category A and three Category B firms) had generally implemented effective remedial actions to address findings identified in prior inspections. More broadly, firms are responding to our inspection findings with greater rigor and are strengthening mechanisms for partner accountability.

However, recurring firm-level findings continue to emerge in critical areas, including partner workload monitoring, resource adequacy, fee pressures associated with expanding PIE portfolios, and oversight of component auditors in group audits. While common remediation measures such as targeted training programmes, enhanced monitoring, and updated guidance have proven effective in addressing engagement-specific findings, they have not consistently translated into sustained firm-wide behavioural change. This suggests that some remediation efforts remain insufficiently targeted or fail to address deeper cultural and structural causes.

Where issues recur, firms should undertake more robust root cause analyses and implement targeted interventions that strengthen accountability, reinforce professional scepticism, and embed quality-focused behaviour throughout the organisation. We will continue to engage closely with firms on themes that persist across inspection cycles.

Overall observations from this year's inspections

Several observations emerged consistently from our inspections. First, inspection findings were more likely to arise where engagement teams did not perform sufficiently robust risk assessments at the planning stage, resulting in inappropriate identification or assessment of audit risks and inadequate responses to those risks.

Second, resource constraints and excessive partner workloads continued to adversely affect audit execution in certain firms. In particular, inspections highlighted the importance of ensuring that engagement acceptance and continuance decisions are supported by sufficient competence, capacity, and sector-specific expertise.

Third, while firms generally responded positively to inspection findings, recurring findings suggest that some remediation efforts remain focused on addressing symptoms rather than the underlying cultural, behavioural, or structural factors that contribute to audit quality issues. Sustainable improvements require firm leadership to embed quality-focused behaviour throughout the organisation and to ensure that **commercial considerations do not compromise audit quality**.

Executive Summary

Persistent themes across inspection cycles

Several themes have consistently emerged across inspections and continue to warrant focused attention.

- **Resource management and partner workload** – Firm-level findings relating to resource adequacy, partner workload monitoring, and the acceptance of engagements relative to firm capability remain prevalent in SQM inspections.
- **Audit fees** – Substantial reductions in audit fees pose a significant risk to audit quality because they may leave auditors with insufficient time and resources to address audit risk effectively, increasing the chance that material misstatements go undetected. Audit committees also play a critical role in safeguarding audit quality. Therefore, they should critically challenge any significant fee reduction to assess whether the audit scope, staffing, and planned procedures will remain sufficient to deliver a high-quality audit.
- **Professional scepticism and management assumptions** – Recurring findings in revenue recognition, asset impairment assessments, going concern assessments, and fraud risk identification often stem from insufficient challenge of management assumptions and inadequate corroboration of audit evidence.
- **Group audit oversight** – Cross-border audits involving component auditors, particularly in the Chinese Mainland, continue to reveal weaknesses in direction, supervision, evaluation of component auditor work, and consolidation procedures.
- **Use of IT and reliability of information produced by the entity (IPE)** – Findings related to the understanding of IT environments, evaluation of general IT controls (**GITC**s) and IT application controls (**ITAC**s), and testing of system-generated information were common across firm categories and engagement types.

Further technical area-by-area findings are set out in Section 1 and Annex 4.

Areas of progress – despite ongoing challenges

The profession is improving its SQMs and remediation efforts, but audit execution quality – particularly in complex, high-risk engagements – continues to require significant attention.

A positive cultural shift is underway, with firms moving beyond a compliance-focused mindset toward embedding audit quality as a core organisational value supported by stronger leadership accountability.

Cross-border regulatory cooperation has also strengthened. In particular, the continued support of the Supervision and Evaluation Bureau of the Ministry of Finance has enabled access to audit working papers in the Chinese Mainland, helping to ensure consistent regulatory oversight for Hong Kong-listed entities operating across jurisdictions.

Our Anti-Money Laundering (**AML**) inspections have also contributed to safeguarding market integrity. Since 2023, we have conducted more than 140 AML inspections and recently issued Guidance on Suspicious Transaction Reporting to strengthen the profession's ability to identify and address financial crime risks.

Executive Summary

Progress is further reinforced by stronger corporate governance practices. It is now standard practice for PIE auditors to share inspection outcomes with client audit committees, enhancing oversight of auditor appointments, audit quality and audit fees.

Furthermore, collaborative regulatory efforts with The Stock Exchange of Hong Kong Limited (**SEHK**) have led to a substantial reduction in late auditor resignations, which fell from 71 to 36 between December 2025 and March 2026 compared with the same period in the previous year. Following the AFRC Guidance Notes on Change of Auditors, SEHK has recently published an updated set of frequently asked questions on the appointment, removal and remuneration of auditors in April 2026. This update has reinforced governance for auditor changes, enhanced transparency and supported more informed investor decision-making.

Looking ahead

The year ahead will continue to present significant challenges, including economic uncertainty, talent shortages, increasing initial public offering (**IPO**) activity, and rapid technological change.

In this environment, audit firms must exercise discipline in client acceptance and continuance decisions, undertaking only those engagements for which they possess the necessary capacity, competence, and technological capability to deliver high-quality audits. Professional scepticism must remain at the heart of audit execution.

As firms increasingly leverage technology to address workload pressure, technology should be viewed as an enabler of audit quality, not a substitute for human judgment. AI and data analytics can enhance efficiency and risk identification, but only when supported by robust governance, ethical safeguards, and effective integration with firms' SQMs.

Cybersecurity also demands heightened attention. Audit firms are custodians of highly sensitive, market-relevant information and therefore face growing exposure to sophisticated cyber threats. Firms should strengthen controls over data access, third-party platforms, cloud service providers, and information handling, while maintaining robust incident response capabilities.

In summary, sustainable audit quality is not achieved through compliance alone. It is built through leadership, accountability, professional scepticism, and an enduring commitment to doing the right thing, even in the most complex circumstances. By strengthening these foundations and addressing emerging risks proactively, audit firms can continue to enhance audit quality, safeguard market integrity, and reinforce public trust in Hong Kong's capital markets.

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Section 1: Overview

I. Purpose of the AFRC inspections

Inspection is one of the AFRC's key regulatory tools for monitoring audit firms' compliance with professional standards, laws and regulations, and for driving improvements in audit quality.

Our inspections are subject to appropriate oversight by the Inspection Committee and the Process Review Panel of the AFRC. This oversight helps ensure that inspections are conducted fairly, consistently and in accordance with internal procedures. Over the years, we have continuously enhanced our inspection methodology to elevate both efficiency and effectiveness in response to a rapidly changing world and shifting risk landscape. Grounded in the core principles of proportionality and risk-based assessment, this dynamic approach not only strengthens our regulatory framework but also drives continuous improvement that benefits the entire profession.

II. Purpose of this report

This report summarises the work of the AFRC Inspection Department for the year ended 31 March 2026 (**2025 Inspections**), highlighting key findings, observations and insights from our inspections of 66 firms. Except for those which were chosen only for assessment of their compliance with AML/counter-terrorist financing (**CTF**) requirements, our inspections of firms also included inspections of their SQMs, as well as a sample of their audit engagements (and other assurance engagements, where applicable).

This report serves distinct purposes for different stakeholders across the financial reporting ecosystem:

Auditors – The report provides practical guidance to help the profession strengthen practices and drive continuous self-improvement. By highlighting inspection findings and leading practices, the report helps auditors identify potential pitfalls and raise the bar in audit quality.

Audit committees and company directors – The report provides key insights into regulatory expectations and audit quality risks. By understanding the AFRC's inspection focus and results, audit committees and company directors can better evaluate the quality of their company audits, enhance oversight of the financial reporting process, and strengthen their practices in auditor appointments, re-appointments and audit fee determination.

Other stakeholders – The report presents key inspection findings and insights, highlighting the significance of high-quality audits for all stakeholders and reinforcing the auditor's role in fostering trust and transparency in financial reporting.

III. Overall approach

To exercise our statutory inspection powers effectively and efficiently, we adopt a risk-based approach and apply the principle of proportionality. This approach enables us to remain agile and responsive to evolving market conditions while effectively utilising our resources to identify and address risks to audit quality.

Selection of firms and engagements

We prioritised our inspections based on heightened risks and complexity of an audit through our data-driven, risk-based assessment. To enhance the robustness of our inspections, we also randomly selected a small number of firms and engagements for inspection.

In the selection process, we considered, among others, the following risk factors:

Market risks
- Industries more vulnerable to adverse changes in economic conditions
- Emerging industries or businesses
- Mid-and large-cap stocks

Firm-specific risks
- Firms that served a significant number of PIEs
- Firms that grew rapidly within a relatively short period
- Firms that did not show any improvement in audit quality over the years
- Firms with a perceived lack of expertise in specialised industries

Engagement-specific risks
- First-year audits and recent auditor changes
- Incoming auditors accepting an aggressive fee cut
- Engagement partners with excessive workloads
- Substantial fee reliance on key clients

Inspection scope and interpretation

Our inspections assess auditors' compliance with applicable professional standards, laws, and regulations. This typically involves reviewing selected aspects of a firm's SQM, a sample of completed audit engagements, and the firm's compliance with the Guidelines on AML and CTF for Professional Accountants (**AML Guidelines**).

As our inspections are risk-based and focus on a selected sample of engagements each year, the findings presented in this report should not be interpreted as a comprehensive identification of all weaknesses or deficiencies within a firm's SQM, the engagements inspected, or its AML/CTF policies and procedures.

The findings should also not be interpreted as indicating that:

- A firm's SQM was ineffective; or
- The financial statements of the inspected engagements were materially misstated.

Rather, the findings identified specific areas within the scope of our inspections where improvements are needed. They, together with the ratings of individual PIE engagements, provide valuable insights into audit quality — the execution of audits and the effectiveness of firms' SQM practices — and form one part of our overall assessment of audit quality across the profession.

Inspection results should also be interpreted in the context of the AFRC's risk-based inspection approach. The engagements selected for inspection are not representative of all audits performed by a firm or of the profession as a whole. Higher-risk and more complex engagements are more likely to be selected for inspection and, accordingly, are more likely to reveal deficiencies requiring remediation. The results therefore provide insights into areas of heightened audit quality risk rather than statistical measures of overall audit quality across the profession.

To assist audit firms in strengthening audit quality, this report includes illustrative examples of key findings identified from our 2025 Inspections, together with highlighted “Alert” messages that reinforce important audit quality considerations. These examples are intended to provide practical insights into common pitfalls and recurring findings observed during our inspections. We encourage firms to carefully consider these observations and reminders when evaluating and enhancing their own policies, procedures, and audit practices.

Follow-up actions after an inspection

Having regard to the inspection report issued to the auditors, the AFRC may take various follow-up actions under sections 21H and/or 20ZZE of the AFRCO. Such actions may include requiring the auditors to take a measure or corrective action, initiating an investigation by the AFRC, or imposing a sanction.

All firms subject to our inspections are required to submit remediation plans, with specific implementation timelines, to address identified findings. If the quality of the remediation plan submitted by a firm does not meet our expectations, we will take follow-up action, including requiring the firm to take specific measures or corrective actions. Failure to comply may lead to regulatory action.

Where matters arise regarding serious non-compliance with our statutory requirements or professional standards, we will refer them to our Investigation and Compliance Department and Discipline Department for consideration of possible investigation and disciplinary action.

During the year, the AFRC sanctioned certain practice units and professional persons for their misconduct related to significant deficiencies identified during our inspections.

These deficiencies include:

- Failure to comply with statutory requirements issued by the AFRC for the purposes of inspections;
- Contraventions of registration and notification requirements under the AFRCO;
- Professional and practice irregularities in relation to the integrity of audit documentation; and
- Failure to comply with the AML Guidelines.

Details of the disciplinary cases can be accessed on the AFRC website.

Stakeholder engagements and resources

We continued to communicate with firm leadership and publish resources through multiple channels to help foster a quality-driven culture across firms and support continuous improvement in the accounting profession. The following is a summary of the publications and engagements with firm leaders and audit professionals during this reporting period.

Engagements

Briefing sessions and meetings

We held two sharing sessions to brief firm leaders and QCSRPs about the key findings and insights from our 2024-25 inspections and to set regulatory expectations for improving audit quality.

We met with firm leaders in person to **reinforce the importance of a quality-driven firm culture and remind them of their duties to ensure** consistent delivery of high-quality audits.

We held sharing sessions with selected firms to discuss common findings from our 2025-26 inspections of IT audits and audits of FS entities, emphasising the need for timely remedial action and continuous improvement.

Publications

Audit Focus – provides **key reminders** to auditors for year-end audits

Our 2025 Audit Focus provided practical reminders and highlighted key areas that required particular attention from auditors.

Checkpoint – provides **practical guidance** to auditors on specific audit matters

In December 2025, we issued a Checkpoint relating to ***Information Produced by the Entity for Use as Audit Evidence***.

Embracing an AI-empowered Future for the Accounting Profession – encourages the safe and responsible implementation of AI technologies

In February 2026, we issued guidance materials to provide practical insights into potential AI use cases relevant to accounting professionals.

Videos

AFRC Connect – promotes **audit quality** and advances **professional excellence** within the profession

In this reporting period, we launched two videos on IT audits and journal entry testing.

Report Digest – distills **key messages** from our Audit Focus

In January 2026, we distilled our essential takeaways from the 2025 Audit Focus and communicated them via our Report Digest.

Read our publications and videos for more guidance and educational information to support the profession in upholding the audit quality.

Publications **Videos**

IV. Overall inspection results

In the 2025 Inspections, we inspected 25 PIE auditors, and they are:

Table 1. List of PIE auditors inspected in the 2025 Inspections

Category A Firms (5 firms)	
• BDO Limited (BDO) • Deloitte Touche Tohmatsu (Deloitte) • Ernst & Young (EY)	• KPMG • PricewaterhouseCoopers (PwC)

Category B Firms (16 firms)	
• Asian Alliance (HK) CPA Limited • Baker Tilly Hong Kong Limited • BEIJING XINGHUA CAPLEGEND CPA LIMITED[1] • Cheng & Cheng Limited • Confucius International CPA Limited • FAN, CHAN & CO. LIMITED • Forvis Mazars CPA Limited • Grant Thornton Hong Kong Limited	• HLB Hodgson Impey Cheng Limited • Jon Gepsom CPA Limited • KTC Partners CPA Limited • McMillan Woods (Hong Kong) CPA Limited • OOP CPA & Co.[1] • Prism Hong Kong Limited • Rongcheng (Hong Kong) CPA Limited • RSM Hong Kong

Category C Firms (4 firms)	
• Conpak CPA Limited • PKF Hong Kong Limited	• Wilson & Partners CPA Limited[1] • WM CPA Limited[1]

1 Subject to our inspection for the first time in 2025.

Below are the overall inspection results of the 25 PIE auditors subject to the 2025 Inspections, along with our key observations. Further details are presented in Sections 2 to 3 and Annexes 2 to 4 of this report.

Inspections of SQMs

The 2025 Inspections marked the completion of our Second Inspection Cycle, which ran from 1 April 2023 to 31 March 2026. The inspection results indicate that firm-wide governance and culture are critical drivers of improvement in audit quality. Firms that consistently invest in a robust SQM are better equipped to address audit quality risks, ensure the consistent delivery of high-quality audits, and prevent the recurrence of significant findings identified in previous inspections.

During this inspection cycle, we observed that many firms previously subject to our inspections have taken steps to improve their audit practices. These measures include cultivating quality-centric cultures, strengthening monitoring and remediation processes, investing in talent development, and harnessing technology to bolster the effectiveness of their SQMs. To sustain and build on this progress, firm leadership should reinforce a culture of continuous feedback and strong accountability, take clear ownership of the firm's SQM effectiveness, deepen investigation of the root cause(s) of the identified deficiencies, encourage open and transparent sharing of lessons learned from inspection findings and proactively and continually enhance audit practices.

Inspections of PIE engagements

Our engagement inspections were primarily related to audits completed in 2025 for financial statements prepared for the year ended 31 December 2024 or 31 March 2025.

Elaboration of audit quality rating (AQR) in our PIE engagement inspections

Each PIE engagement subject to inspection is rated based on the number and severity of inspection findings. We use AQRs to describe our overall assessment of the quality of a PIE audit completed by a firm. There are four categories of AQR, and they are:

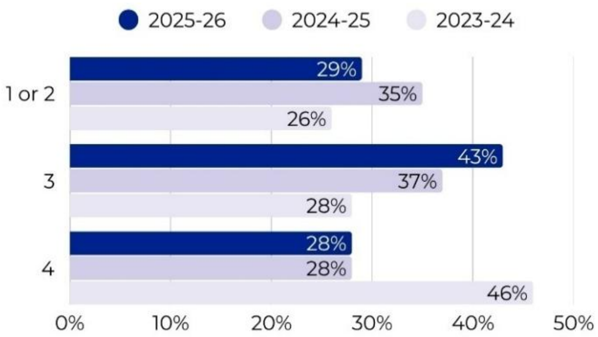
1 – Good
2 – Limited Improvements required
3 – Improvements required
4 – Significant Improvements required

1 represents the highest score, and 4 the lowest.

In interpreting the inspection results, it is important to recognise that an AQR of 3 or 4 does not necessarily indicate that the financial statements are materially misstated.

Furthermore, given the relatively small number of engagements inspected for each firm in a given year, the AQRs presented in this report are not necessarily indicative of the audit quality across the firms' entire portfolio.

The bar chart below presents the percentage distribution of PIE engagements inspected by AQR category from 2023-24 to 2025-26.



It is important to note that the AQR on the left reflects inspection results from various engagements completed by different firms in the past three years. While the data may not be directly comparable, the trend suggests gradual improvement, reflecting efforts by some PIE auditors to strengthen audit quality.

Recent trends in PIE engagement inspection results

The percentage of PIE engagements rated AQR of 4 declined from a peak of 46% in 2023-24 to 28% in both 2024-25 and 2025-26. While this indicates that progress has been made over time, further improvement remains necessary.

Notably, the pace of improvement has moderated over the past two years. This moderation should be considered in the context of our increasingly targeted inspection approach, which has focused on more complex and higher-risk audits, including engagements within the FS sector, audits of larger multinational entities, and audits involving sophisticated IT environments that had not previously been inspected in depth. As a result, inspection outcomes in recent years may not be directly comparable with those from earlier inspection cycles.

Nonetheless, the results demonstrate that significant audit quality challenges remain, particularly in more complex and higher-risk engagements, and underscore the need for firms to continue strengthening their SQMs and audit execution.

Driving audit quality through timely and robust remediation

Firms that were subject to our previous inspections have made improvements to varying degrees in response to our expectations and prior-year feedback. For some, the improvements made are substantial. This improvement reflects, at least in part, the efforts undertaken by firm leadership and the positive impact of the inspection insights and guidance materials we have published on this topic.

To evaluate the effectiveness of remedial actions taken by firms, our inspections in the Second Inspection Cycle included follow-up reviews of nine PIE engagements (completed by three Category A firms and five Category B firms) for which we had previously identified significant findings. While follow-up inspections are not rated, the results indicated that six firms (three Category A firms and three Category B firms) had implemented effective remedial actions to address findings from prior inspections. These outcomes demonstrate that firms that take appropriate and timely actions aligned with our regulatory expectations can achieve meaningful improvements in audit quality.

Read our Guide and Inspection Insights for more practical reminders on performing root cause analysis and remediation:

An External Auditor's Guide to Performing Root Cause Analysis

Inspection Insights – Root Cause Analysis and Remediation: A Call to Action for Quality Improvement

Reinforcing governance for auditor changes and remuneration

A robust governance framework remains fundamental to upholding the integrity of financial reporting and ensuring high audit quality. It supports sound decision-making in the appointment and re-appointment of auditors, thereby reducing the likelihood of unnecessary late auditor changes that may place pressure on audit execution and adversely affect audit quality.

Compared with the same period last year, the number of late auditor resignations decreased from 71 to 36 between 1 December 2025 to 31 March 2026. In addition, resignation letters from outgoing auditors now provide more specific and tailored explanations of the underlying circumstances leading to their resignation, moving away from generic boilerplate disclosures such as "audit fee disagreements".

In April 2026, SEHK updated frequently asked questions on the appointment, removal and remuneration of auditors. The revised frequently asked questions clarify that any changes of auditor due to actions taken by the listed entities (e.g. where a listed entity requests the auditor to resign) must be approved through formal shareholder votes at general meetings.

Additionally, to ensure the auditor's appointment or re-appointment is considered based on due process with all relevant information, listed entities are now required to disclose the estimated audit fee either as a specific amount or as a range in their circular and explain the basis of determination and the assumptions (e.g. business complexity, the expected audit scope, audit timetable and auditor's resources required). The final fee should not deviate materially from the estimate without a valid reason. Audit committees of the listed entities must justify their fee-related decisions to ensure adequate fees and resourcing for the performance of quality audits.

Collectively, these measures reinforce the important role of boards and audit committees in supporting high audit quality through effective governance over the appointment and remuneration of auditors.

Inspections of non-PIE engagements

In the 2025 Inspections, we inspected 17 non-PIE engagements completed by PIE auditors. Our inspections this year focused on entities with notable public interest, covering audits and related assurance engagements for licensed insurers, mandatory provident fund schemes, occupational retirement schemes, and investment funds.

Inspection results for audits in these specialised industries indicate opportunities for improvement, which is not uncommon in the context of first-time inspections. The findings underscore the importance of assigning engagement teams with the requisite sector-specific knowledge and experience to support the delivery of high-quality audits in these complex and specialised sectors.

V. Observations on audit quality drivers

Based on our observations, we identified several key factors that may increase the risk of auditors not maintaining audit quality, although the actual impact varies depending on the unique circumstances of each engagement. When present, either individually or in combination, these factors typically resulted in engagements rated 3 (Improvements required) or 4 (Significant Improvements required). These key factors are outlined below.

Insufficient partner involvement due to heavy partner workload

Our inspection results show that audit partners who assume a substantial number of roles as engagement partner and/or engagement quality reviewer (**EQR**) are more likely to experience poor inspection results. On average, partners at Category A and B firms who received an AQR of 3 or 4 handled close to ten PIE audits per year, while in an extreme case, a single partner managed up to 25 PIE audits as either the engagement partner or EQR within a single year. Among the 55 partners subject to the 2025 Inspections, 18 were overseeing more than ten PIE audits a year.

A quality audit requires effective direction, supervision and review by the engagement partner and EQR. Excessive workload can impair a partner's ability to fulfil these responsibilities, limiting the depth and consistency of their involvement and, ultimately, affecting audit quality.

Fee pressure in first-year audits affects audit quality

Of the 18 first-year PIE engagements inspected, ten incoming auditors were paid lower audit fees than their predecessors, with reductions ranging from less than 5% to approximately 40%. Nine of these ten engagements were rated 3 or 4.

Substantial reductions in audit fees can compress profit margins, incentivising firms and/or engagement partners to prioritise cost containment at the expense of audit quality. In such cases, auditors may respond by reducing the scope of work, limiting the involvement of experienced personnel, or adjusting audit strategies in ways that fail to address the heightened risks inherent in first-year audit engagements. Such pressure may also create pervasive threats to auditor objectivity and scepticism.

The audit committee of listed entities is responsible for overseeing the external auditor and ensuring that the auditor is appropriately remunerated for the audit work performed. Adequate remuneration is essential for auditors to allocate sufficient resources and to perform quality audits in line with professional standards and regulatory requirements. When assessing the auditor's remuneration, the audit committee should consider the resources needed, including the engagement team's capacity, competence, capability, and specialised expertise.

Time pressure arising from late auditor changes

Of the 18 first-year PIE engagements inspected, eight listed entities changed their auditors late, i.e., one month before or after the PIE's financial year-end date. All eight engagements were rated 3 or 4.

Late auditor changes compress the available time for audit planning, risk assessment, and execution. They may also reduce the time available for effective direction, supervision and review by the engagement partner and EQR.

We have observed persistent risks to audit quality arising from poor resource management across the profession in today's increasingly vibrant capital market. Firms are expected to take prompt and effective action to address these risks with reference to the key observations and expectations set out below.

Alert: Maintaining high standards of competence and capability amid the vibrant capital market

Ensure adequate resources supported by reasonable fees and audit timetables

Significant fee reductions could lead to resource constraints and compromise audit quality or create threats to independence. Late auditor changes, on the other hand, result in compressed audit timetables and inadequate audit planning. Firms must allocate sufficient resources commensurate with the risks of the engagement, only accept engagements where there is sufficient time for proper planning and execution, and refrain from accepting fees so low that they would compromise audit quality.

Invest in staff development and specialist support

There has been an increase in inspection findings in areas such as testing of IT controls, evaluation of expected credit loss (**ECL**) allowances in FS audits, and audits of clients operating in complex IT environments. These findings underscore the need for industry-specific and subject matter expertise. Firms should provide focused training and engage qualified specialists where necessary to address the complexities of audits in specialised industries.

Monitor partner workload effectively

Our inspections revealed that when audit engagement partners are responsible for a large number of audit clients, it becomes increasingly difficult for them to be sufficiently involved in each engagement, especially in areas involving significant management estimations and judgements. Engagement partners have primary responsibility for providing effective direction, supervision, and review of an engagement team's work, and for taking overall accountability for audit quality. Firms should implement robust workload monitoring mechanisms and intervene promptly when partner workloads become excessive. They should consider the complexity of engagements, the partners' other roles and responsibilities, and the need for partners to raise concerns when workload pressures become unmanageable.

Where the workload associated with an engagement or portfolio of engagements exceeds the capacity of a single partner, firms should consider assigning additional partners with the requisite competence and authority to share responsibilities. In such cases, the respective roles, responsibilities, and areas of accountability of each partner should be clearly defined, communicated, and documented to ensure effective oversight, coordination, and audit quality.

Strengthen oversight in group audits

Oversight of group audits remains a key area of concern, particularly as cross-border audits involving component auditors (both within and outside the network) become increasingly prevalent. These engagements require the group engagement team to effectively direct, supervise, and review the work performed by component auditors so that they can deliver a quality audit. As the group auditor, firms are expected to rigorously assess the competence, capabilities, and independence of component auditors prior to engagement acceptance and continuance, provide appropriate direction and supervision throughout the audit, and critically evaluate the sufficiency and appropriateness of the audit evidence obtained. All such procedures should be clearly and properly documented in the group audit files.

Section 2: Inspections of Annually Inspected PIE Auditors

I. Approach

Our 2025 Inspections of Category A firms involved evaluating selected components of each firm's SQM, reviewing a sample of their audit engagements (and other assurance engagements, where applicable) and assessing the effectiveness of the remedial actions proposed to address findings from prior-year inspections.

In 2025, we maintained a risk-focused, cyclical approach to SQM inspections for all Category A firms. Our reviews focused on key aspects relating to acceptance and continuance, engagement performance, relevant ethical requirements, and information and communication.

II. Inspection results and observations

Inspections of SQMs

All five Category A firms have taken steps to address audit quality risks, adapting their approaches to reflect the scale and diversity of their client portfolios and service offerings. The profile of Hong Kong-listed entities has evolved in recent years, with more companies operating in innovative, technology-driven, or high-growth sectors seeking listings. These developments present new challenges for firms' quality risk management and oversight processes.

Operationally, these firms are at different stages of transformation, including broader adoption of onshore and offshore delivery centres, greater reliance on auditors' specialists, and expanding use of technology in executing audits. While these advancements have modernised audit practices, they have also increased the need for effective oversight and seamless coordination across teams and locations to ensure audit quality is consistently maintained.

To address these complexities, firms are moving away from after-the-fact measures and towards more proactive quality management processes. However, the extent and effectiveness of these efforts vary among firms, and there remain areas where further improvement and more robust implementation of quality management are needed, to ensure that audit quality is upheld across engagements.

Our 2025 Inspections identified both areas requiring attention and notable audit quality initiatives within the SQMs at some Category A firms. A summary of these findings and initiatives by area is set out on the following pages.

Findings identified from our SQM inspections

Areas where inspection findings in specific Category A firms were identified and warrant immediate attention and action:

Insufficient evaluation of the firm's resources

- Significant growth in audit engagements was not matched by a corresponding increase in the number of audit managers and audit partners.
- The evaluation of the availability and competence of engagement team members, including the auditor's specialists, was insufficient when accepting clients from industries that are relatively new to the firm.

Insufficient partner workload monitoring

- Partner workload assessment did not sufficiently account for the complexities and audit risks across different engagements. For example, for certain partners, only the minimum required hours for partner involvement were considered, without adjustment for the size and complexity of the engagements.
- Follow-up action was not taken promptly for partners whose workloads exceed the firm's predefined thresholds.

Appointment and objectivity of EQR

- Insufficient procedures to identify, evaluate, and address the intimidation and self-interest threats to independence arising from an EQR who has a direct reporting line to the engagement partner, or from a reciprocal EQR arrangement between two engagement partners, i.e., each serving as an EQR for the other's audit engagement.

Insufficient consideration of the management integrity of audit clients during acceptance and continuance

- Policies and procedures were insufficient to ensure that engagement teams adequately assessed the integrity and ethical values of key management and those charged with governance when making acceptance or continuance decisions. Specifically, the criteria for determining when to perform more extensive background checks and when to include additional personnel in these checks were unclear.

Timeliness of audit file assembly for non-PIE engagements

- Monitoring procedures were insufficient to ensure the final audit files of non-PIE engagements were assembled and archived within the required timeframes in accordance with the firm's own policies.

Insufficient evaluation over the use of external electronic confirmation platforms

- The use of external confirmation platforms, e.g., Confirmation.com, to send, receive, and manage third-party audit confirmations, including bank confirmations, is becoming increasingly prevalent as an alternative to traditional paper-based methods.
- Procedures were insufficient to ensure that auditors maintained proper control over the confirmation process when using external electronic confirmation platforms. In particular, firms did not sufficiently evaluate whether their internal controls were appropriately designed and operating effectively to address user entity responsibilities before relying on these platforms.

Audit quality initiatives observed

We encourage all firms to consider adopting these practices, if relevant to their circumstances, to support continuous improvement in audit quality.

Acceptance and continuance

As observed, a common finding of this year's SQM inspections is that several firms across different categories accepted or continued engagements under conditions where their resources, partner capacity, or competence were inadequate for the engagement profile. Audit quality initiatives observed:

Enhanced client acceptance and continuance procedures

- An independent oversight committee was established by some firms to approve the acceptance of large, complex, or potentially high-risk audit clients, based on pre-defined criteria.

Engagement performance

Engagement-level findings have continued to recur year on year in similar technical areas, indicating that lessons from past inspections do not always translate into improved execution on current engagements. Audit quality initiatives observed:

Improved engagement quality through timely and rigorous monitoring

- Pre-issuance quality reviews were mandated for engagements that were recently inspected to ensure that all identified issues were fully addressed before the issuance of audit reports.

Strengthened integrity and quality of audit documentation

- An independent team was established to perform sample checks on the integrity and quality of audit documentation, including re-performing selected substantive audit procedures.
- The assembly of final audit files was completed within two to 14 days after the date of the auditor's report, much less than the 60 days ordinarily required by Hong Kong Standard on Auditing (**HKSA**) 230 *Audit Documentation*.
- Technology to detect incomplete audit working papers prior to archiving and send automatic reminders for files approaching archive deadlines was implemented.

Information and communication

The aforementioned recurring engagement-level findings also imply that knowledge does not consistently diffuse within firms. Audit quality initiatives observed:

Promoting audit quality through structured communication

- A variety of communication methods in all firms were implemented, e.g., emails, group meetings, shared digital workspaces, to ensure prompt and transparent communication of information related to both internal and external inspections, as well as audit quality enhancement initiatives, to all audit staff.
- Four firms published transparency reports that included audit quality metrics, such as internal quality review results, people survey results, and/or training hours of audit partners and staff. These reports also describe initiatives taken to further strengthen audit quality.

Relevant ethical requirements

The adoption of automated monitoring systems for personal independence compliance, together with comprehensive training programmes, reflects a strong commitment to proactively managing independence risks before they affect audit quality. We encourage other firms to explore similar system-wide enhancements. Audit quality initiatives observed:

Upholding high standards of integrity and independence across all levels

- Technological tools were deployed by one firm to monitor personal independence compliance for all professional staff against their financial interest records, which enables the firm to promptly identify and address any exceptions or potential conflicts.
- Scenario-based learning was integrated into ethics and integrity training to cultivate an ethical mindset across the firm, enabling partners and staff to identify, navigate, and report complex ethical dilemmas.

Alert: Foundation of audit quality – Safeguarding auditor independence

Effective direction, supervision, and review are fundamentally reliant on engagement partner independence. As the ultimate gatekeeper of audit quality, the engagement partner's objective and independent mindset is the driving force behind professional scepticism. Without true objectivity, the review process does not rigorously challenge management's assertions.

This risk is particularly acute when audit partners become financially dependent on key clients, as such dependency creates a self-interest threat. When personal financial security is tied to client satisfaction, a partner's ability to make tough, objective judgments is compromised.

To mitigate these risks, firm leadership must set a strong tone at the top, champion ethical values, and establish a robust corporate governance framework that safeguards auditor independence and rewards professional scepticism, ensuring that audits remain objective, credible and in the public interest.

Auditors are also encouraged to read Section 3 of our 2024-25 Annual Inspection Report for the leading practices observed in key SQM components, in addition to the above, and adopt these practices to strengthen their SQMs as a whole.

2024-25 Annual Inspection Report

Inspections of engagements

In 2025, we expanded our PIE engagement inspections for Category A firms, increasing the number from 24 in 2024 to 28 in 2025 (see Table 2). The additional inspections focused on industry sectors with heightened public interest, e.g., FS, or those adversely affected by current economic volatility, such as consumer discretionary and real estate, etc.

The following table shows the PIE engagement inspection results of Category A firms.

Table 2. Number of PIE engagement inspections of Category A firms and their AQR in 2025 Inspections

Category	Total number of firms inspected	Number of PIE engagements inspected			
		Total	AQR of 1 or 2	AQR of 3	AQR of 4
Category A (note)	5	28	12	11	5

Note: Annex 2 presents the names and inspection results of PIE engagements for individual firms.

Unsatisfactory inspection results and quality risk indicators

While some of the engagements inspected are inherently more complex, our observations underscore the necessity of ensuring adequate resources, maintaining pricing discipline, and providing effective oversight to support the consistent delivery of quality audits, particularly in today's dynamic audit environment.

It is concerning that five PIE engagements completed by three different Category A firms received a AQR of 4 (Significant Improvements required). The three Category A firms are:

- BDO
- Deloitte
- EY

Our analysis found that all five engagements exhibited at least one characteristic typically associated with unsatisfactory inspection results. These include aggressive pricing on first-year audits, insufficient resource deployment, limited involvement of auditor's specialists, and most notably, insufficient partner involvement due to heavy workload. Specifically, we found that:

- Three engagements were first-year audit engagements. The audit fee for two engagements decreased by approximately 40% despite them being first-year audits.
- Total audit hours of another engagement decreased by around 20% year-on-year.
- There was limited involvement of an auditor's expert for a client operating in a specialised industry.
- Partner involvement was insufficient for three engagements, as each partner took on the roles of engagement partner and EQR for more than ten PIE engagements in a year, while also assuming management responsibilities.

While these metrics may not capture all root causes of audit execution challenges, they are clearly contributing factors to unsatisfactory inspection results. More importantly, they may signal gaps between a firm's stated commitment to quality and the reality of how resources, workloads, and commercial considerations are managed in practice.

For firm leadership, these findings point to underlying issues that require immediate attention and action. Leadership must take full responsibility to ensure that **commercial pressures do not compromise quality**. Specifically, firms should accept or continue engagements only at sustainable fee levels, allocate personnel with appropriate expertise and experience, and rigorously monitor partner workloads to ensure sufficient involvement and supervision throughout the audit process.

Critical reminders for Category A firms

Category A firms bear an elevated responsibility for upholding audit quality and protecting the public interest, due to their significant market share, and pivotal role in shaping the profession. Their leadership, governance, and SQMs should therefore set a strong benchmark for the wider audit profession.

Alert: Audits in the FS and IT sectors inherently require auditors to place significant reliance on audit clients' IT systems. Findings identified from our 2025 Inspections indicate an increasing proportion of findings arising from insufficient testing of clients' internal controls, including those related to GITCs and ITACs.

Cross-border audits involving component auditors are common across Category A firms. When performing these audits, Category A firms should also consider our Alert message: ***Strengthening group audit oversight*** on page 24 of this report.

Examples of these findings are detailed in Annex 4.

Alert: Embracing an AI-empowered and digital future for the accounting profession

There is a growing trend among Category A firms to deploy artificial intelligence (**AI**) tools and other emerging technologies from global networks to support their audit procedures. Prominent applications include advanced data analytics platforms and AI chatbots utilised for querying firm audit methodologies. While these tools offer significant opportunities to enhance operational efficiency and audit quality, their deployment introduces new complexities that firms should carefully manage.

Integrate AI and technological tools within the SQM framework

Firms should ensure that AI and other technological tools are seamlessly integrated into their SQM frameworks. This integration requires robust governance structures to oversee the responsible and ethical application of the technology. Furthermore, rigorous oversight and ongoing risk assessments are essential to mitigate technological bias and safeguard confidential client information against the complex cybersecurity and data protection threats inherent in AI-driven environments.

Ensure team competence and readiness for exercising professional judgment when using technological audit tools

The effective use of technological audit tools depends entirely on the engagement team's readiness to exercise sound professional judgment. Firms should ensure auditors possess the requisite skills to critically evaluate AI-generated outputs and perform appropriate procedures to obtain sufficient appropriate audit evidence. While AI tools can augment analytical capabilities, they cannot supplant human oversight. Auditors retain ultimate accountability for all conclusions and must maintain professional scepticism throughout the engagement, for example, by independently verifying the reliability and relevance of automated results rather than placing undue reliance on them.

All firms are encouraged to refer to the AFRC's article *Embracing an AI-Empowered Future for the Accounting Profession (February 2026)*, which provides practical guidance on responsible adoption of AI. The guideline emphasises robust governance, sound risk management, effective human oversight, and adherence to professional and ethical standards to safeguard audit quality and the public interest while fostering innovation.

Embracing an AI-Empowered Future for the Accounting Profession

Section 3: Inspections of Non-annually Inspected PIE Auditors

I. Approach

We continue to adopt a risk-based approach in our inspections of Category B and C firms during the Second Inspection Cycle. Although these firms are not inspected annually, those assessed as having higher audit quality risks based on their client portfolios and past inspection results are subject to more frequent inspections.

Our 2025 Inspections of Category B and C firms involved a review of each firm's SQM covering all its SQM components, a sample of their audit engagements (and other assurance engagements, where applicable), and an assessment of the effectiveness of the remedial actions proposed to address findings from prior-year inspections.

II. Inspection results and observations

Inspections of SQMs

In our 2025 Inspections, we evaluated the SQMs at ten Category B firms and three Category C firms. Of these 13 firms, eight were Category B firms, and one was a Category C firm that had been inspected prior to HKSQM 1 coming into effect on 15 December 2022. These previously inspected firms have largely addressed the findings identified under HKSQC 1.

However, HKSQM 1 requires firms to be more vigilant, as it demands a more proactive, risk-based approach to quality management. Unlike the compliance-driven focus of HKSQC 1, HKSQM 1 emphasises ongoing monitoring and tailored responses to quality risks, placing greater responsibility on firm leadership to ensure their firms' SQMs remain both compliant and effective in a dynamic environment.

Nevertheless, our 2025 Inspections revealed that certain newly introduced SQM requirements, most notably those concerning the EQR cooling-off period, have been overlooked and require immediate attention and action from firm leadership. Beyond SQM requirements, Category B and C firms must also maintain strict ethics and independence, which have, at times, been neglected. Firms are reminded that any serious non-compliance with the Professional Accountants Ordinance and Code of Ethics for Professional Accountants will not be tolerated under any circumstances.

The following sections set out key findings from our 2025 SQM inspections of Categories B and C firms that require urgent attention and prompt remedial action.

Significant findings identified from our SQM inspections

During our 2025 Inspections, we identified the following significant non-compliance with the AFRCO and the Code of Ethics for Professional Accountants (**CoE**).

Contraventions of the registration requirements under the AFRCO

Certain firms have authorised individuals to act as engagement partners on PIE engagements before these individuals were registered with the AFRC in that capacity.

Please read the AFRC's **Guide for the Registration of PIE Auditors** for more details of the registration requirements with the AFRC.

Self-review threats arising from non-compliance with cooling-off requirements

Two firms did not establish policies and procedures that specify, as a condition for eligibility, a cooling-off period of two years before the engagement partner can assume the role of EQR as required by section 325.8 of Chapter A of the CoE and HKSQM 2. We observed instances at the same two firms in which individuals were appointed as EQR immediately after finishing serving as engagement partners, without a 2-year cooling-off period.

Fee dependency on PIE audit clients

One firm did not identify that the total fees from a PIE audit client exceeded 15% of the firm's total fees for two consecutive years and did not apply any safeguards to reduce the threats to independence to an acceptable level in accordance with paragraph R410.18 of Chapter A of the CoE.

Alert: Excessive client concentration threatens firm and partner independence

Excessive reliance on a single client presents significant threats to independence at both the firm and partner levels. When an audit client contributes a disproportionately large share of a firm's total fees, the resulting dependence and the fear of losing that revenue substantially heightens both self-interest and intimidation threats. Similarly, when an individual partner is financially dependent on a key client relationship, their objectivity and independence are put at serious risk.

To safeguard independence and maintain public trust, firm leadership must proactively monitor and manage client concentration risks at both the firm and partner levels.

Common findings identified from our SQM inspections

Our inspections identified common SQM findings across multiple Category B and C firms, **including issues previously highlighted in our 2024-25 Annual Inspection Report**. All firm leadership is urged to promptly strengthen their SQMs and audit practices wherever such findings have been identified within their firms.

Auditors should read Section 3 of our 2024-25 Annual Inspection Report for common findings identified in our 2024 SQM inspections.

In the 2025 Inspections, we identified new findings arising from the increasing use of **technological resources,** including:

Inadequate design or inappropriate use of resources to support IT-related audit procedures

- While standardised IT-related audit working paper templates (**Templates**) had been developed by some firms, the Templates lacked sufficient procedures to guide engagement teams to obtain a sufficient understanding of clients' IT environments and to identify and assess risks of material misstatement arising from the use of IT in the audit client's IT environment and information systems.
- The Templates were not used in the inspected engagements, suggesting gaps in training and adoption.
- When used, the Templates were not filled out properly, as the engagement team did not provide sufficient responses to all required procedures.

Inadequate controls over the use of technological resources

- Password controls over technological resources were ineffective. While email passwords had to be changed every six months, there was no overarching password policy, and controls over password expiration on staff computers and use of removable storage devices were lacking.
- No assessment was ever performed on the suitability or risks of using third-party cloud platforms for data security and backup, as well as hosting of email server. As such, there were also no safeguards in place to address the risks.
- No policies or procedures were established requiring the firm to perform periodic backups of electronic engagement documentation, increasing the risk of data loss.

Inspections of engagements

(a) Category B firms

In the 2025 Inspections, we increased the number of Category B firm inspections to align with our risk-based regulatory approach. This was driven by an increase in the number of Category B firms, rising from 21 as at 31 December 2023 to 26 as at 31 December 2024, as well as a growth in the number of listed entities audited by these firms, an increase from 939 to 1,015 over the same period.

The following table shows the PIE engagement inspection results of Category B firms.

Table 3. Number of PIE engagement inspections of Category B firms and their AQR in 2025 Inspections

		Number of PIE engagements inspected			
Category	Total number of firms inspected	Total	AQR of 1 or 2	AQR of 3	AQR of 4
Category B (note)	16	24	4	11	9

Note: Annex 3 presents the names and inspection results of PIE engagements for individual firms.

In the 2025 Inspections, nine PIE engagements were rated 4 (Significant Improvements required) and they were completed by the following eight Category B firms:

- Asian Alliance (HK) CPA Limited
- Baker Tilly Hong Kong Limited
- Confucius International CPA Limited
- FAN, CHAN & CO. LIMITED
- Grant Thornton Hong Kong Limited
- KTC Partners CPA Limited
- OOP CPA & Co.
- Prism Hong Kong Limited

Category B firms continue to face challenges in balancing business growth with audit quality, particularly with newly accepted audit engagements. Of the 16 engagements inspected, 11 were first-year audits, and ten of these were rated 3 or 4. These results suggest that some firms accepted engagements beyond their competence or capacity, resulting in audit quality being compromised.

Inspection findings frequently arose at the audit planning stage, where auditors failed to perform robust risk assessments. This led to inappropriate identification and assessment of audit risks, as well as inadequate audit responses to address those risks.

These challenges were often exacerbated when audit clients lacked competent finance personnel and/or effective controls over financial reporting. In such circumstances, delivering a high-quality audit demands greater professional scepticism, the involvement of more experienced personnel with relevant expertise, and the allocation of sufficient time and resources to address the heightened engagement risks.

Notwithstanding these challenges, there are encouraging signs of improvement for Category B firms. More firms are responding to our inspection feedback to strengthen their practices. The number of PIE engagements inspected receiving AQR of 1 or 2 at Category B firms increased steadily, from zero in the 2023 inspections, to two in 2024, and to four in 2025.

Notably, one Category B firm, subject to our first inspection, received an AQR of 2 in the 2025 PIE engagement inspections. This result highlights several quality drivers, including investments in recruiting and developing sufficient and appropriate talent, and effective use of available resources.

Critical reminders for Category B firms

All firms should carefully consider whether the inspection findings in Annex 4 may be relevant to their own firms and take appropriate action as necessary.

It is important to recognise that addressing findings superficially will not remediate firm-wide deficiencies or drive sustainable improvements in audit quality effectively. Leadership must take full ownership for rigorously identifying and addressing the underlying issues within the firm. Only through deep, critical root cause analyses and decisive action would meaningful and lasting enhancements in audit quality be achieved.

Examples of such remedial actions include:

- enhancing resourcing planning and capacity management.
- recruiting and retaining suitably qualified personnel.
- strengthening training and supervision.
- improving engagement review and consultation processes.
- involving auditor's experts early, when they are used.
- declining engagements that exceed the firm's competence and capability.
- reinforcing internal monitoring processes to ensure that identified deficiencies are effectively addressed to prevent them from recurrence.

(b) Category C firms

Category C firms represent a limited public-interest footprint, collectively auditing 62 listed entities (less than 0.1% of total market capitalisation), with less than ten engagements audited by each firm. These firms often operate with resource constraints, including insufficient industry experience and specialised expertise.

Our oversight of smaller PIE auditors is driven by the regulatory objective of maintaining uniform audit quality across the entire market. Despite their smaller market share, inspecting these firms is essential to identify deficiencies early and compel timely remediation, ensuring that all PIEs receive high-quality audits. Firms that use this regulatory feedback to drive continuous improvement will not only strengthen their SQMs but also position themselves for sustainable, high-quality growth.

In the 2025 Inspections, we inspected four Category C firms, three of which had their PIE engagements inspected for the first time. The following table shows the PIE engagement inspection results of these Category C firms.

Table 4. Number of PIE engagement inspections of Category C firms and their AQR in 2025 Inspections

		Number of PIE engagements inspected			
Category	**Total number of firms inspected**	**Total**	**AQR of 1 or 2**	**AQR of 3**	**AQR of 4**
Category C	4	4	0	2	2

Our inspections revealed that resource constraints at some firms adversely affected engagement teams' ability to exercise appropriate professional scepticism, particularly in performing risk assessments and designing and executing audit procedures to address identified risks.

Significant findings were identified in several critical audit areas, including the identification and evaluation of fraud risks arising from unusual transactions, going concern considerations, and asset impairment assessments involving significant accounting estimates and management judgements.

Critical reminders for Category C firms

All firms should consider whether our inspection findings in Annex 4 may be relevant to them and take appropriate action accordingly. Firms are required to take immediate action to identify and remediate severe and pervasive deficiencies in their SQMs. They are expected to read and apply the guidance in our previous publications, particularly on root cause analysis and remediation, which are designed to help them develop robust, targeted remedial actions that address underlying systemic weaknesses. Remediation plans should include concrete steps, milestones, and timelines for remedial action to demonstrate leadership's commitment to addressing the root causes that affect audit quality.

Alert: Annex 4 provides a summary of significant findings identified in the 2025 Inspections of PIE engagements. These findings are presented to support audit firms in evaluating and strengthening their audit practices, particularly in areas where findings have been repeatedly observed.

Alert: Strengthening group audit oversight

As the capital markets of Hong Kong and the Chinese Mainland become increasingly connected, many audit firms continue to expand their cross-border practices by using component auditors in the Chinese Mainland for group audits of listed entities.

While engagement partners must possess Chinese Mainland expertise and exercise rigorous supervision, a critical risk to audit quality has emerged. Some Hong Kong firms are now increasingly dependent on Chinese Mainland component auditors for client referrals and resource support. This reliance may undermine the group auditor's independence and ability to objectively evaluate, challenge, and ultimately take responsibility for the component auditor's work.

To safeguard the quality of group audits, all firms should address the following critical areas identified in our inspections.

Critically assess competence, capability, and suitability of component auditors at client acceptance

- Evaluate at client acceptance whether the component auditors have sufficient experience, resources, and technical capability for new PIE audit clients in unfamiliar or specialised sectors and regions.
- Consider the results of the monitoring and remediation process or external inspections related to the component auditor when assessing whether the component auditors have the appropriate competence and capabilities.

Ensure component auditors' independence and ethical compliance

- Ensure component auditors understand and comply with the group auditor's independence and ethical requirements. Critically evaluate whether there are any independence threats arising from financial interests in audit clients and the provision of non-audit services.
- Confirm and monitor the component auditors' own independence, rather than relying solely on generic or negative confirmations from the component auditors that do not have any specific matters relating to independence to report.

Enhance review and documentation of component auditor's work

- Review the component auditor's audit working papers for significant risk areas and prepare complete and timely documentation to support direction, supervision, and review of work.
- Assemble audit documentation for work performed by the component auditors within the required time frame (ordinarily within 60 days of the report date) and ensure the integrity of audit files to support the group audit opinion.

Strengthen firm-level oversight of component auditors within a network

- Being in the same network does not guarantee that the component auditor fully understands the specific nuances or risks of a group audit engagement.
- Firm leadership must systematically evaluate the network's internal or external inspection results. Using this data, the firm should establish firm-wide policies that mandate enhanced oversight when utilising network firms exhibiting higher audit quality risk.
- Firm leadership must develop a robust infrastructure that equips engagement teams with clear authority, standardised protocols, and necessary resources to effectively direct and review the work of component auditors within a network.

Section 4: Inspections of Non-PIE Auditors

I. Approach

Non-PIE auditors, which comprise approximately 98% of Hong Kong's 4,600 practice units, play an indispensable role in supporting Hong Kong's economy and the financial reporting ecosystem.

We maintained a consistent approach in the inspection of non-PIE auditors, applying an appropriate level of proportionality in our selection to account for their generally smaller scale, lower complexity, and different risk profiles specific to them. Firm selection is also risk-based, with emphasis on those with more engagements or higher public-interest characteristics.

The 2025 Inspections of non-PIE auditors included a review of each firm's SQM, a sample of its audit (and other assurance engagements, where applicable), its compliance with the AML Guidelines, and, where applicable, an evaluation of the effectiveness of the remedial actions proposed by firms to address deficiencies identified in prior-year inspections.

II. Inspection results and observations

Inspections of SQMs

In a volatile market, audit quality cannot be a reactive, engagement-by-engagement effort. To effectively manage systemic risks, non-PIE firms must recognise that audit quality is a firm-wide outcome, underpinned by a robust SQM, that embeds a culture of quality across all firm's processes, and decision-making, rather than leaving it to the discretion of individual engagement teams.

To support the sustainable development of non-PIE auditors, particularly those undertaking more complex engagements or expanding their practices, we highlight the following key areas where improvements to firm-wide SQMs are needed:

Enhancing competence and readiness in upholding professional standards

- Prior to accepting or continuing an engagement, firms should rigorously evaluate whether they possess the competence and readiness to perform the audits in accordance with professional standards. This is particularly important for engagements involving complex IT environments, specialised industries, or other areas requiring specialised knowledge and skills.

- Adopting a by-default substantive audit approach for all audits may not be appropriate to address the risks of material misstatement arising from the use of IT in today's IT-driven environment. Firms should reassess their audit approach and move away from the presumption that substantive procedures alone are adequate.

- Firms should develop their IT-related competencies within the engagement team and, where necessary, involve IT specialists to support audit procedures that require IT audit experience and knowledge.

Strengthening resource management to ensure audit quality is not compromised

- Sufficient resources and professional capability must be commensurate with the complexity and audit risk of an engagement. Excessive workload shifts the audit focus from judgment-based scepticism to a tick-the-box exercise, significantly increasing the risk of uncorroborated management representations and superficial internal reviews.
- Reliance on work performed by personnel from service providers creates a concern where firms have not established sufficient policies and procedures to ensure that those individuals meet the firm's quality requirements and professional standards.

Heightened scrutiny where audit clients are introduced by non-professional service providers

- A specific concern arises where audit clients are introduced to firms by service providers who are not professional accountants, particularly where the firm derives substantial revenue from such arrangements. **These arrangements raise a combination of client acceptance, independence, and AML/CTF concerns that warrant heightened scrutiny.** Prior to client acceptance, firms must thoroughly assess management integrity and relevant risk factors, ensuring that all independence threats are properly identified and addressed.

Promoting a culture of self-improvement

- Firms are encouraged to strengthen their SQMs by implementing targeted remedial actions and prompt corrective measures to directly address specific inspection findings. They should also take full ownership of these actions to ensure they are consistently and effectively executed.
- Firms that maintain open and transparent communication with the AFRC, including timely reporting of relevant matters, help support continuous improvement and reinforce the quality and integrity of the audit profession.

Inspections of engagements

The 2025 engagement inspections revealed recurring findings in several key audit areas. These findings continue to show that the fundamental barriers to upholding audit quality by the non-PIE auditors arise not from isolated technical slips, but from weaknesses in audit planning, risk identification and assessment, control testing, and evidence gathering and evaluation.

Reinforcing engagement-specific risk assessment and design of audit responses

Common finding: Firms often performed risk assessments in a generic manner without tailoring them to the specific circumstances of their audit clients. This resulted in risk assessments that did not adequately reflect the entity's business model, industry conditions, or external risk factors which impacted the entity, thereby undermining the effectiveness of the overall audit approach and their design of audit procedures in response to the risk assessments.

Why it is important: The identification and assessment of entity-specific risks of material misstatement form the foundation for designing appropriate audit procedures. Firms should therefore ensure that risk assessments are robust, entity-specific, and clearly linked to the nature, timing, and extent of audit procedures, enabling the auditor to obtain sufficient appropriate audit evidence.

Enhancing audit responses to IT risks

Common finding: Where entities rely heavily on IT systems such as Point of Sale systems, online sales channels, or other automated processes, engagement teams must identify IT risks by understanding the entity's IT environment and evaluating any relevant IT-related controls, including GITCs, automated controls, and IT-dependent manual controls. In such cases, a purely substantive approach is unlikely to be sufficient to address risks arising from processing and recording of transactions within the systems.

Why it is important: Where an entity's financial reporting involves IT-dependent processes, auditors should perform procedures to understand and evaluate the design and operating effectiveness of the relevant IT-related controls and test the accuracy and completeness of data and reports generated from the IT systems before relying on them as audit evidence. This could provide a higher level of assurance on the audit evidence obtained.

Strengthening controls over the design and execution of audit confirmation procedures

Common finding: Inspection findings include inadequate control over the confirmation process, particularly when confirmations were not sent or received directly by the auditors but through audit clients; insufficient alternative procedures for non-responses; or discrepancies identified in confirmations replies were not properly investigated.

Why it is important: External confirmations provide more reliable audit evidence to support the auditor's work and conclusions when effective controls are in place. Auditors should enhance controls over the confirmation process by ensuring that requests are sent and responses are received directly between the auditors and confirming parties and appropriate procedures are performed to verify confirmation responses.

The following Checkpoint and AFRC Connect videos highlight key reminders to support non-PIE auditors in areas where we identified common findings.

Checkpoint –
Obtaining an Understanding of the Audit Clients' IT Environments
Reminders for Auditors' Reporting on Licensed Corporations
Information Produced by the Entity for Use as Audit Evidence

AFRC Connect –
EP1: How Important is Audit Risk Assessment?
EP 2: Understand and Evaluate IT Risks and Controls
EP 3: The Vital Role of Journal Entry Testing

Critical reminders for non-PIE auditors

Firms should carefully evaluate whether their SQMs are genuinely supporting audit quality, whether engagement teams have the competence and capacity for the engagements they undertake, and whether their approach to obtaining and evaluating audit evidence remains fit for purpose in an increasingly digital and complex business environment.

Proportionality does not mean reduced expectations. It means applying quality management measures that are appropriate to the firm's circumstances while continuing to uphold high standards of professional scepticism, discipline, accountability, and demonstrable improvement in audit quality.

Alert: Ensuring the appropriate use of external resources

Firm leadership bears ultimate responsibility for the effectiveness of their firms' SQMs and the quality of their audits. The use of external personnel gives rise to additional quality risks relating to the effectiveness of the firm's monitoring and remediation process and the performance of quality engagements.

We observed that a number of non-PIE auditors, in addition to using Hong Kong Institute of Certified Public Accountants (**HKICPA**) or other service providers' SQM and audit manuals as references for designing their firm policies and practices, engaged external personnel to perform a portion of activities related to both the SQMs and engagements. Examples of such activities include SQM monitoring, completed-file reviews, audit execution, engagement quality reviews, and IT audits involving IT specialists, or valuation work involving specialists, who may come from network firms, non-network firms or third-party service providers.

In this regard, non-PIE auditors should pay particular attention to the following areas when using external resources:

Clearly design the scope of work, roles, and responsibilities of external personnel at the outset of the engagement

We observed instances where the nature and extent of the planned scope of work were insufficient to meet professional standards, and the firm was unaware of these gaps.

Maintain robust and ongoing oversight of the external personnel throughout the engagement process to ensure all work performed by the external personnel meets the firm's requirements

We observed some firms did not exercise sufficient oversight and maintain ongoing communication, often deferring their reviews until the conclusion of the engagement or, in some instances, did not perform the review at all. This lack of continuous oversight led to significant discrepancies between the actual procedures performed by the external personnel and the firm's requirements.

Assess whether external personnel have the appropriate competence, capabilities, and understanding of applicable professional standards, including Hong Kong Standards on Quality Management

We noted that some external personnel had limited experience or competence in supporting SQM or performing engagement reviews, and in certain cases were unable to identify issues later found by the AFRC during inspections.

Ensure all work performed is properly documented and retained by the firm in accordance with the firm's policies and procedures and the requirements in applicable professional standards

We noted a lack of sufficient documentation of external personnel's work, including the nature, timing, and extent of procedures performed, conclusions reached, and how the firm evaluated or challenged significant professional judgements made in arriving at those conclusions.

Non-PIE auditors are expected to maintain robust oversight when engaging external parties, ensuring clearly defined responsibilities, sufficient support and documentation, effective communication, and adherence to applicable professional standards, thereby upholding audit quality and accountability.

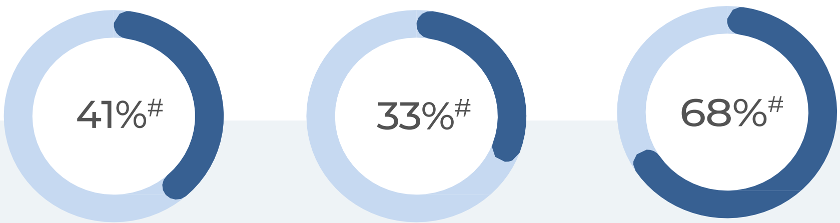
Section 5: Anti-Money Laundering and Counter-terrorist Financing Compliance Monitoring Inspections

I. Approach

In 2025, we continued to adopt a risk-based approach to AML/CTF compliance monitoring inspections (**ACMI**), focusing on firms with higher money laundering/ terrorist financing (**ML/TF**) risk exposure. Our inspections are primarily complemented by ongoing education and capacity building initiatives, aimed at supporting firms in strengthening their systems and meeting their AML/CTF obligations. When serious or persistent non-compliance is identified, enforcement is the regulatory toolkit that the AFRC will use to deter misconduct and reinforce our regulatory expectations, as reflected in the first disciplinary sanctions against multiple practice units.

II. Inspection results and observations

Common findings identified from our ACMI



Customer due diligence procedures | **Staff hiring and training** | **Screening clients against financial sanction list**

 # Percentage of firms inspected with at least one finding in that area in 2025 ACMI

Overall inspection results

In the 2025 Inspections, we reviewed 50 firms' compliance with AML/CTF requirements. While the overall deficiency rate remained broadly similar to last year, firms were generally cooperative during the inspections and proactive in discussing their remediation with us. The findings nevertheless highlight the need for continued focus on embedding regulatory requirements into day-to-day practices.

Improving awareness in AML/CTF compliance, with execution challenges remaining

Customer Due Diligence (CDD) procedures

Despite many firms having CDD policies and procedures in place, deficiencies were identified in their application. Common findings included failure to complete CDD measures in a timely manner (prior to establishing business relationships) and insufficient ML/TF risk assessments, e.g. inadequate screening of politically exposed persons. Firms are reminded that effective compliance requires not only well-designed policies and procedures, but also their consistent and timely execution in practice.

Screening clients against the financial sanctions list

Similar to CDD, deficiencies in sanctions screening largely related to execution. Findings included failure to conduct timely name checks of clients and their beneficial owners against the latest lists designated by the United Nations Security Council at the time of establishing client relationships and on an ongoing basis, and inconsistent evaluation of potential matches against those lists.

Sanctions screening is a frontline safeguard against the profession being used, however inadvertently, to facilitate transactions or relationships involving sanctioned parties. Firm leadership is expected to ensure that screening processes are timely, current, and consistently applied across the entire client portfolio.

Staff hiring and training

Common deficiencies included insufficient AML/CTF training, even for Compliance Officer (**CO**) and Money Laundering Reporting Officer (**MLRO**) and lack of a clear training policy. These training shortfalls directly caused the observed execution gaps in CDD and sanctions screening, as untrained staff cannot reliably apply procedures.

Management oversight

While not widespread, the risks associated with inadequate management oversight are important to highlight. We observed a non-PIE practice unit that failed to appoint an appropriate senior member as its CO and MLRO, as required by the AML Guidelines. Such a decision indicates that the firm's leadership does not attach sufficient importance to AML oversight. Furthermore, this lack of seniority raises significant concerns regarding the CO's authority and competence to effectively mitigate ML/TF risks, and casts doubt on the MLRO's capability to properly identify and report suspicious transactions.

Alert: Developments in Suspicious Transaction Reporting

During the year, we implemented a range of initiatives aimed at strengthening the profession's understanding of STR obligations[1]. These involved ongoing engagement with key stakeholders, enhanced collaboration with the **JFIU**, and broader outreach activities to address common practical challenges encountered by practitioners.

In particular, we worked with the profession and the JFIU through participation in the user acceptance testing of STREAMS 2[2]. This engagement provided valuable insights into the operational aspects of the reporting process. We also collaborated with the HKICPA on the issuance of Anti-Money Laundering and Counter-Terrorist Financing – Frequently Asked Questions on Suspicious Transaction Reporting, incorporating feedback from the JFIU to clarify reporting expectations and address practical questions raised by the profession. Please read the publication.

Anti-Money Laundering and Counter-Terrorist Financing – Frequently Asked Questions on Suspicious Transaction Reporting

While the overall number of suspicious transaction reports reported remains low, we observed a gradual improvement in firms fulfilling their obligations to report suspicious transactions. More firms demonstrated a clearer understanding of when and how suspicious transaction reports should be made, pointing to growing awareness and early signs of more reporting, albeit with significant room for improvement.

1 Reporting suspicious transactions is a legal obligation under the relevant legislation in Hong Kong, applicable to all practices, regardless of the nature of services carried out.

2 STREAMS 2 is the system used by the JFIU to receive, process and disseminate Suspicious Transaction Reports.

Section 6: Challenges and Opportunities of IPO Market

Recent IPO market momentum

Hong Kong's IPO market continues to demonstrate strong momentum, with capital-raising activity remaining robust and the listing pipeline at a multi-year high. The strength of the pipeline, supported by a record number of A+H dual-listed issuers and specialist technology companies, reflects resilient market demand and strong issuer interest, while also placing additional demands on auditors in their role as the reporting accountants.

Regulatory expectations on quality-first management

The prevailing level of market activity requires unwavering adherence to professional standards throughout the listing process. In February 2026, the AFRC issued an open letter to alert PIE auditors to the importance of maintaining sufficient expertise, resources, and professional integrity when undertaking IPO engagements.

The regulatory message is clear: **market growth must be accompanied by disciplined execution, robust quality control and oversight, and the consistent application of sound professional judgment**. Firms should strengthen their SQMs and implement effective resource planning. The surge in IPO activities should be regarded as an opportunity to strengthen capabilities and build long-term professional resilience.

2026-27 inspection focus

In this context, our 2026-27 inspections will focus on how firms identify and address the quality risks associated with the significant increase in IPO activities. Specifically,

Capacity monitoring
Firms have been required to periodically submit information on their resource levels and partner workloads. This will help us identify those that may be more exposed to heightened audit quality risks.

SQM inspections
We will place greater emphasis on evaluating firms' client and engagement acceptance procedures, with particular focus on IPO engagements. We will also review how firms assess their own resources, workload, and capacity before accepting new engagements.

Engagement inspections
The number of inspections of IPO engagements will be increased to provide a direct assessment of audit quality in these cases.

Regulatory collaboration
We will continue to collaborate with other regulators, e.g., the Securities and Futures Commission and SEHK, to enhance our oversight of audit quality in IPO engagements.

Annex 1: Categorisation of PIE Auditors

Registered PIE auditors are categorised into three groups (A, B and C) based on the number of listed entity audits they undertake annually. Category A firms audit more than 100 listed entities, Category B firms audit between 10 and 100 listed entities, and Category C firms audit at least one but fewer than 10 listed entities.

Category A firms, which audit approximately 87% of listed entities by market capitalisation, are inspected annually. Category B and Category C firms, which collectively audit less than 5% of listed entities by market capitalisation, are inspected at least once every three years during the Second Inspection Cycle.

The number of PIE engagements selected for inspection is determined with reference to the total number of PIE audit engagements undertaken by a PIE auditor as at 31 December immediately preceding the commencement of the inspection year on 1 April.

From the 2026 year onwards, Category B and Category C firms will continue to be subject to non-annual inspections. The frequency of inspection will be determined based on a range of risk factors, including the size and nature of their audit clients and other audit quality considerations, and will generally range from once every two years to once every six years.

Annex 2: PIE Engagement Inspection Results by Individual Category A Firms

The tables below present the Category A firms inspected in 2025 and the results of the PIE engagements selected for inspection.

Given the risk-based nature of our inspections and the limited number of engagements selected for inspection, the AQRs presented below should be interpreted in the context of the engagements inspected and may not be representative of the quality of audits performed across a firm's entire portfolio of PIE engagements.

Table 5. Number of PIE engagements inspected by Category A firms and their AQRs (excluded follow-up inspections) in 2025 Inspections

Category A firms	Number of listed entities (by auditor appointments) as at 31 December 2024	Number of PIE engagements inspected			
		Total	AQR of 1 or 2	AQR of 3	AQR of 4
BDO	175	5	0	3	2
Deloitte	265	6	3	1	2
EY	379	6	2	3	1
KPMG	262	5	2	3	0
PwC	319	6	5	1	0

Annex 3: PIE Engagement Inspection Results by Individual Category B Firms

The tables below present the Category B firms inspected in 2025 and the results of the PIE engagements selected for inspection.

Given the risk-based nature of our inspections and the limited number of engagements selected for inspection, the AQRs presented below should be interpreted in the context of the engagements inspected and may not be representative of the quality of audits performed across a firm's entire portfolio of PIE engagements.

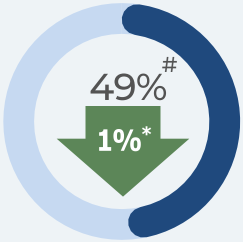
Table 6. Number of PIE engagements inspected by Category B firms and their AQRs (excluded follow-up inspections) in 2025 Inspections

Category B firms	Number of listed entities (by auditor appointments) as at 31 December 2024	Number of PIE engagements inspected			
		Total	AQR of 1 or 2	AQR of 3	AQR of 4
Asian Alliance (HK) CPA Limited	12	2	0	1	1
Baker Tilly Hong Kong Limited	66	2	0	1	1
BEIJING XINGHUA CAPLEGEND CPA LIMITED	17	2	2	0	0
Cheng & Cheng Limited	10	2	1	1	0
Confucius International CPA Limited	33	2	0	0	2
FAN, CHAN & CO. LIMITED	10	2	0	1	1
Forvis Mazars CPA Limited^	75	N/A	N/A	N/A	N/A
Grant Thornton Hong Kong Limited^	59	1	0	0	1
HLB Hodgson Impey Cheng Limited	87	1	0	1	0
Jon Gepsom CPA Limited	11	1	0	1	0
KTC Partners CPA Limited	22	1	0	0	1
McMillan Woods (Hong Kong) CPA Limited	65	2	0	2	0
OOP CPA & Co.	10	2	0	1	1
Prism Hong Kong Limited	54	2	1	0	1
Rongcheng (Hong Kong) CPA Limited^	42	1	0	1	0
RSM Hong Kong^	53	1	0	1	0

^ Subject to our specific scope inspections.

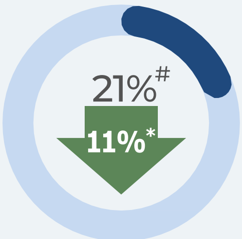
Annex 4: Inspection Findings of PIE Engagements

The following section presents a summary of significant findings identified in each of the five most frequently reviewed areas, together with the pervasiveness of these findings in the PIE engagements inspected. These significant findings, individually, or in aggregate, typically result in an engagement being rated 3 or 4.



Revenue recognition

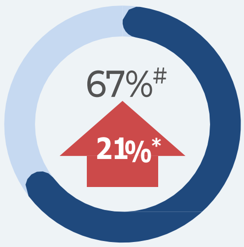
- Not identifying relevant controls. Even if identified, not evaluating their design and implementation to address significant risks
- Lack of audit procedures to evaluate the reasonableness of significant assumptions and underlying data used to measure progress towards complete satisfaction of performance obligations
- Audit procedures relying on management's representations to support the timing of revenue recognition for significant transactions



Journal entry testing

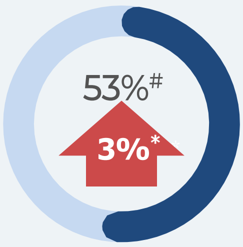
- Not examining external supporting documents to test the appropriateness of selected journal entries
- Not evaluating the inconsistencies in underlying audit evidence for selected journal entries
- Lack of journal entry testing for some in-scope components for a group audit

Impairment of receivables



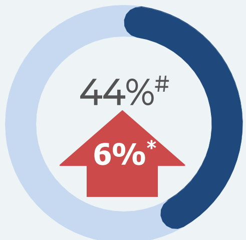
- Relying on inquiry of management to conclude that the assumptions used by management in estimating the provision for significant amounts of long-aged overdue receivables were appropriate
- Lack of audit procedures to ascertain the accuracy of key source data, including aging of receivables, used in ECL assessment
- Lack of audit procedures to follow up discrepancies between external audit confirmation responses and the ledger balances

Impairment of non-current assets



- Not evaluating the appropriateness of key assumptions used in determining terminal values in discounted cash flow forecasts
- Not testing the accuracy of the carrying amounts of the cash-generating units used in the impairment assessments
- Inappropriate inclusion of financing cash flows in the cash flow forecasts

Use of IT



- Insufficient evaluation and testing of GITCs, particularly regarding privileged access management, user access management and controls maintained by the service organisation
- Insufficient evaluation and testing of automated controls and IT-dependent manual controls, particularly in respect of the coverage of relevant testing scenarios and the reliability of interfaces between systems through which data is transferred and processed
- Insufficient evaluation of the reliability of IPE, particularly the populations for substantive tests and key inputs in significant accounting estimates

 # Percentage of PIE engagements inspected with at least one significant finding in that area in the 2025 Inspections

** Year-on-year percentage point change*

In the 2025 Inspections, significant findings in the following areas notably increased when compared with those identified in the prior-year inspections. These findings include:

Addressing fraud risks associated with unusual transactions

(Significant findings identified in five out of five inspected PIE engagements)

- Not understanding and evaluating the effectiveness of internal controls over significant amounts of prepayments
- Not evaluating the business rationale of purchase commitments with amounts significantly exceeding full-year cost of sales, and the associated upfront deposits paid
- Not evaluating the commercial rationale for sustaining relationships with customers with long-aged material trade receivables

Going concern assessment

(Significant findings identified in four out of four inspected PIE engagements)

Unmodified opinion with an emphasis of matter paragraph

- Not critically evaluating whether management's going concern assessment had considered all relevant facts and circumstances, e.g. loan covenant breaches were not evaluated in the going concern assessment
- Lack of appropriate audit evidence supporting management representations and verbal waivers on immediate repayment obligations for overdue bank and other loans

Disclaimer of opinion due to scope limitation

- Audit evidence available in the file contradicted the disclosed scope limitation, suggesting the engagement team concluded a scope limitation without sufficiently evaluating the evidence or performing alternative procedures
- Inadequate disclosure of the matter giving rise to the scope limitation in the auditor's report, with insufficient detail regarding its nature and underlying reasons
- Inaccurate disclosures of the basis of preparation in the financial statements, including inaccurate disclosure of the relevant facts and circumstances giving rise to a material uncertainty related to going concern

Group audit

(Significant findings identified in nine out of 23 inspected PIE engagements involving the uses of component auditors)

Group auditor's oversight of component auditors

- Lack of evidence and documentation in evaluating the component auditor's work on significant risk areas
- Not identifying and evaluating the impact of inconsistencies between financial information audited by component auditors and consolidation schedules prepared by management for the group financial statements. The inconsistencies were significant, either individually or in aggregate

Audit procedures on consolidation processes

- Not testing the appropriateness, completeness and accuracy of significant consolidation adjustments made by management for the group financial statements

Auditors are expected to read our Audit Focus which provides essential reminders to help ensure high-quality audits across key focus areas.

Audit Focus

Audit Focus – Financial Services

Our observations on use of IT

Understanding of the audit client's IT environment

Auditors' compliance with the requirement to obtain an understanding of the audit client's IT environment under HKSA 315 (Revised 2019) *Identifying and Assessing the Risks of Material Misstatement* (**HKSA 315**) has remained a key focus throughout our inspections in recent years. Over the years, findings in this area were consistently identified across multiple inspected engagements. This year, we observed a notable reduction in such findings, which we consider an encouraging indication that firms have taken meaningful steps to address the findings previously identified. This improvement is, in part, a reflection of the positive impact of the guidance materials and educational resources we have published on this topic. Whilst this progress is acknowledged, auditors are reminded that this area continues to warrant close and sustained attention, and that the requirements under HKSA 315 should be consistently and fully addressed, across all engagements to ensure audit quality is upheld.

IPE

In addition, the evaluation of the reliability of IPE has been identified as an area of persistent weakness in our inspections. IPE encompasses a broad range of information generated by the entity's IT systems, including system-generated reports, data extracts, transaction listings and other outputs that auditors frequently rely upon in the design and performance of audit procedures. Where such information is used without first establishing its reliability, there is a risk that audit conclusions are drawn on the basis of incomplete or inaccurate data, thereby undermining the sufficiency and appropriateness of audit evidence obtained. Auditors are reminded that the evaluation of IPE reliability is not limited to substantive procedures but extends to any information extracted from the entity's systems that forms part of the audit evidence.

Use of service organisations

The increasing adoption of cloud technology in entities' IT environments has introduced additional considerations when performing an audit engagement. Where an entity's key systems and processes are hosted or managed by third-party cloud service providers, engagement teams are required under HKSA 402 *Audit Considerations Relating to an Entity Using a Service Organization* (**HKSA 402**) to obtain a sufficient understanding of the nature of the services provided and to evaluate the reliability of those service organisations. This year, an insufficient understanding and evaluation of third-party service organisation reliability was identified as a common finding across a number of inspected engagements. Engagement teams are reminded that a thorough and documented evaluation of service organisations is expected to be on file in accordance with the requirements of HKSA 402.

Read our Checkpoint and AFRC Connect for more observations on the use of IT:

Checkpoint – Obtaining an Understanding of the Audit Clients' IT Environments

AFRC Connect – Understand and Evaluate IT Risks and Controls

Checkpoint – Information Produced by the Entity for Use as Audit Evidence

Our observations on FS sector engagements

Hong Kong's standing as an international financial centre depends largely on the strength and resilience of its FS sector. This sector is of clear public interest significance. Although not all issuers in this sector are listed, most are regulated entities whose operations are closely linked to investor protection, market integrity, and broader financial stability. As a result, audit quality in this sector is a key regulatory priority.

In 2025, our inspections covered a broad range of FS sub-sectors, including banks, insurers, investment and retirement funds, licensed corporations, and insurance broker companies. These inspections spanned both larger and smaller audit firms, enabling us to assess audit quality across a diverse cross-section of the market.

We also worked closely with fellow financial regulators and overseas audit regulators to exchange supervisory priorities, share information, and deepen our understanding of market developments and regulatory expectations. This collaboration helped support a more informed and consistent supervisory approach. In parallel, we engaged with auditors to share common findings in this sector and to reinforce our expectations regarding audit quality and professional scepticism.

Our work continues to indicate that the findings outlined below are recurring across FS engagements. Auditors should strengthen their focus in these areas to better address the unique risks associated with FS audits:

Tests of controls

- Inspected only the signature of preparers and reviewers, instead of inspecting source documents and evaluating the nature of the specific control activities the control owners performed in executing the controls
- Insufficient details in evidencing how the internal controls were operating effectively

Accounting estimates

- Insufficient evaluation of the appropriateness of significant management assumptions, including both qualitative and quantitative ones
- Insufficient details in evidencing the basis of accounting estimates made

Use of auditor's experts

- Insufficient evaluation of the adequacy of the expert's work for the audit purposes
- Insufficient testing of the reliability of source data provided and used by the experts

Given the scale, complexity, and public importance of these entities, we will continue to devote significant attention to this sector. We will also maintain our focus on whether audit firms possess the sector-specific knowledge, experience, and capabilities necessary to perform these engagements effectively. This remains essential to safeguarding confidence in the financial reporting of entities that are important to the stability of Hong Kong's financial system.

Read our Audit Focus and Checkpoint for more observations and practical reminders for FS sector engagements:

Audit Focus –
Financial Services Sector

Checkpoint –
Reminders for Auditors' Reporting on Licensed Corporations

Annex 5: Glossary

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

ACMI	AML/CTF compliance monitoring inspections
AFRCO	Accounting and Financial Reporting Council Ordinance
AI	Artificial intelligence
AML	Anti-Money Laundering
AML Guidelines	Guidelines on AML and CTF for professional accountants as set out in Chapter F of the CoE issued by the HKICPA
AQR	Audit quality rating
CDD	Customer due diligence
CO	Compliance officer
CoE	Code of Ethics for Professional Accountants
CTF	Counter-terrorist financing
ECL	Expected credit loss
EQR	Engagement quality reviewer
FS	Financial services
GITC	General IT control
HKICPA	Hong Kong Institute of Certified Public Accountants
HKSA	Hong Kong Standard on Auditing
HKSA 315	HKSA 315 (Revised 2019) Identifying and Assessing the Risks of Material Misstatement
HKSA 402	HKSA 402 Audit Considerations Relating to an Entity Using a Service Organization
HKSQC 1	Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements
HKSQM 1	Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements
HKSQM 2	Engagement Quality Reviews
IPE	Information produced by the entity
IPO	Initial public offering
IT	Information technology
ITAC	IT application control
JFIU	Joint Financial Intelligence Unit
ML	Money laundering
MLRO	Money laundering reporting officer
PIE	Public interest entity
QCSRP	Quality control system responsible person
SEHK	The Stock Exchange of Hong Kong Limited
SQM	System of quality management
Templates	Audit working paper templates
TF	Terrorist financing

Contacts

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