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The Role of Professional Audit Judgment in the Verification of Financial Statements of Hong Kong-Listed Companies

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Abstract

A financial statement audit is required for Hong Kong-listed companies. This process enables auditors to verify the accuracy of evidence, identify issues in management's accounting practices, review accounting estimates and assess their reasonableness, and avoid rigid adherence to standardized procedures. With many overseas and various businesses, there are numerous complex items within the financial statements, such as foreign-currency transactions, impairment losses, fair-value adjustments, revenue recognition, and related-party transactions, all of which demand substantial professional judgment in audit planning and evidence collection. This paper studies the functions of professional audit judgment in the verification processes described above, introduces the main applications, identifies existing deficiencies, and proposes countermeasures addressing the risks of assessment, evidence evaluation, expert participation, audit technology, professional scepticism, and quality control. Professional judgment should be based on facts, experience and documentation; it is not mere guesswork; otherwise, it would lack the objectivity and reliability required for auditing.

Keywords

Professional audit judgment; Hong Kong-listed companies; financial statement verification; audit evidence; professional skepticism; audit quality

Hong Kong is a well-known overseas stock exchange. Numerous Hong Kong-listed companies operate across mainland China, Southeast Asia, Europe, and America; they have complex ownership structures, financing channels, operational models, and accounting environments, and thus need considerable estimation and judgment in their financial statements. The reliability of financial statements depends on the quality of accounting standards and audits (Lam et al., 2021).

Financial statement verification includes account balances, transaction records, disclosures, internal control, accounting estimates, and supporting documents. Certain items can be verified through recalculation and document verification; others require expert judgment. The indices of asset recovery, default probability, reasonableness of revenue forecast, and going-concern ability are not fixed by rules.

Audit professional judgement is the application of knowledge, experience, auditing standards, and ethics to address audit problems that do not have obvious or consistent evidence. According to the Chinese Institute of Certified Public Accountants (CICPA), goodwill impairment is a very subjective item for auditors and is thus at high risk of material misstatement. This paper studies the function of professional audit judgment in verifying the financial statements of Hong Kong-listed companies and examines the five dimensions of risk identification, accounting-estimate assessment, audit-evidence evaluation, complex-transaction handling, and audit-conclusion formulation.

1. Conceptual Understanding of Professional Audit Judgment

Professional Audit Judgement is an organised Decision-Making process. Auditors will not act arbitrarily in their judgement; this is not to be assumed. A good judgment should be based on the audit objectives, relevant accounting and auditing standards, the nature of the audited entity, the credibility of evidence, and the possible consequences of different conclusions.

Professional Judgement has three purposes in financial statement audits. It directs auditors' attention to areas requiring greater scrutiny. It clarifies whether sufficient appropriate evidence is available. It determines whether identified misstatements are material individually or in aggregate.

Judgment is required to make judgments about the fair presentation of financial statements. There are two types of risks for auditors. The first is that the accounting estimate made by management is unreasonable. The second reason is that due to time constraints, there is little prior knowledge of the client or too much reliance on management's representations; thus, the audit team cannot obtain sufficient appropriate audit evidence (Che et al., 2026).

Professional judgement is closely related to professional scepticism. Professional scepticism is to have a questioning mind and remain vigilant about any signs of material misstatement due to fraud or error. It does not mean that the auditors will immediately distrust management. The auditor should consider both the management's explanations and other relevant information to decide how much to audit.

According to the 2024 review of the audit market for listed companies, audit work is gradually encompassing key audit matters, going-concern assessments, internal control evaluations, and the issuance of audit opinions. All of the above require auditors to combine professional standards with specific knowledge of the audited company (Liao et al., 2019). Thus, it can be seen that audit quality is determined by both the existence of standards and the quality of professional judgement exercised in their application (Chan et al., 2026).

2. Main Application Areas

2.1 Risk Assessment and Audit Planning

Professional judgement precedes the substantive test. Auditors should know the company, its industry, ownership structure, business model, financing, internal controls, and the external environment. Hong Kong-listed companies should consider the extent of the relationship among the listed company and its subsidiaries, related parties, controlling shareholders, and overseas operations in this regard.

A company with a large number of subsidiaries will have consolidation risks. The risks of changes in fair values, inventory losses, and revenue recognition are borne by the property development company. A technology company has a large amount of intangible assets and capitalised development expenses. A financial institution will have to calculate various expected credit losses. The risks will not be covered by the general audit checklist.

Auditors rely on their professional judgment to determine whether the company's business is relatively simple or complex. This assessment will also influence the nature, timing, and extent of audit procedures. When the auditor believes that the risk of material misstatement is high, they will need to extend the scope of audit work, increase the size of audit samples, use audit specialists, obtain more external confirmations, or perform audit procedures closer to the reporting date.

The economy will affect the audit plan. Changes in interest rates, property prices, foreign exchange rates, geopolitics, and changes in consumer demand will affect asset values, expected credit losses, revenue forecasts, and going-concern assumptions. The Hong Kong Accounting and Financial Reporting Council has pointed out that changes in the economy will affect management's estimates and audit work in certain areas, such as expected credit losses, fair value, impairment, and going concern judgments. Therefore, the auditor needs to update the risk assessment and will not use last year's audit plan.

2.2 Evaluation of Accounting Estimates

Among all the uses of professional judgment, accounting estimates are among the most significant. The auditor will not just verify that the formula used by management is correct. Verify that the assumptions are reasonable, consistent among themselves, and based on reliable data from the company.

A typical case is goodwill impairment. Management forecasts the company's future cash flows, growth rates, discount rates, and terminal values. A small change in the above assumptions will result in a different impairment amount.

Verify that the assumptions are consistent with the actual operating conditions and external market environments of the company. If the previous forecasts have been too optimistic repeatedly, the current forecasts may also be biased.

Expected Credit Loss is also a problem. Assess the credit risk of the borrowing company, its history of defaults and losses, collateral, and future economic conditions, etc. While a mathematical model may be technically correct, professional interpretation is still required to assess whether the data and assumptions are appropriate. The model is technically correct, but if the data or assumptions are not suitable, the results will still be unreasonable.

Fair Value Accounting also has problems. If there is an active market, the market price will provide relatively strong evidence. If there is no active market, then the valuation will be based on discounted cash-flow models or other assumptions. Assess the professional competence and independence of the valuation specialist, verify the correctness of the data, and determine how much the key assumptions in the valuation affect the results.

Professional judgement will also be used in the retest of management's estimates. Compare the previous year's forecast with the actual data. The large and frequent deviations are probably caused by a bad estimate or a deliberate bias. The above will help auditors know where to be more cautious in their current audit (Chiu et al., 2025).

2.3 Evaluation of Audit Evidence

Financial statement audits are based on audit evidence. The persuasiveness of evidence varies by source. Generally speaking, external confirmations, bank statements, legal opinions and independent market data are more reliable than the internal schedules and verbal explanations. Professional judgement should be exercised to weigh the relevance, reliability, sufficiency and consistency of all kinds of evidence.

For example, the management may issue a sales contract and recognise the revenue. The auditor should still determine whether the contract is legitimate, whether the goods have been delivered, whether the customer has accepted the goods, whether there is a right of return for the transaction, and whether there are any side agreements. A document alone is not sufficient to prove the contents of a transaction.

Conflicting Evidence is a problem. If management's forecast is high and the industry's demand is falling according to data, then there is a discrepancy. If a subsidiary has high profits but weak cash flow and overdue accounts receivable, the auditor should be aware that revenue and accounts receivable may be inflated.

Professional Judgement Determines if there is Sufficient Evidence. The auditor should not stop testing just because the planned procedures have been carried out. If the risk remains high or evidence is inconsistent, additional procedures may be necessary. This rule is especially applicable to Hong Kong-listed companies with cross-border operations; thus, the auditors will need to handle many different legal systems, languages, reporting standards and document-keeping rules.

2.4 Complex Transactions and Related-Party Arrangements

Hong Kong-listed companies can carry out mergers and acquisitions, equity financing, asset transfers, connected transactions and other organised arrangements. There will be significant changes in the financial statements and possibly some management compensation.

A reasonable person would know that this is a transaction in economic terms. Determine whether the transaction has a reasonable purpose in the course of business, whether the counterparty is independent, whether the price is reasonable, and whether it has been properly disclosed.

Be careful with related-party transactions. There is no official designation of a related party, but the parties may still be connected. Auditors need to examine the ownership structure, common directors, financing mode, family relationships, and other irregular business terms.

The auditor should also determine if the transactions were organised close to the end of the reporting period to achieve an abnormal accounting result. For example, although there is an asset sale and then a repurchase agreement, it is actually a financing transaction disguised as a disposal. Professional Judgement helps the auditor find such substance-over-form problems.

2.5 Audit Conclusion and Reporting Decision

The last audit opinion will also be based on professional judgment. Determine whether the identified misstatements are material, ascertain whether there are serious deficiencies in the audit evidence, and decide whether, taking all the

above into account, the financial statements present a true and fair view in accordance with the reporting framework.

Going-concern assessment is relatively urgent at present in the economy. The auditor should not only accept management's statement that the company will continue to operate. Consider debt maturity, refinancing ability, cash flow forecasts, covenant compliance, litigation, concentration of customers, availability of financial support, etc.

If there is significant uncertainty, the auditor needs to determine whether there are adequate disclosures in the financial statements and, if not, whether a material uncertainty related to going concern should be disclosed in the audit report. If the auditor cannot obtain sufficient appropriate audit evidence, it will be considered the scope of the audit. The extent and seriousness of the problem will determine how to report it.

Record the reasons for the auditor's conclusion. Documentation should present the problem, the evidence collected, other views considered, consultations held, and the reasons for the final conclusion. Good documentation will improve the quality of the audit and provide a reference for future audits (Brassel et al., 2016).

3. Existing Problems

3.1 Excessive Reliance on Standardized Procedures

Standard Audit Plans are uniform but restrict the freedom of professional judgement. Some audit teams carry out the required work without considering whether this work can reduce the actual risks to the company. A list can show which tasks have been done. It cannot prove that the task was suitable.

3.2 Management Bias and Insufficient Skepticism

Management is often motivated to show good financial results. The reasons for such incentives are financing demands, performance objectives, stock price fluctuations, listing regulations, and so on. If the auditors are only given management's explanation, they may not find any problems or suspicious transactions (Liu et al., 2023).

3.3 Uneven Experience Within Audit Teams

Complex audits of Hong Kong-listed companies need knowledge of accounting, auditing, valuation, taxation, corporate law, and cross-border regulations. Junior staff have good technical training but little actual work experience. If senior management does not pay more attention, the audit team will be unaware of some serious issues.

4. Improvement Measures

4.1 Establish a Risk-Oriented Judgment Framework

Audit firms need to establish a system of risk identification, evidence assessment, estimation evaluation, consultation, documentation, and review. The framework should require auditors to state the reasons for considering a problem to be at a high or low risk, and why certain procedures have been chosen as reasonable.

4.2 Strengthen Industry and Company-Specific Knowledge

Gain knowledge of the industry before the audit. They should know the economic reasons for the company's development, the main sources of income, the primary operating risks, and the normal trade conditions in that industry. Multinational and cross-border enterprises should also consider local laws, currency fluctuations, tax policies and governance of their foreign subsidiaries in their audits.

4.3 Improve the Review of Accounting Estimates

Sensitivity Analysis of Significant Judgements by the Audit Team. Identify the assumptions that will have a considerable impact on the financial statements and determine whether these assumptions are in line with the company's previous operating results and external data (Christensen et al., 2014). If the company's assumptions are very uncertain, there will be no independent estimates or reasonable ranges.

5. Conclusion

Hong Kong-listed companies will need to rely more on professional judgement. Due to cross-border operations,

complex financial instruments, digital transactions, climate change risks, artificial intelligence, volatile economic conditions and other reasons, many new problems have arisen in financial reporting and audit verification. Audit firms should improve training, supervision, technical governance, specialist support and overall quality management. Regulators and audit committees should enhance the disclosure of important judgments and key audit items. Exercise of professional judgement by auditors to protect the interests of investors and enhance the credibility of Hong Kong's stock market.

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