

HAUT CONSEIL
DU COMMISSARIAT AUX COMPTES



HIGHLIGHTS
ANNUAL
REPORT 2013



FROM THE CHAIR

CHRISTINE THIN

2013 marked our organisation's 10th year of existence since it was founded by the French Financial Security Act of 1 August 2003 (Loi de Sécurité Financière). These past years have been challenging, and the challenges remain, for instance in ensuring that the audit reform recently adopted by the European Union will be implemented to create a high quality and coherent system for auditing. Currently, the H3C is examining the impact of this new legislation on the scope of duties of statutory auditors in France, as well as on those of the regulators, with the perspective of transposing the reform into national legislation.

2013 also saw increased collaboration between audit regulators. As part of its mandate, the H3C contributed to the creation of a European database to collect and exchange national findings from inspections of audit firms. In addition, the H3C participated in the IFIAR's second report on global inspection findings. Last but not least, the H3C signed cooperation agreements with its Canadian, Swiss and American counterparts and continued negotiations with the Japanese audit supervisory authority.

A specific standard authorising statutory auditors to perform audit services on social and environmental information, under certain conditions, was approved. This standard is important as it serves two purposes: it meets companies' need for increased confidence in their communication in this area and it allows statutory auditors to provide particular services that are not strictly limited to financial information.

Concerning inspections, over one thousand audit firms were inspected in 2013: the identified improvements and areas of expected progress are set out in the H3C annual report and are presented hereafter.

Going forward, the H3C will continue to strive for better audit quality. We are confident in the future of the audit profession which will shortly face and adapt to new rules.

THE H3C

- The H3C is the central body of the statutory auditors' oversight system in France and was created by the Financial Security Act of 1 August 2003.
- Its actions emanate from the global trend to reinforce the credibility of statutory audits.
- The H3C has been financially autonomous since 2008. Its annual resources totalled EUR 8.5 million in 2013.
- The H3C's organisation is defined by law and decree:
 - Based on the independence of the Board and the competence and diversity of professional backgrounds of its members.
 - The Secretary General, assisted by directorates, prepares the Board's work. He has specific powers with regards to inspections of audit firms.
 - At end December 2013, the Secretariat General was composed of 48 officers.

AUDIT REFORM

In response to the 2008 financial crisis, the European Commission implemented a process in 2010 to reform the regulation and supervision of the European financial sector. End 2011, the Commission proposed a directive and a regulation modifying the organisation of statutory audits in Europe. The aim of this legislation was to strengthen investors' confidence in companies' financial statements notably through improvements in audit quality, strengthening transparency and preventing conflicts of interest. The proposed legislation also tightened public oversight of auditors.

The European legislation (Directive 2014/56/UE and Regulation 537/2014) was adopted in 2014. The transposition of this legislation into national law will be completed by June 2016. The H3C will lend its expertise on the changes to be made to French legislation and will prepare its recommendations.

In particular, the H3C will examine the following:

- **The scope of application of provisions from the regulation.**
- **Audit performance:** independence and ethical requirements, professional standards, audit reports, non-audit services, rules relating to fees, mechanisms for firm rotations.
- **Quality control:** definition of public interest entities, implementation of external inspections, impact on organisations.
- **Role of supervisory bodies:** delegation, certification, recording and registration of statutory auditors, sanctions.
- **Cooperation between oversight bodies.**

INTERNATIONAL COOPERATION

Bilateral Cooperation

The H3C signed cooperation agreements with its American, Swiss and Canadian counterparts. The objective of such agreements is information exchange. The agreement with its American counterpart also includes provisions for joint inspections in France and in the USA. In particular, a series of joint inspections was conducted in France by a team composed of H3C and PCAOB staff, under the supervision of the H3C's Secretary General.

Intra-European Cooperation

- The EGAOB (European Group of Auditors' Oversight Bodies) continued its work on the assessment of third countries' public oversight systems, pending the reform of the organisation of European cooperation between audit regulators and in particular, the creation of a new oversight coordination body.
- The EAIG (European Audit Inspection Group), a European platform for coordinating external inspections, set up a database to collect and exchange national findings from inspection of audit firms.

Following on from 2012, the H3C co-signed a number of joint letters with its counterparts at the EAIG in response to consultations organised by the IAASB and IESBA on proposed changes to international audit and ethical standards, namely in relation to audit reports, auditors' responsibilities relating to other information in documents accompanying financial statements, and the standard-setting boards' proposed strategies and work plans.

International Cooperation

The H3C continued its contribution to the work of the IFIAR (International Forum of Independent Audit Regulators), which published its second global survey of audit inspection findings identified in its members' respective inspections of audit firms affiliated with the largest international audit firm networks.

INSPECTIONS

2013 INSPECTIONS SCHEDULE

PIE audit firms (holding PIE engagements)

- 183 PIE audit firms inspected, including 5 firms belonging to large international networks;
- 729 engagements inspected, including 319 PIE engagements.

Non-PIE audit firms (holding non-PIE engagements)

- 977 non-PIE audit firms inspected;
- 1 963 engagements inspected.

Under article R.821-26 of the Commercial Code (code du commerce), Public Interest Entities are: entities holding transferable securities admitted to trading on a regulated market; charitable organisations; social security organisations mentioned in article L. 114-8 of the Social Security Code (code de la sécurité sociale); credit institutions; insurance companies; pension fund organisations governed by title III of book IX of the Social Security Code; private health insurance organisations or private health insurance groups governed by book II of the Mutual Insurance Code (code de la mutualité). A PIE audit firm can hold both PIE and non-PIE engagements.

INSPECTION FINDINGS

PIE audit firms

Overall, inspections performed at the PIE audit firms revealed an improvement in the application, by the firms, of recommendations issued. However, measures must be taken for the recommendations to be applied to all engagements held and not only on those that have been inspected.

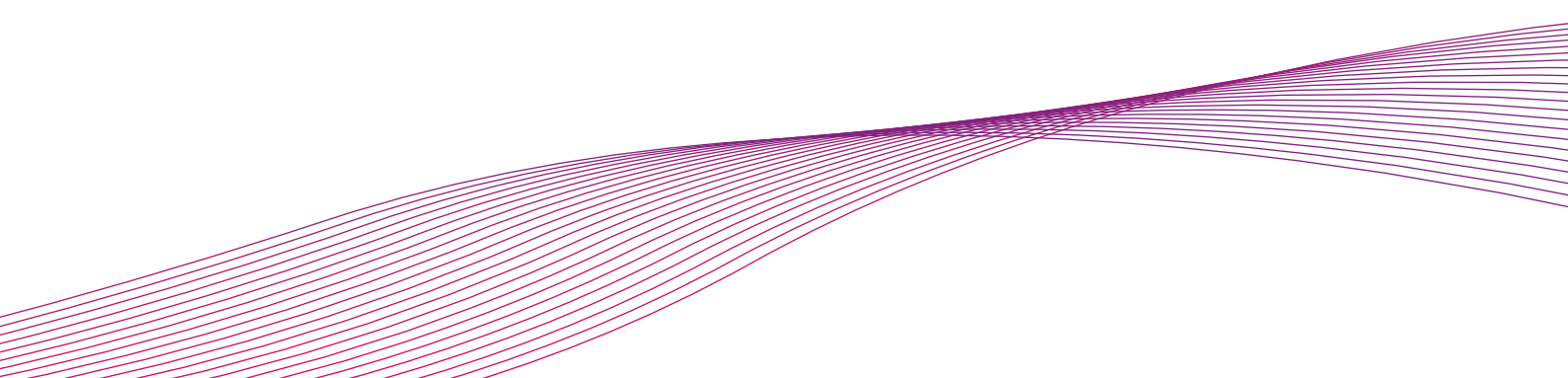
- Progress was made on audit procedures and methodologies, although their effectiveness and correct application by the signatory partners have not yet been fully demonstrated. Firms still need to ensure that they are

able to master the risk of inadequate performance of audits especially given the complexity of engagements held and their regulatory and legal environment. The analysis and monitoring of risks impairing the auditor's independence and training for audit partners both require further improvement.

- Improvements were made in audit work performed on engagements where deficiencies or weaknesses had been identified during previous inspections. For the majority of engagements, the opinions issued were supported by appropriate audit work. In contrast, documentation of audit work performed remains insufficient for a number of work files. This lack of documentation results not only in the inspectors having to perform additional verifications but also brings into question the reliability of the audit work performed by the statutory auditors.
- For 71 engagements (including 47 PIE engagements) the audit opinions were not supported by appropriate audit work. For those engagements, either deficiencies in the scope and quality of audit work performed on material information or on significant risks, or a lack of documentation provided resulted in insufficient evidence to draw audit conclusions.
- These results are in line with those presented in the IFIAR's annual survey based on inspections of audit firms affiliated with the largest international audit firm networks.

Non-PIE audit firms (holding non-PIE engagements)

- Findings from inspections on non-PIE audit firms remain comparable to previous years. Non-PIE audit firms still need to formalise their audit procedures and ensure that a suitable system to prevent money laundering is set up. Progress also needs to be made by providing an appropriate framework, where firms must call on external collaborators or where exemptions on time allocations for audit work are concerned, or for monitoring training for partners.
- Performance of audit work was deemed satisfactory in the majority of engagements inspected. As in previous years, improvements need to be made to the audit approach, to the documentation of conclusions drawn from the work performed, to the review of financial information provided by the entities, and to the drafting of audit reports.
- For 73 engagements inspected, the audit opinions were not supported by appropriate audit work.



INSPECTIONS

H3C RECOMMENDATIONS

In light of the findings from 2013, the H3C issued the following recommendations to audit firms:

1. Comply fully with recommendations issued by the H3C's Secretary General.
2. Ensure the auditor's independence vis-à-vis the entities audited, by adopting a specific organisational format for the purposes of statutory audit where the firm has a multi-disciplinary activity, and paying attention to the prevention and treatment of situations entailing a risk of impairment of independence, and informing the H3C of any such situations.
3. Improve training on the specificities of statutory audits.
4. Ensure that independent quality control review is effective.
5. Improve the level of audit procedures, notably by:
 - systematically documenting the audit approach, along with the audit work performed, in particular for high-risk areas and the review of financial information;
 - applying auditing standards fully;
 - strengthening the collaborative process while performing joint audits;
 - demonstrating professional scepticism and documenting professional judgment, namely vis-à-vis accounting estimates and data prepared by the entities being audited.

The H3C also reminded audit firms that they must fully comply with all regulatory obligations (declarative obligations, requests to diverge from the audit hours volume threshold, rotation of signatory partners, transparency reports and resignations).

FOLLOW-UP TO INSPECTIONS FROM PREVIOUS CYCLES

Subsequent to all inspections, recommendations are issued to the audit firm based on the deficiencies reported. In the most serious cases, a referral can be addressed to the Public Prosecutor.

| | PIE audit firms Previous triennial inspection plan: 2009-2011 | PIE firms Current inspection plan: 2012-2014 | Non-PIE audit firms Multi-annual inspection plan: 2008-2013 |
|---|---|--|---|
| Number of individual recommendations issued to audit firms* | 550 | 146 | 4 500 |
| of which improvement plan requested | 165 | 36 | 614 |
| of which referrals issued to Public Prosecutor | 16 | 14 | 166 |

*total number of letters addressed since 2010

JURISDICTIONAL AFFAIRS

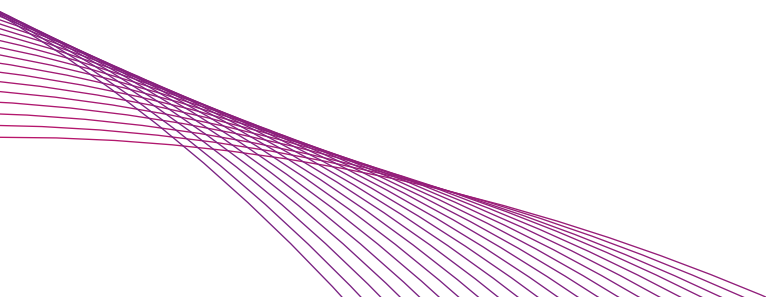
The H3C rules on decisions pertaining to registration, discipline and fee claims of statutory auditors.

In this respect, the level of jurisdictional activity in 2013 was comparable to 2012.

The H3C submitted 16 disciplinary decisions in 2013, as highlighted in the table thereafter.

| | 2013 | 2012 |
|--------------|-----------|------------|
| Discipline | 5 | 4 |
| Fees | 1 | 4 |
| Registration | 10 | 10* |
| TOTAL | 16 | 18* |

*including one provisional judgment



OPINIONS AND REFERRALS

The H3C has been entrusted with overseeing compliance by statutory auditors with professional ethics and independence rules.

The H3C set up a specialised committee to facilitate dealing with the questions it receives. The committee's mission is to decide whether the questions raised to the H3C are of general interest and hence deserve to be made public, or if they require a direct response to the submitter.

In 2013 the H3C issued opinions on the following topics:

Opinion 2013-03

Can a professional structure holding audit engagements request an independent statutory auditor from outside his firm to implement internal quality control reviews within the firm?

Opinion 2014-02

Can a signatory partner subject to rotation conduct an engagement quality control review of his former engagement during his two-year cooling-off period?

Opinion 2014-03

Issues related to the statutory audit of accounts of agricultural cooperatives performed by specialized review federations.

The Secretary General issued direct responses for individual situations regarding:

- Self-review
- Appointments, termination of audit engagements
- Joint audit
- Commercial activity
- Consecutive engagements

In December 2013, the H3C published two releases:

- the first concerned the assessment review of banks by the European Central Bank (ECB);
- the second highlighted implementation issues on the best professional practices in relation to partner rotation.

Furthermore, the H3C continued to examine important issues in relation to the audit profession such as the scope of the non-audit services prohibition and the matter of audit firms forming part of a network.

PROFESSIONAL STANDARDS

The duties of statutory auditors are set out in legal and regulatory texts, and in particular in the auditing standards approved by the Minister of Justice. The H3C issues opinions on the audit standards drafted by the French professional body, the CNCC (Compagnie Nationale des Commissaires aux Comptes), prior to their approval by the Minister of Justice.

In 2013, the H3C issued a favourable opinion on the standard for "services performed on social and environmental information directly related to the duties of the statutory auditor". This standard authorises statutory auditors to perform audit services on social and environmental information and serves two purposes: it meets the companies need

for more security in their communication in this area and it allows statutory auditors to provide particular services that are not strictly limited to financial information.

In addition, the H3C continued its work on adapting French auditing standards to their international equivalents. The H3C is currently working on international auditing standard ISA 402 (audit considerations relating to an entity using a service organisation) and standard ISA 220 related to quality assurance of statutory audits. This work is performed in the context of the provisions of the European Directive on statutory audit, which empowers the European Commission to adopt international auditing standards.

The full version of the 2013 Annual Report is available in French on the website www.h3c.org