AUDIT REFORM IN FRANCE – LAW, REGULATION & GUIDANCE

Ordinance no. 2016-315 regarding Statutory Audit

Decree no. 2016-1026 regarding Statutory Audit

CNCC/Afep-Medef Guidance on Non-Audit Services

‘Sapin II Law’ (Law 2016-1691 of December 9, 2016 regarding transparency, fight against corruption and modernization of the economy)

Decree no. 2017-540 regarding the Statutory Auditors’ Code of Ethics

March 17, 2016

June 17, 2016

July 26, 2016

December 2016

April 12, 2017

Entry into application of EU regulation 537/2014 and Ordinance
The ordinance transposing the EU Audit Reform in France has entered in **application since June 17, 2016**, however with some transitional provisions:

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When their total consolidated or combined assets exceed 5 billions euros for 2 consecutive financial periods:

- Financial holding companies when one of their subsidiaries is a credit company
- Mixed financial holding companies when one of their subsidiaries is a PIE
- Insurance group companies
- Mutual insurance group companies
- Mutual group unions
- Social protection insurance group companies

Additional PIE in France

When their total consolidated or combined assets exceed 5 billions euros for 2 consecutive financial periods:

- Financial holding companies when one of their subsidiaries is a credit company
- Mixed financial holding companies when one of their subsidiaries is a PIE
- Insurance group companies
- Mutual insurance group companies
- Mutual group unions
- Social protection insurance group companies

Applicable as from the first financial period starting after December 31, 2017
Prohibited NAS

PIE and entities of its chain of control (1) in the EU

For the Statutory Auditor and his network, prohibited services are defined by:

- Article no. 55 § 1 of the EU Regulation no. 537/2014
- Decree no. 2017-540 regarding the Code of Ethics

Clarifications introduced by the ‘Sapin II Law’:

The UE network members of the Statutory Auditor of a French PIE can provide to the entities in the EU, that control the PIE or are controlled by the PIE, certain types of prohibited NAS:

- if the Member State in which the services are provided authorizes them (the targets are the tax and evaluation services authorized by derogation in certain Member States);
- Provided that the Statutory Auditor analyzes the risks to his independence and applies the appropriate safeguards.

(1) Control within the meaning of I and II of article no. L 233-3 of the French Commercial Code
Indicative list of services generally provided that do not affect the independence of the Statutory Auditor (as annexed to the Statutory Auditors’ Institute (CNCC) guidance):

- Services related to the formerly called “Related Services”:
  - Audit;
  - Limited review;
  - Attest reports, consultations;
  - Consultations on internal control relating to the preparation and processing of accounting and financial information;
  - Agreed procedures reports;
  - Services provided during the acquisition of entities;
  - Services provided during the sale of companies (except valuation part);
  - Services relating to CSR information;
- Comfort letters in the context of market transactions;
- Assurance reports provided in accordance with ISAE 3402 and ISAE 3000 standards.
AUDIT REFORM – AUDIT FIRMS ROTATION

MAXIMUM CUMULATIVE DURATION OF AN APPOINTMENT IN FRANCE FOR PIE

Sole Auditor

- 10 years
- + 6 years (with mandatory tender)

Joint Audit

- 24 years (renewal without mandatory tender)

Total

- 16 years
- 24 years

The French Oversight (H3C) can exceptionally extend the appointment period by 2 years

COOLING-OFF PERIOD: 4 YEARS

(a) If at the end of the 10 years, the PIE designates a joint auditor (voluntarily or mandatorily), the cumulative duration of the appointment can be extended to 14 years, bringing the cumulative total duration to 24 years.

According to the length of time the auditors have already been in place, the EU regulation 537/2014 sets transitional provisions.
AUDIT REFORM – AUDIT FIRMS ROTATION

Antiority of the appointment

20 years or more

Test date of anteriority: June 16, 2014

From 11 to less than 20 years

Neither renewal nor new engagement from June 17, 2020

Neither renewal nor new engagement from June 17, 2023

Less than 11 years

Engagement continuance until the end of its maximum duration (10 years, 16 years in case of tender, 24 years in case of joint audit)

Transitional provisions

Test date of anteriority: June 16, 2014
Rotation applies to all PIE and charities (both natural and legal persons)

Rotation applies for the significant subsidiaries of PIE (when the PIE and its subsidiary have the same auditor)

Partners can sign for a maximum period of 6 consecutive financial periods within the limit of 7 years

The cooling-off period is of 3 years (instead of 2 previously)

Transitional provision for PIE / Partner Rotation: Applicable from the first financial period starting after December 31, 2016

Progressive rotation applicable to the senior audit staff, in particular those who are registered
Engagements relating to Statutory Audit

Recommendations on Statutory Auditors who are proposed for appointment by the Shareholders’ Meeting

The Statutory Auditor must respect the conditions of independence and, concerning the PIE, the conditions of Article no. 6 of the UE regulation (requirements for NAS, duration of the engagement and fees)

Approval for the PIE of other services than accounts certification (after the analysis of the risks to his independence and safeguards)

Monitors the engagement completion, taking into account the Oversight (H3C) observations and conclusions (for PIE), and report of the engagements and of the results of the assurance engagement to the Board

Audit Fees (fees earned from a PIE during 3 financial periods > 15 % total fees earned by the Statutory Auditor) :

Analysis of the risks regarding the independence, and possibility to submit the engagement to a quality control review
Engagements relating to the financial information and the internal control

- Monitors the elaboration of the financial information and, when applicable, recommendations to ensure its integrity.
- Monitors the effectiveness of the internal control and risk management systems, as well as, when applicable, the internal audit (procedures relating to the preparation and processing of the accounting and financial information).
Supplementary Auditor Report to the Audit Committee

- This report is set by the Article no. 11 of the EU Regulation 537/2014, and has to be presented no later than the Audit report.
- This report is to be written, dated and signed by the Statutory Auditors who perform the Statutory Audit.
- Upon request, the Statutory Auditors have to send this report without delay to the Oversight (H3C) (and other authorities, depending on the status/activity).

Applicable from the first financial period starting after June 16, 2016.
A declaration of independence has to be provided.

Every Key Audit Partner who has been involved in the control has to be identified.

The use of an off-network auditor or an external expert has to be indicated, and the receipt of their declaration of independence has to be confirmed.

The nature, frequency and extent of the communication with the Audit Committee, the management body and the administrative and supervisory body have to be described, including the meetings date.

The scope of the legal control and of its implementation calendar have to be described.

**Distribution of work** between the Statutory Auditors:

The Methodology used has to be described, providing:
- which parts of the balance sheet have been directly audited, which parts have been verified based on system and compliance tests
- an explanation of the substantial variations in the weighting of these tests compared to the year before, even if the Statutory Audit was performed by other Statutory Auditors on the previous financial period

The report has to describe:
- the quantitative Materiality Threshold applied to control the financial statement (and, when applicable, the specific materiality threshold for certain categories of financial transactions, account balances, or information)
- the qualitative factors taken into account to set this Materiality Threshold
If, during the Statutory Audit, an event or conditions that could seriously question the entity's going concern of its activities has been identified, the report has to:
- mention them and explain the assessments relating to them
- precise if they constitute significant uncertainties
- present a summary of guarantees, comfort letters, public intervention commitments and any other support measures taken into account to assess that the entity is able to continue operating

For each significant deficiency detected:
- in the entity’s internal financial control system
- or in the case of consolidated financial statements
- that of the mother company and/or in its accounting system
the report has to indicate whether or not the entity’s management solved it or them out

Significant cases assuming proven or suspected non-compliance with the legal, regulatory or statutory provisions, identified during the audit, and considered relevant given the Audit Committee’s engagement

Indication and analysis of the assessment methodologies applied to the different parts of the annual or consolidated financial statement, including the impact of the changes that occurred

Scope of consolidation and exclusion criteria from the scope (in case of consolidated financial statements)
Identification, when applicable, of the audit work performed by third countries auditors who do no belong the Statutory Auditors’ network in charge of the audit of the consolidated accounts

Indication whether or not obtention of the requested explanations and documents from the audited entity

Significant difficulties encountered during the audit, significant issues discussed with the company management and issues deemed to be of importance for the oversight of the reporting process

Reasons for potential disagreements within the College of Statutory Auditors (very rare in practice)
Auditors’ appointment of a PIE: Tender procedure

- New Statutory Auditor
- Renewal of the Statutory Auditor’s appointment at the end of the 10 years
  (for PIE that appointed one Statutory Auditor only)

Mandatory tender procedure
(except for SME and companies with a small market capitalization)
Auditors’ appointment of a PIE: Tender procedure

- Preparation of the tender documents by the PIE (mention of the selection criteria with transparency and non-discrimination)
- Evaluation of the tenders and preparation of a report on the conclusions of the selection procedure
- Report validation by the Audit Committee
- The Audit Committee submits to the Board of Directors (or Supervisory Board) a justified recommendation with two possible choices at least and a reasoned preference. It states that no third party influenced it.

Statutory Auditor is appointed during the General Meeting

Proposal of the Board addressed to the General Meeting with the recommendation and the preference of the Audit Committee.

Any restrictive contractual clause regarding the appointment of a Statutory Auditor is invalid.