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2 December 2013

FAO Catherine Woods
Financial Reporting Council
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Our ref: tp/031213

Dear Sirs

Draft guidance to the Directors of Companies applying the UK Corporate Governance Code and associated changes to the Code

We are pleased to comment on the draft guidance to directors of companies applying the UK Corporate Governance Code. We have commented on the specific matters on which you have requested feedback in more detail below, but also have some overall observations.

We are very pleased that following the negative comment from many respondents (including ourselves) about the previous set of proposals on going concern, the FRC has taken a more proportionate approach in the revised draft Guidance. In particular, we are pleased that guidance to SMEs will be provided separately. We were concerned that the previous proposals, whilst difficult to manage across the board, would be particularly onerous for smaller businesses and would likely result in a significant increase in emphases of matter in financial statements, with the result either of undesirable negative consequences for businesses or the emphasis of matter paragraph losing its sting. We hope that when the FRC drafts revised guidance for smaller businesses, it is both practical and proportionate.

We have no objection to the inclusion of guidance on going concern and risk assessment in the same document and in our view this makes a great deal of sense given that consideration of a company's going concern status is likely to form an integral part of the company's risk assessment, and indeed management of risks in this area. We would also agree that logically the risks disclosed in the annual report should flow from the risk identification and management process undertaken by the company and this has of course been emphasised in previous comment by the Financial Reporting Review Panel.

We are also pleased to note that a more proportionate timetable for applying the changes is being proposed, namely for accounting periods beginning on or after 1 October 2014.

1. Does the revised draft guidance achieve the objectives of addressing certain aspects of the Board's responsibilities in respect of risks and controls? Is the structure of, and level of detail in, the draft guidance appropriate?

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Overall we believe that the objectives, structure and level of detail in the draft guidance are appropriate and have commented on the specific questions raised in turn below.

We note that there is a typographical error in the heading of section 3 'Excercising'.

2. Do you agree that the current guidance on reviewing the risk management and internal control system is still fit for purpose or are any more substantive changes to these sections required?

We agree that the current guidance is still fit for purpose and that there is no particular need for any substantive changes.

3. Do you agree with the recommendation that the Board should explain what actions have been or are being taken to remedy any significant failings or weaknesses identified from their review of the effectiveness of the risk management and internal control systems?

We have no particular objection to this recommendation which stops short of any explicit requirement to certify that the internal control system is effective (or for that matter that it is not) but rather is forward looking. This should help contribute to balanced reporting as it will allow both for the identification of a negative (the issue in question) and a positive (the actions the board has taken, or is taking, to address the issue).

4. Do you believe that the questions which boards may wish to consider in applying the guidance, and indicators that may assist them in their assessment, set out in Appendix D and E are of use to directors? Do you have any suggestions as to how they might be improved?

We believe that the questions and indicators given in these appendices are helpful although would note (as is clear in the consultation paper) that companies need to regard these as indicative rather than prescriptive.

5. Do you believe that the approach to going concern taken in Appendix B of the draft revised guidance is appropriate? If not, how should it be amended and why?

We believe that the approach taken in the revised guidance is a vast improvement and in particular are pleased that the requirement for a 'high level of confidence' has largely been dropped, although we still have some concerns.

As you know we were extremely concerned about the potential knock-on effects of the original proposals and the difficulty businesses would have either in obtaining a 'high level of confidence' in challenging times or in actually assessing a longer 'foreseeable future' given that finance is now often provided on a much more short term basis than has previously been the case. Whilst we agree that twelve months from the date of approval of the financial statements is not fixed as the period over which going concern should be assessed, and that all available information should be taken into account, this will often be a realistic period for which reliable information is available. In the absence of a crystal ball, it is very difficult to assess periods further into the future with any degree of certainty, particularly for smaller businesses.

We would agree that there is (or should be) a single assessment process over going concern which informs each of the relevant financial reporting requirements and that it is sensible for the revised guidance to take the approach that this is the case.

6. Do you agree with the guidance given (on material uncertainties) in Appendix C of the draft revised guidance? If not, how should it be amended and why?

We agree that it is appropriate to give more emphasis to the overriding requirement to use judgement in determining whether uncertainties are material and welcome the removal of the more prescriptive requirements.

However, we are still somewhat uncomfortable with the requirement for the board to have a 'high level of confidence' that solvency and liquidity can be effectively managed during twelve months from the date of approval of the financial statements, where severe distress has occurred. In such circumstances, where the business has experienced severe distress (of whatever sort), even though the business may have weathered the storm it will generally be quite difficult for a high, rather than a satisfactory, level of confidence to be obtained. This is therefore still likely to result in an increased level of emphases of matter and could therefore still, in our view, have adverse effects on the availability of finance for such companies.

We are also concerned about some of the examples of financial distress which have been retained in Appendix C, for instance when raising finance may be outside the normal course of business. As the guidance itself notes, what is outside the normal course of business is a matter of judgement and given unsettled economic times many businesses have needed to have recourse to sources of finance that they may not have considered in more favourable times. This therefore does not necessarily constitute 'crisis management'. We also do not believe that renegotiating covenants to avoid breaching them is necessarily an indicator of 'severe distress' and there may well be situations where there is necessary other than the 'severe economic downturn' suggested in the guidance. Some further clarity would be useful in this area to avoid giving the impression that any renegotiation of covenants 'to avoid breaching them' rather than in connection with a planned acquisition automatically signifies 'severe distress'.

Finally, as noted in our response to the earlier consultation, we are not convinced that it necessarily matters whether actions that may be taken by a company in assessing the appropriateness of the going concern basis are inside or outside the normal course of business, so long as the end result is that a significant uncertainty does not exist. An action that is clearly outside the normal course of business, such as a successful rescue package, may well achieve this result.

7. Do you agree with the revised guidance relevant to directors of banks?

As you will be aware from our response to the original draft, our concern about giving separate guidance for banks is that they appeared to be allowed a type of opt out (in the event of central bank support) that was not available for other entities. We have no further comments to make other than that we agree that changes should be made to ensure consistency with the draft guidance for other companies contained in this consultation document.

8. Do you agree with the draft revised auditing standards? If not, what should be changed and why?

Whilst we still hold the view that the FRC should be making revisions to auditing standards by influencing the IAASB – rather than making unilateral changes which lead to increasing divergence with the IAASB's versions of the ISAs – we agree that the change to require the auditor to report if they have *anything material* to add to what the directors have included in the annual report in respect of going concern (instead of *anything* to add) is appropriate in the context of the revised proposals.

9. Do you believe that the proposed revisions to C1 and C2 of the Code are appropriate? Do you have any comments on the detailed wording?

The proposed changes to the Corporate Governance Code on the whole appear appropriate in reflecting the draft guidance. In particular we would agree that a clear link between the disclosures made on principal risks in the strategic report, and those it makes on its going concern status in the financial statements (whilst clarifying the differences between the two), is appropriate and would assist users of the financial statements. We also agree that reference to 'principal' rather than 'significant' risks is appropriate.

However, whilst we have no objection to encouraging disclosure of how principal risks are managed and mitigated we do not think this should be mandated, given that as noted in the consultation paper this is not required by the Companies Act. The proposed revised wording of paragraph C.2.1 appears to suggest that this will be mandatory.

We have no objection to the deletion of paragraph C.1.3 in theory although as noted in the consultation paper a parallel requirement is contained in the Listing Rules.

We hope that our responses are useful to you. If you have any questions, then please contact Tessa Park.

Yours faithfully

Kingston Smith LLP