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19 October 2010

Ms Jane Leavens
Corporate Law & Governance Directorate
Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET

Dear Ms Leavens

**BIS CONSULTATION ON THE FUTURE OF NARRATIVE REPORTING**

I am writing to comment on the above consultation paper on behalf of Railpen Investments, the investment monitoring arm of the Railways Pension Trustee Company Limited, the corporate trustee of the UK railway pension funds with approximately £18 billion of assets under management and 350,000 beneficiaries. As a major institutional investor, we have a long standing interest in better corporate reporting and welcome this consultation.

We consider that reporting of relevant and material non-financial information is an essential part of the disclosure required to enable shareowners and investors to make informed investment decisions. Conventional financial reporting primarily describes what has already occurred, for example, revenues, net earnings and depreciation of assets during a specified time period. These are essential to understanding a company's financial results and condition at a point in time but the audited financial accounts on their own are retrospective and do not provide sufficient qualitative and forward-looking information.

The so-called 'value gap' between more traditional financial accounting measures of value, such as book value on the one hand and market capitalisation on the other, suggests a need to go beyond conventional accounting. Non-financial business reporting can help to inform the investment process by revealing in both quantitative and qualitative terms those drivers that increasingly shape company performance. The existence of the 'value gap' suggests that investors understand the potential importance of non-financial reporting in making investment decisions. It follows that we consider that appropriate narrative reporting can help bridge the gap.

Although the BIS consultation is specifically framed in the UK context, this issue has global applicability and I would draw attention to the enclosed Statement and Guidance on Non-financial Business Reporting which I helped to draft and which was published by the International Corporate Governance Network in December 2008 to help generate substantive

dialogue between investors and company boards about the content and timing of non-financial business reporting. The guidance sets out seven aspects of non-financial reporting but it is very emphatically not about encouraging the wild proliferation of irrelevant unmanageable data. It is more about encouraging companies to provide sufficient, timely and credible information with a clear link to the company's strategy.

We support the Government's wish to see greater coherence in narrative reporting without increasing the regulatory burden on business. We also share the view that although there have been some improvements in the quality of narrative reporting since the introduction of the business review requirements but there is still considerable room in our view for improvement, notwithstanding some notable exceptions which demonstrate that effective reporting is a prize that is not beyond our reach.

We hope that it will be possible to drive up the quality to the level of the best that genuinely seek to be forward looking and to go beyond boilerplate reporting. We appreciate that consultation seeks to address, at least in part, whether the OFR should be reinstated but given that the current UK reporting regime has grown incrementally from a variety of sources, we agree that it is appropriate to extend the scope to a fuller review of all aspects of narrative reporting.

As we understand it, the substantive differences between the OFR and the enhanced Business Review are not great and the main divergence was the higher duty on the external auditor to report on whether the information in the OFR was consistent with the audited accounts and whether the OFR was inconsistent with any other information that came to light during the audit. As a result of the repeal of statutory OFR, the ASB's Reporting Standard 1 was reissued as Reporting Statement 1 (RS1) as voluntary guidance. We consider that regardless of whether the OFR is reinstated, it would be sensible for the ASB to review RS1 to ensure that it is still current.

We have some reservations about an overly prescriptive approach which could have unintended consequences and result in more, rather than less, legalistic boilerplate reporting through bare compliance with the letter than true compliance with the spirit. We hope that market led best practice will be sufficient but recognise that the authorities should keep a watching brief. In this regard, we welcome the expanded role of the FRC's Financial Reporting Review Panel to include narrative reporting and we hope that this is developed further.

We share the ASB's concern about immaterial clutter which was well expressed in its review of narrative reporting and in "Rising to the Challenge" in October 2009. A possible approach to counter this may be to encourage companies to explain how they measure and record the materiality of issues of potential importance to the business.

We also concur with the FRC's view that the linkage between the front and back ends of the annual report and accounts needs to be improved. In this regard we favour the concept of more joined up reporting and support the Prince of Wales' Accounting for Sustainability Trust's initiative to set up the International Integrated Reporting Committee (IIRC) and I currently serve on the IIRC Working Group.

We appreciate the current consultation is the opening phase of a more detailed exercise and we would encourage the Government to take into account in later phases other developments including the imminent publication of the IASB's guidance on management commentary and the new requirement in the UK corporate governance code to report on business models. Subsequent phases will no doubt also take into account the implications from the Secretary of State's separate review of corporate governance.

We also wish to make the point that improved technology may well assist better reporting. We note that XBRL is being rolled out by regulators in some jurisdictions and whilst it is not necessarily the full answer, there may be lessons to learn. Web-based technology is still developing and will enable companies to report more coherently whilst providing links to standing data. Companies could perhaps be encouraged to make greater use of technology in reporting through some sort of prominent award for innovation possibly with BIS endorsement or possibly as a new category under the Queen's Awards for Enterprise.

In addition to the general observations in this letter, we would like to add our detailed comments in response to your specific questions as set out in the attached appendix and would also draw attention to our paper on "Say on Pay Six Years on – Lessons from the UK Experience" which we attach in support of our detailed comments to question 14 on the Directors' Remuneration Report.

I hope that these comments are helpful. Please contact me if they need clarification or you feel that we can otherwise be of assistance. In the meanwhile, we look forward to participating in the subsequent phases of this consultation exercise.

Yours sincerely

**Frank Curtiss**
**Head of Corporate Governance**

**ENCS**

**Detailed response to consultation questions**
**Copy of "ICGN Statement and Guidance on Non-financial Business Reporting"**
**Copy of "Say on Pay Six Years on – Lessons from the UK Experience"**