25 The North Colonnade
Canary Wharf
London
E14 5HS

Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

FINAL NOTICE

To: **Rio Tinto Plc**

6 St James Square
London
SW1Y 4AD

17 October 2017

1. ACTION

1.1. For the reasons given in this notice, the Authority hereby imposes on Rio Tinto Plc ("Rio Tinto") a financial penalty of £27,385,400.

1.2. Rio Tinto agreed to settle at an early stage of the Authority's investigation. Rio Tinto therefore qualified for a 30% discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £39,122,007 on Rio Tinto.

2. SUMMARY OF REASONS

2.1. The Authority takes this action because Rio Tinto has breached the Authority's Disclosure and Transparency Rules ("DTR") by its failure in 2012 to account correctly for high-value mining assets based in the Republic of Mozambique when publishing its interim results. Rio Tinto acquired Riversdale Mining Limited ("Riversdale") (an Australian listed mining company which Rio Tinto later referred to as Rio Tinto Coal Mozambique ("RTCM")) in August 2011 for US$3.7 billion. Rio Tinto's valuation of RTCM was based on a plan to rapidly establish coal production by RTCM, with a significant aspect of this plan being RTCM's ability to barge coal from the mines down the Zambezi river to the coast for exporting to market. During the due diligence of Riversdale, the ability to barge was (among other matters) identified as a significant risk to the financial model being used to support the acquisition price.

2.2. Within a few months of the acquisition, risks identified prior to acquisition began to evolve and, in particular, it became apparent that RTCM would only be able to barge one third of the intended maximum amount of coal and that this coal transportation capacity would need to be replaced with higher cost alternatives. In addition to the lost barging capacity, shortly before the end of 2011 Rio Tinto discovered that their application to barge on the Zambezi river would be rejected by the Government of the Republic of Mozambique ("GoM").

2.3. During the first half of 2012, RTCM sought to resubmit their barging proposal to the GoM as part of a revised coal transportation proposal including a new rail and port system, while at the same time working on detailed plans for the development of RTCM's mines. In April 2012, the GoM again rejected the barging option in terms making clear that there was no reasonable prospect of barging being part of any viable proposal. RTCM then began to carry out financial modelling of its mining business on the basis that other more expensive transport options that would be slower to establish were required. This modelling indicated that the NPV of RTCM, based on the best information available at that time, was negative.

2.4. However, Rio Tinto decided that, while it was formulating its revised plans, it would not need to carry out an impairment test, as required by International Accounting Standards ("IAS") 36, to assess whether an impairment was required to be recorded in its financial reporting for half year 2012 ("HY2012") and reasoned, in purported support of this decision, that the lack of clarity around how it would develop the mines, and in particular transport the coal to market, meant that reaching a valuation figure for RTCM was premature and that it was appropriate to continue to value RTCM at the acquisition price.

2.5. The Authority considers that this demonstrated a serious lack of judgement. There were indicators of impairment for RTCM which, in accordance with the International Financial Reporting Standards (which UK public companies are required to follow), meant that Rio Tinto was required to carry out an impairment test. Had Rio Tinto complied with its obligation to carry out an impairment test, a material impairment would have been required to be reported to the market at HY2012. Rio Tinto's financial reporting was therefore inaccurate and misleading and this continued until 17 January 2013 when Rio Tinto finally announced an impairment of RTCM writing off approximately 80% of its value. RTCM was ultimately sold for substantially less than even this write-down value.

2.6. Contrary to DTR 4.2.4R(1), Rio Tinto failed to comply with IAS 34. In these circumstances, IAS 34 required Rio Tinto to conduct an impairment test of RTCM and record a material impairment in accordance with IAS 36. Contrary to DTR 1.3.4R Rio Tinto, by failing to act upon signs that an impairment assessment was required, failed to take all reasonable care to ensure that information disseminated in its HY2012 interim reporting was not misleading. This resulted in the omission of important information, namely that RTCM was materially impaired.

2.7. The Authority therefore has decided to impose a financial penalty on Rio Tinto in the amount of £27,385,400 pursuant to section 91 of the Financial Services and Markets Act 2000.

3. DEFINITIONS

3.1. The definitions below are used in this Final Notice.

the "Act" means the Financial Services and Markets Act 2000;

the "Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority;

the "Board" means the Rio Tinto board of directors;

"CGU" means Cash Generating Unit. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets;

the "Controllers" means Rio Tinto Controllers;

"Controllers Manual" means internal Rio Tinto guidance for Controllers;

"DEPP" means the Authority's Decision Procedures and Penalties Manual;

"DTR" means the Disclosure and Transparency Rules;

"E&E" means exploration and evaluation;

"EG" means the Authority's Enforcement Guide;

"ESIA" means Environmental and Social Impact Assessment;

"GoM" means the Government of the Republic of Mozambique;

The "Handbook" means the Authority's Handbook of rules and guidance;

"HY2012" means the six month interim financial period ended 30 June 2012;

"IAS" means the International Accounting Standards;

"IFRS" means the International Financial Reporting Standards;

"mtpa" means million metric tonnes per annum;

"NPV" means Net Present Value. The discounted cash flow (DCF) method of valuation is an income based approach to assessing the value of an asset or group of assets. An income based approach to valuation provides an indication of value by converting future cash flows to a single current value. Under the DCF method, the forecasted cash flows are discounted back to the valuation date, resulting in a net present value (NPV) of the asset. In this notice, the NPV calculation is the output of a DCF valuation;

"PEG" means Project Evaluation Guidelines. It is the view on commodity prices produced internally within the Economics department at Rio Tinto;

"Product Group" means an entity overseeing commodity sectors within Rio Tinto;

"Relevant Period" means the period from 29 May 2012 to 8 August 2012;

"Rio Tinto" means Rio Tinto plc;

"Riversdale" means Riversdale Mining Limited;

"RTCM" means Rio Tinto Coal Mozambique;

"RTE" means Rio Tinto Energy;

"SPP" means strategic planning process;

"T&I" means Rio Tinto's Technology and Innovation Group;

"the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber); and

"YE2011" means the annual financial period ended 31 December 2011.

4. FACTS AND MATTERS

Requirements of the IFRS

4.1. IFRS are the standards issued by the International Accounting Standards Board (or its predecessor) and include standards referred to as either IAS or IFRS. The relevant standards in relation to this matter are summarised in Annex A.

4.2. IAS 34 prescribes the minimum content of an interim financial report and the principles for recognition and measurement in complete or condensed financial statements for an interim period. It requires the inclusion of significant events which include recognition of a loss from the impairment of assets.

4.3. The requirements for impairments are governed by IAS 36, the objective of which is to ensure that assets are carried at no more than the recoverable amount and, if they are not, that an impairment loss is recognised. IAS 36 requires that an assessment is made at the end of each reporting period, including at the time of interim financial statements, of whether there is any indication that an asset may be impaired. If there is such an indicator, IAS 36 requires an estimation of the recoverable amount to be made ("an impairment test").

4.4. IAS 36 includes a non-exhaustive list of indicators that an asset may be impaired that should be considered "*as a minimum*" including a variety of both internal and external factors.

Company Background

4.5. The Rio Tinto group is an international mining group headquartered in the United Kingdom, combining Rio Tinto Plc, quoted on the London Stock Exchange and Rio Tinto Limited, which is listed on the Australian Securities Exchange. Rio Tinto Plc also lists American Depository Receipts on the New York Stock Exchange. During the Relevant Period Rio Tinto Plc had an average market capitalisation of approximately £41.7 billion (US$64.3 billion), making it one of the largest mining companies in the world.

4.6. Rio Tinto acquired 100% of the shares of Riversdale for approximately US$3.7 billion by August 2011. Riversdale, a mining company, was publicly listed on the Australian Securities Exchange and held coal mining interests in Mozambique. RTE, a Product Group of Rio Tinto at that time which was responsible for the company's coal and uranium Business Units, led the acquisition. Its Coal Development Group had identified Riversdale's assets in Mozambique as the largest remaining coking coal opportunity in the world.

4.7. Riversdale's assets comprised three main areas — Benga (a largely undeveloped ore body on which Riversdale was developing a small starter mine) as well as Zambeze and Tete East which were both undeveloped exploration areas. The acquisition included 65% of Benga (as Riversdale only owned 65%) with the remaining share being owned by a separate company unrelated to Rio Tinto.

4.8. After acquisition, Rio Tinto referred to Riversdale as RTCM and defined it as a CGU which included approximately US$1.8 billion of intangible assets (related to the assets of Zambeze and Tete East which were E&E assets) and approximately US$1.8 billion of "*investments in equity accounted units*" related to the assets of Benga. The underlying assets of Benga consisted of mainly E&E assets, but because it was an equity accounted unit under IAS Benga was a financial asset rather than an E&E asset. The CGU also included US$530 million of goodwill.

4.9. Under IAS 34, at each reporting period (including interim) Rio Tinto was required to assess whether any indicators of impairment existed relating to RTCM and, if so, to carry out an impairment test.

Rio Tinto's group structure

4.10. Rio Tinto contained five Product Groups which were organised based on the type of raw materials they extracted or processed. RTCM was defined by Rio Tinto as a

Business Unit and was allocated to the RTE Product Group. Therefore, RTCM reported to RTE which in turn reported to Rio Tinto.

4.11. Rio Tinto's Audit Committee reported to the Board and its responsibilities included the review of accounting principles adopted in the preparation of public financial information and the review with management and external auditors of compliance with financial reporting standards. The Audit Committee consisted of Non-Executive Directors but was also attended by certain executive directors.

4.12. The Controllers Group operated within Rio Tinto group in the UK and was responsible for external reporting (including annual and half year financial statements and their compliance with IFRS), planning and budgeting and internal reporting and management accounts. This role included, among other things, co-ordinating and overseeing impairment reviews and preparing Audit Committee papers.

Rio Tinto's half year financial reporting process

4.13. Rio Tinto's financial year matched the calendar year. Prior to half-year interim financial reporting, Rio Tinto required Business Units such as RTCM to submit papers which included a discussion of the Business Unit's review of potential impairment indicators. The Business Units were supported by the relevant Product Groups such as RTE. Controllers then analysed the potential impairments at CGU level and presented the results of this work to the Audit Committee, initially in June, to flag any potential impairment indicators (referred to by Rio Tinto as 'triggers') and then again in July to present the final assessments of impairment indicators.

4.14. The Rio Tinto Controllers Manual outlined the process by which Rio Tinto assessed impairment triggers and carried out impairment tests. The manual used the term "asset" for both individual assets and CGUs. The manual stated that "*[i]f there are material changes in circumstances during the first half of the financial year (but after publication of the year-end accounts) that may be expected to give rise to impairment, it may be necessary to obtain revised valuations from* [Business Units] *in the run up to the Group's half year results announcement*".

4.15. The responsibility for identifying impairments resided with the Business Units who were required to assess whether indicators existed and notify Controllers if this was the case. The Controllers Manual gave examples of indicators that should be considered as a 'minimum', which largely mirrored the examples in IAS 36 paragraph 12. The Controllers Manual set out that if any of these factors existed, *"a formal estimate of the recoverable amount of any assets of CGUs that appear to have been impacted materially* ***must*** *be prepared"* (emphasis added). These examples of indicators included:

(a) significant changes that are likely to have an adverse effect in the technological, legal or economic environments in which the entity operates, or in the market to which an asset is dedicated;

(b) significant changes to the extent or manner of use of the asset that are likely to have an adverse effect on its recoverable value, including restructuring or discontinuation of use; and

(c) indications that the economic performance of an asset is, or will be, significantly worse than expected.

Due diligence and acquisition of Riversdale

4.16. In August 2010, RTE provided a paper on the Riversdale acquisition to Rio Tinto's Investment Committee. This paper stated that the valuation of Riversdale was US$3.4 billion, an 80% premium to the market capitalisation, based on factors including the potential to transport up to between 30mpta to 45mpta of coal by barging it 540km down the Zambezi river to the coast for shipping to market.

4.17. The RTE document was supported by papers from internal Rio Tinto technical and business evaluation divisions. These papers highlighted that RTE was only in the initial stages of assessing a development strategy and it was possible that significant valuation challenges could occur. They highlighted that valuation was based on the crucial assumption that the majority of the coal product could be barged down the Zambezi river, that project infrastructure was very uncertain, and that RTE's assumed ramp up (i.e. speed of development) appeared to be optimistic.

4.18. In November 2010, a further RTE paper was submitted to Rio Tinto's Investment Committee which confirmed barging as, in theory, a viable option representing a lower cost long term solution. However, this paper was supported by a further technical assessment which identified various risks to the assumptions supporting the valuation of Riversdale, including the uncertainty relating to the underlying assets and the practical viability of barging. It also highlighted that projected development plans beyond only the Benga mine were based on the assumption of a barging operation to export the coal.

4.19. In December 2010, the Investment Committee and then the Rio Tinto Board of Directors approved the proposal to acquire Riversdale. On 8 April 2011, Rio Tinto acquired a controlling interest in Riversdale and continued to increase its interest in the months that followed until it held 100% ownership by 1 August 2011.

Issues identified for RTCM prior to YE2011

Early valuations of RTCM

4.20. In late 2011, Rio Tinto decided to include in its planning for RTCM the potential volumes expected to be produced at Minjova, an adjacent potential coal mining area that, while not part of the Riversdale transaction, was also owned by Rio Tinto. Like the Zambeze and Tete East tenements, limited resource information was available for Minjova at the time.

4.21. Also in late 2011, RTE and RTCM identified that 10mtpa was likely to be the maximum amount of coal that could be transported by barging, rather than the 30mtpa (by 2030) assumed at acquisition. It was on the basis of a maximum of 10mtpa that Rio Tinto had in September submitted an Environmental and Social Impact Assessment ("ESIA") submission to the GoM for permission to barge down the Zambezi river. This left 20mtpa that would need to be transported by other potentially higher cost solutions.

4.22. RTCM subsequently presented an NPV of US$4.9 billion in November of 2011 (after the inclusion of Minjova) as part of Rio Tinto's annual planning process. This included approximately US$2 billion in lost value due to infrastructure problems, although this was said to be more than offset by an expected increase in PEG prices resulting in a valuation above carrying value. When RTE management queried this reduction in valuation attributable to the infrastructure problems, RTCM clarified that this was caused by projected infrastructure costs that were potentially far greater than that assumed at acquisition because of an expected reduced – although still significant – capacity for barging and the likelihood that RTCM would need to rely on more expensive upgrades of existing rail and port capacity or develop expensive "greenfield" (i.e. new) infrastructure solutions.

Initial rejection of barging transport option

4.23. By the end of November 2011, RTCM was aware that the GoM intended to issue a denial of RTCM's ESIA submission. This decision appears to have taken RTCM by surprise. The formal rejection letter from the GoM dated 14 December 2011 reached Rio Tinto in January 2012.

4.24. Rio Tinto senior management indicated to RTCM that the decision on barging was a "*[m]ajor disappointment on infrastructure capacity"* and highlighted the *"need to look for faster capacity increase and barging success*" because barging was "*critical to cost effective and near term volume/value unlocking*".

4.25. From early December 2011, Rio Tinto decided to try to pursue with the GoM the option of an integrated transportation system for coal production which included rail and port in addition to barging.

Early 2012 write down in expected Reserves & Resources

4.26. After the acquisition, Rio Tinto began the testing necessary to confirm the reserves and resources at the different mines that comprised RTCM's assets. Rio Tinto had expected that its own testing methodology would reveal that the reserves and resources would be significantly lower than what had previously been declared by Riversdale. However, by December 2011 it was clear that the result was significantly worse than had been anticipated at the time of the acquisition. The Zambeze resource was revised down to approximately 22%, the Benga resource to approximately 25%, and the Benga reserve to 50%, of the reserves which had been stated by Riversdale in 2010.

4.27. On 6 February 2012, the Audit Committee was informed that reported reserves and resources would be significantly lower than anticipated at acquisition, but were also informed that these would still be "*substantial and able to underpin the significant growth planned by RTCM*". Significant drilling and testing continued throughout 2012 to determine the extent and quality of the ore body.

The deteriorating picture for RTCM leading up to HY2012

Negative NPV calculations and a further rejection of barging

4.28. There were, however, further negative signs in relation to the value of RTCM from a relatively early stage in 2012. For example, a monthly update from RTCM to RTE in March 2012 stated that, due to changes from the acquisition model in assumptions and capital costs required, estimated to be in excess of US$10 billion, a "*negative overall value*" resulted.

4.29. The GoM again rejected the barging element of RTCM's proposed integrated transportation system at a meeting with RTCM management on 18 April 2012. An RTCM manager described the outcome of the meeting in the following terms "*the government again rejected the notion of barging coal on the Zambezi river, and made it absolutely clear to me that they did not wish to have the barging matter raised again with government. So effectively that meeting killed dead the bid model that had been developed for the acquisition of Riversdale*".

4.30. By April 2012, RTCM was developing a "*bottom up order of magnitude assessment of RTCM business value*" which led to internal modelling indicating possible negative NPVs for RTCM. By early May 2012 the NPV estimated by RTCM, which did not include any barging as a coal transportation option, was negative US$680 million. The negative NPVs were said to be due to a "*number of prejudicial developments*" resulting in updated assumptions being used in the valuation models, particularly in relation to the capital costs required to develop the mines, including the cost to transport more than 10mtpa of coal from the mines without being able to use river barging to the extent envisaged in the acquisition model.

<u>Meeting in Brisbane on 11 May 2012</u>

4.31. On 11 May 2012 a meeting took place in Brisbane attended by senior representatives from RTCM, RTE and Rio Tinto ("the Brisbane meeting"). The purpose of this meeting was to discuss the progress of the RTCM project, in comparison with the progress that had been expected at acquisition. At the meeting the key issues relating to RTCM were fully aired, including that:

(a) the acquisition assumptions on infrastructure ramp up and barging were "*brave*" and were by then a "*moot point as barging has been rejected by the Government"* and the Government was unlikely to change its position;

(b) coal production was "*infrastructure constrained*". Additional rail capacity on existing lines was unlikely to exceed 10mtpa by 2018 and a greenfield rail and port development, which could only be in place by 2018 at the earliest, was "*the only way of delivering substantially higher transport capacity at competitive cost*";

(c) updated adverse information related to coal resource characteristics had a "*negative impact on value*", ramp up production delays were a "*huge value loss*" and higher than anticipated costs for moving the coal had a "*negative impact on valuation*"; and

(d) applying the development model which RTCM considered would deliver the most positive outcome for the project, which required considerable capital expenditure, the "*indicative*" NPV of RTCM was negative US$680 million.

4.32. Possible positive medium and long-term outcomes for RTCM were presented at the meeting which explored in detail RTCM's considerable challenges. It was explained that RTCM was in the process of undergoing several analyses to evaluate potential future pathways for the business and that, over the life of the mine, it may have very strong future cash flows. However, it was also made clear to senior management that critical assumptions made at acquisition could no longer be sustained. At the conclusion of the meeting, senior management explained to RTCM that, in light of the then current capital constraints on the Rio Tinto group in general, there was no appetite for very large capital spends on RTCM. It was suggested to RTCM that it should minimise its capital exposure over the coming years by reducing the rate at which the business was developed. RTCM should establish the smaller Benga operation first, minimising costs and pursuing partnership options for funding.

<u>Half year 2012 impairment considerations by RTCM, RTE and Rio Tinto</u>

4.33. As part of Rio Tinto's usual business planning cycle RTCM was required to submit a range of valuations as at 1 July 2012 covering various approaches to project development; "committed", "probable" and "possible" approaches, combined with differing economic scenarios which factored in different possible future PEG prices. "Probable" projects were defined as those "*considered the most likely business unit development pipeline*" and the "base case" was defined as the "committed" and the "probable" scenarios combined.

4.34. RTCM initially proposed that the base case in the Business Plan would include only the Benga mine (and an associated power plant), as the Zambeze, Tete East and Minjova projects required a new greenfield rail and port system which would require very large capital outlays which had not been sanctioned.

4.35. By 15 May 2012, the Controllers were made aware of certain issues that had been raised at the Brisbane meeting; namely that barging faced "*formidable practical challenges*" and did not "*have political support*", and that significant new rail and port development was "*required to unlock the full coal production potential*". The Controllers were also made aware that there had been a significant downgrade in reserves and resources. The Controllers began to consider the possibility of impairment of RTCM at half year 2012. However they also began to consider whether, given that a mandatory impairment review of RTCM would be required in September and October with or without an impairment "trigger", it was still too early in the planning for the life of the project to consider impairment.

4.36. By 23 May 2012, RTE considered that RTCM should not submit a new valuation for the end of second quarter 2012 ("Q2") but should instead assess value using the original acquisition model. A further email of 25 May suggests this is in order "*to hold value*".

4.37. However, the acquisition model had assumed barging to be the key method of transporting coal. As a further email of 29 May from one controller notes, this had of necessity been "*completely abandoned (for now)*", following "*a clear message [from the Mozambique government] to Rio… to abandon the barging idea or lose the right to mine in Mozambique*". Later that day, another controller commented that the circumstances set out in this email appeared to constitute a "*hard trigger*" for impairment.

4.38. The previous day, 28 May 2012, the Controllers had considered the matter with RTCM and expressed concern that they would not be able to convince the Audit Committee that a detailed revised valuation was not necessary at half year 2012. The Controllers said that "*it seems likely we will need to raise the change in circumstances to the Group Audit Committee (mid-June) as a possible impairment trigger*" and requested from RTCM a "*range of valuations based on the options internally*", even if probability weighted and to the nearest billion dollars. They further advised that "*depending on the magnitude of any potential shortfall between book value and estimated fair value we may have to do further work either to support the book value or calculate a shortfall to write off*".

4.39. However, on 29 May 2012, and following a call between Controllers and RTE and RTCM finance staff, it appeared that a different approach had been agreed for the approach to the Audit Committee. This approach involved RTE and RTCM drafting a paper on RTCM impairment indicators (the "Impairment Paper") which would advocate that the identified issues did not constitute an impairment indicator on the basis of "*the early stage of planning for the project, the fact that this is a recent acquisition, and other market indicators of value*".

4.40. The first Rio Tinto Audit Committee meeting for half year took place on 18 June 2012, and included a Paper on Accounting Issues (the "18 June Paper"). The paper highlighted "*some uncertainty*" around coal transportation and stated that "*[e]nvironmental concerns have been raised by the Government in connection with the proposed barging operation. While barging has not been entirely ruled out in the future, it seems unlikely that the situation will be resolved in the short term. A number of options are available, including incremental capacity on the existing rail lines, greenfield rail and port development (independently owned or shared development) and revised partial barging options*". The paper then concludes "*[o]n balance, while there may be potential indicators for the need to consider impairment at half year, it is not expected that any impairment will need to be recorded as it is too early to assess the impact of the developments on the fair value of the projects*".

4.41. Therefore, although the Audit Committee were told that the GoM had raised environmental concerns regarding barging which were unlikely to be resolved in the short term and which might represent an impairment trigger, in the 18 June Paper it was not made clear that the GoM had issued a second, and emphatic, rejection of any barging proposal whatsoever and that RTCM accordingly considered it essential to completely abandon all barging proposals at least for the time being. Furthermore the Audit Committee were not informed that extensive internal modelling of options which excluded barging had led to multiple specific negative NPV figures for RTCM, the earliest of which dated back to at least March 2012.

<u>The consideration of RTCM after the June Audit Committee leading up to HY2012</u>

4.42. After the June Audit Committee meeting, senior employees of RTE and RTCM discussed current and future business valuations of RTCM. One senior employee expressed the view that preparations for a mandatory full year impairment review would need to be completed in September. The employee noted that current business valuations were a "*significant departure*" from what was anticipated at acquisition and that "*we need to properly put to rest the comparison to the acquisition assumptions*".

4.43. In a separate conversation another RTE employee advised another RTCM employee that "*there will definitely be an impairment review of RTCM at year end*" (which in this context appears to be the full year impairment review in September), but that, in relation to whether an impairment test was required imminently, "*[t]he work we have done already with controllers should get us close to the solution for half year*".

4.44. On 20 June 2012, RTCM submitted a May 2012 monthly report to RTE which stated that "*[b]ottom-up business analysis and value optimisation work continued to improve RTCM system value. NPV now stands around zero for the four-mine, BPP and 75Mtpa infrastructure corridor scenario under current PEG and cost assumptions*".

4.45. The following day, RTE circulated a further draft presentation titled "*Rio Tinto Energy Five Year Business Plan 2012-2017*". This was a consolidated plan, taking into account all of the separate Business Plans from the Business Units within the RTE Product Group. Included within this plan was a "*BU Valuation*" table showing the values assigned to each Business Unit in the committed, probable and possible scenarios. The central probable scenario was stated as US$3.5 billion with a note stating "*RTCM Probable Valuation remain [sic] based on acquisition valuation*". However the document did not make clear on what basis the acquisition valuation was considered justifiable as a central case.

4.46. By 24 June 2012 a decision appears to have been made to use a vastly lower central probable value for RTCM of negative US$0.2 billion (with the 'possible' valuation as US$3.5 billion). An RTE analyst commented that this was "*catastrophic for the central valuation [of RTE]*". On 27 June, the RTE presentation was submitted to the Controllers with the negative US$0.2 billion central probable valuation included and the same figure was then also included in a draft RTE paper to the Controllers titled "*Plan Review Committee Meeting – Product Group Q2F Five Year Business Plan Submission*" (although these same documents then appear to have been later resubmitted with the valuation figures removed from the RTE presentation but still included in the version of the RTE paper).

4.47. On 27 June 2012, the Controllers sent a further draft of the Impairment Paper to RTE. This draft paper stated "*[i]t is acknowledged that the changed circumstances could give rise to an impairment trigger, but this is not yet certain because it is not possible to assess whether the economic performance will be worse than expected*". In relation to current valuations, it stated "*[i]t is not possible to* *provide a proper valuation of RTCM to an acceptable degree of accuracy while the options remain at such an early stage of review. A valuation that only includes the items considered probable will omit value that is present but has not been fully quantified; this value would be attributed to RTCM by a market participant. The level of uncertainty also prohibits calculation of an accurate probability weighted valuation*".

4.48. The paper then considered three types of analysis to "*give some indication of the value of RTCM*". All three of these appeared to be based on the assumptions (including barging) used in the acquisition model, with a two year delay on the production date factored in (reducing valuation by approximately US$1 billion) along with updated assumptions for PEG prices, inflation and foreign exchange (increasing value by approximately US$3 billion).

4.49. A draft of the impairment paper dated 16 July 2012 contained an "*assessment of impairment indicators for RTCM in line with RT policy*" and assessed potential IAS 36 indicators in detail before concluding that, "*[a]n assessment of impairment indicators has been performed for RTCM. Overall, we do not believe that there is an impairment indicator".* This was purportedly justified on the basis that, although there were known uncertainties relating to infrastructure problems, the central case was still under development and Rio Tinto were confident of finding a viable path. It was further purportedly justified on the basis that, current and expected PEG prices and the inclusion of Minjova produced a valuation for RTCM which if based on acquisition assumptions exceeded its carrying amount.

4.50. The conclusions from the impairment paper were reflected in the paper on accounting issues that was provided for the Audit Committee for its meeting on 30 July 2012, albeit briefly; despite the complexity of the issues concerned, and despite the extensive debate that had taken place between RTCM, RTE and the Controllers on how best to characterise those issues, the Audit Committee paper contains only two small paragraphs relating to RTCM. The first stated that an assessment of impairment indicators had been performed and that, although it was acknowledged that there was uncertainty over future transportation, Rio Tinto were confident of finding a viable infrastructure path and that the "*breadth of the options*" meant that a central case was still under development, and therefore no indicator existed. The second paragraph simply repeated the (flawed) basis for valuing RTCM using the acquisition assumptions.

4.51. On 8 August 2012, Rio Tinto released its half year results which did not include an impairment to the value of RTCM. The published results made no reference to the impairment indicators for RTCM, including that barging would not be permitted leading to either significantly higher capital costs or significantly lower production of coal, and that internal information available at that time produced negative valuations.

Events leading to recognition of an impairment on 17 January 2013

4.52. In August 2012, a Strategic Planning Process ("SPP") was begun for RTCM. The SPP team was situated within Rio Tinto's Technology and Innovation Group ("T&I") and its purpose was to find the best strategic development path for parts of the business which would benefit from assistance in analysing strategic options. RTCM had initially approached the SPP team in March 2012, and in August 2012 that team visited Mozambique to begin their work.

4.53. By late November 2012, it had become clear that the results of the SPP work being carried out by T&I were generally negative and tended to suggest that only Benga had any value for RTCM with many of the development plans being economically unviable. This was consistent in key respects with some of the earlier work carried out by RTCM itself during the HY2012 process but which had been effectively discounted for impairment purposes on the purported basis that the situation remained too uncertain to be properly quantified.

4.54. At this stage RTCM remained unimpaired. No full year goodwill impairment review of RTCM as envisaged at half year had, in fact, been completed in September 2012. On 26 November 2012, an Audit Committee meeting took place where RTCM was discussed. The minutes of the 26 November meeting noted the Audit Committee's concern at the "*limited impairment headroom*" for RTCM, but that management had advised that this was "*expected given the relatively recent acquisition of RTCM"*.

4.55. During December 2012, Rio Tinto received updated reporting on the reserves and resources for the mines, and in particular for Minjova, which concluded that much of the coal would be uneconomic to extract. The updated information resulted in a large proportion of the potential volumes being removed from the estimates of RTCM's future coal production. Internal analysis, which was carried out to establish the effect this would have on the value of RTCM, finally led Rio Tinto to a formal revised downward valuation of RTCM to US$611 million from approximately US$3.5 billion.

4.56. On 17 January 2013, Rio Tinto announced that it was to record an impairment of US$3 billion against its 2012 earnings in relation to RTCM. Rio Tinto attributed this step to new information revising downwards the estimates of recoverable coking coal volumes and a reassessment of the overall scale that the business could achieve. It also highlighted that RTCM coal production was infrastructure constrained and that barging had not received formal approvals.

5. FAILINGS

5.1. The failure to conduct an impairment test and recognise an impairment to the carrying value of RTCM in its HY2012 financial reporting (published 8 August 2012), resulted in Rio Tinto breaching the Authority's Disclosure and Transparency Rules as in force at the time of the breach: (i) DTR 1.3.4R and (ii) DTR 4.2.4R(1). These breaches are discussed below and the provisions referenced below are set out in full at Annex A to this Notice.

DTR 4.2.4R(1)

5.2. DTR 4.2.2R requires issuers to make public a half-yearly financial report covering the first 6 months of the financial year.

5.3. DTR 4.2.4R(1) states*: If an issuer is required to prepare consolidated accounts, the condensed set of financial statements must be prepared in accordance with IAS 34.* As a parent entity, Rio Tinto is required to present consolidated accounts under IFRS 10.

5.4. IAS 34 requires that interim financial statements recognise losses from the impairment of assets and comply with IAS 36 which states that "*[a]n entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity **shall** estimate the recoverable amount of the asset*" (emphasis added).

5.5. Rio Tinto did not comply with IAS 36 by failing to:

(a) recognise that indicators of impairment which existed for RTCM at the time of HY2012 required it to conduct an assessment of whether the recoverable amount of RTCM was greater than the carrying value; and

(b) recognise a material impairment loss to RTCM in its HY2012 interim financial reporting.

5.6. At HY2012, impairment indicators existed which, in accordance with IAS 36 (and Rio Tinto's own Controllers Manual), both individually or collectively, required Rio Tinto to carry out an impairment test for RTCM as a CGU as at 30 June 2012.

5.7. Under IAS 36, various categories of indicators are set out. These include significant changes in the technological, economic or legal environment; or in the extent or manner in which the relevant assets were expected to be used; or which gave rise to significantly higher cash flows than were originally budgeted. Each of the following factors, present at HY2012, fell into one or more of those categories:

(a) the rejection by the GoM making it clear that barging would not be permitted;

(b) the significant additional capital expenditure which would be associated with developing an alternative rail and port solution; and

(c) the restrictions which that alternative solution would impose on coal production and subsequent cash flows.

5.8. Furthermore, there had been significant downgrading of the resource characteristics of the RTCM mines. This was significantly greater than the downgrading which had been anticipated at acquisition, and was an indicator of impairment both under IAS 36 and – as a material change in the estimates of proven and probable ore reserves – under the Controllers Manual.

5.9. Furthermore, documents show that multiple assessments of RTCM's NPV carried out internally by Rio Tinto prior to HY2012, taking into account some or all of the above factors, resulted in figures dramatically lower than the carrying value, including negative NPVs. This constituted evidence derived from internal reporting that the economic performance of RTCM would be worse than expected which is also an indicator of impairment under both IAS 36 and the Controllers Manual.

5.10. Although the Controllers acknowledged in the HY2012 papers submitted to Rio Tinto's Audit Committee that impairment indicators for RTCM may exist, the Audit Committee did not have those indicators set out to them clearly. This could have been done briefly, as set out above, and was essential for that Audit Committee to fully consider their potential implications for the value of RTCM. Instead, far too heavy reliance was placed in those papers on supposed lack of clarity around the strategic options for RTCM going forward, in particular in relation to the coal chain, which purportedly meant that it was not possible to assess the impact on RTCM. This reliance by Rio Tinto was wrong.

5.11. IFRS does not recognise uncertainty as a reason in itself not to carry out an impairment review. The Conceptual Framework for Financial Reporting, which sets out the key concepts which underlie the preparation of financial statements, explains that "*…the uncertainties that inevitably surround many events and circumstances… are recognised by the disclosure of their nature and extent and by the exercise of prudence... Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities and expenses are not understated*."

5.12. Therefore, to manage uncertainty in compliance with IFRS, Rio Tinto should have incorporated it into an impairment review by using reasonable and supportable assumptions that represent management's best estimate, or by weighting outcomes by probability. This was not done.

5.13. Furthermore, on 28 May 2012, when first considering in detail the question of potential impairment of RTCM for HY2012, Rio Tinto's Controllers had discussed among themselves a process using best estimates of value on a risk weighted basis which, had it been followed, would have been more likely to ensure that impairment indicators were properly recognised and a calculation of a formal estimate of the recoverable amount conducted. The Controllers appeared explicitly to recognise that it was necessary to have such estimates for the purpose of articulating and quantifying the extent of any problem, even if the estimates were only approximate.

5.14. However, the papers eventually provided to the Audit Committee relied instead on generalities, as set out above, and do not contain any such analysis or quantification. As a result the Audit Committee was not provided with highly pertinent information including how the best available modelling at that time indicated RTCM had a negative value. The Authority considers this to have been a serious misjudgement by Rio Tinto in relation to its proper management of its financial reporting.

5.15. For all these reasons Rio Tinto, by failing to recognise impairment indicators and calculate a formal estimate of the recoverable amount at the time of HY2012, did not prepare its HY2012 accounts in accordance with the relevant accounting standards and thus breached DTR 4.2.4R(1).

DTR 1.3.4R

5.16. DTR 1.3.4R states: *An issuer must take all reasonable care to ensure that any information it notifies to a RIS is not misleading, false or deceptive and does not omit anything likely to affect the import of the information.*

5.17. As set out above, despite the existence of indicators of impairment at HY2012, Rio Tinto failed to conduct a formal estimate of the recoverable amount of RTCM to assess whether the value was materially below its carrying value (which by the time of HY2012 was US$3.55 billion).

5.18. Had it done so, as it was obliged to do, using reasonable and supportable assumptions, the value would have been materially below that carrying value and Rio Tinto would have been obliged to record an impairment in its HY2012 accounts.

5.19. Therefore, Rio Tinto failed to take reasonable care that its interim financial report for HY 2012 was accurate and included everything of import.

<u>The impairment that should have been recognised at HY2012</u>

5.20. Rio Tinto's external auditor calculated the materiality figure (the amount that the auditor considered would present a risk of 'material misstatement' of Rio Tinto's financial statements) for Rio Tinto at 18 June 2012 as US$500 million. At HY2012, the external auditor calculated this figure as US$250 million based on half of the full year materiality. Therefore, the Authority considers that an impairment of US$250 million or greater would be material to the interim financial statements. Rio Tinto's Controllers Manual, in relation to the existence of impairment indicator, states that "*a formal estimate of the recoverable amount of any assets or CGUs that appear to have been impacted **materially** must be prepared"* (emphasis added).

5.21. The calculation of the recoverable amount would have involved an estimation using the higher of either the "value in use" ("VIU") or "fair value less cost to sell" ("FVLCS") of RTCM. In this case the Authority has determined that it is likely that

Rio Tinto would have used FVLCS as a basis for the calculation, using a Discounted Cash Flow analysis ("DCF") which incorporated the best information available. DCFs are based on the theory that the value of an asset equates to the present value of its expected future free cash flows at the date of valuation. In order to calculate the value of a mineral property using a DCF, the future free cash flows of the mine over the life of the mine are estimated and are then discounted to the valuation date.

5.22. In the absence of Rio Tinto having produced its own assessment of the recoverable amount of RTCM prior to the issuance of the HY2012 Interim Financial Statements, we consider it reasonable to refer to NPV calculations produced by Rio Tinto using DCF analysis that appears to be based upon management's best estimates of the conditions that existed for RTCM as at 30 June 2012. The Authority has determined that the financial model used in the May 2012 NPV calculation of negative US$680 million provides a reasonable basis for the assessment of the recoverable amount at HY2012.

5.23. The Authority considers that the key assumptions used to generate the May 2012 NPV value of negative US$680 million, namely that there would be a slower increase in production of coal and significant increase in capital expenditure as a result of the coal transportation infrastructure issues (particularly barging), could not be reasonably adjusted to lead to a recoverable amount for RTCM that was not materially below its carrying value. Any principle mitigating factors could also not prevent the calculated value being significantly below carrying value.

5.24. Therefore, the Authority considers that, using the May 2012 NPV as a basis for assessing the recoverable amount of the RTCM assets prior to issuance of Rio Tinto's 2012 Interim Financial Statements, a material impairment was required.

5.25. The facts and matters behind the impairment indicators described at paragraph 5.7 above were known to RTCM, RTE and Rio Tinto's Controllers in May/June 2012 and were considered in preparation at that time of the Impairment Paper, Business Plan and the papers for the Audit Committee meeting on 18 June 2012. However, as recorded in these papers, despite knowing these facts and matters Rio Tinto decided not to recognise an impairment or even carry out an impairment review of RTCM at that time. The Authority finds that Rio Tinto did not therefore take reasonable care in its consideration of this issue.

5.26. By failing to recognise a material impairment at HY2012, via its published interim statements and accompanying Regulatory Information Service announcement Rio Tinto not only failed to take reasonable care but in fact released to the market information which omitted matters of import because its reporting of first half-year underlying earnings contained materially inaccurate information regarding the value of RTCM.

6. SANCTION

Financial penalty

6.1. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. In determining the appropriate financial penalty, the Authority has had regard to Chapter 6 of DEPP.

6.2. The total financial penalty which the Authority has decided to impose on Rio Tinto is **£27,385,400**. In summary this penalty is calculated as follows.

Step 1 – Disgorgement

6.3. Pursuant to DEPP 6.5A.1, at Step 1, the Authority seeks to deprive a firm of the financial benefit derived directly from the breach. Rio Tinto did not derive any financial benefit from the breaches and so there is no amount subject to disgorgement.

Step 2 – Seriousness of the breach

6.4. Pursuant to DEPP 6.5A.2G at Step 2, the Authority determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.

6.5. However, in this case, the Authority considers that the revenue generated by Rio Tinto is not an appropriate indicator as it does not reflect the harm or risk of harm resulting from Rio Tinto's breaches.

6.6. The Authority considers the appropriate indicator is Rio Tinto's average daily market capitalisation, as it relates to its UK listing, throughout the period of the breach as it reflects the harm or risk of harm resulting from the breaches. The Authority considers that the period of the breaches is the date Rio Tinto began to fail to take "reasonable care" in relation to its consideration of RTCM's impairment issues on 29 May 2012, until the date the HY2012 interim financial reporting was made on 8 August 2012 which omitted an impairment to RTCM. Rio Tinto's average daily market capitalisation in relation to its UK listing over this period is £41,730,140,520**.**

Scale

6.7. The Authority considers that a scale of 0-0.5% of market capitalisation (applied according to the seriousness of the breach) is appropriate in order that the penalty properly reflects the seriousness of the breach.

Level of seriousness

6.8. In assessing the seriousness level for the purpose of penalty, the Authority takes into account various factors which reflect the impact and nature of the breach.

Impact of the breach

6.9. These failings are serious as Rio Tinto is one of the UK's biggest issuers, with a wide shareholder base and a very significant asset-base and significant resources at its disposal. A failure by large listed companies to account properly for impairments clearly creates a significant risk that harm could be caused through investment decisions being made on the basis of incorrect information. Rio Tinto failed to prevent misleading information being released to the market and created a risk of harm to consumers.

Nature of the breach

6.10. The breach continued for between two and three months during the period leading up to and including HY2012 reporting on 8 August 2012. However the Authority considers that the duration of the breach is of secondary importance compared to the impact or potential impact of Rio Tinto's published financial information being materially inaccurate for over five months until the recording of the impairment on 17 January 2013.

6.11. The failure to impair RTCM related to one Business Unit of Rio Tinto and was not a systemic or widespread failure. The Authority has not found that Rio Tinto knew that it needed to impair RTCM but failed to do so. However, for the reasons outlined above, a failure to properly consider and report all relevant and important information relating to possible impairment matters through Rio Tinto's processes for financial reporting, which exist to ensure the accuracy of the financial information being reported, is a serious matter. Furthermore, the Authority does not view this as merely the result of a flawed process; there were serious misjudgements by Rio Tinto which contributed to the failure.

6.12. The Authority therefore considers the seriousness of the breaches to be level 2. Therefore the Step 2 figure is 0.125% of £41,730,140,520 or £52,162,676.

6.13. DEPP 6.5.3G(3) states that the Authority recognises that a penalty must be proportionate to the breach. The Authority may decrease the level of the penalty arrived at after applying Step 2 of the framework if it considers that the penalty is disproportionately high for the breach concerned. In this case the Authority does consider that the Step 2 figure is disproportionately high and should be adjusted.

6.14. In order to achieve a penalty that (at Step 2) is proportionate to the breach, the Step 2 figure is reduced by 25% to £39,122,007.

Step 3 – mitigating and aggravating factors

6.15. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2 to take into account factors which aggravate or mitigate the breach. However in this instance the Authority does not consider that there are any mitigating or aggravating factors. The Step 3 figure is therefore £39,122,007.

Step 4 – adjustment for deterrence

6.16. Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.

6.17. The Authority considers that the Step 3 figure of £39,122,007 represents a sufficient deterrent to Rio Tinto and others, and so has not increased the penalty at Step 4.

6.18. The Step 4 figure is therefore £39,122,007.

Step 5 – settlement discount

6.19. Lastly, because Rio Tinto has reached a settlement with the Authority in the Authority's settlement discount scheme, Rio Tinto qualifies for a 30% discount to its penalty. Accordingly, Rio Tinto's financial penalty is **£27,385,400.**

7. PROCEDURAL MATTERS

Decision maker

7.1. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

7.2. This Final Notice is given under, and in accordance with, section 390 of the Act. The following statutory rights are important.

Manner of and time for Payment

7.3. The financial penalty must be paid in full by Rio Tinto to the FCA no later than 1 November 2017.

If the financial penalty is not paid

7.4. If all or any of the financial penalty is outstanding on 1 November 2017, the FCA may recover the outstanding amount as a debt owed by Rio Tinto and due to the FCA.

Publicity

7.5. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FCA must publish such information about the matter to which this notice relates as the FCA considers appropriate. The information may be published in such manner as the FCA considers appropriate. However, the FCA may not publish information if such publication would, in the opinion of the FCA, be unfair to the person with respect to whom the action was taken or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

7.6. The Authority intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

Authority contacts

7.7. For more information concerning this matter generally, contact Stephen Robinson (direct line: 020 7066 1338) or Andrew Cawser (direct line: 020 7066 1108) of the Enforcement and Market Oversight Division of the Authority.

Mario Theodosiou

Head of Department,
Financial Conduct Authority, Enforcement and Market Oversight Division

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS

1. RELEVANT STATUTORY PROVISIONS

1.1. The Authority's general duties established in section 1B of the Act include the strategic objective of ensuring that the relevant markets function well and the operational objectives of protecting and enhancing the integrity of the UK financial system and securing an appropriate degree of protection for consumers.

2. RELEVANT REGULATORY PROVISIONS

2.1. Unless otherwise stated, the regulatory provisions set out below were in force at all material times.

Disclosure and Transparency Rules

DTR 4.2 Half-yearly financial reports

Preparation and content of condensed set of financial statements

2.2. **DTR 4.2.4R(1)**: "If an issuer is required to prepare consolidated accounts, the condensed set of financial statements must be prepared in accordance with IAS 34. [Note: article 5(3) of the TD]"

DTR 1.3 Information gathering and publication

Misleading information not to be published

2.3. **DTR 1.3.4R**: "An issuer must take all reasonable care to ensure that any information it notifies to a RIS is not misleading, false or deceptive and does not omit anything likely to affect the import of the information."

International Financial Reporting Standards

2.4. IFRS are the standards issued by the International Accounting Standards Board (or its predecessor) and include standards referred to as either IAS or IFRS.

International Accounting Standard 34

Interim Financial Reporting

Objective

2.5. "The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash flows and its financial condition and liquidity."

2.6. The full version of IAS 34 can be found at http://www.ifrs.org

International Accounting Standard 36

Impairment of Assets

Objective

2.7. "The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the entity to recognise an impairment loss. The Standard also specifies when an entity should reverse an impairment loss and prescribes disclosures."

2.8. The full version of IAS 36 can be found at http://www.ifrs.org