Rio Tinto

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By email: codereview@frc.org.uk

13 September 2023

Dear Sir / Madam,

UK Corporate Governance Code – Consultation response

Rio Tinto is a global mining company. Its shares are listed on the London and Australian stock exchanges, with American Depository Receipts listed in New York. Rio Tinto presents its Group financial statements under IFRS and is audited by KPMG. The annual results are also filed in New York on a Form 20-F that include Internal Control Over Financial Reporting attestations as required by the Sarbanes-Oxley Act ("SOx").

We are broadly supportive of the general direction of the consultation paper, although we have some concerns regarding the detail and potential unintended consequences of areas of ambiguity.

1. As a group that is regulated in multiple jurisdictions, we believe that is important that a principle of equivalence should be established within the Code. That is, where UK companies are already subject to regulatory oversight in other jurisdictions, equivalence should be established to ensure that an existing system of processes or controls can cover the substantively similar requirements to be introduced with these proposals. An obvious example is ensuring that an organisation's SOx. attestation can also support the statement on control effectiveness in respect of financial reporting for the purposes of the Code.

2. Meeting the new requirements of the code will come at a cost – in terms of internal and external resourcing and management and Board time. We note and support the retention of the 'comply or explain' principle, but are concerned that certain stakeholders, including proxy agencies, will measure adherence more bluntly. This places an additional burden on UK listed companies when the requirements are more stringent than those in other locations. At a time when the competitiveness of the UK listed market is under pressure from alternative international locations, it will be important that the benefits arising from these new requirements are clearly identified and the value which will flow from these benefits is justified in the context of these additional costs.

3. The broadening of the control attestation from 'financial reporting' to 'reporting' represents a fundamental shift in approach. A distinction should be drawn between financial reporting, where accounting standards, internal control frameworks and auditing frameworks are mature and well understood, and non-financial reporting, where this is not always the case. Applying a risk-based approach, it may not be necessary or desirable to expect the same level of control over elements of non-financial reporting. In order to avoid a situation where disclosure practice by issuers effectively sets the standard, it will be important for specific frameworks and guidance to be developed and shared in this area. The Code (and any accompanying guidance) should explicitly recognise that

different levels of control and assurance will exist for companies of different scale and complexity, and that this is an appropriate outcome in seeking to be proportionate.

4. We do not believe it is practicable to ensure continuous monitoring is in place over risks and controls throughout the period and to the date of reporting. The process of reviewing the effectiveness of these controls and systems to support a sufficiently robust declaration takes time to operate and it is only practicable to provide a positive confirmation at the balance sheet date. Similarly, deficiencies in reporting controls identified during a period and remediated in advance of reporting should not give rise to a deficiency at the balance sheet date. This also underlines the importance of equivalence with the requirements of other jurisdictions which operate to a balance sheet date.

5. Timely publication of high quality guidance will be critical in allowing companies to prepare for the new requirements. This should include guidance on scope, materiality, the application of appropriate frameworks and explicit guidance on what is not required. This should also establish the intended scope over which the attestation on reporting controls applies – is this limited to the annual report, or does it extend to other corporate publications, presentation materials and press releases? There is a real risk that in the absence of such guidance that companies and assurance providers take an approach that is not in proportion with the intent of the Code, further increasing the effort and cost of compliance.

We welcome the opportunity to comment on the proposals set out in the consultation paper and have set out our responses to certain specific questions in the appendix to this letter.

Yours faithfully,

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Appendix

Section 1 – Board leadership and company purpose

Q3: Do you have any comments on the other changes proposed in Section 1?

“Culture” should be clearly defined. We suggest amending Provision 2 in Section 1 as follows:

“The Board should agree the desired culture and monitor how effectively the organisation is making progress towards it and how this is linked to people metrics. The annual report should demonstrate how the Board has assured itself that progress towards the desired culture is being made (and equally explain if it is not being made).”

Section 4 – Audit, risk and internal control

Audit and Assurance Policy

Q10: Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?

We are supportive of the introduction of an Audit and Assurance Policy (“AAP”) as a single repository of audit and assurance information and believe it will provide stakeholders with a clear understanding of assurance sought by the company.

We welcome the principle of increased engagement with shareholders and other stakeholders but remain sceptical about how much capacity these groups have for this enhanced form of engagement. We are concerned about the concept of an advisory bote on the AAP and believe the focus should be on strengthening shareholder engagement.

We agree the Audit Committee should have oversight of the AAP, in co-ordination with other committees where relevant. Within this framework, we would expect other committees to maintain direct relationships with assurance providers as appropriate – for example the Sustainability Committee in respect of ESG reporting.

The Audit Committee should exercise its judgment and discretion over the development of the AAP, informed by the particular circumstances of the company and its assessment of risk. This should not be a tick-box exercise.

Sustainability reporting

Q12: Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting, and where appropriate ESG metrics, where such matters are not reserved for the board?

While we agree that audit committees should have oversight of controls over narrative reporting as part of the overall risk management framework and AAP, we expect they would delegate elements of this framework to specialist committees where they exist.

Where companies have established sustainability committees with experience in ESG policies, frameworks and metrics we believe it can be appropriate for the sustainability committee to maintain oversight over sustainability reporting. This also ensures that reporting and assurance is appropriately connected with development and oversight of related strategic matters.

We agree that a connection between the oversight of financial and ESG reporting is likely to be helpful given the increasing relevance of sustainability matters within financial reporting and the resilience statement.

‘Narrative reporting’ needs to be clearly defined. The consultation focuses heavily on sustainability reporting and ESG, however the Annual Report contains much broader narrative information – for example, the strategic report, business reviews, risk report and remuneration report. It is also unclear whether the scope of the proposals extends beyond the Annual Report to other corporate publications, press releases and supporting materials.

Risk Management and Internal Controls

Q13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?

As we interpret them, we agree that the proposed amendments appear proportionate, in that they build upon existing obligations to ensure robust systems of risk management and internal control. However, there is a risk that, in the absence of specific and robust guidance, different companies, assurance providers and stakeholders will interpret the requirements differently. This could lead to all companies being drawn towards the most stringent and demanding interpretation of the requirements, instead of one informed by their own risk characteristics.

The development and publication of clear and timely updated guidance will be important in establishing a common understanding of acceptable frameworks and approaches to meeting these requirements.

It is important that this guidance allows sufficient flexibility for each company to adapt the approach in response to its own unique circumstances and should encourage a risk-based approach.

As noted in our BEIS consultation response, the principle of equivalence is important. If companies are subject to regulatory oversight in other jurisdictions, we would expect that existing systems of control and associated assurance can cover all substantively similar requirements introduced. Additional mandatory requirements risk adding cost and complexity for little benefit.

Q14: Should the board's declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?

We are cautious about stating that continuous monitoring should be in place over risks and controls throughout the period. The process of reviewing the effectiveness of these controls and systems to support a sufficiently robust declaration takes time to operate and it is only practicable to provide a positive confirmation at the balance sheet date, perhaps supplemented by exception-based reporting of events since the balance sheet date. It could be considered good practice for Audit Committees to receive an update on the effectiveness of the system of risk management and internal control at the half-year to monitor progress of the improvement of any gaps or weaknesses identified as part of the full-year declaration and to prioritise other actions over the remaining six months of the year.

For financial reporting risks and controls, the declaration should be effective as at the balance sheet date, consistent with the associated financial information, adjusted for post balance sheet events. Many elements of the financial reporting framework are only operated annually or periodically and are fundamentally connected to the period covered by the financial report. This also allows for consistency with the associated SOx attestation and so reduces duplication and re-work.

For financial reporting and other reporting controls, many controls are intrinsically linked to the report produced and the period it covers. Where a control deficiency has been identified earlier in the period, but remediated prior to the reporting date, there is no deficiency at the date of the report, and therefore identifying an associated material weakness would not be useful to stakeholders.

Q15: Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?

The internal control framework operates over both financial and non-financial reporting and note there is a growing interest in elements of non-financial reporting, particularly ESG. It therefore seems appropriate that the Board’s attestation over the risk and control environment should cover broader reporting controls.

However, we note that standards for financial reporting and internal control over financial reporting are much more mature than equivalent frameworks for narrative and non-financial reporting. Recognising this distinction, we propose that the code refers to ‘financial and non-financial reporting’. We expect that many companies will have established frameworks for assessing internal control over financial reporting (for example SOx) and will rely upon these. For non-financial reporting, a risk-based approach should be taken using an appropriate framework and we understand the intention is not to apply ‘UK SOx’ to all forms of reporting. This also recognises the distinction between information contained in the financial statements and subject to audit and other reporting. It will not be possible to provide an equivalent level of assurance over non-financial reporting as for financial reporting, particularly in areas where reporting and assurance frameworks are new or non-existent.

It is important that ‘narrative reporting’ is clearly defined. In the consultation, it is not clear whether this is intended to mean non-financial metrics (e.g. ESG metrics), supporting narrative to financial and non-financial metrics, or both. A clearer description might be ‘financial and other reporting, including narrative reporting’.

On page 44 of the consultation, the amendments to the section describing the role of the audit committee remove ‘the significant issues that the audit committee considered relating to the financial statements and how these issues were addressed’ and add ‘the significant issues that the audit committee considered relating to narrative reporting, including sustainability matters, and how these matters were addressed’. This appears to regard financial reporting matters as a sub-element of ‘narrative reporting’ and does not well represent a core function of the committee in considering issues relating to the financial statements.

The guidance should clarify the scope of reporting information subject to the attestation. Is this intended to be information in the Annual Report, or also other forms of reporting (interim reports, quarterly operational reviews, other publications, press releases, etc)?

Q16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

The guidance should provide examples of methodologies or frameworks, but **allow companies flexibility to adapt it to their unique circumstances and characteristics (per para 69)**. We agree this should not be prescriptive, but should help companies understand expectations and interpret them based on their unique circumstances.

There is a risk that in the absence of explicit guidance that companies may be drawn to existing frameworks (for example SOx in respect of ICOFR as one potential framework) and seek to apply an equivalent framework to different types of risk. We do not believe this is the intent behind the amendments, and illustration of alternative approaches in the guidance will help clarify this. Explicit guidance on what is not expected would also be helpful.

Similarly, there is a risk that in the absence of guidance, companies look to assurance providers to set the benchmark. This may lead to disproportionate responses.

<u>Q17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal controls system or a material weakness?</u>

Existing guidance in para 70 provides a good definition and aligned to other standards/frameworks which will apply to Rio Tinto given the multiple jurisdictions and compliance requirements it operates within.

The concept of materiality is mature and well developed in financial reporting, with appropriate consideration of qualitative and quantitative factors. In respect of non-financial reporting, operational and compliance controls, a materiality assessment might be more judgmental and this determination rightly sits with the Board.

As noted above, it will be important to define the intended scope of 'reporting' and 'narrative reporting' controls.

<u>Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?</u>

Clear guidance on what is required with regards to reporting on emerging risks and the Board's responsibility and liability. Additionally, the current control guidance relates mostly to financial controls; additional guidance for non-financial controls will be valuable.

<u>Q19: Do you agree that current Provision 30, which requires companies to state whether they are adopting a going concern basis of accounting, should be retained to keep this reporting together with reporting on prospects in the next Provision, and to achieve consistency across the Code for all companies (not just PIEs)?</u>

We agree.

<u>Q20: Do you agree that all Code companies should continue to report on their future prospects?</u>

We agree. Reporting on future prospects provides insight to stakeholders on the developing external environment, including the risk landscape and the implications for the company's business model. Done well, this provides insight into the possible combination of risk events which might occur and the levers available to management to remain resilient in event of a material risk occurrence.