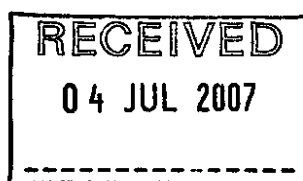


# RIO TINTO

CHAIRMAN

3 July 2007

Mr Julian Rose  
Secretary  
Market Participants Group,  
Financial Reporting Council  
5<sup>th</sup> Floor,  
71-91 Aldwych House,  
London WC2B 4HN



*Julian Rose*

## **CHOICE IN THE UK AUDIT MARKET – INTERIM REPORT OF THE MARKET PARTICIPANTS GROUP (APRIL 2007)**

Thank you for the opportunity to comment on the Interim Report.

We agree with the Group's observations that the current level of auditor concentration has given rise to concern amongst market participants about the uncertainty and costs that could arise should one or more of the Big Four firms leave the market.

We would note that, even in the existing market, there is little choice. Rio Tinto, like many FTSE 100 firms, has one of the Big Four firms as auditor, uses another to carry out internal audit services and a third for assistance in financial system design and support. There is, therefore, little scope for competitive tender with only one remaining large firm available should we wish to change auditor. Further, it may be that the services the remaining firm supplies to us prevent it from meeting the very strict independence criteria required. We feel strongly, therefore, that it is necessary to increase the level of choice in the current audit service market.

We support the three criteria of effectiveness, quality and costs, used in the report to assess the merits of the provisional recommendations.

Generally, we support the provisional recommendations; but it may be that more radical action is required to restructure the auditing profession. It is generally impracticable for large companies to use firms other than the Big Four; and in the current circumstances, choice is fundamentally limited.

We wish to comment specifically on the following recommendations:

### ***Section A.2.1 – Provisional recommendation 5***

*The FRC should continue its efforts to promote understanding of audit quality and should promote greater transparency of the capabilities of individual audit firms.*

There is currently very little information on which to base any assessment of the quality of auditors, and we have little experience of working with non-Big Four firms. It is therefore difficult for us to assess the quality of service that could be expected from these firms. There is therefore a high dependence on the brands of the Big Four firms and their reputation in the process of audit selection.

Rio Tinto plc 6 St James's Square London SW1Y 4LD  
Telephone 020 7930 2399 Fax 020 7930 3249

REGISTERED OFFICE: 6 St James's Square London SW1Y 4LD Registered in England No. 719885

We support both this recommendation and the existing FRC initiatives to promote audit quality; but consider the opportunities for progress down this route to be limited.

#### **Section A.2.2 – Provisional recommendation 6**

*The accounting profession should establish mechanisms to improve access by the incoming auditor to information relevant to the audit held by the outgoing auditor.*

One of the main barriers to changing auditors is the costs and risks associated with the change. It takes time for a new audit team to develop understanding of the company's business and this can cause disruption to the finance function of companies. We therefore support provisional recommendation 6 which seeks to ease this process.

This is a particularly important recommendation. The regulations governing the conduct of the Audit firms should oblige them actively to support new auditors taking over their assignments by providing copies of working papers and as much liaison and overlap as may reasonably be required by the new auditor and the client. Competition should be on the basis of quality of work and cost and should not be pursued by trying to preserve barriers to changes in auditors. This should apply whether or not the new auditor is a member of the same umbrella organisation as the old auditor.

#### **Section A2.3 – Provisional recommendation 7**

*The FRC should provide independent guidance for audit committees and other market participants on considerations relevant to the use of firms from more than one audit network.*

Rio Tinto, operates in many countries and, taking into account all the factors required for an effective audit including experience of the industry, specialised technical knowledge and geographical coverage, there are very few audit firms which have the capability to offer services across such a large number of locations. Whilst we understand the potential benefits of the use of firms from more than one audit network, we would note that our experience is that the use of one audit network contributes to an efficient process and that even the use of another Big Four firm in specific locations can cause delay. This is a critical issue for large international groups reporting to tight deadlines. International audit firms have standard procedures across the world and very efficient communication systems: it can be difficult to fit another firm's procedures into that model. Moreover, there may be occasions when the Big Four have different opinions on the interpretation of accounting standards.

#### **Section A2.4 and A2.6 – Provisional recommendations 8 and 10**

*The FRC should amend the section of the Smith Guidance with communications with shareholders to include a requirement for the provision of information relevant to the auditor selection decision.*

*Investor groups, corporate representatives and the FRC should develop practices for shareholder engagement on auditor appointment and re-appointments and should consider the option of having a shareholder vote on audit committee reports.*

We support the provisional recommendation for disclosure to provide greater transparency about auditor appointment decisions. However, we consider the disclosure should be in terms of policies rather than detailed specifics.

While there may be a case for increased engagement with shareholders on audit appointments, we share the concerns noted by the Group that this could result in some pressure to put the audit out to tender at regular intervals even if the audit service is felt to be satisfactory.

#### **Section A3.1 and A3.2 – Provisional recommendation 11 and 12**

*Authorities with responsibility for ethical standards for auditors should consider whether any rules could have a disproportionately adverse impact on auditor choice when compared to the benefits to auditor objectivity and independence.*

*The FRC should review the Independence section of the Smith Guidance to ensure that it is consistent with the relevant ethical standards for auditors.*

The rules on auditor independence do limit the choice that large companies have. The constraints are particularly severe for SEC registrants. The current rules are unnecessarily burdensome and place heavy limitations on the choices available to companies seeking both audit and non-audit services. We would suggest that these rules could be relaxed considerably without impairing audit quality. The restrictions should be confined to those that are truly necessary and effective in protecting auditor independence.

We consider that it is reasonable to allow auditors to undertake non-audit work provided the audit committee considers that allowing such work will not prevent the auditor from being objective and independent. The audit committee's policy in this area could be part of the increased disclosure discussed above.

**Section B.1- Provisional recommendation 13**

*Regulators should develop protocols for a more consistent response to audit firm issues based on their seriousness.*

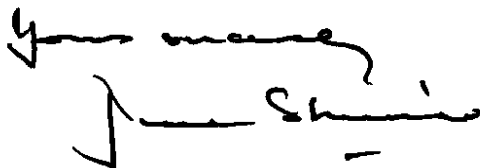
Currently, in the event of misconduct or breaches by an audit firm, companies may wait to see how regulators respond to the issue and, indeed how other companies react, before committing themselves to a change of auditor. This can lead to a period of uncertainty. We agree that it would be helpful if regulators were to establish clearly understood protocols, if possible global, which dealt with possible audit firm issues. There should be sensible, proportionate and timely reactions to rule breaches and the market should be kept informed during the process. Efforts should be made by regulators to understand as soon as possible whether the incident is an isolated breach or symptomatic of a wider malaise in the firm involved.

**Section C.1- Provisional recommendation 15**

*Major public interest entities should consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning.*

We consider it impracticable for companies to maintain back up arrangements, given that the supply side for audit services offers such little choice and especially with the difficulty of finding another firm that is independent and that does not have too big an involvement with a competitor of the audit client. A radical change in the supply side of the large firm audit market would provide more realistic opportunities to establish contingency plans. It would also reduce the necessity for these because greater choice would enable a would-be client to find a new auditor more easily and quickly in case of need.

We hope these comments will be of interest and assistance to you.

A handwritten signature in black ink, appearing to read "Paul Skinner". The signature is written in a cursive style with a large initial "P" and a long horizontal stroke.

Paul Skinner