Rio Tinto sets high safety standards for all its employees. Recognising and rewarding safe behaviour and training for emergencies help cultivate safe practices.

FINANCIAL PERFORMANCE

2007 compared with 2006

The charge against net earnings for the T&I group was US$78 million, compared with US$50 million in 2006. The increase was due to the higher level of activity, reflected also by higher staff numbers, and the continued development and deployment of leading operational practice across the Group.

2006 compared with 2005

The charge against net earnings for the group was US$50 million, compared with US$41 million in 2005. The increase was due to the greater level of activity, reflected also in the addition of staff.

Cash flow

2007 compared with 2006

Cash flow from operations, including dividends from equity accounted units, was a record US$12,569 million, 15 per cent higher than in 2006 due to the effect of higher earnings and favourable working capital movements.

Tax paid for 2007 increased to US$3,421 million, US$622 million higher than for 2006 largely due to the delayed tax effect of the increased earnings in 2006 compared to 2005 and tax paid by Alcan. Net interest paid of US$489 million for 2007 was US$361million higher than 2006, arising mostly from Alcan acquisition debt arrangement costs and interest paid on the Alcan debt.

The Group invested at record levels, in particular in expansion projects. Expenditure on property, plant and equipment and intangible assets was US$4,968 million in 2007, an increase of US$980 million over 2006. This included the completion of the second phase of the Dampier port and Yandicoogina iron ore mine expansions, as well as construction of the Hope Downs iron ore mine in Western Australia, the expansion of the Yarwun alumina refinery, the A418 dike construction at the Diavik diamond mine and the Madagascar ilmenite mine. The Group's ongoing and recently approved capital projects, which will impact future year's cash flows are on pages 17 and 18 of the *Annual report*.

The net cash cost of acquisitions in 2007 was US$37,526 million, which was net of US$13 million related to disposals. Almost all of the acquisition cost related to Alcan. The acquisition was financed by US$38 billion of syndicated bank loans. Acquisitions less disposals were US$279 million in 2006 mainly relating to the acquisition of an initial stake in Ivanhoe Mines.

Dividends paid in 2007 of US$1,507 million were US$1,066 million lower than dividends paid in 2006 which included a special dividend of US$1.5 billion. The share buy back programme was discontinued after the announcement of the Alcan acquisition on 12 July 2007: returns to shareholders from the on-market buy back of Rio Tinto plc shares in 2007 totalled US$1,611 million (net of US$13 million proceeds from the exercise of options), compared with US$2,339 million in 2006.

2006 compared with 2005

Cash flow from operations, including dividends from equity accounted units, was US$10,923 million, 36 per cent higher than in 2005. The increase was mainly due to increased profits. There was a cash outflow on working capital in both years reflecting higher receivables across all product groups due to higher metal prices and sales volumes. The cash outflow on inventory was US$454 million in 2006 compared to US$249 million in 2005, partly due to increased operating activity and production costs.

Expenditure on property, plant and equipment and intangible assets was US$3,988 million in 2006, an increase of US$1,434 million over 2005. This included the second phase of the Dampier port and Yandicoogina iron ore mine expansions, as well as construction of the Hope Downs iron ore mine in Western Australia, the A418 dike construction at the Diavik diamond mine, the Madagascar ilmenite mine and the capacity increases at Rio Tinto Energy America.

Tax paid in 2006 increased to US$2,799 million, US$1,782 million higher than in 2005. The increase reflected higher profits including the lag effect of tax payments on higher profits from 2005.

Acquisitions less disposals were US$279 million in 2006 mainly relating to the acquisition of an initial stake in Ivanhoe Mines. In 2005, there were net proceeds of disposal arising mainly from the sale of the Group's interest in Lihir.

Dividends paid in 2006 of US$2,573 million were US$1,432 million higher than dividends paid in 2005. These included the special dividend totalling US$1.5 billion which was paid to shareholders in April 2006. Capital management activity also included the on market buyback of Rio Tinto plc shares in 2006, comprising US$2,299 million from the 2006/07 programme and US$95 million in January from the 2005–2006 programme (before deducting US$24 million proceeds from the exercise of options). In 2005 an off market buyback of Rio Tinto Limited shares returned US$774 million to shareholders and an on market buyback of Rio Tinto plc shares returned US$103 million.

Balance sheet

Rio Tinto commissioned expert valuation consultants to advise on the fair values of Alcan's assets. As required under International Financial Reporting Standards (IFRS), the tangible and intangible assets of the acquired business have been uplifted to fair value. The residue of the purchase price not allocated to specific assets and liabilities has been attributed to goodwill. The provisional values incorporated in the 2007 *Full financial statements* will be subject to revision within 12 months of the date of acquisition as permitted by the relevant accounting standard, IFRS 3. Details of the Alcan assets acquired are included in note 41 to the 2007 *Full financial statements*.

The completion of the Alcan acquisition was financed under a US$40 billion syndicated bank loan at floating interest rates of which US$38 billion was drawn down. This, together with the debt held by Alcan on acquisition, resulted in an increase in net debt of US$42.8 billion to US$45.2 billion at 31 December 2007 of which US$8.1 billion is classified as short term borrowings. The US$40 billion loan is split into four facilities with final maturities ranging up to five years. Facilities A and B of this acquisition related debt are subject to mandatory prepayment to the extent of the net proceeds from disposals of assets and from the raising of funds through capital markets, under specific thresholds and conditions. Debt to total capital rose to 63 per cent and interest cover was 20 times. In addition, the Group's share of the third party net debt of equity accounted units totalled US$0.7 billion at 31 December 2007. US$0.3 billion of this debt is with recourse to the Rio Tinto Group.

Goodwill arising from the Alcan acquisition relating to subsidiaries was US$14.5 billion and that relating to equity accounted units was US$2.8 billion. The future economic benefits represented by the goodwill include those associated with synergies, future development and expansion projects and the assembled workforce. The Group has decided to dispose of Alcan Packaging, which is presented in the balance sheet in the lines: 'Assets held for sale' and 'Liabilities of disposal groups held for sale'.

Net assets attributable to Rio Tinto shareholders increased by US$6.5 billion. The increase reflected profit after tax attributable to Rio Tinto shareholders of US$7.3 billion less returns to shareholders of US$2.8 billion comprising US$1.5 billion of dividends and US$1.3 billion of share buybacks. In addition, there was a positive currency translation effect of US$1.9 billion as the Australian dollar, the Canadian dollar and the Euro all strengthened against the US dollar.

Financial risk management

The Group's policies with regard to financial risk management are clearly defined and consistently applied. They are a fundamental part of the Group's long term strategy covering areas such as foreign exchange risk, interest rate risk, commodity price risk, credit risk and liquidity risk and capital management. From 1 January 2008, Rio Tinto Alcan has adopted the Rio Tinto Group policy on trading and hedging.

The Group's business is finding, mining and processing mineral resources, and not trading. Generally, the Group only sells commodities it has produced but may purchase commodities to satisfy customer contracts from time to time and to balance the loading on production facilities. In the long term, natural hedges operate in a number of ways to help protect and stabilise earnings and cash flow.

The Group has a diverse portfolio of commodities and markets, which have varying responses to the economic cycle. The relationship between commodity prices and the currencies of most of the countries in which the Group operates provides further natural protection in the long term. In addition, the Group's policy of borrowing at floating US dollar interest rates helps to counteract the effect of economic and commodity price cycles. These natural hedges significantly reduce the necessity for using derivatives or other forms of synthetic hedging. Such hedging is therefore undertaken to a strictly limited degree, as described in the sections on currency, interest rate, commodity price exposure and treasury management below.

The Group's 2007 *Full financial statements* and disclosures show the full extent of its financial commitments including debt.

The risk factors to which the Group is subject that are thought to be of particular importance are summarised on pages 10 to 11.

The effectiveness of internal control procedures continues to be a high priority in the Rio Tinto Group. The Boards' statement on internal control is included under Corporate governance on page 122.

Liquidity and capital resources

The Group's total capital is defined as Rio Tinto's shareholders' funds plus amounts attributable to outside equity shareholders plus net debt. The Group's over-riding objectives when managing capital are to safeguard the business as a going concern; to maximise returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure in order to reduce the cost of capital.

The unified credit status of the Group is maintained through cross guarantees whereby contractual obligations of Rio Tinto plc and Rio Tinto Limited are automatically guaranteed by the other. Rio Tinto plc and Rio Tinto Limited continue to maintain solid investment grade credit ratings from Moody's and Standard and Poor's, despite the credit rating downgrade announced on completion of the Alcan acquisition. These ratings continue to provide access to global debt capital markets in significant depth.

Rio Tinto does not have a target debt/equity ratio, but has a policy of maintaining a flexible financing structure so as to be able to take advantage of new investment opportunities that may arise. Following the acquisition of Alcan, the Group has publicly stated an objective to reduce its debt to equity ratio from current levels through a targeted asset divestment programme and through operating cash flows to a level consistent with a 'single-A' credit rating. This policy is balanced against the desire to ensure efficiency in the debt/equity structure of the Rio Tinto balance sheet in the longer term through pro-active capital management programmes. In February 2008, the Group announced the sale of its interest in the Greens Creek mine for US$750 million and of its interest in the Cortez gold mine for US$1.7 billion plus retained royalty interest as part of its asset divestment programme.

The Group maintains backup liquidity for its commercial paper programme and other debt maturing within 12 months by way of bank standby credit facilities, which totalled US$3.7 billion (undrawn) at 31 December 2007. The Group's committed bank standby facilities contain no financial undertakings relating to interest cover and are not affected to any material extent (other than an increase in interest margin) by a reduction in the Group's credit rating. The main covenant in the Rio Tinto group relates to a financial covenant over Corporate debt drawn under the Syndicated Acquisition Facility, for which a compliance certificate must be produced attesting a certain ratio of Net Borrowings to EBITDA. There are no covenants relating to corporate debt which are under negotiation at present. The Group's policy is to centralise debt and surplus cash balances wherever possible.

As at 31 December 2007, the Group had contractual cash obligations arising in the ordinary course of business as follows:

Contractual cash obligations	Total US$m	Less than 1 year US$m	Between 1 and 3 years US$m	Between 3 and 5 years US$m	After 5 years US$m
Expenditure commitments in relation to:					
Operating leases	1,782	283	517	468	514
Other (mainly capital commitments)	3,978	3,113	801	64	–
Long term debt and other financial obligations					
Debt (a)	47,019	8,263	21,069	13,335	4,352
Interest payments (b)	9,238	2,310	3,184	1,660	2,084
Unconditional purchase obligations (c)	7,271	1,525	1,571	1,079	3,096
Other (mainly trade creditors)	7,295	6,144	639	363	149
Total	**76,583**	**21,638**	**27,781**	**16,969**	**10,195**

Notes

(a) Debt obligations include bank borrowings repayable on demand.

(b) Interest payments have been projected using the interest rate applicable at 31 December, 2007, including the impact of interest rate swap agreements where appropriate. Much of the debt is subject to variable interest rates. Future interest payments are subject, therefore, to change in line with market rates.

(c) Unconditional purchase obligations relate to commitments to make payments in the future for fixed or minimum quantities of goods or services at fixed or minimum prices. The future payment commitments have not been discounted and mainly relate to commitments under 'take or pay' power and freight contracts. They exclude unconditional purchase obligations of jointly controlled entities apart from those relating to the Group's tolling arrangements.

Information regarding the Group's pension commitments and funding arrangements is provided in the Post retirement benefits section of this Financial review and in note 49 to the 2007 *Full financial statements*. The level of contributions to funded pension plans is determined according to the relevant legislation in each jurisdiction in which the Group operates. In some countries there are statutory minimum funding requirements while in others the Group has developed its own policies, sometimes in agreement with the local trustee bodies. The size and timing of contributions will usually depend upon the performance of investment markets. Depending on the country and plan in question the funding level will be monitored quarterly, bi-annually or annually and the contribution amount amended appropriately. Consequently it is not possible to predict with any certainty the amounts that might become payable in 2009 onwards. The impact on cash flow in 2007 of the Group's pension plans, being the employer contributions to defined benefit and defined contribution pension plans, was US$246 million. In addition there were contributions of US$30 million in respect of unfunded healthcare schemes. Contributions to pension plans for 2008 are estimated to be around US$220 million higher than for 2007. This is predominantly down to the inclusion of the Alcan plans for the full year, although it is also partly due to changes in funding rules in the US. Healthcare plans are unfunded and contributions for future years will be equal to benefit payments and therefore cannot be predetermined.

Information regarding the Group's close down and restoration obligations is provided in the relevant section of this review and in note 27 to the 2007 *Full financial statements*. Close down and restoration costs are a normal consequence of mining, and the majority of close down and restoration expenditure is incurred at the end of the relevant operation. Generally, the Group's close down and restoration obligations to remediate in the long term are not fixed as to amount and timing and are not therefore included in the above table.

On the basis of the levels of obligations described above, the unused capacity under the Group's commercial paper and European Medium Term Notes programmes, the Group's anticipated ability to access debt and equity capital markets in the future and the level of anticipated free cash flow, there are reasonable grounds to believe that the Group has sufficient short and long term sources of funding available to meet its liquidity requirements.

Dividends and capital management

Rio Tinto's progressive dividend policy aims to increase the US dollar value of dividends over time, without cutting them in economic downturns.

Dividends paid on Rio Tinto plc and Rio Tinto Limited shares are equalised on a net cash basis; that is without taking into account any associated tax credits. Dividends are determined in US dollars. Rio Tinto plc dividends are declared and paid in pounds sterling and Rio Tinto Limited dividends are declared and paid in Australian dollars, converted at exchange rates applicable to the US dollar two days prior to the announcement of dividends. Holders of American Depositary Receipts (ADRs) receive a US dollar dividend at the rate declared. Changes in exchange rates could result in a reduced sterling or Australian dollar dividend in a year in which the US dollar value is maintained or increased. The interim dividend for each year in US dollar terms will be equivalent to 50 per cent of the total US dollar dividends declared in respect of the previous year.

The Group announced a re-basing of its ordinary dividend in February 2007, increasing the full year ordinary dividend in respect of 2006 by 30 per cent to 104 US cents. The 2007 full year ordinary dividend represents a 31 per cent increase on 2006. In addition, the Group has announced an intention to increase its annual dividend by at least 20 per cent in each of 2008 and 2009.

Final 2007 dividends to Rio Tinto Limited shareholders will be fully franked. The board expects Rio Tinto Limited to be in a position to pay fully franked dividends for the reasonably foreseeable future.

On 2 February 2006 the Group announced a US$4 billion capital management programme which was subsequently increased to $7 billion in October 2006. The capital return was comprised of a US$1.5 billion special dividend (US$1.10 per share) paid in April 2006 which was paid concurrently with the 2005 final ordinary dividend, but did not form part of the Group's progressive ordinary dividend policy, and an initial US$2.5 billion share buyback programme (increased to US$5.5 billion) to be completed over the remaining period to the end of 2007. The programme was suspended on 12 July 2007 at the time the Alcan offer was announced, by which time US$3.9 billion had been completed under the US$7 billion capital management programme, bringing the total cash returned to shareholders under announced capital management programmes since 2005 to US$6.4 billion.

Treasury management and financial instruments

Treasury operates as a service to the business of the Rio Tinto Group and not as a profit centre. Strict limits on the size and type of transaction permitted are laid down by the Rio Tinto board and are subject to rigorous internal controls.

Rio Tinto does not acquire or issue derivative financial instruments for trading or speculative purposes; nor does it believe that it has exposure to such trading or speculative holdings through its investments in joint ventures and associates. Derivatives are used to separate funding and cash management decisions from currency exposure and interest rate management. The Group uses interest rate and cross currency interest rate swaps in conjunction with longer term funds raised in the capital markets to achieve a predominantly floating rate obligation which is consistent with the Group's interest and exchange rate policies, primarily US dollar LIBOR. No material exposure is considered to exist by virtue of the possible non performance of the counterparties to financial instruments held by the Group.

Derivative contracts are carried at fair value based on published price quotations for the period for which a liquid active market exists. Beyond this period, Rio Tinto's own assumptions are used.

Off balance sheet arrangements

In the ordinary course of business, to manage the Group's operations and financing, Rio Tinto enters into certain performance guarantees and commitments for capital and other expenditure.

The aggregate amount of indemnities and other performance guarantees, on which no material loss is expected, including those related to joint ventures and associates, was US$739 million at 31 December 2007.

Other commitments include capital expenditure, operating leases and unconditional purchase obligations as set out in the table of contractual cash obligations, included in the liquidity and capital resources section above.

Exchange rates, reporting currencies and currency exposure

Rio Tinto's shareholders' equity, earnings and cash flows are influenced by a wide variety of currencies due to the geographic diversity of the Group's sales and the countries in which it operates. The US dollar, however, is the currency in which the great majority of the Group's sales are denominated. Operating costs are influenced by the currencies of those countries where the Group's mines and processing plants are located and also by those currencies in which the costs of imported equipment and services are determined. The Australian and Canadian dollars and the Euro are the most important currencies (apart from the US dollar) influencing costs. In any particular year, currency fluctuations may have a significant impact on Rio Tinto's financial results. A weakening of the US dollar against the currencies in which the Group's costs are determined has an adverse effect on Rio Tinto's underlying earnings.

The following sensitivities give the estimated effect on underlying earnings assuming that each exchange rate moved in isolation. The relationship between currencies and commodity prices is a complex one and movements in exchange rates can cause movements in commodity prices and vice versa. Where the functional currency of an operation is that of a country for which production of commodities is an important feature of the economy, such as the Australian dollar, there is a certain degree of natural protection against cyclical fluctuations in the long term, in that the currency tends to be weak, reducing costs in US dollar terms, when commodity prices are low, and vice versa.

The exchange rate sensitivities quoted below include the effect on operating costs of movements in exchange rates but exclude the effect of the revaluation of foreign currency financial assets and liabilities. They should therefore be used with care.

	Average exchange rate for 2007	Effect on net and underlying earnings of 10% change in full year average +/- US$m
Australian dollar (a)	US 84 cents	494
Canadian dollar (a)	US 93 cents	203
Euro	US137 cents	65
Chilean peso	US$1 = 523 pesos	12
New Zealand dollar	US 73 cents	17
South African rand	US 14 cents	55
UK sterling	US 200 cents	24

(a) The sensitivities in the 2007 column are based on 2007 prices, costs and volumes and assume that all other variables remain constant, except that a full years' volumes are included for Alcan where indicated.

Given the dominant role of the US currency in the Group's affairs, the US dollar is the currency in which financial results are presented both internally and externally. It is also the most appropriate currency for borrowing and holding surplus cash, although a portion of surplus cash may also be held in other currencies, most notably Australian dollars, Canadian dollars and the Euro. This cash is held in order to meet short term operational and capital commitments and, for the Australian dollar, dividend payments. The Group finances its operations primarily in US dollars, either directly or using cross currency interest rate swaps. A substantial part of the Group's US dollar debt is located in subsidiaries having a US functional currency.

However, certain US dollar debt and other financial assets and liabilities including intragroup balances are not held in the functional currency of the relevant subsidiary. This results in an accounting exposure to exchange gains and losses as the financial assets and liabilities are translated into the functional currency of the subsidiary that accounts for those assets and liabilities. These exchange gains and losses are recorded in the Group's income statement except to the extent that they can be taken to equity under the Group's accounting policy which is explained in note 1 of the 2007 *Full financial statements*. Gains and losses on US dollar net debt and on intragroup balances are excluded from underlying earnings. Other exchange gains and losses are included in underlying earnings.

The Group does not generally believe that active currency hedging of transactions would provide long term benefits to shareholders. Currency protection measures may be deemed appropriate in specific commercial circumstances and are subject to strict limits laid down by the Rio Tinto board, typically hedging of capital expenditure and other significant financial items such as tax and dividends. There is a legacy of currency forward contracts used to hedge operating cash flow exposures which were acquired with

Alcan and the North companies. Details of currency derivatives held at 31 December 2007 are set out in note 34 to the 2007 *Full financial statements*.

The sensitivities below give the estimated effect on underlying earnings, net earnings and equity of a ten per cent change in the full year closing US dollar exchange rate, assuming that each exchange rate moved in isolation. A strengthening of the US dollar would result in exchange gains based on financial assets and financial liabilities held at 31 December 2007. These balances will not remain constant throughout 2008, however, and therefore these numbers should be used with care.

	Closing exchange rate US cents	Effect on net earnings of 10% change US$m	Of which amount impacting underlying earnings US$m	Effect of items impacting directly on equity US$m
Functional currency of business unit:				
Australian dollar	88	204	99	(20)
Canadian dollar	101	(3)	53	–
South African rand	15	14	12	(4)
Euro	147	33	14	149
New Zealand dollar	78	(9)	3	–

(a) The sensitivities show the net sensitivity of US dollar exposures in Australian dollar functional currency companies, for example, and Australian dollar exposures in US dollar functional currency companies.
(b) The sensitivities indicate the effect of a ten per cent strengthening of the US dollar against each currency.

In addition, some US dollar functional currency companies are exposed to exchange movements on local currency deferred tax balances. The only material exposure is to the Canadian dollar and a ten per cent strengthening of the US dollar would reduce underlying earnings by US$96 million. This would offset the US$53 million gain shown above.

The functional currency of many operations within the Rio Tinto Group is the local currency in the country of operation. Alcan's aluminium and alumina producing operations use a US dollar functional currency including those in Canada and Australia. Foreign currency gains or losses arising on translation to US dollars of the net assets of non US functional currency operations are taken to equity and, with effect from 1 January 2004, recorded in a currency translation reserve. A weakening of the US dollar would have a positive effect on equity. The approximate translation effects on the Group's net assets of ten per cent movements from the year end exchange rates are as follows:

	Closing exchange rate US cents	2007 Effect on net assets of 10% change in closing rate +/- US$m
Australian dollar	88	1,583
Euro	147	568
Canadian dollar	101	255

Interest rates

Rio Tinto's interest rate management policy is generally to borrow and invest at floating interest rates. This approach is based on the historical correlation between interest rates and commodity prices. In some circumstances, an element of fixed rate funding may be considered appropriate. Rio Tinto hedges interest rate and currency risk on most of its foreign currency borrowings by entering into cross currency interest rate swaps in order to convert fixed rate foreign currency borrowings to floating rate US dollar borrowings. At the end of 2007, US$4.9 billion (2006: U$1.2 billion) of the Group's debt was at fixed rates after taking into account interest rate swaps and finance leases. Based on the Group's net debt at 31 December 2007, the effect on the Group's net earnings of a half percentage point increase in US dollar LIBOR interest rates with all other variables held constant, would be a reduction of US$158 million. These balances will not remain constant throughout 2008, however, and therefore these numbers should be used with care.

Commodity prices

The Group's normal policy is to sell its products at prevailing market prices. Exceptions to this rule are subject to strict limits laid down by the Rio Tinto Board and to rigid internal controls. Rio Tinto's exposure to commodity prices is diversified by virtue of its broad commodity spread and the Group does not generally believe commodity price hedging would provide long term benefit to shareholders. The Group may hedge certain commitments with some of its customers or suppliers. Details of commodity derivatives held at 31 December 2007 are set out in note 34 to the 2007 *Full financial statements*. The forward contracts to sell copper were entered into as a condition of the refinancing of Palabora in 2005. The aluminium forward contracts and embedded derivatives were acquired with Alcan.

Metals such as copper and aluminium are generally sold under contract, often long term, at prices determined by reference to prevailing market prices on terminal markets, such as the London Metal Exchange and COMEX in New York, usually at the time of delivery. Prices fluctuate widely in response to changing levels of supply and demand but, in the long run, prices are related to the marginal cost of supply. Gold is also priced in an active market in which prices respond to daily changes in quantities offered and sought. Newly mined gold is only one source of supply; investment and disinvestment can be important elements of supply and demand. Contract prices for many other natural resource products including iron ore and coal are generally agreed annually or for longer periods with customers, although volume commitments vary by product.

Certain products, predominantly copper concentrate, are 'provisionally priced', ie the selling price is subject to final adjustment at the end of a period normally ranging from 30 to 180 days after delivery to the customer, based on the market price at the relevant quotation point stipulated in the contract. Revenue on provisionally priced sales is recognised based on estimates of fair value of the consideration receivable based on forward market prices. At each reporting date provisionally priced metal is marked to market based on the forward selling price for the period stipulated in the contract. For this purpose, the selling price can be measured reliably for those products, such as copper, for which there exists an active and freely traded commodity market such as the London Metal Exchange and the value of product sold by the Group is directly linked to the form in which it is traded on that market. At the end of 2007 the Group had 270 million pounds of copper sales (2006: 324 million pounds) that were provisionally priced at 304 cents per pound (2006: US 287 cents per pound). The final price of these sales will be determined in 2008. The impact on earnings of a ten per cent change in the price of copper for the provisionally priced sales would be US$58 million (2006: US$66 million).

Approximately 53 per cent of Rio Tinto's 2007 net earnings from operating businesses came from products whose prices were terminal market related and the remainder came from products priced by direct negotiation.

The Group continued to achieve high prices for its products in 2007, and its assessment of the economic and demand outlook remains very positive, despite recent unsettled conditions in the financial markets. The strong increases seen in global minerals demand are driven by demographic and economic fundamentals in fast growing countries like China and India, whose large populations continue to urbanise. These long term trends are driven by domestic developments in those countries, and are therefore insulated to a significant extent from any potential near term weakness in western economies.

The approximate effect on the Group's underlying and net earnings of a ten per cent change from the full year average market price in 2007 for the following products would be:

	Unit	Average market price for 2007 US$	Effect on underlying and net earnings of 10% change in full year average +/- US$m
Copper	pound	3.24	360
Aluminium (a)	pound	1.20	678
Gold	ounce	691	64
Molybdenum	pound	30	69
Iron ore	dmtu	n/a	457

(a) The above sensitivities are based on 2007 volumes except that a full year impact from Alcan has been included where indicated.

The sensitivities give the estimated impact on net earnings of changes in prices assuming that all other variables remain constant. These should be used with care. As noted previously, the relationship between currencies and commodity prices is a complex one and changes in exchange rates can influence commodity prices and vice versa.

The table below summarises the impact of changes in the market price on the following commodity derivatives including those aluminium and option contracts embedded in electricity purchase contracts outstanding at 31 December 2007. The impact is expressed in terms of the resulting change in the Group's net earnings for the year or, where applicable, the change in equity. The sensitivities are based on the assumption that the market price increases by ten per cent with all other variables held constant. The Group's 'own use contracts' are excluded from the sensitivity analysis below as they are outside the scope of IAS 39. Own use contracts are contracts to buy or sell non financial items that can be net settled but were entered into and continue to be held for the purpose of the receipt or delivery of the non financial item in accordance with the business unit's expected purchase, sale or usage requirements.

These sensitivities should be used with care. The relationship between currencies and commodity prices is a complex one and changes in exchange rates can influence commodity prices and vice versa.

Products	Effect on underlying and net earnings of 10% increase from year end price US$m	Effect of items impacting directly on Rio Tinto share of equity of 10% increase from year end price US$m
Copper	–	40
Coal	–	25
Aluminium	41	50
Total	41	115

Sales revenue

The table below shows published 'benchmark' prices for Rio Tinto's commodities for the last three years where these are publicly available, and where there is a reasonable degree of correlation between the benchmark and Rio Tinto's realised prices. The prices set out in the table are the averages for each of the calendar years, 2005, 2006 and 2007. The Group's sales revenue will not necessarily move in line with these benchmarks for a number of reasons which are discussed below.

Commodity	Source	Unit	2005 US$	2006 US$	**2007 US$**
Aluminium	LME	pound	0.86	1.16	**1.20**
Copper	LME	pound	1.66	3.06	**3.24**
Gold	LBMA	ounce	444	602	**691**
Iron ore	Australian benchmark (fines) (a)	dmtu (b)	0.55	0.71	**0.79**

The discussion of revenues below relates to the Group's gross revenue from sales of commodities, including its share of the revenue of equity accounted units, as included in the Financial Information by Business Unit in the 2007 *Full financial statements*.

The sales revenues of the Iron Ore group increased by 27 per cent in 2007 compared with 2006. There was a 9.5 per cent increase in the benchmark price, mainly effective from 1 April 2007 which resulted in an 11 per cent increase in the average Australian iron ore fines benchmark for the calendar year. Sales achieved the benchmark price throughout the year. The price outlook for the 2008 contract year remains very positive, with spot prices in China substantially above prevailing contract prices. In addition to higher prices, sales revenues at Hamersley Iron were higher from record production following completion of the second phase of the Dampier port upgrade and the Tom Price brownfield and Yandicoogina JSE mine expansions.

At IOC, volumes were lower as a result of a seven week strike in the first and second quarters of the year and this was only partly mitigated by higher prices.

The Australian iron ore fines benchmark increased by 19 per cent in April 2006. This together with higher volumes at Hamersley contributed to an increase in the Group's iron ore revenue of 26 per cent in 2006 against 2005.

A significant proportion of Rio Tinto's coal production is sold under long term contracts. In Australia, the prices applying to sales under the long term contracts are generally renegotiated annually; but prices are fixed at different times of the year and on a variety of bases. For these reasons, average realised prices will not necessarily reflect the movements in any of the publicly quoted benchmarks. Moreover, there are significant product specification differences between mines. Sales volumes will vary during the year and the timing of shipments will also result in differences between average realised prices and benchmark prices.

Asian seaborne thermal coal prices continued to rise sharply throughout 2007 mainly due to supply disruptions from key producing countries. Issues relating to infrastructure controlled by external parties are likely to maintain market tightness for the foreseeable future. Published thermal coal benchmarks in Australia improved by 33 per cent in the calendar year whilst coking coal benchmarks decreased by 13 per cent.

Revenues of the Group's Australian coal operations decreased by three per cent in 2007 with lower thermal coal sales largely attributable to infrastructure constraints and a severe weather event. In general, production at the Australian coal mines continued to be constrained by rail and port constraints in Queensland and New South Wales and reduced tonnage of rail and port allotments in Queensland, which curtailed mined production, despite the generally favourable market conditions.

Revenues of the Group's Australian coal operations increased by two per cent in 2006. There was a sustained increase in the received price for thermal coal. This benefit was largely offset by lower coking coal sales because of market weakness and the delay in thermal coal shipments arising from congestion at Newcastle. Published market indications for Australian thermal coal showed a slight increase in thermal coal prices in 2006 and a seven per cent increase in the coking coal benchmark price.

In the US, published market indications of spot prices for Wyoming Powder River Basin thermal coal 8800 BTU (0.80 sulphur) show a decrease of around 20 per cent for the average spot price in 2007 compared with 2006. However, Rio Tinto Energy America's revenues increased by nine per cent in 2007 with improved realised prices. Rio Tinto Energy America has long term contracts and this increased revenue was primarily a result of the replacement of below market legacy contracts with new contracts at current market pricing in 2006 and earlier years. Revenues increased by 19 per cent in 2006 against 2005, with higher realised prices for Powder River Basin coal and increased volumes.

producers fell short of expectations in 2007 while the outlook for demand increased as new-build programmes gathered pace, particularly in China. Higher utilisation rates were also experienced in the nuclear industry. These factors have contributed to tighter markets and an improvement in the longer term outlook for uranium demand.

Large swings in the spot price, driven by speculative behaviour by hedge funds and investors, created a degree of uncertainty in the uranium market. The resultant effect was a de-linking of the spot and long term prices and a reduction in contracting as fuel buyers monitored movements in the market. Despite this, long term prices grew strongly in the early part of the year and remained firm thereafter. Information included in the RWE NUKEM Inc. Price Bulletin indicated price increases of 99 per cent in 2007 and 71 per cent in 2006 for uranium oxide. The large increases reported in the Price Bulletin are not fully reflected in the revenues for the period because uranium oxide is typically sold on long term contracts with pricing determined for several years beyond the commencement of the contracts.

The Group's uranium revenue increased by 69 per cent in 2007 and 27 per cent in 2006 as a result of higher prices with Rössing, in particular, benefiting from positive market conditions and improved pricing. Prices at ERA continued to benefit from the gradual replacement of legacy contracts with newer contracts written in an environment of higher prices.

The average aluminium price of 120 cents per pound was three per cent above the 2006 average price. Global demand growth for 2007 is expected to exceed ten per cent. Rising LME inventories towards the end of 2007 and strong growth in global output pushed aluminium prices lower in the second half of the year. The Group anticipates strong demand and growing supply constraints in China.

The Aluminium group's sales revenues are from aluminium and related products such as alumina and bauxite. Alcan's sales revenue for the two months from acquisition, which includes revenue from Engineered Products, was US$3,798 million. Rio Tinto Aluminium's sales revenue increased by one per cent in 2007 reflecting higher volume and price for bauxite and aluminium and lower volume and price for alumina. Revenue increased by 27 per cent in 2006. Average aluminium prices quoted on the LME increased by 35 per cent against 2005 but achieved spot alumina prices were lower than in 2005.

The Copper group also produces gold and molybdenum as significant co-products. The average copper price of 324 cents per pound was six per cent above the 2006 average price. The gold price averaged $691 per ounce, an increase of 15 per cent on the prior year, whilst the average molybdenum price was $30 per pound, an increase of 20 per cent compared with 2006. Total Copper Group sales revenues in 2007 increased by 20 per cent over 2006. Copper revenues increased by 17 per cent reflecting higher volumes at KUC and Escondida as well as higher prices. Gold revenue increased by 69 per cent with higher volumes at Kennecott Minerals and the Grasberg joint venture. Molybdenum revenue was nine per cent higher than in 2006 with lower volumes as a result of lower ore grade and higher limestone levels in the orebody partly offsetting the improved prices.

The total Copper group sales revenues in 2006 increased by 46 per cent over 2005. Copper revenues increased by 77 per cent, broadly in line with the 84 per cent increase in the LME price. Lower grades and therefore volumes at Freeport more than offset the higher volumes at the other copper operations. A 22 per cent decrease in gold revenue was also attributable to lower grades at Freeport which outweighed the effect of the 36 per cent increase in the gold price. Molybdenum revenue was only six per cent down on 2005 with record production at KUC offsetting much of the effect of the 20 per cent fall in price.

Industrial Minerals sales are made under contract at negotiated prices. Revenue from industrial minerals increased by 11 per cent in 2007 and five per cent in 2006. This was mainly attributable to higher sales volumes of titanium dioxide chloride feedstock.

Diamonds prices realised by Rio Tinto depend on the size and quality of the diamonds in the product mix. Diamond sales revenue increased by 22 per cent in 2007 against 2006 with higher sales volumes and polished pink tender prices at Argyle, and higher volumes at Diavik. The tight supply outlook for rough diamonds is expected to support demand in 2008, especially for better quality rough diamonds produced by Diavik. The 22 per cent decrease in Diamond Group revenue in 2006 against 2005 was almost wholly attributable to the softer markets experienced by Argyle which resulted in surplus rough diamonds being held in inventory at the end of the year.

Critical accounting policies and estimates

Dual listed company reporting

As explained in detail in the Outline of dual listed companies' structure and basis of financial statements in the 2007 *Full financial statements*, the consolidated financial statements of the Rio Tinto Group deal with the results, assets and liabilities of both of the dual listed companies, Rio Tinto plc and Rio Tinto Limited, and their subsidiaries. In other words, Rio Tinto plc and Rio Tinto Limited are viewed as a single parent company with their respective shareholders being the shareholders in that single company.

The 2007 *Annual report* and *Full financial statements* satisfy the obligations of Rio Tinto Limited to prepare consolidated accounts under Australian company law, as amended by an order issued by the Australian Securities and Investments Commission on 27 January 2006 (as amended on 22 December 2006). The 2007 *Full financial statements* disclose the effect of the adjustments to consolidated EU IFRS profit, consolidated total recognised income and consolidated shareholders' funds for the Group that would be required under the version of IFRS that is applicable in Australia ("Australian IFRS").

The US dollar is the presentation currency used in these financial statements, as it most reliably reflects the Group's global business performance.

Ore reserve estimates

Rio Tinto estimates its ore reserves and mineral resources based on information compiled by Competent Persons as defined in accordance with the Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves of December 2004 (the JORC code). The amounts presented under EU and Australian IFRS are based on the reserves, and in some cases mineral resources, determined under the JORC code.

There are numerous uncertainties inherent in estimating ore reserves and assumptions that are valid at the time of estimation may change significantly when new information becomes available.

Changes in the forecast prices of commodities, exchange rates, production costs or recovery rates may change the economic status of reserves and may, ultimately, result in the reserves being restated. Such changes in reserves could impact on depreciation and amortisation rates, asset carrying values, deferred stripping calculations and provisions for close down, restoration and environmental clean up costs.

Acquisition accounting

On the acquisition of a subsidiary, the purchase method of accounting is used whereby the purchase consideration is allocated to the identifiable assets, liabilities and contingent liabilities (identifiable net assets) on the basis of fair value at the date of acquisition.

Rio Tinto acquired Alcan Inc during the year. The Group commissioned expert valuation consultants to advise on the fair values and asset lives of Alcan's assets. The residue of the purchase price not allocated to specific assets and liabilities has been attributed to goodwill. The provisional values and asset lives incorporated in the 2007 *Full financial statements* will be subject to revision within 12 months of the date of acquisition as permitted by IFRS 3 'Business Combinations'.

Asset carrying values

Events or changes in circumstances can give rise to significant impairment charges or reversals of impairment provisions in a particular year. In 2007, the Group's results included net impairment charges of US$58 million (US$113 million after tax and outside shareholders interests). An impairment charge was recognised at Argyle, which was partially offset by impairment reversals at Palabora and Tarong Coal. In 2006, the Group's results included net impairment reversals of US$396 million (US$44 million after tax and outside shareholders interests). Impairments were reversed at KUC and IOC, which more than offset impairment charges at Argyle and Tarong Coal.

When such events or changes in circumstances impact on a particular asset or cash generating unit, its carrying value is assessed by reference to its recoverable amount being the higher of fair value less costs to sell and value in use (being the net present value of expected future cash flows of the relevant cash generating unit). The best evidence of an asset's fair value is its value obtained from an active market or binding sale agreement. Where neither exists, fair value less costs to sell is based on the best information available to reflect the amount the Group could receive for the cash generating unit in an arm's length transaction. In most cases this is estimated using a discounted cash flow analysis. The cash flows used in these analyses are particularly sensitive to changes in two parameters: exchange rates and commodity selling prices. The great majority of the Group's sales are based on prices denominated in US dollars. To the extent that the currencies of countries in which the Group produces commodities strengthen against the US dollar without commodity price offset, cash flows and, therefore, net present values are reduced. Management considers that over the long term, there is a tendency for movements in commodity prices to compensate to some extent for movements in the value of the US dollar (and vice versa). But such compensating changes are not synchronised and do not fully offset each other and over the last few years favourable changes in commodity prices have generally exceeded shifts in exchange rates. Comparing average exchange rates in 2007 against those in 2004, the Australian dollar strengthened by 14 per cent against the US dollar, the Canadian dollar strengthened by 21 percent and the South African rand weakened by eight per cent. In the same period, commodity prices rose substantially: for example, copper prices increased by 149 per cent, aluminium by 54 per cent and gold by 69 per cent.

Reviews of carrying values relate to cash generating units which, in accordance with IAS 36 "Impairment of Assets", are identified by dividing an entity into as many largely independent cash generating streams as is reasonably practicable. In some cases the business units within the product groups consist of several operations with independent cash generating streams, which therefore constitute separate cash generating units.

The cash flow forecasts are based on best estimates of expected future revenues and costs. These may include net cash flows expected to be realised from extraction, processing and sale of mineralised material that does not currently qualify for inclusion in proved or probable ore reserves. Such non reserve material is included where there is a high degree of confidence in its economic extraction. This expectation is usually based on preliminary drilling and sampling of areas of mineralisation that are contiguous with existing reserves. Typically, the additional evaluation to achieve reserve status for such material has not yet been done because this would involve incurring costs earlier than is required for the efficient planning and operation of the mine.

The expected future cash flows of cash generating units reflect long term mine plans which are based on detailed research, analysis and iterative modelling to optimise the level of return from investment, output and sequence of extraction. The plan takes account of all relevant characteristics of the orebody, including waste to ore ratios, ore grades, haul distances, chemical and metallurgical properties of the ore impacting on process recoveries and capacities of processing equipment that can be used. The mine plan is therefore the basis for forecasting production output in each future year and for forecasting production costs.

Rio Tinto's cash flow forecasts are based on assessments of expected long term commodity prices, which for most commodities are derived from an analysis of the marginal costs of the producers of the relevant commodities. These assessments often differ from current price levels and are updated periodically.

In some cases, prices applying to some part of the future sales volumes of a cash generating unit are predetermined by existing sales contracts. The effects of such contracts are taken into account in forecasting future cash flows.

Cost levels incorporated in the cash flow forecasts are based on the current long term mine plan for the cash generating unit. For value in use calculations used in impairment reviews, recent cost levels are considered, together with expected changes in costs that are compatible with the current condition of the business and which meet the requirements of IAS 36. IAS 36 includes a number of restrictions on the future cash flows that can be recognised in value in use calculations in respect of future restructurings and improvement related capital expenditure.

The useful lives of the major assets of a cash generating unit are usually dependent on the life of the orebody to which they relate. Thus the lives of mining properties, and associated smelters, concentrators and other long lived processing equipment generally relate to the expected life of the orebody. The life of the orebody, in turn, is estimated on the basis of the long term mine plan.

Forecast cash flows are discounted to present values using Rio Tinto's weighted average cost of capital with appropriate adjustment for the risks associated with the relevant cash flows, to the extent that such risks are not reflected in the forecast cash flows. For final feasibility studies and ore reserve estimation, internal hurdle rates are used which are generally higher than the weighted average cost of capital.

Value in use and ore reserve estimates are based on the exchange rates current at the time of the evaluation. In final feasibility studies and estimates of fair value, a forecast of the long term exchange rate is made having regard to spot exchange rates, historical data and external forecasts.

Forecast cash flows for ore reserve estimation for JORC purposes and for impairment testing are based on Rio Tinto's long term price forecasts.

All goodwill and intangible assets that are not yet ready for use or have an indefinite life are tested annually for impairment regardless of whether there has been any change in events or circumstances.

Close down, restoration and clean up obligations

Provision is made for environmental remediation costs when the related environmental disturbance occurs, based on the net present value of estimated future costs.

Close down and restoration costs are a normal consequence of mining, and the majority of close down and restoration expenditure is incurred at the end of the life of the mine. The costs are estimated on the basis of a closure plan. The cost estimates are calculated annually during the life of the operation to reflect known developments, eg updated cost estimates and revisions to the estimated lives of operations, and are subject to formal review at regular intervals. Although the ultimate cost to be incurred is uncertain, the Group's businesses estimate their respective costs based on feasibility and engineering studies using current restoration standards and techniques. The initial closure provisions together with changes, other than those arising from the unwind of the discount applied in establishing the net present value of the provision, are capitalised within property, plant and equipment and depreciated over the lives of the assets to which they relate.

Clean up costs result from environmental damage that was not a necessary consequence of mining, including remediation, compensation and penalties. These costs are charged to the income statement. Provisions are recognised at the time the damage, remediation process and estimated remediation costs become known. Remediation procedures may commence soon after this point in time but may continue for many years depending on the nature of the disturbance and the remediation techniques.

As noted above, the ultimate cost of environmental disturbance is uncertain and cost estimates can vary in response to many factors including changes to the relevant legal requirements, the emergence of new restoration techniques or experience at other mine sites. The expected timing of expenditure can also change, for example in response to changes in ore reserves or production rates. As a result there could be significant adjustments to the provision for close down and restoration and environmental clean up, which would affect future financial results.

Overburden removal costs

In open pit mining operations, it is necessary to remove overburden and other barren waste materials to access ore from which minerals can economically be extracted. The process of mining overburden and waste materials is referred to as stripping. During the development of a mine, before production commences, it is generally accepted that stripping costs are capitalised as part of the investment in construction of the mine.

Where a mine operates several open pits that are regarded as separate operations for the purpose of mine planning, stripping costs are accounted for separately by reference to the ore from each separate pit. If, however, the pits are highly integrated for the purpose of mine planning, the second and subsequent pits are regarded as extensions of the first pit in accounting for stripping costs. In such cases, the initial stripping of the second and subsequent pits is considered to be production phase stripping relating to the combined operation.

Stripping of waste materials continues during the production stage of the mine or pit. Some mining companies expense these production stage stripping costs as incurred, while others defer such stripping costs. In operations that experience material fluctuations in the ratio of waste materials to ore or contained minerals on a year to year basis over the life of the mine or pit, deferral of stripping costs reduces the volatility of the cost of stripping expensed in individual reporting periods. Those mining companies that expense stripping costs as incurred will therefore report greater volatility in the results of their operations from period to period.

Rio Tinto defers production stage stripping costs for those operations where this is the most appropriate basis for matching costs with the related economic benefits and the effect is material. Stripping costs incurred in the period are deferred to the extent that the current period ratio exceeds the life of mine or pit ratio. Such deferred costs are then charged against reported profits to the extent that, in subsequent periods, the ratio falls short of the life of mine or pit ratio. The life of mine or pit ratio is based on the proved and probable reserves of the mine or pit and is obtained by dividing the tonnage of waste mined either by the quantity of ore mined or by the quantity of minerals contained in the ore. In some operations, the quantity of ore is a more practical basis for matching costs with the related economic benefits where there are important co-products or where the grade of the ore is relatively stable from year to year.

The life of mine or pit waste-to-ore ratio is a function of an individual mine's pit design and therefore changes to that design will generally result in changes to the ratio. Changes in other technical or economic parameters that impact on reserves will also have an impact on the life of mine or pit ratio even if they do not affect the pit design. Changes to the life of mine or pit ratio are accounted for prospectively.

In the production stage of some operations, further development of the mine requires a phase of unusually high overburden removal activity that is similar in nature to preproduction mine development. The costs of such unusually high overburden removal activity are deferred and charged against reported profits in subsequent periods on a units of production basis. This accounting treatment is consistent with that for stripping costs incurred during the development phase of a mine or pit, before production commences.

Deferred stripping costs are included in property, plant and equipment or in investment in equity accounted units, as appropriate. These form part of the total investment in the relevant cash generating unit, which is reviewed for impairment if events or changes in circumstances indicate that the carrying value may not be recoverable. Amortisation of deferred stripping costs is included in operating costs or in the Group's share of the results of its jointly controlled entities and associates as appropriate.

During 2007, production stage stripping costs incurred by subsidiaries and equity accounted operations were US$56 million higher than the amounts charged against pre tax profit (2006: production stage costs exceeded the amounts charged against pre-tax profit by US$20 million). In addition, US$117 million of deferred stripping was written off in 2007 as part of the Argyle impairment and there were net impairment reversals of US$36 million affecting deferred stripping in 2006. The net book value carried forward in property, plant and equipment and in investments in jointly controlled entities and associates at 31 December 2007 was US$884 million (2006: US$929 million).

Information about the stripping ratios of the business units, including equity accounted units, that account for the majority of the deferred stripping balance at 31 December 2007, along with the year in which deferred stripping is expected to be fully amortised, is set out in the following table:

	Actual stripping ratio for year			Life of mine stripping ratio		
	2005	2006	2007	2005	2006	2007
Kennecott Utah Copper (2019) (a) (b)	2.02	2.04	1.99	1.51	1.36	1.32
Grasberg Joint Venture (2015) (a)	3.12	3.01	3.47	2.43	2.63	3.05
Diavik (2008) (c)	1.21	0.89	0.42	0.91	0.96	0.91
Escondida (2040) (e)	0.09	0.08	0.07	0.12	0.12	0.10

Notes

(a) Stripping ratios shown are waste to ore.

(b) Kennecott's life of mine stripping ratio decreased in 2006 as the latest mine plan included higher metals prices, which made previously uneconomic material (waste) economic to mine as ore.

(c) Diavik's stripping ratio is disclosed as bench cubic metre per carat. The fall in actual ratio arises as the end of the pipe life nears.

(d) Escondida's stripping ratio is based on waste tonnes to pounds of copper mined.

Borax capitalised stripping costs as part of a distinct period of new development during the production stage of the mine. Capitalisation stopped in 2004. The capitalised costs will be fully amortised in 2034.

Functional currency

The determination of functional currency affects the carrying value of non current assets included in the balance sheet and, as a consequence, the amortisation of those assets included in the income statement. It also impacts exchange gains and losses included in the income statement.

The functional currency for each entity in the Group, and for jointly controlled entities and associates, is the currency of the primary economic environment in which it operates. For many of Rio Tinto's entities, this is the currency of the country in which each operates. Alcan's aluminium and alumina producing operations use a US dollar functional currency including those in Canada and Australia. Transactions denominated in currencies other than the functional currency are converted to the functional currency at the exchange rate ruling at the date of the transaction unless hedge accounting applies. Monetary assets and liabilities denominated in foreign currencies are retranslated at year end exchange rates.

The US dollar is the currency in which the Group's Financial statements are presented, as it most reliably reflects the global business performance of the Group as a whole.

On consolidation, income statement items are translated into US dollars at average rates of exchange. Balance sheet items are translated into US dollars at year end exchange rates. Exchange differences on the translation of the net assets of entities with functional currencies other than the US dollar, and any offsetting exchange differences on net debt hedging those net assets, are recognised directly in the foreign currency translation reserve.

Exchange gains and losses which arise on balances between Group entities are taken to the foreign currency translation reserve where the intra group balance is, in substance, part of the Group's net investment in the entity.

The balance of the foreign currency translation reserve relating to an operation that is disposed of is transferred to the income statement at the time of the disposal.

The Group finances its operations primarily in US dollars but part of the Group's US dollar debt is located in subsidiaries having functional currencies other than the US dollar. Except as noted above, exchange gains and losses relating to such US dollar debt are charged or credited to the Group's income statement in the year in which they arise. This means that the impact of financing in US dollars on the Group's income statement is dependent on the functional currency of the particular subsidiary where the debt is located. With the above exceptions, and except for derivative contracts which qualify as cash flow hedges, exchange differences are charged or credited to the income statement in the year in which they arise.

Deferred tax on fair value adjustments

On transition to EU IFRS with effect from 1 January 2004, deferred tax was provided in respect of fair value adjustments on acquisitions in previous years. No other adjustments were made to the assets and liabilities recognised in such prior year acquisitions and, accordingly, shareholders' funds were reduced by US$720 million on transition to EU IFRS primarily as a result of deferred tax on fair value adjustments to mining rights. In general, these mining rights are not eligible for income tax allowances. In such cases, the provision for deferred tax was based on the difference between their carrying value and their nil income tax base. The existence of a tax base for capital gains tax purposes was not taken into account in determining the deferred tax provision relating to such mineral rights because it is expected that the carrying amount will be recovered primarily through use and not from the disposal of the mineral rights. Also, the Group is only entitled to a deduction for capital gains tax purposes if the mineral rights are sold or formally relinquished.

For acquisitions after 1 January 2004 provision for such deferred tax on acquisition results in a corresponding increase in the amounts attributed to acquired assets and/or goodwill under EU IFRS.

Post retirement benefits

The difference between the fair value of the plan assets (if any) of post retirement plans and the present value of the plan obligations is recognised as an asset or liability on the balance sheet. The Group has adopted the option under IAS 19 to record actuarial gains and losses directly in the Statement of Recognised Income and Expense.

The most significant assumptions used in accounting for post retirement plans are the long term rate of return on plan assets, the discount rate and the mortality assumptions.

The long term rate of return on plan assets is used to calculate interest income on pension assets, which is credited to the Group's income statement. The discount rate is used to determine the net present value of future liabilities and each year the unwinding of the discount on those liabilities is charged to the Group's income statement. The mortality assumption is used to project the future stream of benefit payments, which is then discounted to arrive at the net present value of liabilities.

Valuations are carried out using the projected unit method.

The expected rate of return on pension plan assets is determined as management's best estimate of the long term return on the major asset classes, ie equity, debt, property and other, weighted by the actual allocation of assets among the categories at the measurement date. The expected rate of return is calculated using geometric averaging.

The sources used to determine management's best estimate of long term returns are numerous and include country specific bond yields, which may be derived from the market using local bond indices or by analysis of the local bond market, and country specific inflation and investment market expectations derived from market data and analysts' or governments' expectations as applicable.

In particular, the Group estimates long term expected returns on equity based on the economic outlook, analysts' views and those of other market commentators. This is the most subjective of the assumptions used and it is reviewed regularly to ensure that it remains consistent with best practice.

The discount rate used in determining the service cost and interest cost charged to income is the market yield at the start of the year on high quality corporate bonds. For countries where there is no deep market in such bonds the yield on Government bonds is used. For determining the present value of obligations shown on the balance sheet, market yields at the balance sheet date are used.

Details of the key assumptions are set out in note 49 to the 2007 *Full financial statements*.

For 2007 the charge against income for post retirement benefits net of tax and minorities was US$168 million. This charge included both pension and post retirement healthcare benefits. The charge is net of the expected return on assets which was US$371 million after tax and minorities.

In calculating the 2007 expense the average future increase in compensation levels was assumed to be 4.7 per cent and this will decrease to 3.7 per cent for 2008 reflecting the increased weighting of lower inflation countries following the Alcan acquisition. The average discount rate used for the Group's plans in 2007 was 5.4 per cent and the average discount rate used in 2008 will be 5.6 per cent reflecting the weighted average level of discount rates following the Alcan acquisition.

The average expected long term rate of return on assets used to determine 2007 pension cost was 6.9 per cent. This will decrease to 6.4 per cent for 2008. This reduction results mainly from a lower allocation to equities as a result of the Alcan acquisition.

Based on the known changes in assumptions noted above and other expected circumstances, the impact of post retirement costs on the Group's EU IFRS net earnings in 2008 would be expected to increase by some US$198 million to US$366 million. The main reason for this increase is the inclusion of the Alcan pension expense for the full year. The actual charge may be impacted by other factors that cannot be predicted, such as the effect of changes in benefits and exchange rates.

The table below sets out the potential change in the Group's 2007 net earnings (after tax and outside interests) that would result from hypothetical changes to post retirement assumptions and estimates. The sensitivities are viewed for each assumption in isolation although a change in one assumption is likely to result in some offset elsewhere.

	EU IFRS US$m
Sensitivity of Group's 2007 net earnings to changes in:	
Expected return on assets	
– increase of 1 percentage point	39
– decrease of 1 percentage point	(39)
Discount rate	
– increase of 0.5 percentage points	7
– decrease of 0.5 percentage points	(6)
Salary increases	
– increase of 0.5 percentage points	(6)
– decrease of 0.5 percentage points	6
Demographic – allowance for additional future mortality improvements	
– participants assumed to be one year older	7
– participants assumed to be one year younger	(7)

The figures in the above table only show the impact on underlying and net earnings. Changing the assumptions would also have an impact on the balance sheet.

Further information on pensions and other post retirement benefits is given in note 49 to the 2007 *Full financial statements*.

Temporary differences related to closure costs and finance leases

Under the 'initial recognition' rules in paragraphs 15 and 24 of IAS 12 'Income Taxes', deferred tax is not provided on the initial recognition of an asset or liability in a transaction that does not affect accounting profit or taxable profit and is not a business combination.

The Group's interpretation of these initial recognition rules has the result that no deferred tax asset is provided on the recognition of a provision for close down and restoration costs and the related asset, or on recognition of assets held under finance leases and the associated lease liability, except where these are recognised as a consequence of business combinations.

On creation of a closure provision, for instance, there is no effect on accounting or taxable profit because the cost is capitalised. As a result, the initial recognition rules would appear to prevent the recognition of a deferred tax asset in respect of the provision and of a deferred tax liability in respect of the related capitalised amount.

The temporary differences will reverse in future periods as the closure asset is depreciated and when tax deductible payments are made that are charged against the provision. Paragraph 22 of IAS 12 extends the initial recognition rules to the reversal of temporary differences on assets and liabilities to which the initial recognition rules apply. Therefore, deferred tax is not recognised on the changes in the carrying amount of the asset which result from depreciation or from the changes in the provision resulting from expenditure. When tax relief on expenditure is received this will be credited to the income statement as part of the current tax charge. The unwind of the discount applied in establishing the present value of the closure costs does affect accounting profit. Therefore, this unwinding of discount results in the recognition of deferred tax assets.

The application of this initial recognition exemption has given rise to diversity in practice: some companies do provide for deferred tax on closure cost provisions and the related capitalised amounts. Deferred tax accounting on initial recognition is currently the subject of an IASB/FASB convergence project which may at some future time require the Group to change this aspect of its deferred tax accounting policy.

If the Group were to provide for deferred tax on closure costs and finance leases under EU IFRS the benefit to underlying and net earnings would have been US$21 million (2006: US$9 million) and to equity would have been US$185 million (2006: US$127 million).

US deferred tax potentially recoverable

The Group's US tax group has alternative minimum tax credits and temporary differences that have the potential to reduce tax charges in future years. These 'possible tax assets' totalled US$182 million at 31 December 2007 (2006: US162 million). Of these, US$119 million were recognised as deferred tax assets (2006: US$97 million), leaving US$63 million (2006: US$65 million) unrecognised, as recovery was not considered probable.

During 2006, updated projections of future taxable profits for the operations that form part of Rio Tinto's US tax group resulted in the recognition of previously unrecognised possible tax assets of $335 million. Recoveries are dependent on future commodity prices, costs, financing arrangements and business developments in future years.

During 2007, principally as a result of high commodity prices, US$170 million of these possible tax assets were utilised (2006: US$140 million).

Exploration

Under the Group's accounting policy, exploration and evaluation expenditure is not capitalised until the point is reached at which there is a high degree of confidence in the project's viability and it is considered probable that future economic benefits will flow to the Group.

The carrying values of exploration and evaluation assets are reviewed twice per annum by management and the results of these reviews are reported to the *Audit committee*. There may be only inferred resources to form a basis for the impairment review. The review is based on a status report regarding the Group's intentions for development of the undeveloped property. In some cases, the undeveloped properties are regarded as successors to orebodies currently in production and will therefore benefit from existing infrastructure and equipment.

Contingencies

Disclosure is made of material contingent liabilities unless the possibility of any loss arising is considered remote. Contingencies are disclosed in note 35 to the 2007 *Full financial statements*.

Underlying earnings

The Group presents "Underlying earnings" as an additional measure to provide greater understanding of the underlying business performance of its operations. The adjustments made to net earnings to arrive at underlying earnings are explained above in the section on underlying earnings.