# *FORTESCUE METALS GROUP LTD*

**ABN 57 002 594 872**

# *Annual Financial Report*

# *30 JUNE 2006*

**Registered Office and Principal Place of Business;**

**Level 2**
**87 Adelaide Terrace**
**East Perth**
**Western Australia  6004.**

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This financial report covers both Fortescue Metals Group Ltd as an individual entity (the "Company") and the consolidated entity consisting of Fortescue Metals Group Ltd and its subsidiaries ("Fortescue"). The financial report is presented in the Australian currency.

Fortescue Metals Group Ltd is a company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is:

Level 2
87 Adelaide Terrace
East Perth
Western Australia 6004

A description of the nature of Fortescue's operations and its principal activities is included in the Directors' Report on pages 2 -17, which is not part of this financial report.

The financial report was authorised for issue by the Directors on 18 July 2006. The Company has the power to amend and reissue the financial report.

Through the use of the internet, we have ensured that our corporate reporting is timely, complete, and available globally at minimum cost to the Company. All press releases, financial reports and other information are available on the Company's website at www.fmgl.com.au.

## DIRECTORS' REPORT

Your Directors present their report, together with the financial report of Fortescue Metals Group Ltd (the "Company") and its controlled entities ("Fortescue") for the year ended 30 June 2006 and the auditors' report thereon.

## DIRECTORS

The names and details of Directors of the Company in office during the financial year and until the date of this report are as follows:

Mr Gordon Toll
Mr Herb Elliott
Mr Andrew Forrest
Mr Graeme Rowley
Mr Russell Scrimshaw
Mr Ken Ambrecht

Directors were in office for the entire period.

### Names, qualifications, experience and special responsibilities

**Mr Gordon Toll – Chairman – Age 59**
Mr Toll was appointed as a Non Executive Director of the Company in January 2005 and became Chairman in May 2005. He is a member of the Audit Committee. Mr Toll previously held senior executive positions with BHP Billiton Ltd and Rio Tinto plc and in those roles had experience in the development of iron ore projects within the Pilbara region of Western Australia. Mr Toll has been Chairman of Linq Capital Ltd (responsible entity for Linq Resources Fund) since July 2002, Chairman of Eastern Mediterranean Minerals Ltd since May 2005, a Non-Executive Director of Avocet Mining plc since March 2005 and a Non Executive Director of Compass Resources NL since July 2001.

**Mr Herb Elliott AC, MBE – Deputy Chairman - Age 68**
Mr Elliott was elected a Non Executive Director of the Company in October 2003 and became Deputy Chairman in May 2005. Mr Elliott is Chairman of the Audit Committee and is a member of the Remuneration Committee. Mr Elliott is also Chairman of Telstra Foundation Limited and a Director of Ansell Limited since February 2001. Previous executive roles include President of PUMA North America. Mr Elliott is the former inaugural Chairman of the National Australia Day Committee and was a Commissioner on the Australian Broadcasting Commission.

**Mr Andrew Forrest – Chief Executive Officer – Age 45**
Mr Forrest has been Chief Executive Officer of the Company since April 2003 and was Interim Chairman from then until May 2005. Mr Forrest is Chairman of Moly Mining Ltd (since April 2003) and the Australian Children's Trust. His previous roles include Chairman of Siberia Mining Corporation Limited (now Monarch Ltd), Chief Executive Officer and Deputy Chairman of Anaconda Nickel Limited (now Minara Resources Ltd), Chairman of the Murrin Murrin Joint Venture, Director of the West Australian Chamber of Minerals and Energy and Chairman of Athletics Australia. Mr Forrest has extensive experience in the mining sector with specialist expertise in major project finance.

**Mr Graeme Rowley AM – Executive Director – Age 66**

Mr Rowley has been Executive Director of Operations of the Company since October 2003. Previously he was an executive with Rio Tinto plc holding senior positions in Hamersley Iron and Argyle Diamonds. Mr Rowley's previous directorships have included the Dampier Port Authority, the Pilbara Development Commission, the Council for the West Pilbara College of TAFE and the Western Australian State Government's Technical Advisory Council. Mr Rowley has extensive experience in operational management of both iron ore ship loading facilities and heavy haul railway within the Pilbara.

**Mr Russell Scrimshaw – Executive Director – Age 56**

Mr Scrimshaw was a Non Executive Director of the Company from October 2003 through to June 2005, at which time he became Executive Director Commercial. Since becoming an Executive Director of the Company, Mr Scrimshaw has relinquished previous Non Executive roles as Chairman of Fusia Ltd, Non Executive Director of Mobilesoft Ltd and a Director of Athletics Australia. He is Chairman of the Remuneration Committee. He is a board member of the Garvan Institute and is an Associate Member of the Australian Society of Certified Practicing Accountants. Mr Scrimshaw previously held executive positions within the Commonwealth Bank of Australia, Optus, Alcatel, IBM and Amdahl USA.

**Mr Ken Ambrecht – Non Executive Director – Age 58**

Mr Ambrecht is a Non Executive Director of the Company and is a member of the Audit Committee. Mr Ambrecht is the Managing Director of KCA Associates LLC, which provides investment advisory services. He has been a Non Executive Director of American Financial Capital Inc since April 2005 and Great American Financial Resources Inc since July 2004. Mr Ambrecht was previously Managing Director of First Albany Capital Inc. and a Managing Director of the high yield division of the Royal Bank of Canada following a 25 year career in the capital markets division of Lehman Brothers.

## DIRECTORS' MEETINGS

The numbers of meetings of the Company's Board of Directors and of each Board committee held during the year ended 30 June 2006, and the numbers of meetings attended by each Director were:

| | | | Committee Meetings | | | |
|---|---|---|---|---|---|---|
| | Board Meetings | | Audit | | Remuneration | |
| **Director** | **A** | **B** | **A** | **B** | **A** | **B** |
| Mr Gordon Toll | 11 | 13 | 2 | 3 | 1 | 2 |
| Mr Herb Elliott | 10 | 13 | 3 | 3 | 3 | 3 |
| Mr Andrew Forrest | 13 | 13 | * | * | * | * |
| Mr Graeme Rowley | 13 | 13 | * | * | * | * |
| Mr Russell Scrimshaw | 11 | 13 | * | * | 3 | 3 |
| Mr Ken Ambrecht | 12 | 13 | 2 | 3 | * | * |

*A = Number of meetings attended*
*B = Number of meetings held during the time the Director held office or was a member of the committee during the year*
** = Not a member of the relevant committee*

The Remuneration Committee also acts as the Nomination Committee.

In addition to the scheduled Board and Committee meetings a number of matters were resolved by circulating Board Resolutions.

| **Director** | **No of Circulating Resolutions Eligible** | **No of Circulating Resolutions Executed** |
|---|---|---|
| Mr Gordon Toll | 3 | 3 |
| Mr Herb Elliott | 3 | 3 |
| Mr Andrew Forrest | 3 | 3 |
| Mr Graeme Rowley | 3 | 3 |
| Mr Russell Scrimshaw | 3 | 3 |
| Mr Ken Ambrecht | 3 | 3 |

## COMPANY SECRETARIES' PARTICULARS

The following people held the position of Company Secretary at the end of the financial year.

**Mr Rod Campbell – Age 46**
Mr Campbell was appointed Joint Company Secretary of the Company in November 2004. Prior to that time Mr Campbell was State Manager Western Australia for RaboBank Australia Ltd and before that was a Senior Manager with State Bank NSW Ltd. Mr Campbell holds a Bachelor of Agricultural Economics from the University of New England and a Diploma from the Securities Institute of Australia.

**Mr Christopher Catlow – Age 45**
Mr Catlow has been Chief Financial Officer of the Company since September 2003 and Company Secretary since November 2003. Mr Catlow has extensive experience in the resources sector, having previously been a Director of Consolidated Rutile Ltd and Sierra Rutile Ltd. He was also Executive General Manager Finance of Iluka Resources Limited and Chief Financial Officer of Energy Equity Corporation Limited and Gold Fields Australia Pty Ltd. Mr Catlow is a Fellow of the Institute of Chartered Accountants in Australia.

## PRINCIPAL ACTIVITIES

The principal activity of the Company during the course of the financial year was the development of the Pilbara Iron Ore and Infrastructure Project.

## RESULTS FROM OPERATIONS

The results from operations are as follows.

| | **2006 $** | **2005 $** |
|---|---|---|
| Operating loss after income tax | (2,145,701) | (4,518,645) |
| Total assets | 221,048,135 | 148,342,886 |
| Net assets | 137,106,130 | 59,440,751 |

*Summary of financial position*

Fortescue's financial position improved significantly during 2006, with net assets increasing 131% to $137.1 million. The improvement was attributable to an increase in total assets of $72.7 million comprised primarily of increases in exploration and evaluation expenditure, partially offset by lower cash balances held at 30 June 2006.

## DIVIDENDS

No dividends have been paid or declared by the Company to members since the end of the previous financial year and the Directors do not recommend the payment of a dividend in respect of the current financial year.

## REVIEW OF OPERATIONS

The highlights of the Company's operations during the year were:

- ongoing development of the Pilbara Iron Ore and Infrastructure Project with focus on the progression of the Definitive Feasibility Study;
- delineation of further resources within the Company's Chichester Range deposits through the completion of exploration and infill drilling programs;
- continuing development of the Company's iron ore marketing program targeting key customers in China, Japan, Korea and Europe;

## ENVIRONMENTAL REGULATIONS

In the course of its normal mining and exploration activities Fortescue adheres to environmental regulations imposed upon it by the various regulatory authorities, particularly those regulations relating to ground disturbance and the protection of rare and endangered flora and fauna. The Company has complied with all material environmental requirements up to the date of this report.

## SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

At the Company's Annual General Meeting held on 8 November 2005 members approved the de-merger of Allied Medical Limited through an "in specie" distribution of shares to the Company's shareholders as at the record date of 23 November 2005.

Allied Medical Limited distributes medical products and is not part of Fortescue's core business model. For the purposes of the de-merger, the Directors valued Allied Medical Limited at $880,000. The in specie share distribution was transacted with the placement of 4,400,000 shares valued at 20 cents per share.

Fortescue and the Company have prepared financial statement in accordance with the Australian Equivalents to International Financial Reporting Standards ("AIFRS") from 1 July 2004. In accordance with the requirements of AASB 1: First-time Adoption of Australian Equivalents to International Financial Reporting Standards, adjustments to the Company and Fortescue's accounts resulting from the introduction of AIFRS have been applied retrospectively to 2005 comparative figures excluding cases where optional exemptions available under AASB 1 have been applied. These consolidated accounts are the first financial statements of Fortescue to be prepared in accordance with AIFRS.

Other than the de-merger of Allied Medical Limited and the first time adoption of AIFRS there have been no significant changes in the state of affairs of Fortescue either during or since the end of the financial year.

## AFTER BALANCE DATE EVENTS

*(i) Capital raising*

On 15 July 2006 Leucadia National Corporation signed a Subscription Agreement to invest US$400 million in Fortescue. Leucadia will receive 26.4 million shares in the Company and US$100 million of Secured Subordinated Loan Notes upon financial close, which occurs when US$2 billion of secured debt and lease facilities have been established. The Notes have a 13 year term, a zero fixed interest rate and a variable interest rate equal to 4% of the revenue, net of government royalties received from the sale of iron ore from Cloud Break and Christmas Creek.

*(ii) Syndicated loan*

The Company has drawn down an additional US$100 million subsequent to year end.

Other than the matters discussed above, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the Company, the results of those operations or the state of affairs of the Company in future financial years.

## FUTURE DEVELOPMENTS, PROSPECTS AND BUSINESS STRATEGIES

In the opinion of the Directors it may prejudice the interests of the Company to provide additional information (except as reported in this Directors' Report), in relation to future developments and business strategies of the operations of the Company and the expected results of those operations in subsequent financial years.

## DIRECTORS' INTERESTS

The relevant interest of each Director in the shares and options issued by the Company, as notified by the Directors to the Australian Stock Exchange in accordance with S205G(1) of the Corporations Act 2001, at the date of this report is as follows:

| **Director** | **Ordinary Shares** |
|---|---:|
| Mr Gordon Toll | 750,000 |
| Mr Herb Elliott | 550,000 |
| Mr Andrew Forrest | 102,307,830 |
| Mr Graeme Rowley | 2,147,569 |
| Mr Russell Scrimshaw | 1,077 ,600 |
| Mr Ken Ambrecht | 750,000 |

No Directors held options during the year.

## SHARE OPTIONS

### Options granted to Directors and officers of the Company

During or since the end of the financial year, the Company did not grant options to Directors. During this period the Company granted options for no consideration over unissued ordinary shares in the Company to the following five most highly remunerated officers and other key management personnel (collectively called "Key Management Personnel") of the Company as part of their remuneration:

| Five most highly remunerated officers | Number of options granted | Exercise price | Expiry date |
|---|---|---|---|
| Mr Alan Watling | - | - | - |
| Mr Peter Thomas | 25,000 | $5.69 | 25 January 2011 |
| Mr John Clout | 30,000 | $7.03 | 1 June 2011 |
| Mr Christopher Catlow | 100,000 | $5.69 | 25 January 2011 |
| Mr Julian Tapp | 40,000 | $5.69 | 25 January 2011 |
| **Other key management personnel** | | | |
| Mr Bill Ramsey | 100,000 | $5.69 | 25 January 2011 |

All options were granted during the financial year. No options have been granted since the end of the financial year.

### Unissued Shares Under Options

The number of options on issue at the date of this report is as follows. All of these options are unlisted.

| Number of Options | Exercise Price $ | Expiry Date |
|---|---|---|
| 2,000,000 | $2.67 | 31 December 2009 |
| 430,000 | $5.69 | 25 January 2011 |
| 500,000 | $7.03 | 1 June 2011 |

These options were issued pursuant to the Company's Employee Incentive Option Scheme and have been allotted to individuals on condition that they serve specified time periods as an employee of the Company before becoming entitled to exercise the options. These options do not entitle the holder to participate in any share issue of the Company or any other body corporate.

### Shares Issued on Exercise of Options

During the financial year, the Company did not issue ordinary shares as a result of the exercise of options. Post financial year end 22,500 shares were issued as a result of the conversion of employee options with an exercise price of $2.67.

## DIRECTORS AND OFFICERS INSURANCES

Since the end of the previous financial year, the Company has paid premiums of $135,420 to insure the Directors and officers of Fortescue.

The liabilities insured are legal costs that may be incurred in defending civil or criminal proceedings that may be brought against the officers in their capacity as officers of Fortescue, and any other payments arising from liabilities incurred by the officers in connection with such proceedings, other than where such liabilities arise out of conduct involving a wilful breach of duty by the officers or the improper use by the officers of their position or of information to gain advantage for themselves or someone else or to cause detriment to Fortescue. It is not possible to apportion the premium between amounts relating to the insurance against legal costs and those relating to other liabilities.

## PRINCIPLES OF COMPENSATION

The objective of Fortescue's executive reward framework is to ensure reward for performance is competitive and appropriate for the results delivered. The framework aligns executive reward with the achievement of strategic objectives and the creation of value for shareholders, and conforms with market best practice for delivery of reward. The Board ensures that executive reward satisfies the following key criteria for good governance practices:

- Competitiveness and reasonableness
- Acceptability to shareholders
- Performance linkage / alignment of executive compensation
- Transparency
- Capital management

In consultation with external remuneration consultants, Fortescue has structured an executive remuneration framework that is market competitive and complimentary to the reward strategy of the organisation.

Alignment to shareholder's interests:

- Has economic profit as a core component of plan design
- Focuses on sustained growth in share price and delivering constant return on assets as well as focusing the executive on key non-financial drivers of value
- Attracts and retains high calibre executives

Alignment to program participants' interests:

- Rewards capability and experience
- Reflects competitive reward for contribution to shareholder growth
- Provides a clear structure for earning rewards
- Provides recognition for contribution

**Fixed Compensation**
Fixed compensation consists of base compensation as well as employer contributions to superannuation funds.

**Performance-Linked Compensation**
Performance-linked compensation includes long-term incentives designed to reward key management personnel for growth in shareholder wealth. The long term incentive ("LTI") is provided as options over ordinary shares of the Company under the rules of the Fortescue Metals Group Incentive Option Scheme ("FMGIOS"). The change in share price is the key performance criteria for the LTI plan as the realised value arising from options issued under the FMGIOS is dependent upon an increase in the share price to above the exercise price of the options.

The success of Fortescue's management team can be determined by their ability to improve the value of the company and achieve KPI's set by the board. The Remuneration Committee considers that fixed compensation combined with the current LTI component is generating the desired outcomes at this stage.

**Consequences of performance on shareholders wealth**
In considering Fortescue's performance and benefits for shareholders wealth, the Remuneration Committee have regard to the following indices in respect of the current financial year and the previous four financial years.

**PRINCIPLES OF COMPENSATION (continued)**

| | 2006 AIFRS | 2005 AIFRS | 2004 AGAAP | 2003 AGAAP | 2002 AGAAP |
|---|---|---|---|---|---|
| Revenue | $12,664,427 | $3,438,050 | $4,266,567 | $1,753,422 | $1,910,539 |
| Net profit/ (loss) | ($2,145,701) | ($4,518,645) | $601,586 | ($834,241) | ($298,276) |
| Dividends paid | - | - | - | - | - |
| Change in share price | $6.60 | $2.85 | $0.30 | $0.12 | ($0.05) |

The overall level of key management personnel's compensation takes into account the performance of Fortescue over a number of years.

**Service agreements**
Remuneration and other terms of employment for the Executive Directors and other Key Management Personnel are formalised in a service agreement. The major provisions of the agreements relating to remuneration are set out below.

Mr Andrew Forrest, *Chief Executive Officer*
- Term of agreement – 16 April 2007
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of $110,000, to be reviewed annually by the Remuneration Committee.

Mr Graeme Rowley, *Executive Director Operations*
- Term of agreement – Unspecified
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of $380,000 to be reviewed annually by the Remuneration Committee.

Mr Russell Scrimshaw, *Executive Director Commercial*
- Term of agreement – Unspecified
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of $250,000 to be reviewed annually by the Remuneration Committee.

Mr Alan Watling, *Head of Infrastructure*
- Term of agreement – Unspecified
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of $300,000, to be reviewed annually by the Remuneration Committee.

Mr Peter Thomas, *Chief Financial Officer of The Pilbara Infrastructure Pty Ltd (subsidiary)*
- Term of agreement – Unspecified
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of $270,000, to be reviewed annually by the Remuneration Committee.

Mr John Clout, *Head of Resource Strategy*
- Term of agreement – Unspecified
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of $200,000, to be reviewed annually by the Remuneration Committee.

Mr Christopher Catlow, *Chief Financial Officer/Joint Company Secretary*
- Term of agreement – Unspecified
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of $300,000, to be reviewed annually by the Remuneration Committee.

**PRINCIPLES OF COMPENSATION (continued)**

Mr Julian Tapp, *Head of Government Relations*

- Term of agreement – Unspecified
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of $230,000, to be reviewed annually by the Remuneration Committee.

Mr Bill Ramsey, *Project Director*

- Term of agreement – Unspecified
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of $200,000, to be reviewed annually by the Remuneration Committee.

All service agreements do not provide termination payments and are able to be terminated on one months' notice.

*Non Executive Directors*
Total compensation for all Non Executive Directors, last voted upon by shareholders at the 2005 AGM, is not to exceed $500,000 per annum and is set based on advice from external advisors with reference to the fees paid to other Non Executive Directors of comparable companies. Directors' base fees are presently up to $40,000 per annum.

The Chairperson receives $162,000 per annum. The Deputy Chairperson receives $46,000 per annum. Non Executive Directors do not receive performance related compensation. Directors' fees cover all main Board activities. Non Executive Directors who sit on a Board Committee receive an additional $4,000 per annum per committee.

**DIRECTORS' AND EXECUTIVE OFFICERS' REMUNERATION (COMPANY AND CONSOLIDATED)**

Details of the nature and amount of each major element of remuneration of each Director of the Company and other Key Management Personnel of Fortescue are:

| | | Short-term | | | | Post-employment | Other long term | | Share-based payments | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Salary & fees $ | Cash bonus $ | Non-monetary benefits $ | Total $ | Super-annuation benefits $ | $ | Termination benefits | Options (A) $ | Total $ | Proportion of remuneration performance related % | Value of options as proportion of remuneration % |
| **Directors** | | | | | | | | | | | | |
| *Non Executive* | | | | | | | | | | | | |
| Mr G Toll (Chairperson) | 2006 | 166,000 | - | - | 166,000 | - | - | - | | 166,000 | - | - |
| | 2005 | 64,000 | - | - | 64,000 | - | - | - | - | 64,000 | - | - |
| Mr H Elliot | 2006 | 51,376 | - | - | 51,376 | 4,624 | - | - | | 56,000 | - | - |
| | 2005 | - | - | - | - | - | - | - | 53,059 | 53,059 | - | 100% |
| Mr K Ambrecht | 2006 | 44,000 | - | - | 44,000 | - | - | - | - | 44,000 | - | - |
| | 2005 | - | - | - | - | - | - | - | 53,059 | 53,059 | - | 100% |
| Mr C Linegar (resigned 27 January 2005) | 2005 | - | - | - | - | - | - | - | 53,059 | 53,059 | - | 100% |
| *Executive* | | | | | | | | | | | | |
| Mr A Forrest, CEO | 2006 | 100,000 | - | - | 100,000 | 10,000 | - | - | - | 110,000 | - | - |
| | 2005 | 100,000 | - | - | 100,000 | 10,000 | - | - | - | 110,000 | - | - |
| Mr G Rowley, Executive Director | 2006 | 345,454 | - | - | 345,454 | 34,546 | - | - | - | 380,000 | - | - |
| Operations | 2005 | 182,000 | - | - | 182,000 | 18,200 | - | - | - | 200,200 | - | - |
| Mr R Scrimshaw, Executive Director | 2006 | 225,000 | - | - | 225,000 | 25,000 | - | - | - | 250,000 | - | - |
| Commerical | 2005 | 55,046 | - | - | 55,046 | 4,954 | - | - | 53,059 | 113,059 | - | 47% |

## DIRECTORS' AND EXECUTIVE OFFICERS' REMUNERATION (COMPANY AND CONSOLIDATED) continued

| | | Short-term | | | | Post-employment | Other long term | | Share-based payments | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Salary & fees $ | Cash bonus $ | Non-monetary benefits $ | Total $ | Super-annuation benefits $ | $ | Termination benefits | Options $ | Total $ | Proportion of remuneration performance related % | Value of options as proportion of remuneration % |
| **5 Most Highly Remunerated Executives** | | | | | | | | | | | | |
| Mr A Watling, Head of Infrastructure | 2006 | 272,727 | 150,000 | - | 422,727 | 27,273 | - | - | 98,258 | 548,258 | - | 18% |
| | 2005 | 156,916 | - | - | 156,916 | 15,692 | - | - | 8,076 | 180,684 | - | 4% |
| Mr P Thomas, Chief Financial Officer, | 2006 | 245,453 | 75,757 | - | 321,210 | 32,121 | - | - | 105,644 | 458,975 | - | 23% |
| Pilbara Infrastructure Pty Ltd | 2005 | 75,003 | - | - | 75,003 | 7,500 | - | - | 7,672 | 90,175 | - | 9% |
| Mr J Clout, Head of Resource Strategy | 2006 | 172,725 | - | - | 172,725 | 18,182 | - | - | 77,265 | 268,172 | - | 29% |
| | 2005 | 133,761 | - | - | 133,761 | 13,376 | - | - | 4,442 | 151,579 | - | 3% |
| Mr C Catlow, Chief Financial | 2006 | 272,727 | - | - | 272,727 | 27,273 | - | - | 49,194 | 349,194 | - | 14% |
| Officer/Company Secretary | 2005 | 163,000 | - | - | 163,000 | 16,300 | - | - | - | 179,300 | - | - |
| Mr J Tapp, Manager Government | 2006 | 209,091 | - | - | 209,091 | 20,909 | - | - | 68,807 | 298,807 | - | 23% |
| Relations | 2005 | 120,000 | - | - | 120,000 | 12,000 | - | - | 4,038 | 136,038 | - | 3% |
| **Other Key Management Personnel** | | | | | | | | | | | | |
| Mr B Ramsey, Project Manager | 2006 | 178,974 | - | - | 178,974 | 17,897 | - | - | 49,194 | 246,065 | - | 20% |
| | 2005 | - | - | - | - | - | - | - | - | - | - | - |
| Total compensation: key management | 2006 | 2,283,527 | 225,757 | - | 2,509,284 | 217,825 | - | - | 448,362 | 3,175,471 | | |
| personnel (consolidated and company) | 2005 | 1,049,726 | - | - | 1,049,726 | 98,022 | - | - | 236,464 | 1,384,212 | | |

All key management personnel are employed by the parent entity.

**Notes in relation to the table of Directors and other Key Management Personnel's remuneration**

(a) The fair value of the options is calculated at the date of grant using the Black-Scholes model and allocated to each reporting period evenly over the period from grant date to vesting date. The value disclosed is the portion of the fair value of the options allocated to this reporting period. In valuing the options, market conditions have been taken into account.

The following factors and assumptions were used in determining the fair value of options on grant date:

| Grant Date | Expiry Date | Fair value per option | Exercise price | Price of shares on grant date | Expected volatility | Risk free interest rate | Dividend yield |
|---|---|---|---|---|---|---|---|
| 28 November 2003 | 28 November 2006 | $0.30 | $0.50 | $0.50 | 26.40% | 5.75% | - |
| 28 November 2003 | 28 November 2006 | $0.26 | $0.75 | $0.50 | 26.40% | 5.75% | - |
| 28 November 2003 | 28 November 2006 | $0.23 | $1.00 | $0.50 | 26.40% | 5.75% | - |
| 1 June 2005 | 31 December 2009 | $1.97 | $2.67 | $2.67 | 26.40% | 5.75% | - |
| 25 January 2006 | 25 January 2011 | $4.60 | $5.69 | $6.15 | 26.80% | 5.13% | - |
| 1 June 2006 | 1 June 2011 | $5.79 | $7.03 | $7.68 | 26.80% | 5.75% | - |

## EQUITY INSTRUMENTS

All options refer to options over ordinary shares of the Company, which are exercisable on a one-for-one basis under the FMGIOS.

### Options over equity instruments granted as compensation

Details on options over ordinary shares in the Company that were granted as compensation to each key management person during the reporting period and details on options that were vested during the reporting period are as follows:

| Executives | Number of options granted during 2006 | Grant date | Number of options vested during 2006 | Fair value of options granted during 2006 | Exercise price of options granted during 2006 | Expiry date of options granted during 2006 |
|---|---|---|---|---|---|---|
| Mr A Watling | - | - | 50,000 | - | - | - |
| Mr P Thomas | 25,000 | 25 January 2006 | 47,500 | $4.60 | $5.69 | 25 January 2011 |
| Mr J Clout | 30,000 | 1 June 2006 | 37,500 | $5.79 | $7.03 | 1 June 2011 |
| Mr C Catlow | 100,000 | 25 January 2006 | - | $4.60 | $5.69 | 25 January 2011 |
| Mr J Tapp | 40,000 | 25 January 2006 | 25,000 | $4.60 | $5.69 | 25 January 2011 |
| Mr B Ramsey | 100,000 | 25 January 2006 | - | $4.60 | $5.69 | 25 January 2011 |

No Directors held options during the year.

No options have been granted since the end of the financial year. The options were provided at no cost to the recipients.

All options expire on the earlier of their expiry date or termination of the individual's employment. The options are exercisable on an annual basis four years from grant date.

### Modification of terms of equity-settled share-based payment transactions

No terms of equity-settled share-based payment transactions (including options granted as compensation to a key management person) have been altered or modified by the Company during the reporting period.

### Exercise of options granted as compensation

During the financial year, the Company did not issue ordinary shares as a result of the exercise of options. Post financial year end 22,500 shares were issued as a result of the conversion of employee options with an exercise price of $2.67.

**Analysis of options over equity instruments granted as compensation**

Details of the vesting profile of the options granted as remuneration to each Director of the Company and Key Management Personnel is detailed below.

| | Options granted | | % vested in year | Forfeited in year | Financial years in which grant vests | Value yet to vest $ | |
|---|---|---|---|---|---|---|---|
| | Number | Date | | | | Min | Max (A) |
| **5 Most Highly Remunerated** | | | | | | | |
| Mr A Watling | 200,000 | June 2005 | 25% | - | (B) | - | 286,698 |
| Mr P Thomas | 190,000 | June 2005 | 25% | - | (B) | - | 272,363 |
| Mr P Thomas | 25,000 | January 2006 | - | - | (B) | - | 102,802 |
| Mr J Clout | 150,000 | June 2005 | 25% | - | (B) | - | 215,024 |
| Mr J Clout | 30,000 | June 2006 | - | - | (B) | - | 170,219 |
| Mr C Catlow | 100,000 | January 2006 | - | - | (B) | - | 411,210 |
| Mr J Tapp | 100,000 | June 2005 | 25% | - | (B) | - | 143,349 |
| Mr J Tapp | 40,000 | January 2006 | - | - | (B) | - | 164,484 |
| **Other Key Management Personnel** | | | | | | - | |
| Mr B Ramsey | 100,000 | January 2006 | - | - | (B) | - | 411,210 |

No Directors held options during the year.

(A) The maximum value of options yet to vest is not determinable as it depends on the market price of shares of the Company on the Australian Stock Exchange at the date the option is exercised. These share prices represent a maximum price included in the volatility assumptions within the valuation of the options.

(B) The options were issued pursuant to the FMGIOS and may be exercised 25% after one year, 50% after two years, 75% after three years and in full after four years from grant date.

**Analysis of movements in options**

The movement during the reporting period, by value, of options over ordinary shares in the Company held by each Key Management Person is detailed below. No Directors held options during the year.

| | Value of Options | | | |
|---|---|---|---|---|
| | Granted in year $ (A) | Exercised in year $ | Forfeited in year $ | Total option value in year $ |
| Mr Alan Watling | - | - | - | - |
| Mr Peter Thomas | 115,101 | - | - | 115,101 |
| Mr John Clout | 173,790 | - | - | 173,790 |
| Mr Chris Catlow | 460,404 | - | - | 460,404 |
| Mr Julian Tapp | 184,161 | - | - | 184,161 |
| Mr Bill Ramsey | 460,404 | - | - | 460,404 |

(A) The value of options granted in the year is the fair value of the options calculated at grant date using the Black-Scholes model. The total value of the options granted is included in the table above. This amount is allocated to remuneration over the vesting period.

## NON-AUDIT SERVICES

The Company may decide to employ the auditor on assignments additional to their statutory audit duties where the auditor's expertise and experience with Fortescue is important.

Details of the amounts paid or payable to the auditor (BDO Chartered Accountants & Advisers) for audit and non-audit services provided during the year are set out below.

The Board of Directors has considered the position and, in accordance with the advice received from the Audit Committee, is satisfied that the provision of the non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The Directors are satisfied that the provision of non-audit services by the auditor, as set out below, did not compromise the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services have been reviewed by the Audit Committee to ensure they do not impact the impartiality and objectivity of the auditor
- none of the services undermine the general principles relating to auditor independence as set out in Professional Statement Fl, including reviewing or auditing the auditor's own work, acting in a management or a decision-making capacity for the Company, acting as advocate for the Company or jointly sharing economic risk and rewards.

During the year the following fees were paid or payable for services provided by the auditor of the Company, its related practices and non-related audit firms.

| | Consolidated | |
|---|---|---|
| **Amounts received or due and receivable by auditors for:** | **2006** | **2005** |
| | **$** | **$** |
| Audit Services | | |
| BDO Chartered Accountants & Advisers | 56,715 | 40,514 |
| | | |
| Financial due diligence | | |
| BDO Chartered Accountants & Advisers | 107,261 | - |
| | | |
| Total Remuneration | 163,976 | 40,514 |

### Auditors' Independence Declaration

A copy of the auditors' independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 17.

## AUDITOR

BDO Chartered Accountants & Advisers continues in office in accordance with section 327 of the *Corporations Act 2001.*

This report is made in accordance with a resolution of the Directors.

**Gordon Toll**
Chairman

Dated at Perth this 18th day of July 2006.

BDO

Chartered Accountants
& Advisers

Level 8, 256 St George's Terrace Perth WA 6000
PO Box 7426 Cloisters Square Perth WA 6850
Tel: (61-8) 9360 4200
Fax: (61-8) 9481 2524
Email: bdo@bdowa.com.au
**www.bdo.com.au**

18 July 2006

The Directors
Fortescue Metals Group Ltd
PO Box 910
WEST PERTH WA 6872

**DECLARATION OF INDEPENDENCE BY BDO TO THE DIRECTORS OF FORTESCUE METALS GROUP LIMITED**

To the best of my knowledge and belief, there have been no contraventions of:

- the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and
- any applicable code of professional conduct in relation to the audit.

Yours faithfully
**BDO**
**Chartered Accountants**

B. McVeigh

**BG McVeigh**
Partner

Quality Endorsed Company ISO 9001 Lic 414208 Standards Australia

*BDO is a national association of separate partnerships and entities.*

# FORTESCUE METALS GROUP LTD
# INCOME STATEMENTS
# FOR THE YEAR ENDED 30 JUNE 2006

| | Note | Consolidated | | Company | |
|---|---|---|---|---|---|
| | | 2006 | 2005 | 2006 | 2005 |
| | | $ | $ | $ | $ |
| Revenue from ordinary activities | | **834,276** | 1,746,572 | **-** | - |
| Revenue from outside ordinary activities | | **-** | - | **-** | 1,721 |
| Total Revenue | 3 | **834,276** | 1,746,572 | **-** | 1,721 |
| Cost of sales | | **(525,834)** | (1,117,215) | **-** | - |
| Personnel expense | 4 | **(4,588,813)** | (2,241,529) | **(4,434,328)** | (1,790,614) |
| Financial income | 6 | **11,830,151** | 1,691,478 | **11,828,132** | 1,722,726 |
| Financial expenses | 6 | **(6,542,596)** | (2,909,000) | **(6,542,596)** | (2,909,000) |
| Other expenses | 5 | **(2,645,585)** | (1,688,951) | **(2,585,726)** | (1,515,661) |
| Loss before tax | | **(1,638,401)** | (4,518,645) | **(1,734,518)** | (4,490,828) |
| Income tax expense | 8 | **-** | - | **-** | - |
| Loss from continuing operations | | **(1,638,401)** | (4,518,645) | **(1,734,518)** | (4,490,828) |
| Loss on sale of discontinued operation net of tax | 7 | **(507,300)** | - | **-** | - |
| Loss for the year | | **(2,145,701)** | (4,518,645) | **(1,734,518)** | (4,490,828) |
| | | | | | |
| Loss attributable to members of the Parent Entity | | **(2,145,701)** | (4,518,645) | **(1,734,518)** | (4,490,828) |
| | | | | | |
| Basic earnings per share (cents) | 25 | **(0.96)** | (2.58) | | |
| Diluted earnings per share (cents) | 25 | **N/A** | N/A | | |

The income statements are to be read in conjunction with the notes to the financial statements.

# FORTESCUE METALS GROUP LTD
# BALANCE SHEETS
# AS AT 30 JUNE 2006

| | Note | Consolidated | | Company | |
|---|---|---|---|---|---|
| | | 2006 | 2005 | 2006 | 2005 |
| | | $ | $ | $ | $ |
| CURRENT ASSETS | | | | | |
| Cash and cash equivalents | 9 | **18,054,207** | 81,158,375 | **18,054,205** | 81,040,753 |
| Trade and other receivables | 10 | **1,372,472** | 1,112,872 | **1,372,472** | 788,407 |
| Inventories | 11 | **-** | 137,413 | **-** | - |
| Financial assets | 12 | **322,723** | 2,723 | **322,723** | 2,723 |
| Other current assets | 13 | **161,231** | 60,356 | **161,231** | 60,356 |
| Total Current Assets | | **19,910,633** | 82,471,739 | **19,910,631** | 81,892,239 |
| NON-CURRENT ASSETS | | | | | |
| Trade and other receivables | 14 | **14,323,479** | 1,334,824 | **18,989,391** | 6,000,736 |
| Exploration and evaluation expenditure | 15 | **182,914,456** | 63,337,525 | **178,248,144** | 58,671,213 |
| Property, plant and equipment | 17 | **3,873,567** | 1,172,798 | **3,873,567** | 1,166,756 |
| Other financial assets | 18 | **26,000** | 26,000 | **26,402** | 26,403 |
| Total Non-Current Assets | | **201,137,502** | 65,871,147 | **201,137,504** | 65,865,108 |
| Total Assets | | **221,048,135** | 148,342,886 | **221,048,135** | 147,757,347 |
| CURRENT LIABILITIES | | | | | |
| Trade and other payables | 19 | **16,674,415** | 9,548,573 | **16,674,415** | 9,374,217 |
| Total Current Liabilities | | **16,674,415** | 9,548,573 | **16,674,415** | 9,374,217 |
| NON-CURRENT LIABILITIES | | | | | |
| Interest-bearing loans and borrowings | 20 | **67,267,590** | 67,719,562 | **67,267,590** | 67,719,562 |
| Deferred tax liabilities | 22 | **-** | 11,634,000 | **-** | 11,634,000 |
| Total Non-Current Liabilities | | **67,267,590** | 79,353,562 | **67,267,590** | 79,353,562 |
| Total Liabilities | | **83,942,005** | 88,902,135 | **83,942,005** | 88,727,779 |
| NET ASSETS | | **137,106,130** | 59,440,751 | **137,106,130** | 59,029,568 |
| EQUITY | | | | | |
| Issued capital | | **147,153,101** | 69,475,651 | **147,153,101** | 69,475,651 |
| Reserves | | **2,907,217** | 773,587 | **2,907,217** | 773,587 |
| Accumulated losses | | **(12,954,188)** | (10,808,487) | **(12,954,188)** | (11,219,670) |
| TOTAL EQUITY | | **137,106,130** | 59,440,751 | **137,106,130** | 59,029,568 |

The balance sheets are to be read in conjunction with the notes to the financial statements.

# FORTESCUE METALS GROUP LTD
# STATEMENTS OF CASH FLOWS
# FOR THE YEAR ENDED 30 JUNE 2006

| | Note | Consolidated 2006 $ | Consolidated 2005 $ | Company 2006 $ | Company 2005 $ |
|---|---|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | |
| Receipts from customers | | **834,276** | 1,662,547 | **-** | - |
| Exploration and evaluation expenditure | | **(124,316,798)** | (46,704,816) | **(124,316,798)** | (46,704,816) |
| Interest received | | **2,219,214** | 1,381,092 | **2,217,195** | 1,376,554 |
| Payments to suppliers and employees | | **(7,847,761)** | (4,701,631) | **(7,031,059 )** | (2,962,037) |
| Net cash used in operating activities | 28(a) | **(129,111,069)** | (48,362,808) | **(129,130,662)** | (48,290,299) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | |
| Payments for purchase of plant and equipment | | **(3,395,704)** | (1,002,788) | **(3,395,704)** | (1,002,788) |
| Loans to other entities | | **-** | (1,138,182) | **-** | (1,138,182) |
| Cash lost on disposal of Allied Medical Ltd | 7(d) | **(137,213)** | - | **-** | - |
| Net cash used in investing activities | | **(3,532,917)** | (2,140,970) | **(3,395,704)** | (2,140,970) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | | | |
| Proceeds from the issue of share capital | | **-** | 75,277,383 | **-** | 75,277,383 |
| Proceeds from borrowings | | **67,267,590** | 49,175,882 | **67,267,590** | 49,175,882 |
| Net cash from financing activities | | **67,267,590** | 124,453,265 | **67,267,590** | 124,453,265 |
| Net increase in cash and cash equivalents | | **(65,376,396)** | 73,949,487 | **(65,258,776)** | 74,021,996 |
| Cash at 1 July | | **81,158,375** | 5,330,037 | **81,040,753** | 5,139,906 |
| Effect of exchange rate changes on cash held | | **2,272,228** | 1,878,851 | **2,272,228** | 1,878,851 |
| Cash at 30 June | 9 | **18,054,207** | 81,158,375 | **18,054,205** | 81,040,753 |

The statements of cash flows are to be read in conjunction with the notes to the financial statements.

# FORTESCUE METALS GROUP LTD
# STATEMENTS OF CHANGES IN EQUITY
# FOR THE YEAR ENDED 30 JUNE 2006

| Consolidated | Issued Capital $ | Accumulated losses $ | Reserves $ | Total Equity $ |
|---|---|---|---|---|
| Opening balance at 1 July 2004 | 20,355,255 | (6,289,842) | - | 14,065,413 |
| Net loss for the period | - | (4,518,645) | - | (4,518,645) |
| Total recognised income and expense for the year | - | (4,518,645) | - | (4,518,645) |
| | | | | |
| Transactions with equity holders in their capacity as equity holders: | | | | |
| Issue of share capital | 14,140,509 | - | - | 14,140,509 |
| Exercise of options | 8,016,405 | - | - | 8,016,405 |
| Distribution to option holders | (181,800) | - | - | (181,800) |
| Convertible notes conversion to equity | 53,386,282 | - | - | 53,386,282 |
| Adjustment to valuation of equity component of convertible notes | (14,607,000) | - | - | (14,607,000) |
| Deferred tax liability on equity portion of convertible notes | (11,634,000) | - | - | (11,634,000) |
| Equity settled share based payment transactions | - | - | 773,587 | 773,587 |
| | 49,120,396 | - | 773,587 | 49,893,983 |
| | | | | |
| Closing balance at 30 June 2005 | 69,475,651 | (10,808,487) | 773,587 | 59,440,751 |

| Consolidated | Issued Capital $ | Accumulated losses $ | Reserves $ | Total Equity $ |
|---|---|---|---|---|
| Opening balance at 1 July 2005 | **69,475,651** | **(10,808,487)** | **773,587** | **59,440,751** |
| Revaluation of property, plant and equipment | **-** | **-** | **879,999** | **879,999** |
| Net income recognised directly in equity | **-** | **-** | **879,999** | **879,999** |
| Net loss for the period | **-** | **(2,145,701)** | **-** | **(2,145,701)** |
| Total recognised income and expense for the year | **-** | **(2,145,701)** | **879,999** | **(1,265,702)** |
| | | | | |
| Transactions with equity holders in their capacity as equity holders: | | | | |
| Issue of share capital | **76,797,450** | **-** | **-** | **76,797,450** |
| Distribution in specie due to Allied Medical Ltd de-merger | **880,000** | **-** | **-** | **880,000** |
| Equity settled share based payment transactions | **-** | **-** | **1,253,631** | **1,253,631** |
| | **77,677,450** | **-** | **1,253,631** | **78,931,081** |
| | | | | |
| Closing balance at 30 June 2006 | **147,153,101** | **(12,954,188)** | **2,907,217** | **137,106,130** |

Amounts are stated net of tax.

The statements of changes in equity are to be read in conjunction with the notes to the financial statements.

**FORTESCUE METALS GROUP LTD**
**STATEMENTS OF CHANGES IN EQUITY**
**FOR THE YEAR ENDED 30 JUNE 2006**

| Company | Issued Capital $ | Accumulated losses $ | Reserves $ | Total Equity $ |
|---|---|---|---|---|
| Opening balance at 1 July 2004 | 20,355,255 | (6,728,842) | - | 13,626,413 |
| Net loss for the period | - | (4,490,828) | - | (4,490,828) |
| Total recognised income and expense for the year | - | (4,490,828) | - | (4,490,828) |
| | | | | |
| Transactions with equity holders in their capacity as equity holders: | | | | |
| Issue of share capital | 14,140,509 | - | - | 14,140,509 |
| Exercise of options | 8,016,405 | - | - | 8,016,405 |
| Distribution to option holders | (181,800) | - | - | (181,800) |
| Convertible notes conversion to equity | 53,386,282 | - | - | 53,386,282 |
| Adjustment to valuation of equity component of convertible notes | (14,607,000) | - | - | (14,607,000) |
| Deferred tax liability on equity portion of convertible notes | (11,634,000) | - | - | (11,634,000) |
| Equity settled share based payment transactions | - | - | 773,587 | 773,587 |
| | 49,120,396 | - | 773,587 | 49,893,983 |
| | | | | |
| Closing balance at 30 June 2006 | 69,475,651 | (11,219,670) | 773,587 | 59,029,568 |

| Company | Issued Capital $ | Accumulated losses $ | Reserves $ | Total Equity $ |
|---|---|---|---|---|
| Opening balance at 1 July 2005 | **69,475,651** | **(11,219,670)** | **773,587** | **59,029,568** |
| Revaluation of property, plant and equipment | **-** | **-** | **879,999** | **879,999** |
| Net income recognised directly in equity | **-** | **-** | **879,999** | **879,999** |
| Net loss for the period | **-** | **(1,734,518)** | **-** | **(1,734,518)** |
| Total recognised income and expense for the year | **-** | **(1,734,518)** | **879,999** | **(854,519)** |
| | | | | |
| Transactions with equity holders in their capacity as equity holders: | | | | |
| Issue of share capital | **76,797,450** | **-** | **-** | **76,797,450** |
| Distribution in specie due to Allied Medical Ltd de-merger | **880,000** | **-** | **-** | **880,000** |
| Equity settled share based payment transactions | **-** | **-** | **1,253,631** | **1,253,631** |
| | **77,677,450** | **-** | **1,253,631** | **78,931,081** |
| | | | | |
| Closing balance at 30 June 2006 | **147,153,101** | **(12,954,188)** | **2,907,217** | **137,106,130** |

Amounts are stated net of tax.

The statements of change in equity are to be read in conjunction with the notes to the financial statements.

## NOTE 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The financial report is a general purpose financial report that has been prepared in accordance with Australian Accounting Standards, Urgent Issues Group Interpretations, other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001.

The financial report includes separate financial statements for Fortescue Metals Group Ltd as an individual parent entity (the "Company") and the consolidated entity consisting of Fortescue Metals Group Ltd and its subsidiaries ("Fortescue"). Fortescue Metals Group Ltd is a company limited by shares, incorporated and domiciled in Australia.

The financial report complies with all Australian equivalents to International Financial Reporting Standards ("AIFRS") in their entirety.

The following is a summary of the material accounting policies adopted by Fortescue in the preparation of the financial report. The accounting policies have been consistently applied, unless otherwise stated.

### Basis of Preparation

*First-time Adoption of Australian Equivalents to International Financial Reporting Standards*
Fortescue and the Company have prepared financial statement in accordance with the Australian Equivalents to International Financial Reporting Standards ("AIFRS") from 1 July 2005. In accordance with the requirements of AASB 1: First-time Adoption of Australian Equivalents to International Financial Reporting Standards, adjustments to the Company and Fortescue's accounts resulting from the introduction of AIFRS have been applied retrospectively to 2005 comparative figures excluding cases where optional exemptions available under AASB 1 have been applied. These consolidated accounts are the first financial statements of Fortescue to be prepared in accordance with AIFRS.

The accounting policies set out below have been consistently applied to all years presented. Changes in accounting policies related to first-time adoption of AIFRS are disclosed in note 35.

Reconciliations of the transition from previous Australian GAAP to AIFRS have been included in note 2 to this report.

*Reporting Basis and Conventions*
The financial report has been prepared on an accruals basis and is based on historical costs.

### Accounting policies

### (a) Principles of Consolidation

A controlled entity is any entity the Company has the power to control the financial and operating policies of so as to obtain benefits from its activities. A list of controlled entities is contained in note 16 to the financial statements. All controlled entities have a June financial year-end.

All inter-company balances and transactions between entities in Fortescue, including any unrealised profits or losses, have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistencies with those policies applied by the Company.

**NOTE 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Where controlled entities have entered or left Fortescue during the year, their operating results have been included/excluded from the date control was obtained or until the date control ceased.

Investments in associates are accounted for in the consolidated financial statements using the equity method. Under this method, Fortescue's share of the post-acquisition profits or losses of associates is recognised in the consolidated income statement , and its share of post-acquisition movements in reserves is recognised in consolidated reserves. The cumulative post-acquisition movements are adjusted against the cost of the investment. Associates are those entities over which Fortescue exercises significant influence, but not control.

**(b) Mineral Exploration and Evaluation Expenditure**

Exploration and evaluation expenditure incurred is accumulated in respect of each identifiable area of interest. These costs are only carried forward to the extent that they are expected to be recouped through the successful development of the area or where activities in the area have not yet reached a stage that permits reasonable assessment of the existence or otherwise of economically recoverable reserves.

Accumulated costs in relation to an abandoned area are written off in full against profit in the year in which the decision to abandon the area is made.

When production commences, the accumulated costs for the relevant area of interest are amortised over the life of the area according to the rate of depletion of the economically recoverable reserves.

A regular review is undertaken of each area of interest to determine the appropriateness of continuing to carry forward costs in relation to that area of interest.

**(c) Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different to those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment and is subject to risks and returns that are different from those of segments operating in other economic environments.

**(d) Foreign Currency Transactions**

The functional currency of each of Fortescue's entities is measured using the currency of the primary economic environment in which that entity operates. The consolidated financial statements are presented in Australian dollars which is the Company's functional and presentation currency.

Transactions in foreign currencies have been converted at rates of exchange ruling on the date of those transactions. At balance date, amounts receivable and payable in foreign currencies are translated to Australian currency at rates of exchange current at that date. Realised and unrealised gains and losses are brought to account in determining the profit or loss for the financial year.

**NOTE 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(e) Revenue Recognition**

Revenue from the sale of goods and disposal of other assets is recognised when Fortescue has passed control of the goods or other assets to the buyer.

**(f) Income Tax**

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the notional income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements, and to unused tax losses.

Deferred tax assets and liabilities are recognised for temporary differences at the tax rates expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantively enacted for each jurisdiction. The relevant tax rates are applied to the cumulative amounts of deductible and taxable temporary differences to measure the deferred tax asset or liability. An exception is made for certain temporary differences arising from the initial recognition of an asset or a liability. No deferred tax asset or liability is recognised in relation to these temporary differences if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in controlled entities where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

*Tax consolidation legislation*
Fortescue has implemented the tax consolidation legislation as of 1 July 2003.

The head entity, Fortescue Metals Group Ltd, and the controlled entities in the tax consolidated group continue to account for their own current and deferred tax amounts. These tax amounts are measured as if each entity in the tax consolidated group continues to be a stand alone taxpayer in its own right.

In addition to its own current and deferred tax amounts, the Company also recognises the current tax liabilities (or assets) and the deferred tax assets arising from unused tax losses and unused tax credits assumed from controlled entities in the tax consolidated group.

Assets or liabilities arising under tax funding agreements within the tax consolidated entities are recognised as amounts receivable from or payable to other entities in the group.

Any differences between the amounts assumed and amounts receivable or payable under the tax funding agreement are recognised as a contribution to (or distribution from) wholly-owned tax consolidated entities.

**NOTE 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(g) Leases**

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

**(h) Acquisitions of Assets**

The cost method of accounting is used for all acquisitions of assets regardless of whether shares or other assets are acquired. Cost is determined as the fair value of the assets given up at the date of acquisition plus costs incidental to the acquisition. Where shares are issued in an acquisition, the value of the shares is determined by reference to the fair value of the assets acquired, including goodwill where applicable.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value at the date of acquisition. The discount rate used is the rate at which a similar borrowing could be obtained under comparable terms and conditions.

Where the fair value of the identifiable net assets acquired, including any liability for restructuring costs, exceeds the cost of acquisition, the difference, representing a discount on acquisition, is accounted for by reducing proportionately the fair values of the non-monetary assets acquired until the discount is eliminated.

**(i) Impairment of Assets**

At each reporting date, Fortescue reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have been impaired. If such an indication exists, the recoverable amount of the asset, being the higher of the asset’s fair value less costs to sell and value in use, is compared to the asset’s carrying value. Any excess of the asset’s carrying value over its recoverable amount is expensed to the income statement.

Where it is not possible to estimate the recoverable amount of an individual asset, Fortescue estimates the recoverable amount of the cash-generating unit to which the asset belongs.

**(k) Cash and cash equivalents**

Cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and bank overdrafts.

**(j) Inventories**

Inventories are measured at the lower of cost and net realisable value.

**(k) Investments and other financial assets**

*Recognition*

Financial instruments are initially measured at cost on trade date, which includes transaction costs, when the related contractual rights and obligations exist. Subsequent to initial recognition these instruments are measured as set out below.

**NOTE 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

*Loans and receivables*
Loans and receivables are non derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised cost using the effective interest rate method.

*Held-to-maturity investments*
These investments have fixed maturities, and it is Fortescue's intention to hold investments to maturity. Any held-to-maturity investments held by Fortescue are stated at amortised cost using the effective interest rate method.

*Available-for-sale financial assets*
Available-for-sale financial assets include any financial assets not included in the above categories. Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to equity.

*Financial liabilities*
Non-derivative financial liabilities are recognised at amortised cost, comprising original debt less principal payments and amortisation.

*Fair value*
Fair value is determined based on current bid prices for all quoted investments. Valuation techniques are applied to determine the fair value for all unlisted securities, including recent arm's length transactions, reference to similar instruments and option pricing models.

*Impairment*
At each reporting date, Fortescue assesses whether there is objective evidence that a financial instrument has been impaired, in the case of available-for-sale financial instruments, a prolonged decline in the value of the instrument is considered to determine whether an impairment has arisen. Impairment losses are recognised in the income statement.

**(l) Fair value estimation**

The fair value of financial assets and financial liabilities must be estimated for recognition and measurement or for disclosure purposes. The fair value of financial instruments traded in active markets (such as publicly traded derivatives, and trading and available-for-sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by Fortescue is the current bid price; the appropriate quoted market price for financial liabilities is the current ask price.

The fair value of financial instruments that are not traded in an active market (for example over-the-counter derivatives) is determined using valuation techniques. Fortescue uses a variety of methods and makes assumptions that are based on market conditions existing at each balance date. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments.

The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to Fortescue for similar financial instruments.

**(m) Property, plant and equipment**

Each class of property, plant and equipment is carried at cost or fair value less, where applicable, any accumulated depreciation and impairment losses.

**NOTE 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

*Assets*
All property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

The carrying amount of plant and equipment is reviewed annually by Directors to ensure it is not in excess of the recoverable amount from these assets. The recoverable amount is assessed on the basis of the expected net cash flows that will be received from the assets employment and subsequent disposal. The expected net cash flows have been discounted to their present value in determining recoverable amount.

Subsequent costs are included in the asset’s carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to Fortescue and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

*Depreciation*
Land is not depreciated. Depreciation on other assets is calculated using the straight line method to allocate their cost or revalued amounts, net of their residual values, over their estimated useful lives, as follows:

| | |
|---|---|
| - Buildings | 25-40 years |
| - Machinery | 10-15 years |
| - Vehicles | 3-5 years |
| - Furniture, fittings and equipment | 3-8 years |

The assets’ residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset’s carrying amount is written down immediately to its recoverable amount if the asset’s carrying amount is greater than its estimated recoverable amount [note 1(i)].

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement. When revalued assets are sold, it is Fortescue’s policy to transfer the amounts included in other reserves in respect of those assets to retained earnings.

**(n) Trade and other payables**

These amounts represent liabilities for goods and services provided to Fortescue prior to the end of financial year which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

**NOTE 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(o) Borrowings**

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in the income statement over the period of the borrowings using the effective interest method.

The fair value of the liability portion of a convertible bond is determined using a market interest rate for an equivalent non-convertible bond. This amount is recorded as a liability on an amortised cost basis until extinguished on conversion or maturity of the bonds. The remainder of the proceeds is allocated to the conversion option. This is recognised and included in shareholders' equity, net of income tax effects.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

**(p) Borrowing costs**

Borrowing costs incurred for the construction of any qualifying asset are capitalised during the period of time that is required to complete and prepare the asset for its intended use or sale. Other borrowing costs are expensed.

**(q) Provisions**

Provisions for legal claims are recognised when: Fortescue has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

**(r) Employee benefits**

*(i) Wages and salaries, annual leave and sick leave*
Liabilities for wages and salaries, including non-monetary benefits, annual leave and accumulating sick leave expected to be settled within 12 months of the reporting date are recognised in other payables and accruals in respect of employees services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled. Liabilities for non-accumulating sick leave are recognised when the leave is taken and measured at the rates paid or payable.

*(ii) Long service leave*
The liability for long service leave is recognised in the provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

*(ii) Share-based payments*
Share-based compensation benefits are provided to employees via the Fortescue Metals Group Incentive Option Scheme ("FMGIOS").

**NOTE 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

*Shares options granted before 7 November 2002 and/or vested before 1 January 2005*
No expense is recognised in respect of these options. The shares are recognised when the options are exercised and the proceeds received allocated to share capital.

*Shares options granted after 7 November 2002 and vested after I January 2005*
The fair value of options granted under the FMGIOS is recognised as an employee benefit expense with a corresponding increase in equity. The fair value is measured at grant date and recognised over the period during which the employees become unconditionally entitled to the options.

The fair value at grant date is independently determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option, the vesting criteria, the impact of dilution, the non-tradeable nature of the option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option. The fair value of the options granted excludes the impact of any non-market vesting conditions.

Upon the exercise of options, the balance of the reserve relating to those options is transferred to share capital.

The market value of shares issued to employees for no cash consideration under the employee share scheme is recognised as a personnel expense with a corresponding increase in equity when the employees become entitled to the shares.

### (s) Issued Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Incremental costs directly attributable to the issue of new shares or options, or for the acquisition of a business, are included in the cost of the acquisition as part of the purchase consideration.

### (t) Dividends

Provision is made for the amount of any dividend declared on or before the end of the financial year but not distributed at balance date.

### (u) Earnings per share

*(i) Basic earnings per share*
Basic earnings per share is calculated by dividing the profit attributable to equity holders of the company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the financial year.

*(ii) Diluted earnings per share*
Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

**NOTE 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(v) Goods and Services Tax ("GST")**

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Tax Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the balance sheet are shown inclusive of GST.

Cash flows are presented in the cash flow statement on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

**(w) Significant accounting judgements, estimates and assumptions**

The carrying amount of certain assets and liabilities are often determined based on estimates and assumptions of future events. In the process of applying Fortescue's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on amounts recognised in the financial statements.

*(i) Exploration and evaluation assets*
Fortescue's accounting policy for exploration and evaluation expenditure is set out at note 1(b). The application of this policy necessarily requires management to make certain estimates and assumptions as to future events and circumstances, in particular, the assessment of whether economic quantities of reserves have been found. Any such estimates and assumptions may change as new information becomes available. If, after having capitalised expenditure under our policy, we conclude that we are unlikely to recover the expenditure by future exploitation or sale, then the relevant capitalised amount will be written off to the income statements.

*(ii) Share-based payment transactions*
Fortescue measures the cost of equity-settled transactions with employees by reference to the fair value of the equity investments at the date of which they are granted. The fair value is determined using the Black-Scholes model, using the assumptions detailed in note 32.

**NOTE 2. IMPACTS OF ADOPTING AUSTRALIAN EQUIVALENTS TO IFRS**

**(i) Reconciliation of Profit or Loss for the year ended 30 June 2005**

| | | Consolidated | | | Company | | |
|---|---|---|---|---|---|---|---|
| | Note | Previous GAAP $ | Effect of Change $ | Australian Equiv.s to IFRS $ | Previous GAAP $ | Effect of Change $ | Australian Equiv.s to IFRS $ |
| Revenue from ordinary activities | | 1,746,572 | - | 1,746,572 | - | - | - |
| Revenue from outside ordinary activities | | - | - | - | 1,721 | - | 1,721 |
| | | 1,746,572 | - | 1,746,572 | 1,721 | - | 1,721 |
| Cost of sales | | (1,117,215) | - | (1,117,215) | - | - | - |
| Personnel expenses | f | (1,467,942) | (773,587) | (2,241,529) | (1,017,027) | (773,587) | (1,790,614) |
| Other expenses | | (1,688,951) | - | (1,688,951) | (1,515,661) | - | (1,515,661) |
| Financial income | | 1,691,478 | - | 1,691,478 | 1,722,726 | - | 1,722,726 |
| Financial expenses | g | - | (2,909,000) | (2,909,000) | - | (2,909,000) | (2,909,000) |
| Loss before tax | | (836,058) | (3,682,587) | (4,518,645) | (808,241) | (3,682,587) | (4,490,828) |
| Income tax expense | | - | - | - | - | - | - |
| Loss for the year | | (836,058) | (3,682,587) | (4,518,645) | (808,241) | (3,682,587) | (4,490,828) |

## NOTE 2. IMPACTS OF ADOPTING AUSTRALIAN EQUIVALENTS TO IFRS (continued)

### (ii) Reconciliation of Cash Flow Statement for the year ended 30 June 2005

The adoption of AIFRS did not result in any material adjustments to the cash flow statements.

### (iii) Reconciliation of Equity

#### (a) At the end of the last reporting period under AGAAP : 30 June 2005

| | Note | Consolidated<br>Previous GAAP<br>$ | Consolidated<br>Effect of Transition to AIFRS<br>$<br>30 June 2005 | Consolidated<br>AIFRS<br>$ | Company<br>Previous GAAP<br>$ | Company<br>Effect of Transition to AIFRS<br>$<br>30 June 2005 | Company<br>AIFRS<br>$ |
|---|---|---|---|---|---|---|---|
| CURRENT ASSETS | | | | | | | |
| Cash and cash equivalents | | 81,158,375 | - | 81,158,375 | 81,040,753 | - | 81,040,753 |
| Trade and other receivables | | 1,112,872 | - | 1,112,872 | 788,407 | - | 788,407 |
| Inventories | | 137,413 | - | 137,413 | - | - | - |
| Financial assets | | 2,723 | - | 2,723 | 2,723 | - | 2,723 |
| Other current assets | | 60,356 | - | 60,356 | 60,356 | - | 60,356 |
| Total Current Assets | | 82,471,739 | - | 82,471,739 | 81,892,239 | - | 81,892,239 |
| NON-CURRENT ASSETS | | | | | | | |
| Trade and other receivables | | 1,334,824 | - | 1,334,824 | 6,000,736 | - | 6,000,736 |
| Exploration and evaluation expenditure | | 63,337,525 | - | 63,337,525 | 58,671,213 | - | 58,671,213 |
| Property, plant and equipment | | 1,172,798 | - | 1,172,798 | 1,166,756 | - | 1,166,756 |
| Other financial assets | | 26,000 | - | 26,000 | 26,403 | | 26,403 |
| Total Non-Current Assets | | 65,871,147 | - | 65,871,147 | 65,865,108 | - | 65,865,108 |
| Total Assets | | 148,342,886 | - | 148,342,886 | 147,757,347 | - | 147,757,347 |
| CURRENT LIABILITIES | | | | | | | |
| Trade and other payables | | 9,305,527 | - | 9,305,527 | 9,139,879 | - | 9,139,879 |
| Provisions | | 243,046 | - | 243,046 | 234,338 | - | 234,338 |
| Total Current Liabilities | | 9,548,573 | - | 9,548,573 | 9,374,217 | - | 9,374,217 |
| NON-CURRENT LIABILITIES | | | | | | | |
| Deferred Tax | b | - | 11,634,000 | 11,634,000 | - | 11,634,000 | 11,634,000 |
| Convertible Notes | a | 50,203,562 | 17,516,000 | 67,719,562 | 50,203,562 | 17,516,000 | 67,719,562 |
| Total Non-Current Liabilities | | 50,203,562 | 29,150,000 | 79,353,562 | 50,203,562 | 29,150,000 | 79,353,562 |
| Total Liabilities | | 59,752,135 | 29,150,000 | 88,902,135 | 59,577,779 | 29,150,000 | 88,727,779 |
| NET ASSETS | | 88,590,751 | (29,150,000) | 59,440,751 | 88,179,568 | (29,150,000) | 59,029,568 |
| EQUITY | | | | | | | |
| Issued capital | c | 95,716,651 | (26,241,000) | 69,475,651 | 95,716,651 | (26,241,000) | 69,475,651 |
| Reserves | d | - | 773,587 | 773,587 | - | 773,587 | 773,587 |
| Accumulated losses | e | (7,125,900) | (3,682,587) | (10,808,487) | (7,537,083) | (3,682,587) | (11,219,670) |
| TOTAL EQUITY | | 88,590,751 | (29,150,000) | 59,440,751 | 88,179,568 | (29,150,000) | 59,029,568 |

## NOTE 2. IMPACTS OF ADOPTING AUSTRALIAN EQUIVALENTS TO IFRS (continued)

### (iii) Reconciliation of Equity

### (b) At the date of transition to IFRS : 1 July 2004

| | Note | Consolidated | | | Company | | |
|---|---|---|---|---|---|---|---|
| | | Previous GAAP $ | Effect of Transition to AIFRS $ 1 July 2004 | AIFRS $ | Previous GAAP $ | Effect of Transition to AIFRS $ 1 July 2004 | AIFRS $ |
| CURRENT ASSETS | | | | | | | |
| Cash and cash equivalents | | 5,330,037 | - | 5,330,037 | 5,139,904 | - | 5,139,904 |
| Trade and other receivables | | 461,181 | - | 461,181 | 225,886 | - | 225,886 |
| Inventories | | 135,583 | - | 135,583 | - | - | - |
| Financial assets | | 2,723 | - | 2,723 | 2,723 | - | 2,723 |
| Other current assets | | 3,384 | - | 3,384 | - | - | - |
| Total Current Assets | | 5,932,908 | - | 5,932,908 | 5,368,513 | - | 5,368,513 |
| NON-CURRENT ASSETS | | | | | | | |
| Non-current receivables | | 196,642 | - | 196,642 | 4,797,162 | - | 4,797,162 |
| Exploration and evaluation expenditure | | 10,420,932 | - | 10,420,932 | 5,820,012 | - | 5,820,012 |
| Property, plant and equipment | | 453,560 | - | 453,560 | 433,825 | - | 433,825 |
| Other financial assets | | 26,000 | - | 26,000 | 26,403 | | 26,403 |
| Total Non-Current Assets | | 11,097,134 | - | 11,097,134 | 11,077,402 | - | 11,077,402 |
| Total Assets | | 17,030,042 | - | 17,030,042 | 16,445,915 | - | 16,445,915 |
| CURRENT LIABILITIES | | | | | | | |
| Trade and other payables | | 2,878,671 | - | 2,878,671 | 2,736,793 | - | 2,736,793 |
| Provisions | | 85,959 | - | 85,959 | 82,709 | - | 82,709 |
| Total Current Liabilities | | 2,964,630 | - | 2,964,630 | 2,819,502 | - | 2,819,502 |
| Total Liabilities | | 2,964,630 | - | 2,964,630 | 2,819,502 | - | 2,819,502 |
| NET ASSETS | | 14,065,412 | - | 14,065,412 | 13,626,413 | - | 13,626,413 |
| EQUITY | | | | | | | |
| Issued capital | | 20,355,255 | - | 20,355,255 | 20,355,255 | - | 20,355,255 |
| Accumulated losses | | (6,289,843) | - | (6,289,843) | (6,728,842) | | (6,728,842) |
| TOTAL EQUITY | | 14,065,412 | - | 14,065,412 | 13,626,413 | - | 13,626,413 |

## NOTE 2. IMPACTS OF ADOPTING AUSTRALIAN EQUIVALENTS TO IFRS (continued)

**Notes to the reconciliations of equity and profit and loss at 1 July 2004 and 30 June 2005**

| | | 30 June 2005 | 1 July 2004 |
|---|---|---|---|
| | | $ | $ |
| (a) | Convertible notes comprise: | | |
| | Adjustment to valuation of Debt component of Convertible Notes under AASB 132 and AASB 139 | 17,516,000 | - |
| | Total | 17,516,000 | - |
| (b) | Deferred tax liabilities comprise: | | |
| | Deferred tax liability on equity portion of convertible notes | 11,634,000 | - |
| | Total | 11,634,000 | - |
| (c) | Contributed equity comprise: | | |
| | Adjustment to valuation of Equity component of Convertible Notes under AASB 132 and AASB 139 | (14,607,000) | - |
| | Deferred tax liability on equity portion of convertible notes | (11,634,000) | - |
| | Total | (26,241,000) | - |
| (d) | Reserves comprise: | | |
| | Share based payments reserve relating employee option plan | 773,587 | - |
| | Total | 773,587 | - |
| (e) | Accumulated losses comprise: | | |
| | Interest Expense on Convertible Notes | (2,909,000) | - |
| | Share based payments expense relating to employee option plan | (773,587) | - |
| | Total | (3,682,587) | - |
| (f) | General and administration expense comprise: | | |
| | Share based payments expense relating to employee option plan | 773,587 | - |
| | Total | 773,587 | - |
| (g) | Other expenses from ordinary activities comprise: | | |
| | Interest Expense on Convertible Notes | 2,909,000 | - |
| | Total | 2,909,000 | - |

## NOTE 3. REVENUE

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | $ | $ | $ | $ |
| **Revenue from Ordinary Activities** | | | | |
| Sales Revenue | 834,276 | 1,746,572 | - | - |
| | | | | |
| **Revenue from Outside Ordinary Activities** | | | | |
| Management Fees | - | - | - | 1,675 |
| Other income | - | - | - | 46 |
| Total Revenue | 834,276 | 1,746,572 | - | 1,721 |

## NOTE 4. PERSONNEL EXPENSES

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | $ | $ | $ | $ |
| Wages and salaries, including superannuation | 2,619,747 | 690,042 | 2,494,956 | 319,395 |
| Other associated personnel expenses | 344,269 | 620,813 | 338,824 | 546,003 |
| Increase in liability for annual leave | 371,166 | 157,087 | 346,917 | 151,629 |
| Equity-settled transactions | 1,253,631 | 773,587 | 1,253,631 | 773,587 |
| | 4,588,813 | 2,241,529 | 4,434,328 | 1,790,614 |

## NOTE 5. OTHER EXPENSES

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | $ | $ | $ | $ |
| Communication costs | 268,244 | 225,114 | 248,427 | 138,269 |
| Office rent | 366,942 | 302,725 | 345,504 | 252,142 |
| Depreciation | 709,897 | 279,393 | 708,762 | 272,009 |
| Travel costs | 598,511 | 193,938 | 585,765 | 155,975 |
| Insurance | 295,420 | 153,798 | 294,731 | 143,581 |
| ASX fees | 66,174 | 116,547 | 66,174 | 116,547 |
| Export market development costs | - | 300,000 | - | 300,000 |
| Other | 340,397 | 117,436 | 336,363 | 137,138 |
| | 2,645,585 | 1,688,951 | 2,585,726 | 1,515,661 |

## NOTE 6. NET FINANCING COSTS

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | $ | $ | $ | $ |
| Interest income | 2,219,214 | 1,381,360 | 2,217,195 | 1,376,508 |
| Interest revenue on close out of convertible notes | 9,451,596 | - | 9,451,596 | - |
| Net foreign exchange gain | 159,341 | 310,118 | 159,341 | 346,218 |
| Financial income | 11,830,151 | 1,691,478 | 11,828,132 | 1,722,726 |
| | | | | |
| Interest expense - convertible notes | (6,542,596) | (2,909,000) | (6,542,596) | (2,909,000) |
| Financial expenses | (6,542,596) | (2,909,000) | (6,542,596) | (2,909,000) |
| | | | | |
| Net financing costs | 5,287,555 | (1,217,522) | 5,285,536 | (1,186,274) |

## NOTE 7. DISCONTINUED OPERATION

**(a) Description**

At the Company's Annual General Meeting held on 8 November 2005 members approved the de-merger of Allied Medical Limited through an "in specie" distribution of shares in Allied Medical Limited shares to Fortescue shareholders as at the record date of 23 November 2005.

Financial information relating to the discontinued operation for the period to the date of demerger is set out below.

**(b) Financial performance and cash flow information**

The financial performance and cash flow information of Allied Medical Limited presented are for the five months ended 30 November 2005 and the year ended 30 June 2005.

| | Period ended | |
|---|---|---|
| | **30 November 2005** | **30 June 2005** |
| | **$** | **$** |
| Revenue | 834,276 | 1,713,603 |
| Expenses | (738,160) | (1,741,420) |
| Profit/(Loss) before income tax | 96,116 | (27,817) |
| | | |
| Income tax expense | - | - |
| Profit/(Loss) after income tax of discontinued operations | 96,116 | (27,817) |
| | | |
| Profit/(Loss) on demerger of the subsidiary before income tax | (507,300) | - |
| Income tax expense | - | - |
| Profit/(Loss) on demerger of the subsidiary | (507,300) | - |
| | | |
| Profit/(Loss) from discontinued operations | (411,184) | (27,817) |
| | | |
| The net cashflows of the discontinuing operation which have been incorporated into the statement of cash flows are as follows: | | |
| Net cash inflow/(outflow) from ordinary activities | 19,593 | (72,509) |
| Net cash inflow/(outflow) from investing activities | - | - |
| Net cash inflow/(outflow) from financing activities | - | - |
| Net increase in cash generated by the subsidiary | 19,593 | (72,509) |

**(c) Carrying amounts of assets and liabilities**

The carrying amounts of assets and liabilities as at 30 November 2005 and 30 June 2005.

| | **30 November 2005** | **30 June 2005** |
|---|---|---|
| | **$** | **$** |
| Cash assets | 137,213 | 117,620 |
| Trade receivables | 376,553 | 318,266 |
| Other receivables | (75) | 6,199 |
| Inventories | 58,937 | 137,413 |
| Property, plant and equipment | 4,907 | 6,042 |
| **Total assets** | **577,535** | **585,540** |
| | | |
| Trade creditors | 37,278 | 165,648 |
| Provision for employee benefits | 32,957 | 8,708 |
| **Total liabilities** | **70,235** | **174,356** |
| | | |
| **Net assets** | **507,300** | **411,184** |

**NOTE 7. DISCONTINUED OPERATION (continued)**

**(d) Details of the demerger of the division**

| | Year ended 30 June 2006 $ | 30 June 2005 $ |
|---|---|---|
| Consideration received or receivable: | | |
| Cash | - | - |
| **Total disposal consideration** | **-** | **-** |
| | | |
| Carrying amount of net non-cash assets sold | (370,087) | - |
| Net cash lost on disposal | (137,213) | |
| **Loss on sale before income tax** | **(507,300)** | - |
| | | |
| Income tax expense | - | - |
| **Loss on sale after income tax** | **(507,300)** | - |

| | Consolidated 2006 $ | Consolidated 2005 $ | Company 2006 $ | Company 2005 $ |
|---|---|---|---|---|
| **NOTE 8. INCOME TAX** | | | | |
| (a) The components of tax expense comprise: | | | | |
| Current tax income | (32,721,293) | (9,016,875) | (32,739,045) | (8,993,081) |
| Deferred tax income | 31,855,675 | 7,883,025 | 31,844,592 | 7,867,575 |
| Benefit of prior year capital losses recouped in the current year | (102,402) | - | (102,402) | - |
| Tax losses recognised – current year | 968,020 | 1,133,850 | 996,855 | 1,125,506 |
| | - | - | - | - |

(b) The prima facie income tax, using rates applicable in the country of operation, on loss from ordinary activities differs from the income tax provided in the financial report as follows:

| | Consolidated 2006 $ | Consolidated 2005 $ | Company 2006 $ | Company 2005 $ |
|---|---|---|---|---|
| Loss before tax - continuing operations | (1,734,518) | (4,518,645) | (1,734,518) | (4,490,828) |
| Loss before tax - discontinuing operations | (411,183) | - | - | - |
| Loss before tax | (2,145,701) | (4,518,645) | (1,734,518) | (4,490,828) |
| | | | | |
| Income tax expense calculated at 30% (2005: 30%) | (643,710) | (1,355,594) | (520,355) | (1,347,249) |
| Sundry non-deductible/ (deductible) expenses | 47,411 | (10,332) | 47,411 | (10,332) |
| Share based payments | 376,089 | 232,076 | 376,089 | 232,076 |
| Research and development | (900,000) | - | (900,000) | - |
| Accounting loss on sale of operations | 152,190 | - | - | - |
| Taxable gain on sale of operations | 102,402 | - | 102,402 | - |
| Deferred Tax Asset on temporary differences and tax losses not brought to account at balance date as realisation is not regarded as probable | 968,020 | 1,133,850 | 996,855 | 1,125,505 |
| Benefit of prior year capital losses recouped in the current year | (102,402) | - | (102,402) | - |
| Income tax expense for the year | - | - | - | - |

| | Consolidated | | Company | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| | **$** | **$** | **$** | **$** |
| **NOTE 8. INCOME TAX (continued)** | | | | |
| (c) Amount recognised directly in equity: | | | | |
| Current tax | - | - | - | - |
| Deferred tax (Note 22) | - | 11,634,000 | - | 11,634,000 |
| | - | 11,634,000 | - | 11,634,000 |
| (d) Deferred Tax Asset not brought to account | | | | |
| Tax losses – revenue | 16,162,550 | 12,994,307 | 20,828,463 | 17,660,220 |
| Tax losses – capital | 44,521,290 | 44,862,630 | 44,521,290 | 44,862,630 |
| | 60,683,840 | 57,856,937 | 65,349,753 | 62,522,850 |
| Tax effect at 30% | 18,205,152 | 17,357,081 | 19,604,926 | 18,756,855 |

The Deferred Tax Asset not brought to account for the 2006 year will only be obtained if:

(a) Fortescue derives assessable income of a nature and of an amount sufficient to enable the benefit to be realised;

(b) Fortescue continues to comply with the conditions for deductibility imposed by tax legislation; and

(c) Fortescue is able to meet the continuity of ownership and/or continuity of business tests.

| | Consolidated | | Company | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| | **$** | **$** | **$** | **$** |
| **NOTE 9. CASH AND CASH EQUIVALENTS - CURRENT** | | | | |
| Cash on hand | 5,064 | 602 | 5,062 | 600 |
| Cash at bank | 18,049,143 | 3,388,738 | 18,049,143 | 3,271,118 |
| Deposits at call | - | 77,769,035 | - | 77,769,035 |
| | 18,054,207 | 81,158,375 | 18,054,205 | 81,040,753 |
| **NOTE 10. TRADE AND OTHER RECEIVABLES – CURRENT** | | | | |
| Trade receivables | - | 1,128,990 | - | 788,407 |
| GST receivables | 1,360,141 | - | 1,360,141 | - |
| Other receivables | 12,331 | - | 12,331 | - |
| Less: provision for doubtful debts | - | (16,118) | - | - |
| | 1,372,472 | 1,112,872 | 1,372,472 | 788,407 |
| **NOTE 11. INVENTORIES – CURRENT** | | | | |
| At cost | - | 137,413 | - | - |

| | Consolidated 2006 $ | Consolidated 2005 $ | Company 2006 $ | Company 2005 $ |
|---|---|---|---|---|
| **NOTE 12. FINANCIAL ASSETS – CURRENT** | | | | |
| Listed investments at fair value | 2,723 | 2,723 | 2,723 | 2,723 |
| Trust accounts | 320,000 | - | 320,000 | - |
| | 322,723 | 2,723 | 322,723 | 2,723 |
| **NOTE 13. OTHER CURRENT ASSETS** | | | | |
| Prepayments | 161,231 | 60,356 | 161,231 | 60,356 |

## NOTE 14. TRADE AND OTHER RECEIVABLES – NON-CURRENT

| | Consolidated 2006 $ | Consolidated 2005 $ | Company 2006 $ | Company 2005 $ |
|---|---|---|---|---|
| Loan receivable | 2,401,778 | 1,334,824 | 2,401,778 | 1,334,824 |
| Security deposits | 6,210,737 | - | 6,210,737 | - |
| Term deposits | 5,710,964 | - | 5,710,964 | - |
| Loans and advances – controlled entities | - | - | 4,665,912 | 4,665,912 |
| | 14,323,479 | 1,334,824 | 18,989,391 | 6,000,736 |

## NOTE 15. EXPLORATION AND EVALUATION EXPENDITURE

| | Consolidated 2006 $ | Consolidated 2005 $ | Company 2006 $ | Company 2005 $ |
|---|---|---|---|---|
| Carrying amount at beginning of year | 63,337,525 | 10,420,932 | 58,671,213 | 5,820,012 |
| Expenditure outlaid in cash | 119,576,931 | 52,832,580 | 119,576,931 | 52,767,188 |
| Expenditure non-cash | - | 84,013 | - | 84,013 |
| Carrying amount at end of year | 182,914,456 | 63,337,525 | 178,248,144 | 58,671,213 |

The ultimate recoupment of costs carried forward for exploration assets is dependent on the successful development and commercial exploitation or sale of the respective areas.

## NOTE 16. CONSOLIDATED ENTITIES

| Company | Class of share | Place of Incorporation | Equity Holding 2006 % | Equity Holding 2005 % | Cost to Company 2006 $ | Cost to Company 2005 $ |
|---|---|---|---|---|---|---|
| **Parent Entity** | | | | | | |
| Fortescue Metals Group Ltd | | Australia | - | - | - | - |
| **Controlled Entities** | | | | | | |
| Allied Medical Ltd | Ordinary | Australia | - | 100 | - | 1 |
| The Pilbara Infrastructure Pty Ltd | Ordinary | Australia | 100 | 100 | 1 | 1 |
| FMG Resources Pty Ltd | Ordinary | Australia | 100 | 100 | 400 | 400 |
| FMG Pilbara Pty Ltd | Ordinary | Australia | 100 | 100 | 1 | 1 |
| FMG Chichester Pty Ltd | Ordinary | Australia | 100 | 100 | - | - |
| FMG Finance Pty Ltd* | Ordinary | Australia | 100 | - | - | - |
| | | | | | 402 | 403 |

*FMG Finance Pty Ltd is a 100% subsidiary of FMG Pilbara Pty Ltd

## NOTE 17. PROPERTY, PLANT AND EQUIPMENT

| | Consolidated 2006 $ | Consolidated 2005 $ | Company 2006 $ | Company 2005 $ |
|---|---|---|---|---|
| Land and buildings – at cost | 315,939 | 114,915 | 315,939 | 114,915 |
| Accumulated depreciation | (852) | - | (852) | - |
| | 315,087 | 114,915 | 315,087 | 114,915 |
| Plant and office equipment – at cost | 4,612,250 | 1,417,569 | 4,612,250 | 1,397,701 |
| Accumulated depreciation | (1,056,372) | (365,948) | (1,056,372) | (352,122) |
| | 3,555,878 | 1,051,621 | 3,555,878 | 1,045,579 |
| Motor vehicles – at cost | 6,958 | 6,958 | 6,958 | 6,958 |
| Accumulated depreciation | (4,356) | (696) | (4,356) | (696) |
| | 2,602 | 6,262 | 2,602 | 6,262 |
| Total property, plant and equipment | 3,873,567 | 1,172,798 | 3,873,567 | 1,166,756 |

**Reconciliation of movements in carrying amounts**

| | Consolidated 2006 $ | Consolidated 2005 $ | Company 2006 $ | Company 2005 $ |
|---|---|---|---|---|
| Land and Buildings | | | | |
| Carrying amount at beginning of year | 114,915 | - | 114,915 | - |
| Additions | 201,024 | 114,915 | 201,024 | 114,915 |
| Depreciation | (852) | - | (852) | - |
| Carrying amount at end of year | 315,087 | 114,915 | 315,087 | 114,915 |
| Plant and equipment | | | | |
| Carrying amount at beginning of year | 1,051,621 | 440,712 | 1,045,579 | 433,825 |
| Additions | 3,214,549 | 978,040 | 3,214,549 | 965,059 |
| Disposal | - | (1,183) | - | (1,183) |
| Demerger of Allied Medical Limited assets | (4,907) | - | - | - |
| Depreciation | (705,385) | (365,948) | (704,250) | (352,122) |
| Carrying amount at end of year | 3,555,878 | 1,051,621 | 3,555,878 | 1,045,579 |
| Motor vehicles | | | | |
| Carrying amount at beginning of year | 6,262 | 12,848 | 6,262 | - |
| Additions | - | 6,958 | - | 6,958 |
| Disposal | - | (12,848) | - | - |
| Depreciation | (3,660) | (696) | (3,660) | (696) |
| Carrying amount at end of year | 2,602 | 6,262 | 2,602 | 6,262 |

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | $ | $ | $ | $ |

## NOTE 18. FINANCIAL ASSETS – NON-CURRENT

| | | | | |
|---|---|---|---|---|
| Unquoted investments – at cost | 26,000 | 26,000 | 26,000 | 26,000 |
| Shares in controlled entities | - | - | 402 | 403 |
| | 26,000 | 26,000 | 26,402 | 26,403 |

Financial assets are available-for-sale assets.

## NOTE 19. TRADE AND OTHER PAYABLES – CURRENT

| | | | | |
|---|---|---|---|---|
| Trade payables | - | 4,161,765 | - | 4,041,314 |
| Other payables and accruals | 16,674,415 | 5,386,808 | 16,674,415 | 5,332,903 |
| | 16,674,415 | 9,548,573 | 16,674,415 | 9,374,217 |

## NOTE 20. INTEREST BEARING LOANS AND BORROWINGS

| | | | | |
|---|---|---|---|---|
| Syndicated loan – secured # | 67,267,590 | - | 67,267,590 | - |
| Convertible notes - unsecured | - | 67,719,562 | - | 67,719,562 |
| | 67,267,590 | 67,719,562 | 67,267,590 | 67,719,562 |

**Convertible Notes**
During the year ended 30 June 2006 the Company exercised its option to convert the convertible notes into ordinary shares in the Company. The number of shares issued was 19,863,533.

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | $ | $ | $ | $ |

The convertible notes are presented in the balance sheets as follows:

| | | | | |
|---|---|---|---|---|
| Face value of notes issued | - | 103,589,844 | - | 103,589,844 |
| Classified as equity securities | - | (35,870,282) | - | (35,870,282) |
| | - | 67,719,562 | - | 67,719,562 |

*Syndicated loan*
The Company put in place during the current financial year a US$200 million syndicated loan note facility with institutional investors. The facility was put in place to ensure the rapid development of its Pilbara Iron Ore and Infrastructure Project is maintained without compromising its capital raising process.

The key terms and conditions of the facility are:
- The facility term is 2 years subject to a review after 12 months;
- Pricing is based on a competitive margin over LIBOR; and
- (#) The facility is secured over Fortescue's total assets per the consolidated balance sheet.

The Company has drawn down US$50 million as at 30 June 2006.

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| **NOTE 21. EMPLOYEES** | | | | |
| Average number of employees during the financial year | 171 | 85 | 171 | 81 |

Note 32 provides details of employee benefits related to share based payments.

**NOTE 22. DEFERRED TAX LIABILITIES – NON-CURRENT**

| | Consolidated 2006 | Consolidated 2005 | Company 2006 | Company 2005 |
|---|---|---|---|---|
| The balance comprises temporary differences attributable to : | | | | |
| - Amounts recognised to profit or loss | - | - | - | - |
| - Equity component of convertible notes | - | 11,634,000 | - | 11,634,000 |
| | - | 11,634,000 | - | 11,634,000 |
| Movements in equity component of convertible notes: | | | | |
| Balance at beginning of year | 11,634,000 | - | 11,634,000 | - |
| Charged to equity | (11,634,000) | 11,634,000 | (11,634,000) | 11,634,000 |
| Balance at end of year | - | 11,634,000 | - | 11,634,000 |

**NOTE 23. ISSUED CAPITAL**

A reconciliation of the movement in capital and reserves for the Company and the consolidated entity can be found in the Statement of Changes in Equity.

| **SHARE CAPITAL** | **2006** | **2005** |
|---|---|---|
| Ordinary shares fully paid: | **Number of shares** | **Number of shares** |
| Balance at beginning of financial year | 217,822,928 | 124,298,108 |
| Conversion of options at 8 cents | - | 69,580,000 |
| Conversion of options at 20 cents | - | 1,000,000 |
| Conversion of options at 50 cents | - | 1,000,000 |
| Conversion of options at 75 cents | - | 1,000,000 |
| Conversion of options at $1.00 | - | 1,000,000 |
| Issue of shares at 55 cents | - | 12,898,470 |
| Issue of shares at $1 | - | 7,046,350 |
| Equity-settled transactions | 3,000 | - |
| Conversion of convertible notes at $4.50 | 8,985,644 | - |
| Conversion of convertible notes at $6.00 | 10,877,888 | - |
| Balance at end of financial year | 237,689,460 | 217,822,928 |

Fully paid ordinary shares entitle the holder to participate in dividends and to one vote per share at meetings of the Company. Ordinary shares participate in the proceeds on winding up of the Company in proportion to the number of shares held.

Effective 1 July 1998, the Company Law Review Act abolished the concept of par value shares and the concept of authorised capital. Accordingly, the Company does not have authorised capital or par value in respect of its issued shares.

## NOTE 24. RESERVES

(a) *The share based payments reserve*
The share based payments reserve records items recognised as expenses on valuation of employee share options.

(b) *Asset revaluation reserve*
The asset revaluation reserve records revaluations of non-current assets. Under certain circumstances dividends can be declared from this reserve.

## NOTE 25. EARNINGS PER SHARE

**Basic earnings per share**

The calculation of basic earnings per share at 30 June 2006 was based on the loss attributable to ordinary shareholders of $2,145,701 (2005: loss $4,518,645) and a weighted average number of ordinary shares outstanding during the financial year ended 30 June 2006 of 223,451,812 (2005: 175,236,990), calculated as follows:

| | **Consolidated** | |
|---|---|---|
| | **2006** | **2005** |
| | **$** | **$** |
| Loss attributable to ordinary shareholders | (2,145,701) | (4,518,645) |
| Weighted average number of ordinary shares used in the calculation of basic earnings per share | 223,451,812 | 175,236,990 |
| Basic earnings per share (in cents) | (0.96) | (2.58) |

**Diluted earnings per share**

The Company's potential ordinary shares, being its options granted, are not considered dilutive as the conversion to these options would result in a decrease in the net loss per share.

**Earnings per share for continuing and discontinued operations**
**Basic earnings per share**

| | **Consolidated** | |
|---|---|---|
| | **2006** | **2005** |
| | **$** | **$** |
| From continuing operations (in cents) | (0.78) | (2.56) |
| From discontinuing operations (in cents) | (0.18) | (0.02) |

For the financial year ended 30 June 2006, earnings per share for continuing and discontinued operations has been calculated using the same figures as earnings per share, except that the loss for the period used in the calculation is the loss relating to continuing operations of $1,734,518 (2005: loss $4,463,011) and the loss relating to discontinued operations of $411,184 (2005: loss $27,817).

## NOTE 26. SEGMENT REPORTING

Segment information is presented in respect of Fortescue's business and geographical segments. The primary format, business segments, is based on Fortescue's management and internal reporting structure.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly income earning assets and revenue, interest-bearing loans, borrowings and expenses, and corporate assets and expenses.

### Primary Reporting

*Business Segments*

Fortescue has the following two business segments:

- Development of the Pilbara Iron Ore and Infrastructure Project; and
- Marketing and distribution of medical products throughout Australia and New Zealand. This business was demerged in November 2005.

### Secondary Reporting

*Geographical Segments*

Fortescue operated predominantly in the geographical location of Australia.

## NOTE 26. SEGMENT REPORTING (continued)

### Business Segments (continued)

| | Mining & Exploration | | Medical (Discontinued) | | Eliminations | | Consolidated | | Less: Medical (Discontinued) | | Consolidated (Continuing Operations) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 $ | 2005 $ | 2006 $ | 2005 $ | 2006 $ | 2005 $ | 2006 $ | 2005 $ | 2006 $ | 2005 $ | 2006 $ | 2005 $ |
| Revenue from external customers: | | | | | | | | | | | | |
| Sales | - | - | 834,276 | 1,746,572 | - | - | 834,276 | 1,746,572 | (834,276) | (1,746,572) | - | - |
| Services | - | 1,721 | - | - | - | (1,721) | - | - | - | - | - | - |
| Total revenue | - | 1,721 | 834,276 | 1,746,572 | - | (1,721) | 834,276 | 1,746,572 | (834,276) | (1,746,572) | - | - |
| Segment result | (7,020,054) | (3,304,554) | 94,098 | 3,431 | - | - | (6,925,956) | (3,301,123) | (94,098) | (3,431) | (7,020,054) | (3,304,554) |
| Loss before financing costs | (7,020,054) | (3,304,554) | 94,098 | 3,431 | - | - | (6,925,956) | (3,301,123) | (94,098) | (3,431) | (7,020,054) | (3,304,554) |
| Net financing income/(costs) | 5,285,536 | (1,186,274) | 2,019 | (31,248) | - | - | 5,287,555 | (1,217,522) | (2,019) | 31,248 | 5,285,536 | (1,186,274) |
| Income tax expense | - | - | - | - | - | - | - | - | - | - | - | |
| Loss on sale of discontinued operation, net of tax | - | - | (507,300) | - | - | - | (507,300) | - | 507,300 | - | - | |
| Profit for the period | (1,734,518) | (4,490,828) | (411,183) | (27,817) | - | - | (2,145,701) | (4,518,645) | 411,183 | 27,817 | (1,734,518) | (4,490,828) |
| Segment assets | 221,048,537 | 147,757,750 | - | 585,540 | (402) | (404) | 221,048,135 | 148,342,886 | - | (585,540) | 221,048,135 | 147,757,347 |
| Total assets | 221,048,537 | 147,757,750 | - | 585,540 | (402) | (404) | 221,048,135 | 148,342,886 | - | (585,540) | 221,048,135 | 147,757,347 |
| Segment liabilities | 83,942,005 | 88,727,779 | - | 174,356 | - | - | 83,942,005 | 88,902,135 | - | (174,356) | 83,942,005 | 88,727,779 |
| Total liabilities | 83,942,005 | 88,727,779 | - | 174,356 | - | - | 83,942,005 | 88,902,135 | - | (174,356) | 83,942,005 | 88,727,779 |
| Cash flows from operating activities | (129,130,662) | (48,290,299) | 19,593 | (72,509) | - | - | (129,111,069) | (48,362,808) | (19,593) | 72,509 | (129,130,662) | (48,290,299) |
| Cash flows from investing activities | (3,532,917) | (2,140,970) | - | - | - | - | (3,532,917) | (2,140,970) | - | - | (3,532,917) | (2,140,970) |
| Cash flows from investing activities | 67,267,590 | 124,453,265 | - | - | - | - | 67,267,590 | 124,453,265 | - | - | 67,267,590 | 124,453,265 |
| Capital expenditure | 122,992,504 | 54,003,525 | - | 12,981 | - | - | 122,992,504 | 54,016,506 | - | (12,981) | 122,992,504 | 54,003,525 |

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | $ | $ | $ | $ |

## NOTE 27. AUDITORS REMUNERATION

| | | | | |
|---|---|---|---|---|
| Amounts received or due and receivable by auditors for: | | | | |
| Auditing – the financial report | 56,715 | 40,514 | 56,715 | 32,564 |
| Financial due diligence | 107,261 | - | 107,261 | - |
| | 163,976 | 40,514 | 163,976 | 32,564 |

## NOTE 28(a) RECONCILIATION OF CASH FLOWS FROM OPERATING ACTIVITIES

| | | | | |
|---|---|---|---|---|
| Loss for the period | (2,145,701) | (4,518,645) | (1,734,518) | (4,490,828) |
| Depreciation | 713,334 | 279,393 | 712,199 | 272,009 |
| Loss on sale of assets | - | 4,157 | - | - |
| Provision – employee entitlements | 367,731 | 157,087 | 343,482 | 151,629 |
| Equity-settled share based payment expenses | 1,253,631 | 773,587 | 1,253,631 | 773,587 |
| Interest expense | (2,909,000) | 2,909,000 | (2,909,000) | 2,909,000 |
| Exploration expenditure capitalised | (119,576,931) | (52,832,580) | (119,576,931) | (52,832,580) |
| Net unrealised gain on foreign exchange | (159,341) | (851,170) | (159,341) | (851,170) |
| Operating profit before changes in working capital | (122,456,277) | (54,079,171) | (122,070,478) | (54,068,353) |
| *Changes in assets and liabilities during the year:* | | | | |
| Increase/ (decrease) in payables | 6,805,042 | 6,426,856 | 6,933,412 | 6,400,599 |
| (Increase) /decrease in financial assets | (320,000) | - | (320,000) | - |
| (Increase) /decrease in receivables and prepayments | (13,725,609) | (708,663) | (13,673,596) | (622,545) |
| (Increase) /decrease in inventory | 78,476 | (1,830) | - | - |
| | (129,618,369) | (48,362,808) | (129,130,662) | (48,290,299) |
| Loss on sale of discontinued operations, net of tax | 507,299 | - | - | - |
| **Net cash used in operating activities** | (129,111,069) | (48,362,808) | (129,130,662) | (48,290,299) |

## NOTE 28(b) NON-CASH FINANCING AND INVESTING ACTIVITIES

In the year ended 30 June 2005 - 46,355 shares at $1.00 each and 50,288 shares at 55 cents each to various suppliers in payment for services.

## NOTE 29. FINANCIAL INSTRUMENTS

*(a) Credit Risk Exposures*

Credit risk refers to the risk that the counterparty will default on its contractual obligations resulting in financial loss to Fortescue. Fortescue has adopted the policy of only dealing with credit worthy counterparties and obtaining sufficient collateral or other security where appropriate, as a means of mitigating the risk of financial loss from defaults. Fortescue measures credit risk on a fair value basis.

**NOTE 29. FINANCIAL INSTRUMENTS (continued)**

Fortescue does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics.

The carrying amount of financial assets recorded in the financial statements, net of any provisions for losses, represents Fortescue's maximum exposure to credit risk without taking account of the value of any collateral or other security obtained.

*(b) Interest Rate Risk*

**Effective interest rates and repricing analysis**

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice.

| 2006 Consolidated | Note | Effective interest rate % | 6 months or less $ | 6-12 months $ | 1-2 years $ | Non interest bearing $ | Total $ |
|---|---|---|---|---|---|---|---|
| Cash and cash equivalents | 9 | 3.95 | 18,049,143 | - | - | 5,064 | 18,054,207 |
| Other receivables | 10 | - | - | - | - | 1,372,472 | 1,372,472 |
| Listed shares | 12 | - | - | - | - | 2,723 | 2,723 |
| Prepayments | 13 | - | - | - | - | 161,231 | 161,231 |
| Loan receivable | 14 | - | - | - | - | 2,401,778 | 2,401,778 |
| Security deposits | 14 | - | - | - | - | 6,210,737 | 6,210,737 |
| Term deposits | 14 | 3.95 | - | - | 5,710,964 | - | 5,710,964 |
| Trust accounts | 12 | - | - | - | - | 320,000 | 320,000 |
| Unquoted investments | 18 | - | - | - | - | 26,000 | 26,000 |
| Trade and other payables | 19 | - | - | - | - | (16,674,415) | (16,674,415) |
| Syndicated loan | 20 | 9.96 | - | - | (67,267,590) | - | (67,267,590) |
| | | | 18,049,143 | - | (61,556,626) | (6,174,410) | (49,681,893) |
| **Company** | | | | | | | |
| Cash and cash equivalents | 9 | 3.95 | 18,049,143 | - | - | 5,062 | 18,054,205 |
| Other receivables | 10 | - | - | - | - | 1,372,472 | 1,372,472 |
| Listed shares | 12 | - | - | - | - | 2,723 | 2,723 |
| Prepayments | 13 | - | - | - | - | 161,231 | 161,231 |
| Loan receivable | 14 | - | - | - | - | 2,401,778 | 2,401,778 |
| Security deposits | 14 | - | - | - | - | 6,210,737 | 6,210,737 |
| Term deposits | 14 | 3.95 | - | - | 5,710,964 | - | 5,710,964 |
| Loans and advances – controlled entities | 14 | - | - | - | - | 4,665,912 | 4,665,912 |
| Trust accounts | 12 | - | - | - | - | 320,000 | 320,000 |
| Unquoted investments | 18 | - | - | - | - | 26,000 | 26,000 |
| Trade and other payables | 19 | - | - | - | - | (16,674,415) | (16,674,415) |
| Syndicated loan | 20 | 9.96 | - | - | (67,267,590) | - | (67,267,590) |
| | | | 18,049,143 | - | (61,556,626) | (1,508,500) | (45,015,983) |

**NOTE 29. FINANCIAL INSTRUMENTS (continued)**

| 2005 Consolidated | Note | Effective interest rate % | 6 months or less $ | 6-12 months $ | 1-2 years $ | Non interest bearing $ | Total $ |
|---|---|---|---|---|---|---|---|
| Cash and cash equivalents | 9 | 4.23 | 3,388,738 | 77,769,035 | - | 602 | 81,158,375 |
| Trade receivables | 10 | - | - | - | - | 1,112,872 | 1,112,872 |
| Inventories | 11 | - | - | - | - | 137,413 | 137,413 |
| Listed shares | 12 | - | - | - | - | 2,723 | 2,723 |
| Prepayments | 13 | - | - | - | - | 60,356 | 60,356 |
| Loan receivable | 14 | - | - | - | - | 1,334,824 | 1,334,824 |
| Unquoted investments | 18 | - | - | - | - | 26,000 | 26,000 |
| Trade and other payables | 19 | - | - | - | - | (9,548,573) | (9,548,573) |
| Convertible notes | 20 | - | - | - | - | (50,203,562) | (50,203,562) |
| | | | 3,388,738 | 77,769,035 | - | (57,077,345) | 24,080,428 |
| **Company** | | | | | | | |
| Cash and cash equivalents | 9 | 4.23 | 3,271,118 | 77,769,035 | - | 600 | 81,040,753 |
| Trade receivables | 10 | - | - | - | - | 788,407 | 788,407 |
| Listed shares | 12 | - | - | - | - | 2,723 | 2,723 |
| Prepayments | 13 | - | - | - | - | 60,356 | 60,356 |
| Loan receivable | 14 | - | - | - | - | 1,334,824 | 1,334,824 |
| Loans and advances – controlled entities | 14 | - | - | - | - | 4,665,912 | 4,665,912 |
| Unquoted investments | 18 | - | - | - | - | 26,000 | 26,000 |
| Trade and other payables | 19 | - | - | - | - | (9,374,217) | (9,374,217) |
| Convertible notes | 20 | - | - | - | - | (50,203,562) | (50,203,562) |
| | | | 3,271,118 | 77,769,035 | - | (52,698,957) | 28,341,196 |

Convertible notes on issue during the financial year did not bear interest during the period.

*(c) Net Fair Value*

The carrying amount of financial assets and financial liabilities recorded in the financial statements represents their respective net fair values, determined in accordance with the accounting policies disclosed in note 1 to the financial statements.

*(d) Foreign currency risk*

Fortescue is exposed to foreign currency risk on cash held, foreign currency loans and exploration and evaluation expenditure. The currency giving rise to this risk is primarily US dollars. Fortescue has not entered into any forward foreign exchange contracts as at 30 June 2006 and is currently fully exposed to foreign exchange risk.

## NOTE 30. COMMITMENTS

*(a) Leasing Commitments*

| | Consolidated | | Company | |
|---|---|---|---|---|
| Operating leases | **2006** | **2005** | **2006** | **2005** |
| | **$** | **$** | **$** | **$** |
| Less than one year | 965,273 | 335,734 | 965,273 | 335,734 |
| Between one and five years | 2,814,202 | 283,844 | 2,814,202 | 283,844 |
| Greater than five years | 276,966 | - | 276,966 | - |
| | 3,779,475 | 619,578 | 3,779,475 | 619,578 |

The property lease regarding Fortescue's previous headquarters at 50 Kings Park Road, West Perth, expires on 1 February 2014, with a five year first term of renewal at 1 February 2013. Contingent rental provisions within the lease agreement require the minimum lease payments to be reviewed every two years from the commencement date.

The property lease regarding Fortescue's current headquarters at 87 Adelaide Terrace, East Perth, expires on 1 April 2010, with a five year option term of renewal commencing 1 April 2010. Contingent rental provisions within the lease agreement require the minimum lease payments to be reviewed annually from the commencement date.

*(b) Exploration Tenement Leases – Commitments for Expenditure.*

In order to maintain current rights of tenure to exploration tenements, Fortescue is required to outlay lease rentals and to meet the minimum expenditure requirements of $7,650,440 over the next financial year (2005 $1,393,844).

Financial commitments for subsequent periods are contingent upon future exploration results and can not be estimated. These obligations are subject to renegotiation upon expiry of the exploration leases or when application for a mining licence is made and have not been provided for in the accounts.

*(c) Project Commitments*

Commitments exist in relation to the project for up to $43,281,584 (2005: $2,400,000) over the next financial year, being the minimum commitment of the Company and the consolidated entity should the project not go forward.

## NOTE 31. KEY MANAGEMENT PERSONNEL DISCLOSURES

The following were key management personnel of Fortescue at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period:

**Directors**
The following persons were Directors of the Company during the financial year:

*Chairman – Non Executive*
Mr Gordon Toll

*Executive Directors*
Mr Andrew Forrest, *Chief Executive Officer*
Mr Graeme Rowley, *Executive Director Operations*
Mr Russell Scrimshaw, *Executive Director Commercial*

*Non Executive Directors*
Mr Herb Elliott
Mr Ken Ambrecht

**Key Management Personnel**

Mr Alan Watling, *Head of Infrastructure*
Mr Peter Thomas, *Chief Financial Officer – The Pilbara Infrastructure Pty Ltd*
Mr John Clout, *Head of Resource Strategy*
Mr Christopher Catlow, *Chief Financial Officer*
Mr Julian Tapp, *Head of Government Relations*
Mr Bill Ramsey, *Project Director*

**Key management personnel compensation**

The key management personnel compensation included in 'personnel expenses' (see note 4) are as follows:

| | Consolidated | | Company | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| | **$** | **$** | **$** | **$** |
| Short-term employee benefits | 2,509,284 | 1,049,726 | 2,509,284 | 1,049,726 |
| Other long term benefits | - | - | - | - |
| Post-employment benefits | 217,825 | 98,022 | 217,825 | 98,022 |
| Termination benefits | - | - | - | - |
| Equity compensation benefits | 448,362 | 236,464 | 448,362 | 236,464 |
| | 3,175,471 | 1,384,212 | 3,175,471 | 1,384,212 |

The Company has taken advantage of the relief provided by ASIC Class Order 06/50 and has transferred the Detailed Remuneration Disclosures to the Directors' Report. The relevant information can be found in the Remuneration Report.

Balances above are recognised on a gross basis. Personnel expenses disclosed in note 4 are recognised net of salary recoveries.

**NOTE 31. KEY MANAGEMENT PERSONNEL DISCLOSURES (continued)**

**Individual Directors and executives compensation disclosures**

Information regarding individual Directors and executives compensation is provided in the Remuneration Report section of the Directors' report.

Apart from the details disclosed in this note, no Director has entered into a material contract with the Company or Fortescue since the end of the previous financial year and there were no material contracts involving Directors' interests existing at year-end.

**Option over equity instruments granted as compensation**

The movement during the reporting period in the number of options over ordinary shares in the Company held directly, indirectly or beneficially, by each key management person, including their related parties is as follows.

**2006**

| | Held at 1 July 2005 | Granted as compensation | Exercised | Other changes during the year | Balance at 30 June 2006 | Vested during the year | Vested and exercisable at the end of the year |
|---|---|---|---|---|---|---|---|
| ***Key Management Personnel*** | | | | | | | |
| A Watling | 200,000 | - | - | - | 200,000 | 50,000 | 50,000 |
| P Thomas | 190,000 | 25,000 | - | - | 215,000 | 47,500 | 47,500 |
| J Clout | 150,000 | 30,000 | - | - | 180,000 | 37,500 | 37,500 |
| C Catlow | - | 100,000 | - | - | 100,000 | - | - |
| J Tapp | 100,000 | 40,000 | - | - | 140,000 | 25,000 | 25,000 |
| B Ramsey | - | 100,000 | - | - | 100,000 | - | - |
| | 640,000 | 295,000 | - | - | 935,000 | 160,000 | 160,000 |

No Directors held options during the financial year.

No options held by key management personnel are vested but not exercisable.

**2005**

| | Held at 1 July 2004 | Granted as compensation | Exercised | Other changes during the year | Balance at 30 June 2005 | Vested during the year | Vested and exercisable at the end of the year |
|---|---|---|---|---|---|---|---|
| ***Directors*** | | | | | | | |
| G Toll | - | - | - | - | - | - | - |
| H Elliott | 750,000 | - | (750,000) | - | - | 750,000 | - |
| A Forrest | 69,555,000 | - | (67,850,000) | (1,705,000) | - | 69,555,000 | - |
| G Rowley | - | - | (1,000,000) | 1,000,000 | - | - | - |
| R Scrimshaw | 750,000 | - | (750,000) | - | - | 750,000 | - |
| K Ambrecht | 750,000 | - | (750,000) | - | - | 750,000 | - |
| ***Other Key Management Personnel*** | | | | | | | |
| A Watling | - | 200,000 | - | - | 200,000 | - | - |
| P Thomas | - | 190,000 | - | - | 190,000 | - | - |
| J Clout | - | 150,000 | - | - | 150,000 | - | - |
| C Catlow | - | - | - | - | - | - | - |
| J Tapp | - | 100,000 | - | - | 100,000 | - | - |
| B Ramsey | - | - | - | - | - | - | - |
| | 71,805,000 | 640,000 | (71,100,000) | (705,000) | 640,000 | 71,805,000 | - |

## NOTE 31. KEY MANAGEMENT PERSONNEL DISCLOSURES (continued)

**Movements in Shares**
The movement during the reporting period in the number of ordinary shares in the Company held directly, inadvertently or beneficially, by each key management person, including their related parties, are set out below.

***2006***
**Ordinary shares**

| Name | Held at 1 July 2005 | Received on exercise of options | Purchases | Sales | Held at 30 June 2006 |
|---|---|---|---|---|---|
| ***Directors*** | | | | | |
| A Forrest | 102,674,330 | - | - | (366,500) | 102,307,830 |
| G Rowley | 2,149,569 | - | - | (2,000) | 2,147,569 |
| H Elliott | 800,000 | - | - | (250,000) | 550,000 |
| R Scrimshaw | 1,077,600 | - | - | - | 1,077,600 |
| K Ambrecht | 750,000 | - | - | - | 750,000 |
| G Toll | 750,000 | - | - | - | 750,000 |
| TOTAL | 108,201,499 | - | - | (618,500) | 107,582,999 |
| ***Other Key Management Personnel*** | | | | | |
| A Watling | - | - | - | - | - |
| P Thomas | 110,000 | - | - | (15,000) | 95,000 |
| J Clout | 5,000 | - | 70 | (2,000) | 3,070 |
| C Catlow | 800,000 | - | - | - | 800,000 |
| J Tapp | - | - | - | - | - |
| B Ramsey | - | - | 22,000 | - | 22,000 |
| TOTAL | 915,000 | - | 22,070 | (17,000) | 920,070 |

***2005***
**Ordinary shares**

| Name | Held at 1 July 2004 | Received on exercise of options | Purchases | Sales | Held at 30 June 2005 |
|---|---|---|---|---|---|
| ***Directors*** | | | | | |
| A Forrest | 39,602,665 | 67,850,000 | 397,335 | (5,175,670) | 102,674,330 |
| G Rowley | 1,359,569 | 1,000,000 | - | (210,000) | 2,149,569 |
| H Elliott | 50,000 | 750,000 | 100,000 | (100,000) | 800,000 |
| R Scrimshaw | 327,600 | 750,000 | - | - | 1,077,600 |
| K Ambrecht | - | 750,000 | - | - | 750,000 |
| G Toll | - | - | 750,000 | - | 750,000 |
| TOTAL | 41,339,834 | 71,100,000 | 1,247,335 | (5,485,670) | 108,201,499 |
| ***Other Key Management Personnel*** | | | | | |
| A Watling | - | - | - | - | - |
| P Thomas | - | - | 120,000 | (10,000) | 110,000 |
| J Clout | - | - | 15,000 | (10,000) | 5,000 |
| C Catlow | 800,000 | - | - | - | 800,000 |
| J Tapp | - | - | - | - | - |
| B Ramsey | - | - | - | - | - |
| TOTAL | 800,000 | - | 135,000 | (20,000) | 915,000 |

**NOTE 31. KEY MANAGEMENT PERSONNEL DISCLOSURES (continued)**

**Other related party transactions**

**Subsidiaries**

Loans are made by the Company to wholly owned subsidiaries for capital purchases. Loans outstanding between the Company and its controlled entities have no fixed date of repayment and are non-interest bearing. During the financial year ended 30 June 2006, such loans to subsidiaries totalled $4,665,912 (2005: $4,665,912). These loans have been recognised as non-current receivables.

During the 2005 financial year, a subsidiary FMG Pilbara Pty Ltd loaned $608,506 (2005: $608,506) to another subsidiary FMG Chichester Pty Ltd. The loan is interest free and has no fixed date of repayment.

## NOTE 32. SHARE BASED PAYMENTS

Shareholders approved the implementation of the Fortescue Metals Group Incentive Option Scheme ("FMGIOS") at the 2005 AGM. The FMGOIS entitles key management personnel and senior employees to purchase shares in the Company. In accordance with these programmes options are exercisable at the market price of the shares at the date of grant.

The terms and conditions of the grants are as follows, whereby all options are settled by physical delivery of shares:

| Grant date / employee entitled | Number of instruments | Vesting conditions | Contractual life of options |
|---|---|---|---|
| Option grant to key management in June 2005 | 2,000,000 | Four years of service | 5 years |
| Option grant to key management in January 2006 | 430,000 | Four years of service | 5 years |
| Option grant to key management in June 2006 | 500,000 | Four years of service | 5 years |
| Total share options | 2,930,000 | | |

The number and weighted average exercise prices of share options is as follows:

| | Weighted average exercise price 2006 | Number of options 2006 | Weighted average exercise price 2005 | Number of options 2005 |
|---|---|---|---|---|
| Outstanding at the beginning of the period | $2.67 | 2,000,000 | $0.09 | 56,970,000 |
| Forfeited during the period | - | - | - | - |
| Exercised during the period | - | - | $0.09 | (56,970,000) |
| Granted during the period | $6.41 | 930,000 | $2.67 | 2,000,000 |
| Outstanding at the end of the period | $3.86 | 2,930,000 | $2.67 | 2,000,000 |
| Exercisable at the end of the period | $2.67 | 500,000 | | - |

The options outstanding at 30 June 2006 have an exercise price in the range of $2.67 to $7.03 and a weighted average contractual life of 5 years.

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes model. The contractual life of the option is used as an input into this model.

## NOTE 32. SHARE BASED PAYMENTS (continued)

The following factors and assumptions were used in determining the fair value of options on grant date:

| Grant Date | Expiry Date | Fair value per option | Exercise price | Price of shares on grant date | Expected volatility | Risk free interest rate | Dividend yield |
|---|---|---|---|---|---|---|---|
| 28 November 2003 | 28 November 2006 | $0.30 | $0.50 | $0.50 | 26.40% | 5.75% | - |
| 28 November 2003 | 28 November 2006 | $0.26 | $0.75 | $0.50 | 26.40% | 5.75% | - |
| 28 November 2003 | 28 November 2006 | $0.23 | $1.00 | $0.50 | 26.40% | 5.75% | - |
| 1 June 2005 | 31 December 2009 | $1.97 | $2.67 | $2.67 | 26.40% | 5.75% | - |
| 25 January 2006 | 25 January 2011 | $4.60 | $5.69 | $6.15 | 26.80% | 5.13% | - |
| 1 June 2006 | 1 June 2011 | $5.79 | $7.03 | $7.68 | 26.80% | 5.75% | - |

**Employee expenses**

| | Note | Consolidated | | The Company | |
|---|---|---|---|---|---|
| | | 2006 $ | 2005 $ | 2006 $ | 2005 $ |
| Share options granted in 2005- equity settled | 4 | 982,580 | 773,587 | 982,580 | 773,587 |
| Share options granted in 2006- equity settled | 4 | 271,051 | - | 271,051 | - |
| Total expense recognised as employee costs | | 1,253,631 | 773,587 | 1,253,631 | 773,587 |

## NOTE 33. CONTINGENT LIABILITIES AND CONTINGENT ASSETS

**Contingent liability**

*ASIC Proceedings*
The Australian Securities and Investment Commission ("ASIC") intends to commence legal proceedings against Fortescue and its Chief Executive Officer in relation to market disclosure of certain agreements signed by the Company in 2004. The agreement in question relate to those signed with China Railway Engineering Corporation ("CREC"), China Harbour Engineering Corporation ("CHEC") and China Metallurgical Construction Corporation ("MCC").

The ASIC statement of claim alleges a breach by the Company and by the CEO of the continuous disclosure provisions of the Corporations Act under Section 674 and also a breach under Section 1041H relating to deceptive and misleading conduct. ASIC is seeking civil penalties of up to $3,000,000 for the Company and $600,000 for the CEO and an order that he compensate Fortescue for any pecuniary penalty it may be required to pay.

Both the Company and the CEO Mr Andrew Forrest will vigorously contest the charges.

**Contingent asset**

*Payroll tax assessment*
A payroll tax assessment for the amount of $1,495,989 was received from the State Revenue Department relating to options issued to The Metals Group Pty Ltd in 2003. The Company has lodged an objection to this assessment on the grounds that these options are not wages for payroll tax purposes under the definitions of the Payroll Tax Assessment Act 2002.

## NOTE 34. AFTER BALANCE DATE EVENTS

*(i) Capital raising*
On 15 July 2006 Leucadia National Corporation signed a Subscription Agreement to invest US$400 million in Fortescue. Leucadia will receive 26.4 million shares in the Company and US$100 million of Secured Subordinated Loan Notes upon financial close, which occurs when US$2 billion of secured debt and lease facilities have been established. The Notes have a 13 year term, a zero fixed interest rate and a variable interest rate equal to 4% of the revenue, net of government royalties received from the sale of iron ore from Cloud Break and Christmas Creek.

*(ii) Syndicated loan*
The Company has drawn down an additional US$100 million subsequent to year end.

Other than the matters discussed above, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the Company, the results of those operations or the state of affairs of the Company in future financial years.

## NOTE 35. CHANGE IN ACCOUNTING POLICY

The following Australian Accounting Standards have been issued or amended and are applicable to the parent and economic entity but are not yet effective. They have not been adopted in preparation of the financial statements at reporting date.

| AASB Amendment | AASB Standard Affected | Nature of Change in Accounting Policy and Impact | Application Date of the Standard | Application Date for the Group |
|---|---|---|---|---|
| 2004–3 | AASB 1: First-time Adoption of AIFRS | No change, no impact | 1 January 2006 | 1 July 2006 |
| | AASB 101: Presentation of Financial Statements | No change, no impact | 1 January 2006 | 1 July 2006 |
| | AASB 124: Related Party Disclosures | No change, no impact | 1 January 2006 | 1 July 2006 |
| 2005–1 | AASB 139: Financial Instruments: Recognition and Measurement | No change, no impact | 1 January 2006 | 1 July 2006 |
| 2005–5 | AASB 1: First-time Adoption of AIFRS | No change, no impact | 1 January 2006 | 1 July 2006 |
| | AASB 139: Financial Instruments: Recognition and Measurement | No change, no impact | 1 January 2006 | 1 July 2006 |
| 2005–6 | AASB 3: Business Combinations | No change, no impact | 1 January 2006 | 1 July 2006 |

## NOTE 35. CHANGE IN ACCOUNTING POLICY (continued)

| | | | | |
|---|---|---|---|---|
| 2005–9 | AASB 132: Financial Instruments: Recognition and Measurement | No change, no impact | 1 January 2006 | 1 July 2006 |
| | AASB 139: Financial Instruments: Disclosure and Presentation | Fortescue is in the process of evaluating the effect of these changes of which the impact is not reasonably estimable at the date of this financial report. | 1 January 2006 | 1 July 2006 |
| 2005–10 | AASB 139: Financial Instruments: Recognition and Measurement | No change, no impact | 1 January 2007 | 1 July 2007 |
| | AASB 101: Presentation of Financial Statements | No change, no impact | 1 January 2007 | 1 July 2007 |
| | AASB 114: Segment Reporting | No change, no impact | 1 January 2007 | 1 July 2007 |
| | AASB 117: Leases | No change, no impact | 1 January 2007 | 1 July 2007 |
| | AASB 133: Earnings per share | No change, no impact | 1 January 2007 | 1 July 2007 |
| | AASB 132: Financial Instruments: Disclosure and Presentation | No change, no impact | 1 January 2007 | 1 July 2007 |
| | AASB 1: First-time Adoption of AIFRS | No change, no impact | 1 January 2007 | 1 July 2007 |
| | AASB 4: Insurance Contracts | No change, no impact | 1 January 2007 | 1 July 2007 |
| | AASB 1023: General Insurance Contracts | No change, no impact | 1 January 2007 | 1 July 2007 |
| | AASB 1038: Life Insurance Contracts | No change, no impact | 1 January 2007 | 1 July 2007 |
| 2006–1 | AASB 121: The Effects of Changes in Foreign Exchange Rates | No change, no impact | 1 January 2006 | 1 July 2006 |
| New Standard | AASB 7: Financial Instruments: Disclosure | No change, no impact | 1 January 2007 | 1 July 2007 |
| New Standard | AASB 119: Employee Benefits: December 2004 | No change, no impact | 1 January 2006 | 1 July 2006 |

## NOTE 35. CHANGE IN ACCOUNTING POLICY (continued)

All other pending Standards issued between the previous financial report and the current reporting dates have no application to either the parent or economic entity.

| AASB Amendment | AASB Standard Affected |
| --- | --- |
| 2005–2 | AASB 1023: General Insurance Contracts |
| 2005–4 | AASB 139: Financial Instruments: Recognition and Measurement |
| | AASB 132: Financial Instruments: Disclosure and Presentation |
| 2005–9 | AASB 4: Insurance Contracts |
| | AASB 1023: General Insurance Contracts |
| | AASB 139: Financial Instruments: Recognition and Measurement |
| | AASB 132: Financial Instruments: Disclosure and Presentation |

**FORTESCUE METALS GROUP LTD AND ITS CONTROLLED ENTITIES**
**ACN 002 594 872**

## Directors' declaration

1 In the opinion of the Directors of Fortescue Metals Group Ltd ('the Company'):

(a) the financial statements and notes including the remuneration disclosures that are contained the Remuneration report in the Directors' report, set out on pages 2 to 57, are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Company and the consolidated entity as at 30 June 2006 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and

(b) the remuneration disclosures that are contained in the Remuneration report in the Directors' report comply with Australian Accounting Standard AASB 124 *Related Party Disclosures* and ASIC Class Order 06/105 *Calculation of director and executive remuneration/* Corporations Act 2001

(c) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

2 The Directors have been given the declarations by the Chief Executive Officer and Chief Financial Officer for the financial year ended 30 June 2006 pursuant to Section 295A of the Corporations Act 2001.

Dated at Perth this 18th day of July 2006.

Signed in accordance with a resolution of the Directors:

Mr Gordon Toll
Chairman

Level 8, 256 St George's Terrace Perth WA 6000
PO Box 7426 Cloisters Square Perth WA 6850
Tel: (61-8) 9360 4200
Fax: (61-8) 9481 2524
Email: bdo@bdowa.com.au
**www.bdo.com.au**

**INDEPENDENT AUDIT REPORT TO THE MEMBERS OF FORTESCUE METALS GROUP LIMITED**

**Scope**

*The Financial Report and Directors' Responsibility*

The financial report comprises the balance sheet, income statement, cash flow statement, statement of changes in equity, accompanying notes to the financial statements, and the directors' declaration for Fortescue Metals Group Limited (the company), for the year ended 30 June 2006.

The directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

*Audit Approach*

We have conducted an independent audit in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgment, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, including compliance with Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

**Independence**

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

The independence declaration given to the directors in accordance with section 307C would be in the same terms if it had been given at the date of this report.

**Audit Opinion**

In our opinion, the financial report of Fortescue Metals Group Limited is in accordance with:

(a) the Corporations Act 2001, including:

(i) giving a true and fair view of the company's financial position as at 30 June 2006 and of its performance for the year ended on that date; and

(ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and

(b) other mandatory financial reporting requirements in Australia.

**BDO**
**Chartered Accountants**

B. McVeigh

**BG McVeigh**
Partner

Dated this 18th day of July 2006
Perth, Western Australia