

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.

FORTESCUE METALS GROUP LTD

DIRECTORS' REPORT

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.

FORTESCUE METALS GROUP LTD
DIRECTORS' REPORT

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 Practising 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:

Director	Board Meetings		Committee Meetings			
	A	B	Audit		Remuneration	
	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.

FORTESCUE METALS GROUP LTD DIRECTORS' REPORT

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.

FORTESCUE METALS GROUP LTD DIRECTORS' REPORT

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.

FORTESCUE METALS GROUP LTD DIRECTORS' REPORT

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.

FORTESCUE METALS GROUP LTD DIRECTORS' REPORT

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.

FORTESCUE METALS GROUP LTD

REMUNERATION REPORT

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.

FORTESCUE METALS GROUP LTD
REMUNERATION REPORT

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.

FORTESCUE METALS GROUP LTD REMUNERATION REPORT

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.

**FORTESCUE METALS GROUP LTD
REMUNERATION REPORT**

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	Termination benefits	Share-based payments	Total	Proportion of remuneration related %	Value of options as proportion of remuneration %
		Salary & fees \$	Cash bonus \$	Non-monetary benefits \$	Total \$	Super-annuation benefits \$	\$		Options (A) \$			
Directors												
<i>Non Executive</i>												
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%
<i>Executive</i>												
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 Operations	2006	345,454	-	-	345,454	34,546	-	-	-	380,000	-	-
	2005	182,000	-	-	182,000	18,200	-	-	-	200,200	-	-
Mr R Scrimshaw, Executive Director Commerical	2006	225,000	-	-	225,000	25,000	-	-	-	250,000	-	-
	2005	55,046	-	-	55,046	4,954	-	-	53,059	113,059	-	47%

**FORTESCUE METALS GROUP LTD
REMUNERATION REPORT**

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

		Short-term				Post-employment	Other long term	Termination benefits	Share-based payments	Total	Proportion of remuneration performance related %	Value of options as proportion of remuneration %
		Salary & fees \$	Cash bonus \$	Non-monetary benefits \$	Total \$	Super-annuation benefits \$	\$		Options \$			
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, Pilbara Infrastructure Pty Ltd	2006	245,453	75,757	-	321,210	32,121	-	-	105,644	458,975	-	23%
	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 Officer/Company Secretary	2006	272,727	-	-	272,727	27,273	-	-	49,194	349,194	-	14%
	2005	163,000	-	-	163,000	16,300	-	-	-	179,300	-	-
Mr J Tapp, Manager Government Relations	2006	209,091	-	-	209,091	20,909	-	-	68,807	298,807	-	23%
	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 personnel (consolidated and company)	2006	2,283,527	225,757	-	2,509,284	217,825	-	-	448,362	3,175,471		
	2005	1,049,726	-	-	1,049,726	98,022	-	-	236,464	1,384,212		

All key management personnel are employed by the parent entity.

FORTESCUE METALS GROUP LTD REMUNERATION REPORT

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:

	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
Executives						
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.

FORTESCUE METALS GROUP LTD
REMUNERATION REPORT

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 Number	Options granted Date	% vested in year	Forfeited in year	Financial years in which grant vests	Value yet to vest \$ 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			Total option value in year \$
	Granted in year \$ (A)	Exercised in year \$	Forfeited 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.

FORTESCUE METALS GROUP LTD
DIRECTORS' REPORT

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 F1, 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.

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

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*.

FORTESCUE METALS GROUP LTD
DIRECTORS' REPORT

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



Gordon Toll
Chairman

Dated at Perth this 18th day of July 2006.

FORTESCUE METALS GROUP LTD

AUDITOR'S INDEPENDENCE DECLARATION



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

BG McVeigh
Partner



BDO is a national association of separate partnerships and entities.

FORTECUE 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.

FORTECUE 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		Company	
		2006 \$	2005 \$	2006 \$	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.

FORTECUE 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.

FORTECUE 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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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").

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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 1 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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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

	Note	Consolidated			Company		
		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
		<u>1,746,572</u>	<u>-</u>	<u>1,746,572</u>	<u>1,721</u>	<u>-</u>	<u>1,721</u>
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		<u>(836,058)</u>	<u>(3,682,587)</u>	<u>(4,518,645)</u>	<u>(808,241)</u>	<u>(3,682,587)</u>	<u>(4,490,828)</u>

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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			Company		
		Previous GAAP \$	Effect of Transition to AIFRS \$ 30 June 2005	AIFRS \$	Previous GAAP \$	Effect of Transition to AIFRS \$ 30 June 2005	AIFRS \$
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

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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	Previous GAAP \$	Consolidated Effect of Transition to AIFRS \$ 1 July 2004	AIFRS \$	Previous GAAP \$	Company 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

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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	<u>17,516,000</u>	-
(b) Deferred tax liabilities comprise:		
Deferred tax liability on equity portion of convertible notes	11,634,000	-
Total	<u>11,634,000</u>	-
(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	<u>(26,241,000)</u>	-
(d) Reserves comprise:		
Share based payments reserve relating employee option plan	773,587	-
Total	<u>773,587</u>	-
(e) Accumulated losses comprise:		
Interest Expense on Convertible Notes	(2,909,000)	-
Share based payments expense relating to employee option plan	(773,587)	-
Total	<u>(3,682,587)</u>	-
(f) General and administration expense comprise:		
Share based payments expense relating to employee option plan	773,587	-
Total	<u>773,587</u>	-
(g) Other expenses from ordinary activities comprise:		
Interest Expense on Convertible Notes	2,909,000	-
Total	<u>2,909,000</u>	-

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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)

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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		Company	
	2006	2005	2006	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
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

(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:

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	<u>(2,145,701)</u>	<u>(4,518,645)</u>	<u>(1,734,518)</u>	<u>(4,490,828)</u>

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	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

	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
	<u>-</u>	<u>11,634,000</u>	<u>-</u>	<u>11,634,000</u>

(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
	<u>60,683,840</u>	<u>57,856,937</u>	<u>65,349,753</u>	<u>62,522,850</u>
Tax effect at 30%	<u>18,205,152</u>	<u>17,357,081</u>	<u>19,604,926</u>	<u>18,756,855</u>

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
	<u>18,054,207</u>	<u>81,158,375</u>	<u>18,054,205</u>	<u>81,040,753</u>

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)	-	-
	<u>1,372,472</u>	<u>1,112,872</u>	<u>1,372,472</u>	<u>788,407</u>

NOTE 11. INVENTORIES – CURRENT

At cost	<u>-</u>	<u>137,413</u>	<u>-</u>	<u>-</u>
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FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

	Consolidated		Company	
	2006	2005	2006	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	-
	<u>322,723</u>	<u>2,723</u>	<u>322,723</u>	<u>2,723</u>

NOTE 13. OTHER CURRENT ASSETS				
Prepayments	161,231	60,356	161,231	60,356

NOTE 14. TRADE AND OTHER RECEIVABLES – NON-CURRENT				
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
	<u>14,323,479</u>	<u>1,334,824</u>	<u>18,989,391</u>	<u>6,000,736</u>

NOTE 15. EXPLORATION AND EVALUATION EXPENDITURE				
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	<u>182,914,456</u>	<u>63,337,525</u>	<u>178,248,144</u>	<u>58,671,213</u>

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.

Company	Class of share	Place of Incorporation	Equity Holding		Cost to Company	
			2006	2005	2006	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	-	-	-
					<u>402</u>	<u>403</u>

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

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
NOTE 17. PROPERTY, PLANT AND EQUIPMENT				
Land and buildings – at cost	315,939	114,915	315,939	114,915
Accumulated depreciation	(852)	-	(852)	-
	<u>315,087</u>	<u>114,915</u>	<u>315,087</u>	<u>114,915</u>
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)
	<u>3,555,878</u>	<u>1,051,621</u>	<u>3,555,878</u>	<u>1,045,579</u>
Motor vehicles – at cost	6,958	6,958	6,958	6,958
Accumulated depreciation	(4,356)	(696)	(4,356)	(696)
	<u>2,602</u>	<u>6,262</u>	<u>2,602</u>	<u>6,262</u>
Total property, plant and equipment	<u>3,873,567</u>	<u>1,172,798</u>	<u>3,873,567</u>	<u>1,166,756</u>
Reconciliation of movements in carrying amounts				
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	<u>315,087</u>	<u>114,915</u>	<u>315,087</u>	<u>114,915</u>
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	<u>3,555,878</u>	<u>1,051,621</u>	<u>3,555,878</u>	<u>1,045,579</u>
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	<u>2,602</u>	<u>6,262</u>	<u>2,602</u>	<u>6,262</u>

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

	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
	<u>26,000</u>	<u>26,000</u>	<u>26,402</u>	<u>26,403</u>

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
	<u>16,674,415</u>	<u>9,548,573</u>	<u>16,674,415</u>	<u>9,374,217</u>

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
	<u>67,267,590</u>	<u>67,719,562</u>	<u>67,267,590</u>	<u>67,719,562</u>

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)
	<u>-</u>	<u>67,719,562</u>	<u>-</u>	<u>67,719,562</u>

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 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

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 Number of shares	2005 Number of shares
Ordinary shares fully paid:		
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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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).

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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

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	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	-
	<u>163,976</u>	<u>40,514</u>	<u>163,976</u>	<u>32,564</u>

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)
<i>Changes in assets and liabilities during the year:</i>				
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)	-	-
	<u>(129,618,369)</u>	<u>(48,362,808)</u>	<u>(129,130,662)</u>	<u>(48,290,299)</u>
Loss on sale of discontinued operations, net of tax	507,299	-	-	-
Net cash used in operating activities	<u>(129,111,069)</u>	<u>(48,362,808)</u>	<u>(129,130,662)</u>	<u>(48,290,299)</u>

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.

FORTESCUE METALS GROUP LTD
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FOR THE YEAR ENDED 30 JUNE 2006

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)
			<u>18,049,143</u>	<u>-</u>	<u>(61,556,626)</u>	<u>(6,174,410)</u>	<u>(49,681,893)</u>
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)
			<u>18,049,143</u>	<u>-</u>	<u>(61,556,626)</u>	<u>(1,508,500)</u>	<u>(45,015,983)</u>

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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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)
			<u>3,388,738</u>	<u>77,769,035</u>	<u>-</u>	<u>(57,077,345)</u>	<u>24,080,428</u>
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)
			<u>3,271,118</u>	<u>77,769,035</u>	<u>-</u>	<u>(52,698,957)</u>	<u>28,341,196</u>

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

NOTE 30. COMMITMENTS

(a) Leasing Commitments

Operating leases	Consolidated		Company	
	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	-
	<u>3,779,475</u>	<u>619,578</u>	<u>3,779,475</u>	<u>619,578</u>

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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
	<u>3,175,471</u>	<u>1,384,212</u>	<u>3,175,471</u>	<u>1,384,212</u>

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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	-

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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	<u>2,930,000</u>		

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

	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
	2006	2006	2005	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	<u>2,000,000</u>
Exercisable at the end of the period	\$2.67	500,000		<u>-</u>

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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.

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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

FORTESCUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 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

FORTECUE METALS GROUP LTD
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 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
DIRECTORS' DECLARATION**

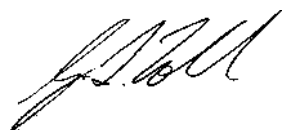
**FORTESCUE METALS GROUP LTD AND ITS CONTROLLED ENTITIES
ACN 002 594 872**

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

FORTESCUE METALS GROUP LTD

INDEPENDENT AUDIT REPORT



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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 both Fortescue Metals Group Limited (the company) and the consolidated entity, for the year ended 30 June 2006. The consolidated entity comprises both the company and the entities it controlled during that year.

The company has disclosed information about the compensation of key management personnel ("compensation disclosures"), as required by Accounting Standard AASB 124 *Related Party Disclosures*, under the heading "Remuneration Report" in pages 8 to 14 of the directors' report, as permitted by the Corporations Regulations 2001.

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. The directors are also responsible for the compensation disclosures contained in the directors' 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 and the compensation disclosures comply with AASB 124 and the Corporations Regulations 2001. 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 and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows and whether the compensation disclosures comply with Accounting Standard AASB 124 and the Corporations Regulations 2001.



BDO is a national association of
separate partnerships or natural entities

FORTESCUE METALS GROUP LTD

INDEPENDENT AUDIT REPORT

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 compensation disclosures, 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:

- (1) 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 and consolidated entity'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; and
- (2) the compensation disclosures that are contained in pages 8 to 14 of the directors' report comply with Accounting Standard AASB 124 and the Corporations Regulations 2001.

BDO
Chartered Accountants



BG McVeigh
Partner

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