

Fortescue Metals Group Limited

ABN 57 002 594 872

Annual report for the year ended 30 June 2010

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Annual report - 30 June 2010

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Australian Business Number	ABN 57 002 594 872
Directors	Mr Herb Elliott - Chairman Mr Andrew Forrest - Chief Executive Officer Mr Russell Scrimshaw - Executive Director Mr Graeme Rowley - Non-Executive Director Mr Ken Ambrecht - Non-Executive Director Mr Geoff Brayshaw - Non-Executive Director Mr Owen Hegarty - Non-Executive Director Dr Ian Burston - Non-Executive Director Mr Li Xiaowei - Non-Executive Director Mr Mark Barnaba - Non-Executive Director Mr Ian Cumming - Non-Executive Director
Secretary	Rod Campbell Mark Thomas
Principal registered office in Australia	Level 2, 87 Adelaide Terrace EAST PERTH, WESTERN AUSTRALIA, 6004 Tel: +61 8 6218 8888 Fax: +61 8 6218 8880 Website: www.fmg.com.au Email: fmg@fmg.com.au
Auditor	BDO Audit (WA) Pty Ltd 38 Station Street SUBIACO, WESTERN AUSTRALIA, 6008
Internal Auditor	KPMG 235 St Georges Terrace PERTH, WESTERN AUSTRALIA, 6000
Bankers	ANZ Banking Group Limited 77 St Georges Terrace PERTH, WESTERN AUSTRALIA, 6000 Citigroup Pty Limited 2 Park Street SYDNEY, NEW SOUTH WALES, 2000
Stock exchange listings	Fortescue Metals Group Limited shares are listed on the Australian Securities Exchange (ASX) ASX Code: FMG Fortescue lists debt securities on the Singapore Stock Exchange (SGX)
Share Register	Computershare Investor Services Pty Limited Level 2, 45 St Georges Terrace PERTH, WESTERN AUSTRALIA, 6000 GPO Box D182 PERTH, WESTERN AUSTRALIA, 6001 Tel: +61 8 9323 2000 Fax: +61 8 9323 2033 For any change in personal details, please contact Computershare.

Directors' report

Your Directors submit their report on the Fortescue consolidated entity, consisting of Fortescue Metals Group Limited (the Company or Fortescue) and the entities that it controlled during the financial year (the Group or the Fortescue Group).

Directors

The Directors of the Company in office during the financial year and until the date of this report are as follows (Directors were in office for the entire period unless otherwise stated).

Non-Executive

Mr Herb Elliott - Chairman
Mr Ken Ambrecht
Mr Geoff Brayshaw
Mr Owen Hegarty
Dr Ian Burston
Mr Li Xiaowei
Mr Graeme Rowley - retired as an Executive Director 2 March 2010
Mr Mark Barnaba - appointed 19 February 2010
Mr Ian Cumming - appointed 28 August 2009
Mr Joseph Steinberg - resigned 28 August 2009

Executive

Mr Andrew Forrest
Mr Russell Scrimshaw

Information on Directors

Mr Herb Elliott AC, MBE (Chairman, Non-Executive Director)

Term of Office

Mr Elliott was appointed as a Non-Executive Director of the Company in October 2003, Deputy Chairman in May 2005 and Chairman in March 2007.

Experience

Mr Elliott is a member of the Audit and Risk Management Committee and Chairman of the Remuneration and Nomination Committee. He was Chairman of the Audit and Risk Management Committee until 5 July 2007. Mr Elliott is Chairman of Telstra Foundation Limited and is a former Director of Ansell Limited and Pacific Dunlop Limited. He is also Chairman of the private corporate health company Global Corporate Challenge. 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 of the Australian Broadcasting Commission. Mr Elliott is a Doctor of the Queensland University of Technology.

Other current directorships (ASX listed entities)

None.

Former directorships in last 3 years (ASX listed entities)

None.

Mr Andrew Forrest (Chief Executive Officer, Executive Director)

Term of Office

Mr Forrest was appointed as a Director and Chief Executive Officer in July 2003.

Experience

Mr Forrest is the founder and Chief Executive Officer of Fortescue and has been CEO of the Company since July 2003. He was the Interim Chairman from July 2003 until May 2005 and is a member of the Company's Remuneration and Nomination Committee. Mr Forrest is Non-Executive Chairman of Poseidon Nickel Limited and the Australian Children's Trust. He is an Adjunct Professor of the China Southern University and a long standing Fellow of the Australian Institute of Mining and Metallurgy. His previous executive roles include founder, Chief Executive Officer and Deputy Chairman of Anaconda Nickel Limited, now Minara Resources Limited, and Chairman of the Murrin Murrin Joint Venture. Non-Executive roles previously included Director of the Australian Export Finance and Insurance Corporation, Director of the West Australian Chamber of Minerals and Energy and President of Athletics Australia. He has also founded a number of charities being the Australian Employment Covenant, Generation One and Australian Children's Trust. Mr Forrest has extensive experience in the mining sector and has won multiple global finance awards as well as The Australian Sports Medal, The Australian Centenary Medal, Western Australian Governor's Award and Citizen of the Year.

Information on Directors (continued)

Other current directorships (ASX listed entities)

Poseidon Nickel Limited (Chairman and Non-Executive Director since July 2007)

Former directorships in last 3 years (ASX listed entities)

None

Mr Russell Scrimshaw (Executive Director)

Term of office

Mr Scrimshaw was appointed as a Non-Executive Director of the Company in October 2003 and as an Executive Director in June 2005.

Experience

Mr Scrimshaw is a former board member of Commonwealth Properties Limited, EDS Australia, Mobilesoft Limited, Telecom New Zealand Australia Pty Limited, the Garvan Institute Foundation and Athletics Australia. He is also an Associate Member of the Australian Society of Certified Practising Accountants. Mr Scrimshaw previously held senior executive positions within the Commonwealth Bank of Australia, Optus, Alcatel, IBM and Amdahl USA.

Other current directorships (ASX listed entities)

None.

Former directorships in last 3 years (ASX listed entities)

None.

Mr Ken Ambrecht (Non-Executive Director)

Term of Office

Mr Ambrecht was appointed as a Non-Executive Director in October 2003.

Experience

Mr Ambrecht is a member of the Audit and Risk Management Committee and the Remuneration and Nomination Committee. He is the Principal of KCA Associates, a financial consulting and advisory firm and a Non-Executive Director of American Financial Corporation Inc and Spectrum Brands Inc. Mr Ambrecht was previously a Non-Executive Director of Dominion Petroleum Limited, Managing Director at First Albany Capital and Managing Director of the Royal Bank of Canada following a 25 year career at Lehman Brothers in New York as Managing Director of the capital markets division.

Other current directorships (ASX listed entities)

None.

Former directorships in last 3 years (ASX listed entities)

None.

Mr Graeme Rowley AM (Non-Executive Director)

Term of Office

Mr Rowley was appointed as an Executive Director in May 2003.

Experience

Mr Rowley retired as an Executive Director of the Company in March 2010 to continue as a Non-Executive Director. Previously, he was an executive with Rio Tinto plc, holding senior positions with 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 is currently Chairman of the National Centre for Excellence in Desalination. Mr Rowley has extensive experience in operational management of both iron ore ship loading facilities and heavy haul railway within the unique Pilbara environment.

Other current directorships (ASX listed entities)

None.

Former directorships in last 3 years (ASX listed entities)

None.

Information on Directors (continued)

Mr Ian M Cumming (Non-Executive Director)

Term of Office

Mr Cumming was appointed as a Non-Executive Director in August 2009.

Experience:

Since June 1978, Mr Cumming has served as a Director and Chairman of the Board of Leucadia National Corporation, a New York based diversified company with extensive interests. Mr Cumming is also a director of SkyWest Inc, HomeFed Corporation, AmeriCredit Corp and Jefferies Group Inc. Mr Cumming is committed to community service as evidenced by his leadership roles in local and national organisations. His involvement has included membership on the National Board of Governors of The Nature Conservancy, the Utah State Board of Regents, the Board of Directors of Ballet West, the Board of Dean's Advisors for the Harvard Business School and the United Nations Global Summit for Sustainable Development of Small Island Developing States.

Mr Cumming received his BA degree in Zoology from the University of Kansas in 1962 and his MBA from Harvard Business School in 1970.

Mr Cumming is also a member of the Remuneration and Nomination Committee.

Other current directorships (ASX listed entities)

None.

Former directorships in last 3 years (ASX listed entities)

None.

Mr Geoff Brayshaw AM (Non-Executive Director)

Term of Office

Mr Brayshaw was appointed as a Non-Executive Director and Chairman of the Audit and Risk Management Committee in July 2007.

Experience

Mr Brayshaw was formerly an audit partner with a large international accounting firm until he retired in June 2005. He has held a number of positions in commerce and with professional bodies including National President of the Institute of Chartered Accountants in 2002, Independent Director and Audit Committee Chairman of AVEA Insurance Limited, Board member of the Small Business Development Corporation and was formerly the Chairman of a Trustee Company of an Aboriginal Corporation. Mr Brayshaw is also a Non-Executive Director and Chairman of the Audit Committee of Poseidon Nickel Limited.

Other current directorships (Plc listed entities)

Poseidon Nickel Limited (since February 2008)

Former directorships in last 3 years (ASX listed entities)

None.

Mr Owen Hegarty (Non-Executive Director)

Term of Office

Mr Hegarty was appointed as a Non-Executive Director in October 2008.

Experience

Mr Hegarty has over 40 years experience in the global mining industry, including 25 years with Rio Tinto plc where he was Managing Director of Rio Tinto Asia and also Managing Director of the Australian copper and gold business. He was the founder and CEO of Oxiana Limited (now Oz Minerals Limited) which grew from a small exploration company to a multi-billion dollar, base and precious metals explorer, developer and producer.

Mr Hegarty was awarded the AusIMM Institute Medal in 2006 and the G.J. Stokes Memorial Award in 2008 for his achievements in the mining industry.

Mr Hegarty is Executive Vice Chairman of Hong Kong listed G-Resources Group Limited, a gold mining company and Executive Vice Chairman of CST Mining Group Limited, also a Hong Kong listed mining company. He is a Director of the AusIMM, a member of the South Australian Minerals and Petroleum Expert Group, and a Director of the WA based Mining Hall of Fame Foundation.

Mr. Hegarty is also Chairman of Tigers Realm Minerals Pty Limited, a private Melbourne based mining company.

Information on Directors (continued)

Other current directorships (ASX listed entities)

None.

Former directorships in last 3 years (ASX listed entities)

Range River Gold Limited (from July 1994 to April 2006)

Dr Ian Burston AM (Non-Executive Director)

Term of office

Dr Burston was appointed a Non-Executive Director on 13 October 2008.

Experience

Dr Burston has more than 30 years of experience in Western Australian and international mining. He was Non-Executive Chairman of Cape Lambert Resources Limited from June 2006 to May 2007 and Executive Chairman from May 2007 to August 2008. Dr Burston was Non-Executive Chairman of Imdex Limited from 2000 to 2009 and has been Chairman and Director of NRW Holdings Limited since July 2007. He has also been a Non-Executive Director of Mincor Resources NL since January 2003 and served as Executive Chairman and Chief Executive Officer of Aztec Resources Limited between June 2003 and February 2006. He is also the Chairman of the Broome Port Authority and a Director of Kanzai Mining Corporation. Formerly, Dr Burston held positions as Managing Director of Hamersley Iron Pty Limited, Aurora Gold Limited and Portman Limited and Chief Executive Officer of Kalgoorlie Consolidated Mines Pty Limited. Previously he worked for the CRA Group (now part of Rio Tinto plc) for 22 years in various senior executive positions.

Dr Burston was awarded the Order of Australia (General Division) in 1993 and was elected Western Australian Citizen of the Year in 1992.

Other current directorships (ASX listed entities)

NRW Holdings Limited (Chairman and Non-Executive Director since July 2007)

Mincor Resources NL (Non-Executive Director since January 2003)

Carrick Gold Limited (Chairman since June 2010 and Non-Executive Director since November 2009)

Condor Nickel Limited (Chairman since June 2010 and Non-Executive Director since March 2010)

Former directorships in last 3 years (ASX listed entities)

Cape Lambert Resources Limited (between July 2006 and August 2008)

Auvex Resources Limited (Chairman and Non-Executive Director from January 2009 to September 2009)

Imdex Limited (from November 2000 to October 2009)

Mr Li Xiaowei (Non-Executive Director)

Term of Office

Mr Xiaowei was appointed as a Non-Executive Director in June 2009.

Experience

Mr Xiaowei joined the Board as a Non-Executive Director on 12 June 2009 following Hunan Valin Iron and Steel Group Co Limited's (Hunan Valin) subscription for ordinary shares in Fortescue on 25 February 2009. He has been Chairman of Hunan Valin since 1999 and Vice President of China Iron & Steel Association. Mr Xiaowei is a graduate of Zhongnan University of Economics and Law, specialising in Business Enterprise Management, and also holds an MA from the Graduate School of the Chinese Academy of Social Sciences. He has previously served as Vice Chairman of Lianyuan Iron and Steel Co Limited, Deputy General Manager of Hunan Provincial Metallurgy Enterprises Group and General Manager of Valin Iron & Steel Group.

Other current directorships (ASX listed entities)

None.

Former directorships in last 3 years (ASX listed entities)

None.

Mark Barnaba (Non-Executive Director)

Term of office

Mr Barnaba was appointed as a Non-Executive Director in February 2010.

Experience

Mr Barnaba is a co-founder and Executive Chairman of Azure Capital, an independent boutique corporate advisor based in Perth, Western Australia. Mr Barnaba has a background in industry, corporate advisory and management consulting and worked with McKinsey & Company in Australia, the United Kingdom and South Africa.

Information on Directors (continued)

Mr Barnaba is a Chairman of the University of Western Australia Business School where he also serves as an Adjunct Professor in Investment Banking and Finance. He is the Chairman of the West Coast Eagles Football Club, Edge Employment Solutions (a disability employment organisation), Western Power, and a Director of the Australia Indonesia Institute. Mr Barnaba previously held positions on the Rhodes Scholarship Selection Committee.

Mr Barnaba received his Bachelor of Commerce with first class honours from the University of Western Australia in 1985 and was awarded the JA Wood University Medal for top graduate, university wide. He then went onto Harvard Business School and received an MBA in 1988, graduating with a high distinction as a Baker Scholar.

In 2009 Mr Barnaba was the recipient of the Western Australian Citizen of the Year Award in Industry and Commerce.

Other current directorships (ASX listed entities)

None.

Former directorships in last 3 years (ASX listed entities)

None.

Company Secretaries' particulars

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

Mr Rod Campbell

Term of office

Mr Campbell was appointed Company Secretary in November 2004.

Experience

Prior to his appointment as Company Secretary, Mr Campbell was State Manager Western Australia for RaboBank Australia Limited and before that was a Senior Manager with State Bank NSW Limited. Mr Campbell holds a Bachelor of Agricultural Economics from the University of New England and a Diploma from the Securities Institute of Australia.

Mr Mark Thomas

Term of office

Mr Thomas was appointed Company Secretary in June 2010.

Experience

Mr Thomas joined Fortescue in April 2004 in the role of Group Financial Controller and went on to become Head of Finance and IT and then Group Manager Finance.

With more than 15 years experience in the mining and professional services industries, Mr Thomas has also held senior finance positions with the Goldfields Australia Group and with a number of professional service providers. He has extensive experience in accounting and finance, IT and business administration in the mining and professional services industries.

Mr Thomas has a Bachelor of Commerce from the University of Western Australia, a Masters of Business Administration and is a Certified Practising Accountant.

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 2010, and the numbers of meetings attended by each director were:

	Board meetings		Committee Meetings			
	A	B	Audit		Remuneration	
			A	B	A	B
Mr Herb Elliott	9	10	7	7	2	2
Mr Andrew Forrest	10	10	*	*	1	2
Mr Russell Scrimshaw	10	10	*	*	*	*
Mr Ken Ambrecht	9	10	7	7	2	2
Mr Graeme Rowley	9	10	*	*	*	*
Mr Geoff Brayshaw	10	10	7	7	*	*
Mr Owen Hegarty	8	10	*	*	2	2
Dr Ian Burston	8	10	7	7	*	*
Mr Li Xiaowei	7	10	*	*	*	*

Directors' Meetings (continued)

Mr Ian Cumming	9	10	*	*	2	2
Mr Mark Barnaba	2	2	*	*	*	*

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

Principal activities

The principal activity of Fortescue is the mining of iron ore from its Cloudbreak and Christmas Creek mine sites and the operation of an integrated mine, rail and port supply chain. Fortescue also maintains an aggressive exploration and metallurgical program which is progressively developing tenement areas outside of the current mining sites.

No significant changes in the nature of the activities of Fortescue occurred during the year.

Review of operations

Fortescue has built on its commitment to safety through the implementation of a Hazard Management Program. Improving safety performance is shown in the key statistics where Fortescue's Lost Time Injury Frequency Rate 12 month rolling average to 30 June 2010 has decreased 65% to below iron ore industry levels.

A strong performance across the integrated mine, rail and port supply chain during the 12 months to 30 June 2010 has resulted in record production levels at all facilities.

Production and shipments for the financial year were as follows on a wet metric tonne basis;

	2010 Tonnes	2009 Tonnes	Increase
Ore mined	41,255,407	31,005,907	+33%
Overburden removed	113,861,580	104,080,840	+9%
Ore processed	38,418,568	27,793,158	+38%
Ore shipped (including third party product)	40,093,093	27,844,966	+44%

In line with the broader iron ore industry the Company moved to a new index pricing regime following the demise of the long standing Benchmark system. The spot price for iron ore has increased by 70% during the 12 months to 30 June 2010.

The expansion of Fortescue's Christmas Creek operation is continuing on schedule to deliver production of 55 million tonnes per annum from the Chichester Ranges. An extension of the rail line from Cloudbreak to Christmas Creek is scheduled for completion in the quarter to 31 December 2010. Construction of the Christmas Creek ore processing facility (OPF) is progressing well with work on all principal sections commenced and wet commissioning of the OPF is currently scheduled for March 2011. The accommodation village is on schedule for handover of first accommodation units at the end of September 2010.

Fortescue's Development and Exploration group have been focused across a number of areas including: 1) the finalisation of studies for the further expansion of the Chichester Hub beyond the current 55Mtpa works program; 2) the completion of the Definitive Feasibility Study (DFS) for the Solomon Hub; and 3) the review of opportunities across other sites including the Western Hub and magnetite projects.

Studies for the expansion from 55Mtpa up to 95Mtpa are well advanced with the main focus now on confirmation of the mine plan. It is expected that a detailed works program will be presented to the Board for its consideration during the latter part of the 2010 calendar year.

Progress on the Solomon Hub DFS is proceeding to plan. The expected delivery date for submission to the Board is the December 2010 quarter.

As previously advised, Fortescue maintained the momentum of its DFS process despite the fact that the impact of the proposed resources tax (now known as the Mineral Resources Rent Tax) forced the Company to place development of the Solomon and Western Hubs on hold. The new tax proposals, if implemented, may create financing uncertainties which cannot be rectified until Fortescue has greater clarity and certainty regarding the application of the proposed tax.

Dividends

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

Environmental regulation

The Fortescue Group's exploration, mining, rail and port activities are governed by a range of environmental regulatory approvals, including the provisions of the *Environmental Protection Act 1986*, the *Mining Act 1978* and the *Rights in Water and Irrigation Act 1914*.

The Group's operations continue to expand at all sites. We have responded by ensuring our environmental monitoring has kept pace with our expansion at these sites to ensure that Fortescue continues to operate in accordance with its environmental obligations and commitments. The Company's environmental performance requirement is reported in the Annual Environmental Report.

The Group's operations have been inspected and audited by the Office of the Environmental Protection Authority (OEPA), the Department of Environment and Conservation (DEC), the Department of Minerals and Petroleum (DMP) and the Department of Water (DoW) a combined total of four times during the year.

The Group also undertakes regular internal and external audits to test our standards and procedures. Opportunities to improve environmental performance are documented and implemented through a continuous improvement process.

Greenhouse gas and energy data reporting requirements

The Fortescue Group is subject to the public reporting requirements of the *Energy Efficient Opportunities Act 2006* (EEO Act) and the *National Greenhouse and Energy Reporting Act 2007*. These requirements relate to the financial year and will be reported later in 2010.

The Energy Efficiency Opportunities Act 2006

Fortescue is a high energy consumer and is bound by provisions within the EEO Act to identify energy saving opportunities for implementation across its business areas. In the past year, an energy audit was undertaken at mine, rail and port operations to highlight current practices with the potential to deliver energy savings. The potential for implementation of these amendments to current practices will be assessed and those modifications that are both implemented and deferred will be publicly reported.

The National Greenhouse and Energy Reporting Act 2007

Fortescue delivered its first *National Greenhouse and Energy Reporting (NGER) Act 2007* submission in 2009 which was independently audited and verified. The Group is required to report its annual Scope 1 and Scope 2 greenhouse gas emissions and energy use and production across all of its operations. The 2009 NGER submission related to the 2009 financial year. The Group will continue to report using financial year periods to ensure that its public greenhouse gas and energy data is consistent, accurate and comparative.

Diesel combustion is the largest source of greenhouse gas emissions at Fortescue. The primary sources of diesel use include our mobile surface mining equipment, power stations and our locomotives.

Fortescue is undertaking an aggressive strategic review and improvement plan to ensure that suitable environmental management systems are in place to maintain compliance with the environmental regulatory obligations and commitments.

Significant changes in the state of affairs

Events subsequent to reporting date

On 15 July 2010 Fortescue announced a 160 million tonne increase to the Solomon resource portfolio. This brings the total Solomon resources portfolio to 2.86 billion tonnes up from 2.7 billion tonnes.

On 5 August 2010 Fortescue entered into a contract with Downer EDI Limited to provide mining services at its Christmas Creek operation. The contract is for a term of six years and is valued at approximately A\$3 billion.

On 10 August 2010 Fortescue announced a 1.23 billion tonnes Resource Estimate for its North Star tenement area. Of this Resource, 310 million tonnes or approximately 25 percent of the Resource is classified as indicated and 920 million tonnes as inferred.

There has been no other material event requiring disclosure subsequent to the period ended 30 June 2010.

Likely developments and expected results of operations

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 likely developments and business strategies of the operations of Fortescue 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 Securities Exchange in accordance with S205G(1) of the Corporations Act 2001, at the date of this report is as follows:

	Ordinary shares	Options
Director		
Mr Herb Elliott	2,167,938	-
Mr Andrew Forrest	972,830,215	-
Mr Graeme Rowley	19,235,690	-
Mr Russell Scrimshaw	8,000,000	600,000
Mr Ken Ambrecht	6,313,130	-
Mr Geoff Brayshaw	44,149	-
Mr Joseph Steinberg	-	-
Mr Owen Hegarty	-	-
Dr Ian Burston	-	-
Mr Li Xiaowei	-	-
Mr Mark Barnaba	-	-
Mr Ian Cumming	-	-
	1,008,591,122	600,000

Unissued shares under options

During or since the end of the financial year, the Company granted options for no consideration over unissued ordinary shares in the Company to the following directors, key management personnel and other executives of the Company as part of their remuneration:

Name	Number of options granted	Exercise price A\$	Expiry date
Key management personnel			
Mr P Meurs	7,500,000	\$5.00	13 May 2015

Unissued shares under options

The number of options on issue in the Company at the date of this report is as follows. All of these options are unlisted and over the ordinary shares of the Company.

Date options granted	Expiry date	Issue price of shares A\$	Number under option
25 January 2006	25 January 2011	\$0.57	568,750
1 June 2006	1 June 2011	\$0.70	1,708,750
11 February 2009	11 February 2014	\$2.50	1,800,000
13 May 2010	13 May 2015	\$5.00	7,500,000
			11,577,500

All options expire on the earlier of their expiry date or termination of the employee's employment. These options were issued pursuant to the Fortescue Metals Group's Incentive Option Scheme (FMGIOS) and have been allotted to individuals on condition that they serve specified time periods as an employee of Fortescue 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 or since the end of the financial year, the Company issued ordinary shares as a result of the exercise of options as follows (there were no amounts unpaid on the shares issued):

Date options granted	Number vested	Issue price of shares A\$	Number of shares issued
1 June 2005	-	\$0.27	4,713,880
25 January 2006	1,046,875	\$0.57	1,268,750
1 June 2006	1,050,000	\$0.70	1,240,000
11 February 2009	450,000	\$2.50	-
13 May 2010	-	\$5.00	-
			<u>7,222,630</u>

Directors and officers indemnities and insurance

Since the end of the previous financial year, the Company has paid premiums to insure the Directors and Officers of the Fortescue Group.

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 the Fortescue Group, 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 the Fortescue Group. It is not possible to apportion the premium between amounts relating to the insurance against legal costs and those relating to other liabilities. Conditions of the policy also preclude disclosure to third parties of the amount paid for the policy.

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 Audit (WA) Pty Ltd and related entities 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 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 and Risk Management 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 APES 110 *Code of Ethics for Professional Accountants*.

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

	Consolidated 2010 US\$	2009 US\$
1. Audit services		
BDO Audit (WA) Pty Ltd		
- Audit and review of financial reports	342,257	251,035
- Other assurance services	<u>21,309</u>	<u>25,210</u>
Total remuneration for audit services	<u>363,566</u>	<u>276,245</u>
2. Services other than statutory audit		
BDO Consultants (WA) Pty Ltd		
- Financial due diligence	<u>428</u>	<u>9,590</u>
Total remuneration for other assurance services	<u>428</u>	<u>9,590</u>

Remuneration report

The remuneration report is set out under the following main headings:

- (a) Principles used to determine the nature and amount of remuneration
- (b) Details of remuneration
- (c) Service agreements
- (d) Share-based remuneration
- (e) Additional information.
- (f) Security policy

The information provided in this remuneration report has been audited as required by section 308(3C) of the *Corporations Act 2001*.

(a) Principles used to determine the nature and amount of remuneration

Key Management Personnel have the authority and responsibility for planning, directing and controlling the activities of Fortescue and other executives. Key Management Personnel and the five most highly remunerated executive officers for Fortescue Group, in accordance with S300A of the Corporations Act 2001, are defined on page 13.

Fortescue's remuneration strategy is designed to build a performance oriented culture and attract, retain and motivate its employees, encouraging them to meet their full potential. In line with this strategy, Fortescue provides market competitive fixed remuneration and incentives.

The remuneration strategy is based on the following principles:

- High levels of employee share ownership will drive an alignment of employee and shareholder interests;
- Remuneration and reward will be competitive and reasonable within the sector that Fortescue operates;
- Performance linkage and alignment of executive remuneration to performance of Fortescue and the individual executive; and
- Transparency in terms of disclosure and compliance with relevant legislative requirements.

Fortescue has structured a remuneration framework that is market competitive and complementary to the reward strategy of the organisation.

The Board has established a Remuneration and Nomination Committee. The Remuneration and Nomination Committee operates in accordance with its charter as approved by the Board. The Remuneration and Nomination Committee is chaired by Mr Herb Elliott and is comprised in the majority by Independent Non-Executive Directors. The Remuneration and Nomination Committee met twice during the year.

The role of the Remuneration and Nomination Committee is to provide assistance and recommendations to the Board in fulfilling its Corporate Governance responsibilities related to the following:

- Chief Executive Officer and Executive Director remuneration;
- Senior executive remuneration;
- Short term and long term incentive plans;
- Matters relating to recruitment, retention and termination policies;
- Succession planning; and
- Nomination and review of applicants for a Board position.

The Committee may engage independent external consultants and advisors to provide any necessary information to assist in the discharge of its responsibilities.

The remuneration structure that has been adopted by Fortescue consists of the following components:

- Fixed Remuneration being annual salary;
- Salary Sacrifice Share Plan; and
- Incentive Schemes

Fixed Remuneration

Fixed Remuneration consists of base remuneration (which is calculated on a total cost basis), as well as employer contributions to superannuation funds. Fixed Remuneration is reviewed against relevant comparator companies, in addition to considering the individual contribution and competence levels.

Remuneration report (continued)

Principles used to determine the nature and amount of remuneration (continued)

Salary Sacrifice Share Plan (SSSP)

As announced in the 2009/10 Federal Budget the Employee Share Scheme rules took on significant changes. Deferral of tax on Employee Share Scheme interests offered under a salary sacrifice scheme is now only available to an employee in which the total value is not more than \$5,000 and is acquired solely under a salary sacrifice arrangement. The legislation introducing the reforms received Royal Assent on 14 December 2009. The Company's SSSP that was suspended in 2009 has been reinstated to reflect these recent changes.

Incentive Plans

The Fortescue Staff Incentive Plan (SIP) operating in the 2010 financial year is structured to reward achievement of the Group's key performance indicators (KPIs) and team KPIs (for example, the Cloudbreak Mine Team). It is open to all permanent employees who satisfy certain tenure and performance conditions. A partial payment for performance has been made in respect of the 6 months to 31 December 2010. Any final payment will be made during the financial year to 30 June 2011 after consideration of the full year results for the financial year to 30 June 2010.

The Fortescue Executive and Senior Staff Incentive Plan (ESSIP) applies to approximately 40 people in leadership roles. Participation is by invitation of the Remuneration and Nomination Committee and awards are approved by the Committee. The ESSIP has three categories: Annual Performance, Growth Performance and Individual Performance. Participation is at a percentage of the employee's total remuneration, determined by the seniority of the role. Any award is taken equally in shares and cash. A key feature is that the number of performance rights to shares is derived by dividing the five day volume weighted average share price at the start of the financial year into the cash amount, ensuring those influential employees are positioned exactly the same as an investor over the course of the financial year. The 2010 financial year is the first year of operation of the ESSIP.

Fortescue Metals Group Incentive Options Scheme

During the financial year the Company issued 7,500,000 employee options under two equal tranches to an executive. Tranche 1 will vest over a three year period, with 33.3% vesting on each anniversary date. Tranche 2 will vest over a four year period, with 25% vesting on each anniversary date. In addition, Directors have imposed a further requirement that the exercise of options is conditional upon Fortescue shares trading above A\$7.00 for Tranche 1 and A\$8.00 for Tranche 2 for a set period. The options have been issued at an exercise price of A\$5.00, which is in accordance with the FMGIOS whereby the price must be at or greater than the volume weighted average price for the five days prior to the offer date, which was 13 May 2010.

A table of unissued shares under option, including expiry date and number of options yet to be exercised, is included in the Directors' Report on page 9. Available options expire between 25 January 2011 and 13 May 2015.

Remuneration structure

The Remuneration and Nomination Committee considers that the above remuneration structure is generating the desired outcomes, evidenced by:

- High retention of overall employees, key management personnel and other executives; and
- Fortescue's record breaking progression from project to producer.

Consequences of performances on shareholder wealth

In considering Fortescue's performance and benefits for shareholder wealth, the Board have regard to the following indices in respect of the current financial year and the previous four financial years.

	2010	2009	2008	2007	2006
Revenue from iron ore operations - US\$'000	3,220,062	1,830,953	139,294	-	-
Net profit/(loss) - US\$'000	580,946	508,042	(771,770)	(31,860)	(1,487)
Dividends paid	-	-	-	-	-
A\$ Change in share price	\$0.43	\$(8.11)*	\$8.52*	\$2.43*	\$0.66*
% Change in share price	12%	(68)%	252%	252%	275%

* = Movements have been adjusted to provide reasonable comparative amounts in light of Fortescue's reorganisation of capital in December 2007, whereby each fully paid ordinary share was split into ten fully paid ordinary shares.

Remuneration report (continued)

Principles used to determine the nature and amount of remuneration (continued)

Non-executive Directors

Total remuneration for all Non-Executive Directors, last voted upon by shareholders at the Annual General Meeting in November 2009, is not to exceed A\$1,000,000 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. Non-Executive Directors' base fees are presently up to A\$120,000 per annum.

The Chairman's base fee is A\$250,000 per annum. The Chairman also receives an additional A\$15,000 per annum being fees in recognition of his membership of the Audit Committee and position as Chairman of the Remuneration & Nomination Committee. Non-Executive Directors do not receive performance related remuneration. Directors' fees cover all main Board activities. Non-Executive Directors who sit on a Board Committee receive an additional A\$5,000 per annum per committee and the chair of a committee, other than the Audit Committee, receives A\$14,000 per annum. The Chairman of the Audit Committee receives an additional A\$15,000 per annum.

Non-Executive Directors do not receive share options. Non-Executive Directors may elect each year to receive a percentage of their remuneration in the Company's shares under the Non-Executive Director Share plan (NEDSP), which would be acquired on market.

Executive Directors

Executive Director fees are disclosed in part (b) of the Remuneration Report.

(b) Details of remuneration

Amounts of remuneration

The key management personnel (as defined in AASB 124 *Related Party Disclosures*) of the Company and the Fortescue Group who have authority and responsibility for planning, directing and controlling the activities of the entity includes the Directors and the following executive officers as set out below:

Directors

Mr Herb Elliott
Mr Andrew Forrest
Mr Russell Scrimshaw
Mr Ken Ambrecht
Mr Geoff Brayshaw
Mr Owen Hegarty
Dr Ian Burston
Mr Li Xiaowei
Mr Graeme Rowley
Mr Mark Barnaba - appointed 19 February 2010
Mr Ian Cumming - appointed 28 August 2009
Mr Joseph Steinberg - resigned 28 August 2009

Executive Officers

Mr Paul Hallam - Director Operations
Mr Peter Meurs - Director Development
Mr William Ramsey - Director Projects
Mr Stephen Pearce - Chief Financial Officer
Mr Isak Buitendag - General Manager Cloudbreak Mine

The five named group executives of the Fortescue Group who receive the highest remuneration are set out below:

Mr Paul Hallam - Director Operations
Mr Peter Meurs - Director Development
Mr William Ramsey - Director Projects
Mr Stephen Pearce - Chief Financial Officer
Mr Isak Buitendag - General Manager Cloudbreak Mine

Remuneration report (continued)

Details of remuneration (continued)

Amounts of remuneration (continued)

Directors' and Executive Officers' Remuneration

2010	Short-term employee benefits			Post-employment benefits	Long-term benefits	Termination benefits	Share-based payments	Total
	Cash salary and fees	Cash bonus*	Non monetary benefits	Super-annuation	Long service leave		Options	
	US\$	US\$	US\$	US\$	US\$	US\$	US\$	US\$
Non-executive								
Mr H Elliott	163,736	-	-	39,895	-	-	-	203,631
Mr G Rowley **	592,561	63,752	15,215	51,225	-	-	-	722,753
Mr G Brayshaw	86,874	-	-	8,687	-	-	-	95,561
Mr K Ambrecht	87,622	-	-	-	-	-	-	87,622
Dr I Burston	86,152	-	-	-	-	-	-	86,152
Mr O Hegarty	78,320	-	-	7,832	-	-	-	86,152
Mr L Xiaowei	85,857	-	-	-	-	-	-	85,857
Mr M Barnaba - appointed 19 February 2010	33,557	-	-	3,356	-	-	-	36,913
Mr I Cumming - appointed 28 August 2009	45,942	-	-	-	-	-	-	45,942
Mr J Steinberg - resigned 28 August 2009	-	-	-	-	-	-	-	-
Executive								
Mr A Forrest	88,210	12,028	6,736	10,024	-	-	-	116,998
Mr R Scrimshaw	653,890	63,752	-	47,379	-	-	161,215	926,236
Other Key Management Personnel								
Mr P Hallam - Director Operations	612,069	72,172	54,179	39,687	-	-	161,215	939,322
Mr P Meurs - Director Development (commenced 12 May 2010)	115,750	-	-	3,676	-	-	689,212	808,638
Mr W Ramsey - Director Projects	416,992	62,549	-	54,931	-	-	60,592	595,064
Mr S Pearce - Chief Financial Officer (commenced 2 March 2010)	227,876	-	2,567	7,351	-	-	-	237,794
Mr I Buitendag - General Manager Cloudbreak Mine	447,348	51,545	-	28,977	-	-	-	527,870
Total directors and other key management personnel	3,822,756	325,798	78,697	303,020	-	-	1,072,234	5,602,505

* Bonuses recognised during the 2010 financial year were accrued as at 30 June 2010. The bonus was issued in recognition of improved performance during the last quarter across all operations of Fortescue.

** Includes remuneration as an Executive Director from 1 July 2009 to 2 March 2010.

All key management personnel and other executives are employed by the parent entity.

Remuneration report (continued)

Details of remuneration (continued)

Amounts of remuneration (continued)

2009	Short-term employee benefits			Post-employment benefits	Long-term benefits	Termination benefits	Share-based payments	Total
	Cash salary and fees	Cash bonus	Non monetary benefits	Super-annuation	Long service leave		Options	
	US\$	US\$	US\$	US\$	US\$	US\$	US\$	US\$
Non-executive directors								
Mr H Elliott	54,713	-	-	65,655	-	-	-	120,368
Mr K Ambrecht	58,851	-	-	-	-	-	-	58,851
Mr J Steinberg	-	-	-	-	-	-	-	-
Mr G Brayshaw	60,496	-	-	6,050	-	-	-	66,546
Mr O Hegarty	38,706	-	-	3,870	-	-	-	42,576
Dr I Burston	42,576	-	-	-	-	-	-	42,576
Mr L Xiaowei	-	-	-	-	-	-	-	-
Executive directors								
Mr A Forrest	70,048	11,334	86,387	8,138	-	-	-	175,907
Mr G Rowley	486,935	55,106	1,610	75,459	-	-	-	619,110
Mr R Scrimshaw	506,258	55,106	-	56,136	-	-	65,977	683,477
Other key management personnel								
Mr P Hallam, Director Operations	218,325	65,723	14,960	79,455	-	-	65,977	444,440
Mr M Minosora, Chief Financial officer, resigned 25 September 2009	206,534	46,961	-	25,349	-	-	65,977	344,821
Mr C Catlow, Director Investments and Business Developments, retired 2 June 2010	413,922	66,177	1,610	48,010	-	-	80,626	610,345
Mr G Cowe - Director Projects, resigned 30 June 2009	438,381	-	-	12,546	-	-	-	450,927
Mr A Watling - Chief Operating Officer, resigned 9 January 2009	252,033	3,018	258,010	36,630	-	60,705	-	610,396
Other Executives								
Mr J Blanning - Head of Mining, resigned 14 January 2009	184,504	1,812	42,421	18,631	-	288,048	103,973	639,389
Total directors and other key management personnel (Consolidated and Company)	3,032,282	305,237	404,998	435,929	-	348,753	382,530	4,909,729

Remuneration report (continued)

Details of remuneration (continued)

Amounts of remuneration (continued)

The relative proportions of remuneration that are linked to performance and those that are fixed are as follows:

	Fixed remuneration		At risk - STI		At risk - LTI *	
	2010	2009	2010	2009	2010	2009
	%	%	%	%	%	%
Directors of Fortescue Metals Group Limited						
Mr A Forrest	90	94	10	6	-	-
Mr R Scrimshaw	76	82	7	8	17	10
Mr H Elliott	100	100	-	-	-	-
Mr G Rowley	91	91	9	9	-	-
Mr K Ambrecht	100	100	-	-	-	-
Mr G Brayshaw	100	100	-	-	-	-
Mr O Hegarty	100	100	-	-	-	-
Dr I Burston	100	100	-	-	-	-
Mr M Barnaba - appointed 19 February 2010	100	-	-	-	-	-
Mr L Xiaowei	100	-	-	-	-	-
Mr I Cumming - appointed 28 August 2009	100	-	-	-	-	-
Mr J Steinberg - resigned 28 August 2009	-	-	-	-	-	-
Other key management personnel						
Mr P Hallam	75	70	8	15	17	15
Mr P Meurs	15	-	-	-	85	-
Mr S Pearce	100	-	-	-	-	-
Mr W Ramsey	79	-	11	-	10	-
Mr I Buitendag	90	-	10	-	-	-
Mr C Catlow**	-	76	-	11	-	13
Mr A Watling**	-	100	-	-	-	-
Mr M Minosora**	-	67	-	14	-	19
Mr G Cowe**	-	100	-	-	-	-
Other executives						
Mr J Blanning**	-	83	-	1	-	16

* Since the long-term incentives are provided exclusively by way of options, the percentages disclosed also reflect the value of remuneration consisting of options, based on the value of options expensed during the year.

**This individual either retired or resigned prior to 30 June 2010

(c) Service agreements

Remuneration and other terms of employment for the Executive Directors, other Key Management Personnel and other executives 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 - Unspecified.
- Base salary, inclusive of superannuation, for the year ended 30 June 2010 of A\$110,000, to be reviewed annually by the Remuneration and Nomination Committee.
- Three month termination clause

Mr Russell Scrimshaw, *Executive Director Sales and Marketing*

- Term of agreement - Unspecified.
- Base salary, inclusive of superannuation, for the year ended 30 June 2010 of A\$795,000 to be reviewed annually by the Remuneration and Nomination Committee.
- One month termination clause.

Mr Paul Hallam, *Director Operations*

- Term of agreement - Unspecified.
- Base salary, inclusive of superannuation, for the year ended 30 June 2010 of A\$800,000, to be reviewed annually by the Remuneration and Nomination Committee.
- Three month termination clause

Mr Stephen Pearce, *Chief Financial Officer*

- Term of agreement - Unspecified.

Remuneration report (continued)

Service agreements (continued)

- Base salary, inclusive of superannuation, for the year ended 30 June 2010 of A\$800,000, to be reviewed annually by the Remuneration and Nomination Committee.
- Three month termination clause.

Mr Peter Meurs, *Director Development*

- Term of agreement - Unspecified.
- Base salary, inclusive of superannuation, for the year ended 30 June 2010 of A\$1,000,000 to be reviewed annually by the Remuneration and Nomination Committee.
- Three month termination clause.

Mr William Ramsey, *Director Projects*

- Term of agreement - Unspecified.
- Base salary, inclusive of superannuation, for the year ended 30 June 2010 of A\$500,000, to be reviewed annually by the Remuneration and Nomination Committee.
- Three month termination clause.

Mr Isak Buitendag, *General Manager Cloudbreak Mine*

- Term of agreement - Unspecified.
- Base salary, inclusive of superannuation, for the year ended 30 June 2010 of A\$520,000, to be reviewed annually by the Remuneration and Nomination Committee.
- Three month termination clause.

Details of performance related remuneration

Details of Fortescue's policy in relation to performance related remuneration is discussed on page 11. The relative proportions of remuneration that are linked to performance are disclosed on page 16. Incentives are approved by the Board of Directors as reward for Fortescue achieving its business targets and KPIs.

(d) Share-based remuneration

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

The terms and conditions of each grant of options affecting remuneration of each Director, Key Management Personnel and other executives in the current or future reporting periods are set out on page 18.

Options granted under the plan carry no dividend or voting rights. When exercisable, each option is convertible into one ordinary share.

Options over equity instruments granted as remuneration

Details of options over ordinary shares in the Company that were granted as remuneration to each Director, Key Management Personnel and other executives of the Company and Fortescue are set out below. When exercisable, each option is convertible into one ordinary share of Fortescue Metals Group Limited. Further information on options is set out in notes 28 and 37 to the financial statements.

Remuneration report (continued)

Share-based remuneration (continued)

Name	Number of options granted during the calendar year		Number of options vested during the year	
	2010	2009	2010	2009
Directors of Fortescue Metals Group Limited				
Mr A Forrest	-	-	-	-
Mr R Scrimshaw	-	600,000	150,000	-
Mr H Elliott	-	-	-	-
Mr K Ambrecht	-	-	-	-
Mr J Steinberg	-	-	-	-
Mr G Brayshaw	-	-	-	-
Mr G Rowley	-	-	-	-
Mr O Hegarty	-	-	-	-
Dr I Burston	-	-	-	-
Mr L Xiaowei	-	-	-	-
Mr I Cumming	-	-	-	-
Mr M Barnaba	-	-	-	-
Other key management personnel of the Company				
Mr P Hallam	-	600,000	150,000	-
Mr W Ramsey	-	-	-	-
Mr P Meurs	7,500,000	-	-	-
Mr S Pearce	-	-	-	-
Mr I Buitendag	-	-	-	-

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. Once performance hurdles are met the options are exercisable evenly on an annual basis over the four years from grant date.

The assessed fair value at grant date of options granted to individuals is allocated equally over the period from grant date to vesting date, and the amount is included in the remuneration tables above. Fair values at grant date are independently determined using the Trinomial or Binomial Option Pricing model that takes into account the exercise price, the term of the option, the impact of dilution, 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.

During the financial year the Company issued 7,500,000 employee options under two, equal tranches. Tranche 1 will progressively vest over a three year period, with 33.3% vesting on each anniversary and Tranche 2 will vest over a 4 year period, with 25% vesting on each anniversary date. In addition, the Board of Directors has imposed a further requirement that the exercise of options is conditional upon Fortescue shares trading above certain price requirements (Tranche 1 - A\$7.00 and Tranche 2 - A\$8.00) for a set period. The options have been issued at an exercise price of A\$5.00, which is in accordance with the FMGIOS whereby the price must be at or greater than the volume weighted average price for the five days prior to the offer date, which was 13 May 2010.

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

- (a) grant date: 13 May 2010
- (b) expiry date: 13 May 2015
- (c) fair value per option:
Tranche 1 - A\$2.66 (US\$2.40)
Tranche 2 - A\$2.65 (US\$2.40)
- (d) exercise price: A\$5.00
- (e) price of shares on grant date: A\$4.35
- (f) expected volatility: 76.40%
- (g) risk free interest rate: 5.00%
- (h) dividend yield: nil

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

No terms of equity-settled share based payment transactions (including options granted as remuneration to a key management person) have been altered or modified by the Company during the financial year ended 30 June 2010.

Remuneration report (continued)

Share-based remuneration (continued)

Exercise of options granted as remuneration

Details of ordinary shares in the Company provided as a result of the exercise of options to each Director of Fortescue Metals Group Limited, other key management personnel and other executives of Fortescue are set out below.

Name	Date of exercise of options	Number of ordinary shares issued on exercise of options during the year 2010	Amount paid per share A\$
Directors of Fortescue Metals Group Limited			
Mr H Elliott	-	-	\$-
Mr K Ambrecht	-	-	\$-
Mr J Steinberg	-	-	\$-
Mr G Brayshaw	-	-	\$-
Mr A Forrest	-	-	\$-
Mr G Rowley	-	-	\$-
Mr R Scrimshaw	-	-	\$-
Mr O Hegarty	-	-	\$-
Dr I Burston	-	-	\$-
Mr M Barnaba	-	-	\$-
Mr I Cumming	-	-	\$-
Mr L Xiaowei	-	-	\$-
Other key management personnel of the Company			
Mr P Hallam	-	-	\$-
Mr S Pearce	-	-	\$-
Mr W Ramsey	-	-	\$-
Mr P Meurs	-	-	\$-
Mr I Buitendag	-	-	\$-

(e) Additional information

Details of remuneration - 2010 cash incentives and options

For each cash bonus and grant of options included in the tables on pages 14 and 18, the percentage of the available bonus grant that was paid, or that vested, in the financial year, and the percentage that was forfeited because the person did not meet the service and performance criteria is set out below. The incentives recognised in the 2010 financial year are payable in 2011. The options were issued pursuant to the FMGIOS and may be exercised over a 3 to 4 year period. No options will vest if conditions are not satisfied, hence the minimum value of the option yet to vest is nil. The maximum value of the options that is yet to vest has been determined as the amount of the grant date fair value of the options that is yet to be expensed.

Name	Cash bonus		Share-based compensation benefits (options)				Minimum	Maximum
	Paid	Forfeited	Year granted	Vested	Forfeited	Financial years in which options may vest	of grant yet to vest	of grant yet to vest
	%	%		%	%		\$	\$
Mr H Elliott	-	-	-	-	-		-	-
Mr K Ambrecht	-	-	-	-	-		-	-
Mr G Rowley	9%	-	-	-	-		-	-
Mr A Forrest	10%	-	-	-	-		-	-
Mr R Scrimshaw	7%	-	2009	25%	-	2013	-	483,644
Mr O Hegarty	-	-	-	-	-		-	-
Dr I Burston	-	-	-	-	-		-	-
Mr L Xiaowei	-	-	-	-	-		-	-
Mr J Steinberg	-	-	-	-	-		-	-
Mr G Brayshaw	-	-	-	-	-		-	-
Mr M Barnaba	-	-	-	-	-		-	-
Mr I Cumming	-	-	-	-	-		-	-

Remuneration report (continued)

Share-based remuneration (continued)

Details of remuneration: Bonuses and share-based compensation benefits (continued)

Other key

management personnel

Mr P Hallam	8%	-	2009	25%	-	2013	-	483,644
Mr S Pearce	-	-	-	-	-	-	-	-
Mr P Meurs	-	-	2010	-	-	2013 & 2014	-	17,277,931
Mr W Ramsey	11%	-	-	-	-	-	-	-
Mr I Buitendag	10%	-	-	-	-	-	-	-

Name	A	B	C	D
	Remuneration consisting of options	Value at grant date US\$	Value at exercise date US\$	Value at lapse date US\$
Mr A Forrest	-	-	-	-
Mr R Scrimshaw	17%	644,589	-	-
Mr H Elliott	-	-	-	-
Mr K Ambrecht	-	-	-	-
Mr G Brayshaw	-	-	-	-
Mr G Rowley	-	-	-	-
Mr O Hegarty	-	-	-	-
Dr I Burston	-	-	-	-
Mr L Xiaowei	-	-	-	-
Mr Mark Barnaba - appointed 19 February 2010	-	-	-	-
Mr Ian Cumming - appointed 28 August 2009	-	-	-	-
Mr J Steinberg - resigned 28 August 2009	-	-	-	-
Other key management personnel				
Mr P Hallam	17%	644,589	-	-
Mr S Pearce	-	-	-	-
Mr P Meurs	85%	17,967,143	-	-
Mr W Ramsey	-	-	-	-
Mr I Buitendag	-	-	-	-

A = The percentage of the value of remuneration consisting of options, based on the value of options expensed during the current year.

B = The value at grant date calculated in accordance with AASB 2 *Share-based Payment* of options granted.

C = The value at exercise date of options that were granted as part of remuneration and were exercised during the year, being the intrinsic value of the options at that date.

D = The value at lapse date of options that were granted as part of remuneration and that lapsed during the year because a vesting condition was not satisfied. The value is determined at the time of lapsing, but assuming the condition was satisfied.

(f) Securities policy

Fortescue's Security Trading Policy provides guidance on acceptable transactions in dealing in the Company's various securities, including shares, debt notes and options. Fortescue's Security Trading Policy defines dealing in company securities to include:

- (i) Subscribing for, purchasing or selling Company Securities or entering into an agreement to do any of those things;
- (ii) Advising, procuring or encouraging another person (including a family member, friend, associate, colleague, family company or family trust) to trade in Company Securities; and
- (iii) Entering into agreements or transactions which operate to limit the economic risk of a person's holdings in Company Securities.

The Securities Trading Policy details acceptable and unacceptable periods for trading in Company Securities including detailing potential civil and criminal penalties for misuse of confidential information. The Directors must not deal in Company Securities without providing written notification to the Chairman. The Chairman must not deal in Company Securities without the prior approval of the Chief Executive Officer. The Directors are responsible for disclosure to the market of all transactions or contracts involving the Company's shares.

This is the end of the audited Remuneration Report

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 22.

Rounding of amounts

Fortescue is of the kind referred to in ASIC Class Order 98/100, issued by the Australian Securities and Investments Commission, relating to the "rounding off" of amounts. Amounts in the financial report and Directors' Report have been rounded off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, to the nearest dollar.

Auditor

BDO Audit (WA) Pty Ltd continues in office in accordance with section 327 of the *Corporations Act 2001*.

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

A handwritten signature in black ink, appearing to read 'H Elliott', written in a cursive style.

Mr Herb Elliott
Chairman

Perth
26 August 2010

26 August 2010

The Directors
Fortescue Metals Group Limited
Level 2, 87 Adelaide Terrace
EAST PERTH WA 6004

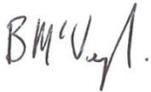
Dear Sirs

DECLARATION OF INDEPENDENCE BY BRAD MCVEIGH TO THE DIRECTORS OF FORTESCUE METALS GROUP LIMITED

As lead auditor of Fortescue Metals Group Limited for the year ended 30 June 2010, I declare that, 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
- any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Fortescue Metals Group Pty Limited and the entities it controlled during the period.



Brad McVeigh
Director



BDO Audit (WA) Pty Ltd
Perth, Western Australia

Fortescue Metals Group Limited ABN 57 002 594 872

Annual report - 30 June 2010

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These financial statements cover the consolidated group consisting of Fortescue Metals Group Limited and its subsidiaries. The financial statements are presented in United States (US) currency.

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

Fortescue Metals Group Limited
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 to 21, which does not form part of this financial statements.

The financial statements were authorised for issue by the directors on 26 August 2010. The Company has the power to amend and reissue the financial statements.

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.fmgj.com.au

Fortescue Metals Group Limited
Statement of comprehensive income
For the year ended 30 June 2010

		Consolidated	
		2010	2009
	Notes	US\$'000	US\$'000
Revenue	5	3,220,062	1,828,598
Other income	6	84,085	38,956
Expenses			
Cost of sales of goods	7	(2,125,552)	(1,350,696)
Re-estimation of subordinated loan note	23	(279,986)	1,124,411
Net foreign exchange gain/(loss)		99,487	(453,744)
Administration expenses	7	(24,705)	(34,620)
Finance costs	7	(394,215)	(490,945)
Profit before income tax		579,176	661,960
Income tax benefit/(expense)	8	1,770	(153,918)
Profit for the year		580,946	508,042
Profit for the year		580,946	508,042
Other comprehensive income			
Revaluation of available for sale financial assets		68	-
Deferred tax translation to US dollars		-	(77,202)
Other comprehensive income for the year, net of tax		68	(77,202)
Total comprehensive income for the year		581,014	430,840
Total comprehensive income for the year is attributable to:			
Owners of Fortescue Metals Group Limited		581,014	430,840
		581,014	430,840
		Cents	Cents
Earnings per share for profit attributable to the ordinary equity holders of the parent entity:			
Basic earnings per share	36	18.85	17.77
Diluted earnings per share	36	18.82	17.70

The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

Fortescue Metals Group Limited
Balance sheet
As at 30 June 2010

		Consolidated	
		2010	2009
	Notes	US\$'000	US\$'000
ASSETS			
Current assets			
Cash and cash equivalents	9	1,235,538	654,942
Trade and other receivables	10	268,745	183,189
Inventories	11	188,291	121,122
Other financial assets	12	95	31
Other current assets	13	8,881	1,498
Total current assets		<u>1,701,550</u>	<u>960,782</u>
Non-current assets			
Trade and other receivables	14	3,878	13,512
Property, plant and equipment	15	1,911,897	1,641,919
Deferred tax assets	17	121,965	120,195
Intangible assets	18	22,750	25,144
Exploration and evaluation	16(a)	29,496	11,889
Development expenditure	16(b)	1,512,017	1,423,222
Total non-current assets		<u>3,602,003</u>	<u>3,235,881</u>
Total assets		<u>5,303,553</u>	<u>4,196,663</u>
LIABILITIES			
Current liabilities			
Trade and other payables	19	406,114	339,085
Borrowings	20	466,761	319,823
Derivatives held at fair value	21	16,285	31,397
Total current liabilities		<u>889,160</u>	<u>690,305</u>
Non-current liabilities			
Borrowings	23	2,508,902	2,250,482
Provisions	25	57,034	55,582
Trade and other payables	22	371,792	349,602
Total non-current liabilities		<u>2,937,728</u>	<u>2,655,666</u>
Total liabilities		<u>3,826,888</u>	<u>3,345,971</u>
Net assets		<u>1,476,665</u>	<u>850,692</u>
EQUITY			
Contributed equity	26(b)	1,274,650	1,229,876
Reserves	27(a)	(74,369)	(74,622)
Retained earnings/(losses)	27(b)	276,384	(304,562)
Capital and reserves attributable to owners of Fortescue Metals Group Limited		<u>1,476,665</u>	<u>850,692</u>
Total equity		<u>1,476,665</u>	<u>850,692</u>

The above consolidated balance sheet should be read in conjunction with the accompanying notes.

Fortescue Metals Group Limited
Statement of changes in equity
For the year ended 30 June 2010

Consolidated	Notes	Attributable to owners of Fortescue Metals Group Limited			Total equity US\$'000
		Contributed equity US\$'000	Reserves US\$'000	Accumulated losses US\$'000	
Balance at 1 July 2008		746,791	2,655	(812,604)	(63,158)
Total comprehensive income for the year	27	<u>-</u>	<u>(77,202)</u>	<u>508,042</u>	<u>430,840</u>
Transactions with owners in their capacity as owners:					
Issue of share capital	26	481,560	-	-	481,560
Exercise of options	26	2,818	(1,474)	-	1,344
Forfeited options	27	-	(41)	-	(41)
Share issue costs	26	(1,293)	-	-	(1,293)
Equity settled share based transactions	27	<u>-</u>	<u>1,440</u>	<u>-</u>	<u>1,440</u>
		<u>483,085</u>	<u>(75)</u>	<u>-</u>	<u>483,010</u>
Balance at 30 June 2009		<u>1,229,876</u>	<u>(74,622)</u>	<u>(304,562)</u>	<u>850,692</u>
Balance at 1 July 2009		1,229,876	(74,622)	(304,562)	850,692
Total comprehensive income for the year		<u>-</u>	<u>68</u>	<u>580,946</u>	<u>581,014</u>
Transactions with owners in their capacity as owners:					
Issue of share capital	26	40,977	-	-	40,977
Exercise of options	26	3,797	(1,586)	-	2,211
Forfeited options	27	-	(456)	-	(456)
Equity settled share based transactions	32	<u>-</u>	<u>2,227</u>	<u>-</u>	<u>2,227</u>
		<u>44,774</u>	<u>185</u>	<u>-</u>	<u>44,959</u>
Closing balance at 30 June 2010		<u>1,274,650</u>	<u>(74,369)</u>	<u>276,384</u>	<u>1,476,665</u>

Amounts are stated net of taxation.

The above statements of changes in equity should be read in conjunction with the accompanying notes.

Fortescue Metals Group Limited
Statement of cash flows
For the year ended 30 June 2010

		Consolidated	
		2010	2009
Notes		US\$'000	US\$'000
Cash flows from operating activities			
	Cash receipts from customers	3,341,632	1,852,369
	Payments to suppliers and employees	<u>(2,046,046)</u>	<u>(1,198,145)</u>
		1,295,586	654,224
	Interest received	18,909	9,884
	Interest paid	<u>(206,943)</u>	<u>(190,760)</u>
35	Net cash inflow from operating activities	<u>1,107,552</u>	<u>473,348</u>
Cash flows from investing activities			
	Exploration and evaluation expenditure	(17,607)	(11,317)
	Development expenditure	(160,352)	(406,122)
	Payments for purchase of property, plant and equipment	(405,868)	(544,698)
	Payment for purchase of intangible assets	-	(2,786)
	Payment of deposits for government guarantees	(27,734)	-
	Proceeds from disposal of plant and equipment	<u>28,407</u>	<u>223,180</u>
	Net cash outflow from investing activities	<u>(583,154)</u>	<u>(741,743)</u>
Cash flows from financing activities			
	Proceeds from the issue of share capital	2,214	453,433
	Proceeds from borrowings	-	96,992
	Repayment of borrowings	(5,661)	(57,221)
	Deposits received	30,000	209,806
	Repayment of deposits	<u>(10,000)</u>	<u>(2,400)</u>
	Net cash inflow from financing activities	<u>16,553</u>	<u>700,610</u>
Net increase in cash and cash equivalents			
		540,951	432,215
	Cash and cash equivalents at the beginning of the financial year	654,942	133,182
	Effects of exchange rate changes on cash and cash equivalents	<u>39,645</u>	<u>89,545</u>
9	Cash and cash equivalents at end of year	<u>1,235,538</u>	<u>654,942</u>

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

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1 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial statements are for the consolidated entity consisting of Fortescue Metals Group Limited and its subsidiaries. Separate financial statements for Fortescue Metals Group Limited as an individual entity are no longer presented as the consequence of a change to the *Corporations Act 2001*, however, limited financial information for the Company as an individual entity is included Note 38.

(a) Basis of preparation

These general purpose financial statements have been prepared in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Australia Accounting Interpretations and the *Corporations Act 2001*.

On 1 January 2009 Fortescue adopted United States (US) dollars as the functional currency of the Company and all of its subsidiaries. The functional currency of an entity is the currency of the primary economic environment in which the entity operates, which should reflect the economic substance of the underlying events and circumstances relevant to the Company. Fortescue's transition from an exploration to a production company has resulted in generating significant cash inflows from iron ore sales. These inflows are denominated in US dollars, which combined with Fortescue's significant US dollar senior secured notes and subordinated loan note, indicate that a significant proportion of cash inflows and cash outflows going forward will be denominated in US dollars.

Compliance with IFRS

The consolidated financial statements of the Fortescue Metals Group also comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and liabilities (including derivative instruments) at fair value through profit or loss.

(b) Principles of consolidation

(i) Subsidiaries

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of the Company as at 30 June 2010 and the results of all subsidiaries for the year then ended.

Subsidiaries are all those entities (including special purpose entities) controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are presently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Company.

(ii) Transactions eliminated on consolidation

Intra-group balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Accounting policies of subsidiaries are consistent with the parent.

(c) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive Officer

Change in accounting policy

The group has adopted AASB 8 Operating Segments from 1 July 2009. AASB 8 replaces AASB 114 Segment Reporting. The new standard requires a 'management approach', under which segment information is presented on the same basis as that used for internal reporting purposes. The adoption of AASB 8 has not changed the disclosure of operating segments for Fortescue nor has there been any other impact on the measurement of the group's assets and liabilities.

1 Summary of significant accounting policies (continued)

(d) Foreign currency translation

(i) *Functional and presentation currency*

Items included in the financial statements of each of Fortescue's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The parent and consolidated financial statements are presented in US dollars, which is the Company's functional and presentation currency.

(ii) *Transactions and balances*

Transactions in foreign currencies have been converted at rates of exchange ruling on the date of those transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Statement of Comprehensive Income. Translation differences on assets and liabilities carried at fair value are reported as part of the fair value gain or loss.

(iii) *Foreign operations*

The results and financial position of all Fortescue entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet
- income and expenses for each Statement of Comprehensive Income are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions), and
- all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of any net investment in foreign entities, and of borrowings designated as hedges of such investments, are taken to equity. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, a proportionate share of such exchange differences are recognised in the Statement of Comprehensive Income, as part of the gain or loss on sale where applicable.

(e) Revenue recognition

Revenue is measured at the fair value of the gross consideration received or receivable. Fortescue recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of Fortescue's activities. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. Fortescue bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

(i) *Sale of goods*

Revenue from the sale of goods and disposal of other assets is recognised when persuasive evidence, usually in the form of an executed sales agreement, or an arrangement exists, indicating there has been a transfer of risks and rewards to the customer, no further work or processing is required by the Group, the quantity and quality of the goods has been determined with reasonable accuracy, the price can be reasonably estimated, and collectability is reasonably assured.

Fortescue recognises revenue when the risks and rewards transfers to the buyer which is typically the bill of lading date. The majority of Fortescue's executed sales agreements allow for an adjustment to the sales price based on a survey of the goods by the customer, therefore the recognition of the sales revenue is based on the most recently determined estimate of product specifications.

Additionally, the sales price is determined on a provisional basis at the date of sale and adjustments to the sales price may subsequently occur depending on movements in quoted market or contractual iron ore prices to the date of final pricing. The date of final pricing is typically when a notice of readiness is received when the vessel has arrived at its final destination. Revenue on provisionally priced sales is recognised based on the estimated fair value of the total consideration receivable.

(ii) *Traded freight*

Revenue from freight services is recognised on the bill of lading date of the customer.

1 Summary of significant accounting policies (continued)

(iii) Interest income

Interest income is recognised using the effective interest method. When a receivable is impaired, the Company reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

(f) Other income

Other income comprises gains on the disposal of available-for-sale financial assets, changes in the fair value of financial assets and non-operational revenue.

(g) 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 applicable income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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 assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in foreign operations where the company 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.

(i) Tax consolidation legislation

Fortescue has implemented the tax consolidation legislation as of 1 July 2003 and is therefore taxed as a single entity from that date.

The head entity, Fortescue Metals Group Limited 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 standalone 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 it has assumed from unused tax losses and unused tax credits 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.

1 Summary of significant accounting policies (continued)

(h) Leases

Leases of property, plant and equipment where Fortescue, as lessee, has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the fair value of the leased property or, if lower, the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in other short-term and long-term payables. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to the Statement of Comprehensive Income over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the asset's useful life and the lease term.

Leases in which a significant portion of the risks and rewards of ownership are not transferred to Fortescue as lessee are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor), except for investment property, are charged to the Statement of Comprehensive Income on a straight-line basis over the period of the lease.

(i) Impairment of assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Assets that have suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(j) Cash and cash equivalents

For Statement of Cash Flows presentation purposes, cash and cash equivalents includes cash on hand, deposits held at call with financial institutions and 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.

(k) Trade receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. An allowance for impairment of trade receivables is established when there is objective evidence that Fortescue will not be able to collect all amounts due.

Collectability of trade receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off by reducing the carrying amount directly. An allowance account is used when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the impairment allowance is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial.

The amount of the impairment loss is recognised in the Statement of Comprehensive Income within other expenses. When a trade receivable for which an impairment allowance had been recognised becomes uncollectible in a subsequent period, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against other expenses in profit or loss.

(l) Inventories

Inventories are valued at the lower of cost and net realisable value. Cost is determined primarily on the basis of weighted average costs. Cost for raw materials and stores is purchase price and for partly processed and saleable products cost is derived on an absorption costing basis. For this purpose the costs of production include:

- labour costs, materials and contractor expenses which are directly attributable to the extraction and processing of ore;

1 Summary of significant accounting policies (continued)

- the amortisation of development expenditure and depreciation of property, plant and equipment used in the extraction and processing of ore; and
- production overheads, including attributable mining and manufacturing overheads.

Stockpiles represent ore that has been extracted and is available for further processing. If there is significant uncertainty as to when the stockpiled ore will be processed it is expensed as incurred. Where the future processing of this ore can be predicted with confidence (if, for example, it exceeds the mine's cut off grade), it is valued at the lower of cost and net realisable value. If the ore will not be processed within 12 months after the balance sheet date it is included within non-current assets. Quantities are assessed primarily through surveys and assays.

(m) Financial assets

Fortescue classifies its investments into the following categories: financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition.

(i) 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 include trade receivables. They are included in current assets, except for those with maturities greater than 12 months after the reporting date which are classified as non-current assets. Loans and receivables are included in trade and other receivables note.

(ii) Derivatives

Financial assets at fair value through profit or loss are financial assets held for trading. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

This category comprises only interest rate swaps. They are carried in the balance sheet at fair value with changes in fair value recognised in the Statement of Comprehensive Income. Other than interest rate derivative financial instruments, Fortescue does not have any assets held for trading nor has it designated any other financial assets as being at fair value through profit or loss.

The fair value of Fortescue's interest rate derivative is based on comparisons to variable LIBOR rates.

(iii) Available for sale financial assets

Available-for-sale financial assets, comprising principally marketable equity securities, are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the reporting date. Investments are designated as available-for-sale if they do not have fixed maturities and fixed or determinable payments and management intends to hold them for the medium to long term. These instruments are recognised at fair value, with changes in fair value being recognised directly in a reserve, unless the change is a decrease below original cost which is considered to be significant or prolonged, in which case the decrease is recognised in the Statement of Comprehensive Income.

Recognition and derecognition

Regular purchased and sales of financial assets are recognised on trade-date – the date on which Fortescue commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transactions costs are expensed in the Statement of Comprehensive Income. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and Fortescue has transferred substantially all the risks and rewards of ownership.

When securities classified as available-for-sale are sold, the accumulated fair value adjustments recognised in equity are included in the Statement of Comprehensive Income as gains and losses from investment securities.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in carrying amount are recognised in equity. Changes in the fair value of other monetary and non-monetary securities classified as available-for-sale are recognised in equity.

Details on how the fair value of financial instruments is determined are disclosed in note 3.

Impairment

1 Summary of significant accounting policies (continued)

Fortescue assesses at each balance date whether there is objective evidence that a financial asset or group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of a security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in equity – is removed from equity and recognised in the Statement of Comprehensive Income. Impairment losses recognised in the Statement of Comprehensive Income on equity instruments classified as available-for-sale which subsequently reverse are not reversed through the Statement of Comprehensive Income.

If there is evidence of impairment for any of Fortescue's financial assets carried at amortised cost, the loss is measured as the difference between the assets carrying amount and the present value of estimated future cash flows. The cash flows are discounted at the financial asset's original effective interest rate. The loss is recognised in the Statement of Comprehensive Income. If the impairment loss subsequently reverses, the reversal is recognised in the Statement of Comprehensive Income.

(n) Financial liabilities

Fortescue classifies its financial liabilities into one of two categories, depending on the purpose for which the liability was acquired.

(i) Fair value through profit and loss

This category comprises only 'out of-the-money derivatives'. They are carried in the balance sheet at fair value with changes in fair value recognised in the Statement of Comprehensive Income. Other than these derivative financial instruments, Fortescue does not have any liabilities held for trading nor has it designated any financial liabilities as being at fair value through profit or loss.

(ii) Financial liabilities measured at amortised cost

Other financial liabilities include the following items:

- Trade payables and other short-term monetary liabilities, which are initially recognised at fair value and subsequently carried at amortised cost using the effective interest method; and
- Borrowings are initially recognised at fair value, net of any transaction costs directly attributable to the issue of the instrument. Interest bearing borrowings are subsequently measured at amortised cost using the effective interest rate method, which ensures that any interest expense over the period to repayment is at a constant rate on the balance of the liability carried in the balance sheet. Interest expense in this context includes initial amortisation of transaction costs and those payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

Fair value is calculated by discounting estimated future cash flows using a market rate of interest.

(o) Equity financial instruments

Financial instruments issued by Fortescue are treated as equity only to the extent that they do not meet the definition of a financial liability. Fortescue's ordinary shares are classified as equity instruments. There have been no changes in what Fortescue considers to be equity since the previous period.

(p) Parent entity financial information

The financial information for the parent entity, Fortescue Metals Group Limited, disclosed in note 38 has been prepared on the same basis as the consolidated financial statements, except as set out below.

(i) Investments in subsidiaries, associates and joint venture entities

Investments in subsidiaries, associates and joint venture entities are accounted for at cost in the financial statements of Fortescue Metals Group Limited. Dividends received from associates are recognised in the parent entity's profit or loss, rather than being deducted from the carrying amount of these investments.

(ii) Tax consolidation legislation

Fortescue Metals Group Limited and its wholly-owned Australian controlled entities have implemented the tax consolidation legislation.

1 Summary of significant accounting policies (continued)

The head entity, Fortescue Metals Group Limited, and the controlled entities in the tax consolidated group 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, Fortescue Metals Group Limited 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.

The entities have also entered into a tax funding agreement under which the wholly-owned entities fully compensate Fortescue Metals Group Limited for any current tax payable assumed and are compensated by Fortescue Metals Group Limited for any current tax receivable and deferred tax assets relating to unused tax losses or unused tax credits that are transferred to Fortescue Metals Group Limited under the tax consolidation legislation. The funding amounts are determined by reference to the amounts recognised in the wholly-owned entities' financial statements.

The amounts receivable/payable under the tax funding agreement are due upon receipt of the funding advice from the head entity, which is issued as soon as practicable after the end of each financial year. The head entity may also require payment of interim funding amounts to assist with its obligations to pay tax instalments.

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

Any difference 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.

(iii) Financial guarantees

Where the parent entity has provided financial guarantees in relation to loans and payables of subsidiaries for no compensation, the fair values of these guarantees are accounted for as contributions and recognised as part of the cost of the investment.

(q) Fair value estimation

The fair value of financial assets and financial liabilities must be estimated for measurement disclosure purposes. Fair values have been determined based on the following methods.

Financial instruments traded in active markets

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.

Financial instruments not traded in active markets

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. Quoted market prices or dealer quotes for similar instruments are used for long-term debt instruments held and then adjusted to reflect risk of the particular instrument. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments.

Trade receivables and payables

The nominal value less estimated credit adjustments of current trade receivables and payables are assumed to approximate their fair values due to their short term nature. The fair value of non-current financial assets and 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.

1 Summary of significant accounting policies (continued)

Share-based payment transactions

The fair value of employee share options is measured using either a binomial or trinomial model. Measurement inputs include share price at measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds). Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

(r) Property, plant and equipment

Recognition and measurement

Each class of property, plant and equipment is stated at historical cost less, where applicable, any accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing an asset to a working condition ready for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment. Purchased software that is integral to the functionality of the related equipment is capitalised as part of the equipment

Subsequent costs

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. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the Statement of Comprehensive Income during the financial period in which they are incurred.

Depreciation

Depreciation on assets, other than land, is calculated using the straight line method or units of production method to allocate their cost or revalued amounts, net of their residual values, over their estimated useful lives. Land is not depreciated.

Gains and losses on disposal are determined by comparing proceeds with carrying amount. These are included in the Statement of Comprehensive Income

(i) Straight line method

Assets within operations where production is not expected to fluctuate significantly from one year to another or which have a physical life that differs from the related mine are depreciated on a straight line basis as follows:

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

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

(ii) Units of production method

Where the useful life of an asset is directly linked to the extraction of ore from the mine, the asset is depreciated using the units of production method. In applying the units of production method, depreciation is normally calculated using the quantity of material extracted from the mine in the period as a percentage of the total quantity of material to be extracted in current and future periods based on proved and probable reserves.

1 Summary of significant accounting policies (continued)

(s) Intangible assets

(i) IT development and software

Costs incurred in developing products or systems and costs incurred in acquiring software and licenses that will contribute to future period financial benefits through revenue generation and/or cost reduction are capitalised to software and systems. Costs capitalised include external direct costs of materials and service, direct payroll and payroll related costs of employees' time spent on the project.

IT development costs include only those costs directly attributable to the development phase and are only recognised following completion of technical feasibility and where Fortescue has an intention and ability to use the asset.

Intangible assets that have a physical life that differs from the related mine are amortised on a straight line basis over periods generally ranging from 3 to 6 years. Where the useful life of intangible assets is directly linked to the extraction of ore from the mine, these assets are amortised on the units of production method.

(ii) Research and development

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will, after considering its commercial and technical feasibility, be completed and generate future economic benefits and its costs can be measured reliably. The expenditure capitalised comprises all directly attributable costs, including costs of materials, services, direct labour and an appropriate proportion of overheads. Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight-line basis over its useful life, which varies from 3 to 5 years.

(t) 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.

(u) Finance costs

Finance costs comprise borrowing costs, unwinding of the discount on provisions and derivatives, borrowing costs and impairment losses recognised on financial assets.

(v) 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 can be 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.

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. The discount rate used to determine the present value reflects current market assessments of the time value of money and the risks specific to the liability. The increase in the provision due to the passage of time is recognised as interest expense.

(w) 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.

1 Summary of significant accounting policies (continued)

(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.

(iii) Share-based payments

Share-based remuneration benefits are provided to employees via the FMGIOS and Performance Rights Plan (PRP). Information relating to these schemes is set out in note 37.

The fair value of options granted under the FMGIOS and PRP are 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 either a binomial or trinomial option pricing model that takes into account the exercise price, the term of the option, the impact of dilution, 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 is measured to reflect expected market vesting conditions, but excludes the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each reporting date, the entity revises its estimate of the number of options that are expected to become exercisable. The employee benefit expense recognised each period takes into account the most recent estimate. The impact of the revision to original estimates, if any, is recognised in the Statement of Comprehensive Income with a corresponding adjustment to equity.

(iv) Bonus plans

Fortescue recognises a liability and an expense for bonuses where contractually obliged or where there is a past practice that has created a constructive obligation.

(x) Contributed equity

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Incremental costs directly attributable to the issue of new shares for the acquisition of a business are not included in the cost of the acquisition as part of the purchase consideration.

If the entity reacquires its own equity instruments, for example as the result of a share buy-back, those instruments are deducted from equity and the associated shares are cancelled. No gain or loss is recognised in the profit or loss and the consideration paid including any directly attributable incremental costs (net of income taxes) is recognised directly in equity.

(y) 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 additional shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

(z) Mineral exploration and evaluation expenditure

Exploration and evaluation expenditure incurred is accumulated in respect of each identifiable area of interest. Exploration and evaluation expenditure includes:

- researching and analysing historical exploration data
- gathering exploration data through topographical, geochemical and geophysical studies

1 Summary of significant accounting policies (continued)

- exploratory drilling, trenching and sampling
- determining and examining the value and grade of the resource
- surveying transportation and infrastructure requirements
- conducting market and finance studies
- administration costs that are directly attributable to a specific exploration area and
- licensing costs

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 a reasonable assessment of the existence or otherwise of 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. Accumulated costs in relation to an abandoned area are written off in full in the Statement of Comprehensive Income in the year in which the decision to abandon the area is made.

(aa) Development expenditure

Once a mining project has been established as commercially viable and technically feasible, expenditure other than that on land, buildings and plant and equipment is capitalised under development expenditure. Development expenditure costs include previously capitalised exploration and evaluation costs, pre-production development costs, development excavation, development studies and other subsurface expenditure pertaining to that area of interest. Costs related to surface plant and equipment and any associated land and buildings are accounted for as property, plant and equipment.

Development costs are accumulated in respect of each separate area of interest. Costs associated with commissioning new assets in the period before they are capable of operating in the manner intended by management, are capitalised. Development costs incurred after the commencement of production are capitalised to the extent they are expected to give rise to a future economic benefit.

When an area of interest is abandoned or the Directors decide that it is not commercial or technically feasible, any accumulated cost in respect of that area is written off in the financial period the decision is made. Each area of interest is reviewed at the end of each accounting period and accumulated cost written off to the Statement of Comprehensive Income to the extent that they will not be recoverable in the future.

Amortisation of carried forward exploration and development costs is charged on a unit of production basis over the life of economically recoverable reserves.

Development assets are assessed for impairment if facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For the purposes of impairment testing, development assets are allocated to cash-generating units to which the development activity relates. The cash generating unit shall not be larger than the area of interest.

(ab) Rehabilitation

The mining, extraction and processing activities of Fortescue give rise to obligations for site rehabilitation. Rehabilitation obligations can include facility decommissioning and dismantling, removal or treatment of waste materials, land rehabilitation and site restoration. The extent of work required and the associated costs are estimated based on feasibility and engineering studies using current restoration standards and techniques. Provisions for the cost of each rehabilitation program are recognised at the time that environmental disturbance occurs.

Rehabilitation provisions are initially measured at the expected value of future cash flows required to rehabilitate the relevant site, discounted to their present value. The value of the provision is progressively increased over time as the effect of discounting unwinds. When provisions for rehabilitation are initially recognised, the corresponding cost is capitalised as an asset, representing part of the cost of acquiring the future economic benefits of the operation. The capitalised cost of rehabilitation activities is recognised in 'Development Expenditure' as rehabilitation assets and amortised accordingly.

Where rehabilitation is expected to be conducted systematically over the life of the operation, rather than at the time of closure, provision is made for the present obligation or estimated outstanding continuous rehabilitation work at each balance sheet date and the costs charged to the Statement of Comprehensive Income in line with remaining future cash flows.

1 Summary of significant accounting policies (continued)

At each reporting date the rehabilitation liability is re-measured to account for any new disturbance, updated cost estimates, changes to the estimated lives of operations, new regulatory requirements and revisions to discount rates. Changes to the rehabilitation liability are added to or deducted from the related rehabilitation asset and amortised accordingly.

(ac) Deferred stripping

Overburden and other mine waste materials are often removed during the initial development of a mine in order to access the mineral deposit. This activity is referred to as development stripping. The directly attributable costs (inclusive of an allocation of relevant overhead expenditure) are capitalised as development costs. Capitalisation of development stripping costs ceases and amortisation of those capitalised costs commences upon extraction of ore. Amortisation of capitalised development stripping costs is determined on a unit of production basis for each separate area of interest.

Capitalised development and production stripping costs are classified as 'Development Expenditure'. Development stripping costs are considered in combination with other assets of an operation for the purpose of undertaking impairment assessments.

Removal of waste material normally continues throughout the life of a mine. This activity is referred to as production stripping and commences upon extraction of ore.

The Cloudbreak and Christmas Creek area of interest has minimal overburden to remove from these alluvial mines, therefore production stripping costs for these mines are not deferred but charged to the Statement of Comprehensive Income as they are incurred.

(ad) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of associated GST, except where the amount of GST incurred is not recoverable from the Australian Tax Office (ATO). 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. The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the balance sheet.

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.

(ae) Rounding of amounts

The Company is of a kind referred to in Class order 98/100, issued by the Australian Securities and Investments Commission, relating to the "rounding off" of amounts in the financial report. Amounts in the financial report have been rounded off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, the nearest dollar.

(af) New accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2010 reporting periods and have not yet been applied in the financial report. The Company's assessment of the impact of these new standards and interpretations is set out below.

(i) AASB 9 *Financial Instruments*

In November 2009, the AASB issued AASB 9 *Financial Instruments* which addresses the classification and measurement of financial assets and is likely to affect the company's accounting for its financial assets. The standard is not applicable until 1 January 2013 and the company is yet to assess its full impact. The Company has not yet decided when to adopt AASB 9.

(ii) AASB Interpretation 19 *Extinguishing financial liabilities with equity instruments* and AASB 2009-13 *Amendments to Australian Accounting Standards arising from Interpretation 19* (effective 1 July 2010)

AASB Interpretation 19 clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished by the debtor issuing its own equity instruments to the creditor (debt for equity swap). It requires a gain or loss to be recognised in profit or loss which is measured as the difference between the carrying value of the financial liability and the fair value of the equity instruments issued. The company will apply the interpretation from 1 July 2010. It is not expected to have any impact on the company's financial statements since it is only retrospectively applied from the beginning of the earliest period presented (1 July 2009) and the company has not entered into any debt for equity swaps since that date.

1 Summary of significant accounting policies (continued)

None of the other amendments or interpretations are expected to affect the financial results of the Fortescue Group.

The Fortescue Group has undertaken the election available to early adopt AASB 2009-5. Paragraph 23 of AASB 8 was amended by the AASB in May 2009 by AASB 2009-5 to clarify that disclosure of total assets for each reportable segment is only required if such an amount is regularly provided to the chief operating decision maker.

2 Critical accounting estimates and judgements

The preparation of the consolidated financial statements requires management to make judgements and estimates that affect how certain assets, liabilities, revenue, expenses and equity are reported. At each reporting period, management evaluates its judgements and estimates based on historical experience and on other various factors it believes to be reasonable under the circumstances, the results of which form the basis of the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions and conditions.

Fortescue has identified the following critical accounting policies under which significant judgements and estimates are made. Further details of the nature of these assumptions and conditions may be found in the relevant notes to the financial statements.

(i) Reserve estimates

Reserves are estimates of the amount of product that can be economically and legally extracted from Fortescue's current mining tenements. In order to calculate reserves, estimates and assumptions are required about a range of geological, technical and economic factors, including quantities, grades, production techniques, recovery rates, production costs, transports costs, commodity demand, commodity prices and exchange rates. Estimating the quantity and/or grade of reserves requires the size, shape and depth of ore bodies or fields to be determined by analysing geological data such as drilling samples. This process may require complex and difficult geological judgements and calculations to interpret the data.

In the Chichester Range project sites, Fortescue has estimated a reserve of 1.625 billion tonnes (Bt) from a resource of 2.2Bt, which includes 126 million tonnes (Mt) of proved and 1,459Mt of probable reserves, as classified under Australasian Code for Reporting of Mineral Resources and Ore Reserves December 2004 (JORC Code). The JORC Code requires the use of reasonable investment assumptions to calculate reserves.

Because the economic assumptions used to estimate reserves change from period to period, and because additional geological data is generated during the course of operations, estimates of reserves may change from period to period. Changes in reported reserves may affect Fortescue's financial results and financial position in a number of ways, including the following:

- Asset carrying values may be affected due to changes in estimated future cash flows
- Depreciation and amortisation charges in the Statement of Comprehensive Income may change where such charges are determined by the units of production basis, or where the useful economic lives of assets change
- The carrying value of deferred tax assets may change due to changes in estimates of the likely recovery of tax benefits.

(ii) Exploration and evaluation expenditure

Fortescue's accounting policy for exploration and evaluation expenditure results in expenditure being capitalised for an area of interest where it is considered likely to be recoverable by future exploitation or sale or where the activities have not reached a stage which permits a reasonable assessment of the existence of reserves. This policy requires management to make certain estimates as to future events and circumstances, in particular whether an economically viable extraction operation can be established. Any such estimates and assumptions may change as new information becomes available. If, after having capitalised the expenditure under the policy, a judgement is made that recovery of the expenditure is unlikely, the relevant capitalised amount will be written off to the Statement of Comprehensive Income.

(iii) Development expenditure

Development activities commence after commercial viability and technical feasibility of the project is established. Judgement is applied by management in determining when a project is commercially viable and technically feasible. Any judgements may change as new information becomes available. If, after having commenced the development activity, a judgement is made that a development asset is impaired, the appropriate amount will be written off to the Statement of Comprehensive Income.

2 Critical accounting estimates and judgements (continued)

(iv) Property, plant and equipment – recoverable amount

In accordance with Fortescue's accounting policy, each asset or cash generating unit is evaluated every reporting period to determine whether there are any indications of impairment. If any such indication exists, a formal estimate of recoverable amount is performed and an impairment loss is recognised to the extent that carrying amount exceeds recoverable amount. The recoverable amount of an asset or cash generating group of assets is measured at the higher of fair value less costs to sell and value in use.

The determination of fair value and value in use requires management to make estimates about expected production and sales volumes, commodity prices, reserves (see 'reserve estimates' above), operating costs, rehabilitation costs and future capital expenditure. Changes in circumstances will alter these projections, which may impact the recoverable amount of the assets. In such circumstances, some or all of the carrying value of the assets may be impaired and the impairment would be charged against the Statement of Comprehensive Income.

(v) Rehabilitation

Fortescue's accounting policy for the recognition of rehabilitation provisions requires significant estimates including the magnitude of possible works required for removal or treatment of waste materials and the extent of work required and the associated costs of rehabilitation work. These uncertainties may result in future actual expenditure differing from the amounts currently provided.

The provision recognised for each site is periodically reviewed and updated based on the facts and circumstances available at the time. Changes to the estimated future costs for operating sites are recognised in the balance sheet by adjusting the rehabilitation asset and provision.

(vi) Subordinated loan note valuation

The Company put in place a US\$100 million subordinated loan note during the 2007 financial year. The key terms and conditions of the facility are:

- Interest under the note is calculated as 4% of the revenue, net of government royalties, from the sale of iron ore FOB Port Hedland from the tenements of the Cloudbreak and Christmas Creek areas only. Accordingly the interest is only payable when Fortescue is in production and is only relevant to iron ore produced from these two tenement areas for a period of 13 years from 18 August 2006
- The note is unsecured and deeply subordinated to any secured debt. In the event that an interest payment is earned but not payable due to secured lender restrictions, the amount unpaid will accrue interest at 9.5% until payment is made

The carrying amount of the note was re-estimated at 30 June 2010 to US\$826,240,000 (30 June 2009: US\$381,631,000) in line with changes in the following management estimates, prevailing market conditions and economic forecasts:

- Production was revised to reflect Fortescue's forecast production profile as at 30 June 2010 of production levels from Christmas Creek and Cloudbreak reaching a maximum run rate of 90mtpa in the 12 months to June 2014 (2009: forecast reaching a maximum 95mtpa in the 12 months to June 2012).
- Future iron ore prices were updated to reflect the forecasts provided by Metalytics Pty Limited, an independent resource sector analyst of future iron ore prices
- The discount rate has been applied since inception and reflects the implicit interest rate of 42% of the subordinated loan note
- Expected royalty rates have not changed since 30 June 2009 and reflect current royalty rates payable to the Western Australian state government and
- The total reserve estimate of Cloudbreak and Christmas Creek has not changed since 30 June 2009.

The explanation of the carrying value re-estimation of the subordinated loan note from US\$381.6 million to US\$826.2 million is included in the non current borrowings note.

3 Financial risk management

In common with all other business, Fortescue is exposed to risks that arise from its use of financial instruments. This note describes Fortescue's objectives, policies and processes for managing those risks and methods used to measure them. Further quantitative information in respect of these risks is presented throughout these financial statements.

General objectives, policies and processes

The Board has overall responsibility for the determination of Fortescue's risk management objectives and policies, and whilst retaining ultimate responsibility for them, it has delegated the authority for designing and operating processes that ensure the effective implementation of the objectives and policies to the Audit and Risk Management Committee. The Audit and Risk Management Committee receives reports as required from the Chief Financial Officer through which it reviews the effectiveness of the processes put in place and the appropriateness of the objectives and policies it sets.

Fortescue's Audit and Risk Management Committee oversees how management monitors compliance with the Fortescue Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Company and Fortescue. Fortescue's Audit and Risk Management Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit and Risk Management Committee.

The overall objective of the Board is to set policies that seek to reduce risk as far as possible without unduly affecting Fortescue's competitiveness and flexibility. Further details regarding these policies are set out below.

Financial risks

Fortescue's activities expose it to a variety of financial risks: market risk (including currency risk, interest rate risk and price risk), credit risk and liquidity risk. Fortescue's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on financial performance. Fortescue uses interest rate swaps to hedge interest rate risk exposures. Derivatives are exclusively used for hedging purposes, i.e. not as trading or other speculative instruments. Fortescue uses different methods to measure different types of risk to which it is exposed.

The company holds the following financial instruments:

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Financial assets		
Cash and cash equivalents	1,235,538	654,942
Trade receivables	256,574	182,023
Financial assets	<u>95</u>	<u>31</u>
	<u>1,492,207</u>	<u>836,996</u>
Financial liabilities		
Borrowings	2,975,663	2,570,305
Trade and other payables	772,906	688,687
Derivatives held at fair values	<u>16,285</u>	<u>31,397</u>
	<u>3,764,854</u>	<u>3,290,389</u>

The carrying amount of the financial assets and liabilities in the table above is assumed to approximate their fair value.

(a) Market risk

Market risk arises from Fortescue's use of interest bearing and foreign currency financial instruments. It is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in interest rates (interest rate risk), foreign exchange rates (currency risk) or other market factors (other price risk).

3 Financial risk management (continued)

(i) Foreign exchange risk

Fortescue's policy is, where possible, to allow group entities to settle liabilities denominated in their functional currency (US Dollar) with the cash generated from their own operations in that currency. Where group entities have liabilities denominated in a currency other than their functional currency (and have insufficient reserves of that currency to settle them) cash already denominated in that currency will, where possible, be transferred from other entities within Fortescue.

Fortescue operates internationally and is exposed to foreign exchange risk arising from various currency exposures primarily with respect to the Australian dollar and Euro. Fortescue is exposed to currency risk on cash reserves, deposits received, trade receivables and borrowings.

Foreign exchange risk arises from future commercial transactions and recognised assets and liabilities denominated in a currency that is not the entity's functional currency. The risk is measured using sensitivity analysis and cash flow forecasting. Fortescue has not entered into any forward exchange contracts as at 30 June 2010 and is currently fully exposed to foreign exchange risk.

The carrying amounts of the group's financial assets and liabilities are denominated in three different currencies as set out below:

	USD US\$'000	30 June 2010 AUD US\$'000	EURO US\$'000	Total US\$'000
Financial assets				
Cash and cash equivalents	963,032	249,561	22,945	1,235,538
Trade and other receivables	172,479	81,074	3,021	256,574
Financial assets	-	95	-	95
Total financial assets	<u>1,135,511</u>	<u>330,730</u>	<u>25,966</u>	<u>1,492,207</u>
Financial liabilities				
Borrowings	2,477,175	120,331	378,157	2,975,663
Trade and other payables	371,792	401,114	-	772,906
Derivative held at fair values	16,285	-	-	16,285
Total financial liabilities	<u>2,865,252</u>	<u>521,445</u>	<u>378,157</u>	<u>3,764,854</u>
	USD US\$'000	30 June 2009 AUD US\$'000	EURO US\$'000	Total US\$'000
Financial assets				
Cash and cash equivalents	141,754	485,663	26,525	654,942
Trade and other receivables	101,360	63,152	17,511	182,023
Financial assets	-	31	-	31
Total financial assets	<u>243,114</u>	<u>548,846</u>	<u>44,036</u>	<u>836,996</u>
Financial liabilities				
Borrowings	2,021,242	114,809	434,254	2,570,305
Trade and other payables	349,602	339,085	-	688,687
Derivative held at fair values	31,397	-	-	31,397
Total financial liabilities	<u>2,402,241</u>	<u>456,894</u>	<u>434,254</u>	<u>3,290,389</u>

(ii) Commodity price risk

The Fortescue Group is exposed to commodity price risk. Contract iron ore prices are based on an international iron ore index. Fortescue has not entered into any forward commodity price contracts as at 30 June 2010 and is currently fully exposed to commodity price risk. Fortescue's exposure to commodity price risk at the reporting date was as follows:

	Consolidated 2010 US\$'000	2009 US\$'000
Subordinated loan note	(826,240)	(381,631)
Trade receivables	158,992	109,163

3 Financial risk management (continued)

(iii) Cash flow and fair value interest rate risk

Interest rate risk

It is Fortescue's policy either to eliminate interest rate risk over the cash flows on its long-term debt finance through the use of fixed rate instruments or to mitigate the risk through the use of floating-to-fixed interest rate swaps. Fortescue currently has a floating-to-fixed interest rate swap over its US\$250 million senior secured notes due in 2011.

Fortescue invests surplus cash in term deposits and in doing so exposes itself to the fluctuations in interest rates that are inherent in such a market.

As at reporting date, Fortescue had the following variable rate borrowings (US\$250 million senior secured notes due 2011 and the subordinated loan note) and interest rate swap contracts outstanding:

Consolidated	30 June 2010 US\$'000	30 June 2009 US\$'000
Borrowings - subordinated loan note	826,240	381,631
Borrowings - senior secured notes	250,947	253,083
Interest rate swaps	<u>16,285</u>	<u>31,397</u>
Net exposure to cash flow interest rate risk	<u>1,093,472</u>	<u>666,111</u>

An analysis by maturities is provided in (c) below.

Interest rate swap contract - senior secured notes

US\$250 million of the senior secured notes Facility is denominated in floating rate notes. It is policy to protect Fortescue from exposure to increasing interest rates. Accordingly Fortescue has entered into interest rate swap contracts under which it is obliged to receive interest at variable rates and to pay interest at fixed rates. The fixed interest rate is at 5% and the variable interest rate is based on 3 month LIBOR.

At 30 June 2010, the notional principal amount and period of expiry of the interest rate swap contract is as follows

	2010 US\$'000	2009 US\$'000
1 - 2 years	250,000	250,000

The contract requires settlement of net interest receivable or payable each 90 days. The settlement dates coincide with the dates on which interest is payable on the underlying senior secured notes. The contracts are settled on a net basis.

The gain or loss from measuring the hedging instrument at fair value is recognised in the Statement of Comprehensive Income immediately.

All borrowings other than the US\$250 million senior secured floating rate notes are issued at fixed interest rates which minimises cash flow interest rate risk.

(iv) Summarised sensitivity analysis

The Company has used the actual ranges of rate and price fluctuations observed over the reporting period to estimate its sensitivity to market rates. The Company's main interest rate exposures are to US Dollar LIBOR and Australian short-term rates; its foreign exchange risk is to the Australian Dollar and Euro rates and other price risk is primarily due to spot iron ore prices.

3 Financial risk management (continued)

The following table summarises the sensitivity of the Fortescue Group's financial assets and financial liabilities to interest rate risk, foreign exchange risk and other price risk.

30 June 2010	Carrying amount US\$'000	Interest rate risk				Foreign exchange risk				Other price risk			
		-25 bps		+25 bps		-10%		+10%		-40%		+40%	
	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	
Financial assets													
Cash and cash equivalents	1,235,538	(3,089)	-	3,089	-	(27,251)	-	27,251	-	-	-	-	
Trade and other receivables	256,574	-	-	-	-	(8,330)	-	8,330	-	(63,596)	-	63,596	
Financial assets	95	-	-	-	-	(10)	-	10	-	(38)	-	38	
Financial liabilities													
Borrowings	2,975,663	625	-	(625)	-	49,849	-	(49,849)	-	262,786	-	(262,786)	
Trade and other payables	772,906	-	-	-	-	40,111	-	(40,111)	-	-	-	-	
Derivatives held at fair value	16,285	(625)	-	625	-	-	-	-	-	-	-	-	
Total increase/ (decrease)		(3,089)	-	3,089	-	54,370	-	(54,370)	-	199,152	-	(199,152)	

30 June 2009	Carrying amount US\$'000	Interest rate risk				Foreign exchange risk				Other price risk			
		-50 bps		+50 bps		-5%		+5%		-10%		+10%	
	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	Profit US\$'000	Other equity US\$'000	
Financial assets													
Cash and cash equivalents	654,942	(3,275)	-	3,275	-	(43,098)	-	43,098	-	-	-	-	
Trade and other receivables	182,023	-	-	-	-	(6,452)	-	6,452	-	(10,916)	-	10,916	
Financial assets	31	-	-	-	-	(1)	-	1	-	(3)	-	3	
Financial liabilities													
Borrowings	2,570,305	1,250	-	(1,250)	-	16,730	-	(16,730)	-	31,120	-	(31,120)	
Trade and other payables	688,687	-	-	-	-	28,900	-	(28,900)	-	-	-	-	
Derivatives held at fair value	31,397	(1,250)	-	1,250	-	-	-	-	-	-	-	-	
Total increase/ (decrease)		(3,275)	-	3,275	-	(3,921)	-	3,921	-	20,201	-	(20,201)	

3 Financial risk management (continued)

(b) Credit risk

Credit risk is managed on a consolidated basis. Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to Fortescue. Credit risk arises from cash and cash equivalents, derivative financial instruments, deposits with banks and financial institutions and credit exposures to customers, including outstanding receivables and committed transactions.

Fortescue is exposed to a concentration of risk with the majority of its iron ore customers being Chinese companies. Fortescue has adopted a policy of only dealing with credit worthy counterparties as a means of mitigating the risk of financial loss from defaults. Cash and cash equivalents are held in various financial institutions with long-term investment grade credit rating and with the capacity for payment of financial commitments considered strong. Fortescue has not recognised any bad debt expense in the 2010 or 2009 financial years.

The maximum exposure to credit risk at the reporting date is the carrying amount of the financial assets as summarised in the Principal Financial Instruments section of this note. For commodity trade receivables Fortescue mitigates its credit risk in most cases by obtaining security in the form of letters of credit prior to ship loading covering approximately 95% of the value of iron ore shipped, thereby reducing credit risk to an acceptable level as determined by the Board.

Fortescue has no receivables past due as at 30 June 2010 (2009: \$nil), nor does it consider there to be any potential impairment loss on these receivables.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities. Fortescue manages liquidity risk by continuously monitoring forecast and actual cash flows.

Financing arrangements

The Fortescue Group is fully drawn on their borrowing facilities as at 30 June 2010 and 30 June 2009.

Maturities of financial liabilities

The tables below analyse Fortescue and the Company's financial liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

The maturity profiles below are undiscounted. The expected maturity profile of Fortescue and the Company's financial liabilities are analysed below:

	Less than 6 months	6 - 12 months	Between 1 and 2 years	Between 2 and 5 years	Over 5 years	Total contract- ual cash flows	Carrying Amount (assets)/ liabilities
Fortescue - at 30 June 2010	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000
Non-derivatives							
Non-interest bearing	530,118	6,000	84,818	180,913	-	801,849	801,849
Variable rate	182,377	97,303	471,274	1,028,607	1,572,076	3,351,637	1,077,186
Fixed rate	<u>99,538</u>	<u>105,141</u>	<u>199,948</u>	<u>192,956</u>	<u>2,345,686</u>	<u>2,943,269</u>	<u>1,922,203</u>
Total non-derivatives	<u>812,033</u>	<u>208,444</u>	<u>756,040</u>	<u>1,402,476</u>	<u>3,917,762</u>	<u>7,096,755</u>	<u>3,801,238</u>
Derivatives							
Interest rate swaps	<u>2,429</u>	<u>8,023</u>	<u>5,833</u>	<u>-</u>	<u>-</u>	<u>16,285</u>	<u>16,285</u>

3 Financial risk management (continued)

	Less than 6 months	6 - 12 months	Between 1 and 2 years	Between 2 and 5 years	Over 5 years	Total contractual cash flows	Carrying Amount (assets)/ liabilities
Fortescue - at 30 June 2009	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000
Non-derivatives							
Non-interest bearing	381,885	42,800	80,200	183,802	-	688,687	688,687
Variable rate	85,819	50,222	113,989	769,436	1,117,831	2,137,297	634,714
Fixed rate	<u>86,409</u>	<u>85,172</u>	<u>171,671</u>	<u>1,018,669</u>	<u>1,442,121</u>	<u>2,804,042</u>	<u>1,966,988</u>
Total non-derivatives	<u>554,113</u>	<u>178,194</u>	<u>365,860</u>	<u>1,971,907</u>	<u>2,559,952</u>	<u>5,630,026</u>	<u>3,290,389</u>
Net settled (interest rate swaps)	<u>3,988</u>	<u>4,320</u>	<u>9,591</u>	<u>13,498</u>	<u>-</u>	<u>31,397</u>	<u>31,397</u>

(d) Fair value estimation

The fair value of financial assets and financial liabilities must be estimated for recognition and measurement for disclosure purposes.

The fair value of borrowings for disclosure purposes would be estimated by discounting the future contractual cash flows at the current market interest rate that is available to Fortescue for similar financial instruments. The current carrying value of the senior secured notes is a close approximation of their fair value. However, due to the unique nature of Fortescue's subordinated loan note, there is no comparable instrument against which Fortescue can benchmark in order to determine the fair value of these borrowings.

As of 1 July 2009, Fortescue Metals Group Limited has adopted the amendment to AASB 7 *Financial Instruments: Disclosures* which requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)
- (b) inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) (level 2), and
- (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (level 3)

The following table presents the group's assets and liabilities measured and recognised at fair value at 30 June 2010. Comparative information has not been provided as permitted by the transitional provisions of the new rules.

Group - as at 30 June 2010	Level 1 US\$'000	Level 2 US\$'000	Level 3 US\$'000	Total US\$'000
Assets				
Available-for-sale financial assets				
Equity securities	<u>95</u>	-	-	<u>95</u>
Total assets	<u>95</u>	-	-	<u>95</u>
Liabilities				
Borrowings	-	826,240	-	826,240
Derivatives held at fair value	-	<u>16,285</u>	-	<u>16,285</u>
Total liabilities	-	<u>842,525</u>	-	<u>842,525</u>

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 end of the reporting period. The quoted market price used for financial assets held by the Company is the current bid price. These instruments are included in level 1.

3 Financial risk management (continued)

The fair value of financial instruments that are not traded in an active market is determined using valuation techniques. The Company uses a variety of methods and makes assumptions that are based on market conditions existing at the end of each reporting period. Quoted market prices or dealer quotes for similar instruments are used to estimate fair value for long-term debt for disclosure purposes. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows. These instruments are included in level 2. In the circumstances where a valuation technique for these instruments is based on significant unobservable inputs, such instruments are included in level 3.

(e) Capital management

In managing its capital, Fortescue's primary objective is to ensure its continued ability to provide a consistent return for its equity shareholders through capital growth. Fortescue considers its capital to comprise its ordinary share capital, accumulated losses, subordinated loan notes and senior secured notes.

The Board seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security offered by a sound capital position.

There were no changes in Fortescue's approach to capital management during the year. Fortescue has not breached any covenants during the 2010 or 2009 financial years. Fortescue's capital management portfolio at 30 June 2010 and 2009 was as follows:

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Total borrowings	2,975,663	2,570,305
Less cash and cash equivalents	<u>(1,235,538)</u>	<u>(654,942)</u>
Net debt	<u>1,740,125</u>	<u>1,915,363</u>
Total equity	<u>1,476,665</u>	<u>850,692</u>
Total capital	<u>3,216,790</u>	<u>2,766,055</u>
Gearing ratio	54 %	69 %

The reduction in the gearing ratio during 2010 resulted primarily from an increase in cash and cash equivalents and equity due to higher operating profit.

4 Segment information

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive Officer

No operating segments have been aggregated to form the above reportable operating segment.

Geographical information

Fortescue operates predominantly in the geographical location of Australia, and this is the location of all segment assets. In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers.

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Revenues from external customers		
China	3,113,779	1,792,166
Other	<u>106,283</u>	<u>36,432</u>
Total revenue from external customers per statement of comprehensive income	<u>3,220,062</u>	<u>1,828,598</u>

4 Segment information (continued)

Major customer information

Revenue from one customer amounted to US\$308 million (2009: US\$121 million), arising from the sale of iron ore and related shipment of product.

5 Revenue

	Consolidated	
	2010 US\$'000	2009 US\$'000
Sale of iron ore	2,575,670	1,569,530
Shipping revenue	592,754	259,068
Sale of third party product	<u>51,638</u>	<u>-</u>
	<u>3,220,062</u>	<u>1,828,598</u>

6 Other income

	Consolidated	
	2010 US\$'000	2009 US\$'000
Accommodation costs on-charged to third parties	38,405	879
Interest received	18,909	9,884
Other income	5,875	4,370
Interest rate swaps	8,285	-
Net gain on disposal property, plant and equipment	3,613	90
Third party port access	8,998	2,355
Profit on debt buy back	-	11,544
Debt forgiven on deposits received	-	6,928
Lease income on facilities	<u>-</u>	<u>2,906</u>
	<u>84,085</u>	<u>38,956</u>

7 Expenses

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Net gains and expenses		
<i>Operating expenses</i>		
Mining costs	867,375	470,636
Rail costs	101,238	60,419
Port costs	70,691	48,304
Operating leases	141,552	104,107
Shipping costs	612,267	490,053
Government royalty	150,558	88,331
Purchases of third party product	<u>28,697</u>	<u>-</u>
	<u>1,972,378</u>	<u>1,261,850</u>
Shipping costs include an amount of US\$58.8 million (FY2009: US\$130.2 million) that relates to an allowance for negotiated settlements for long term CFR contracts and a provision for a contract dispute that is yet to be settled.		
<i>Depreciation and amortisation expense</i>		
Depreciation of property, plant and equipment	80,298	35,946
Amortisation of intangible assets	1,574	353
Amortisation of development expenditure	<u>71,302</u>	<u>52,547</u>
	<u>153,174</u>	<u>88,846</u>
<i>Administration expenses</i>		
Wages and salaries, including superannuation	7,924	6,044
Share based payments expense	1,771	1,399
Legal costs	11,118	8,899
Other administration expenses	<u>3,892</u>	<u>18,278</u>
	<u>24,705</u>	<u>34,620</u>
<i>Finance costs</i>		
Interest expense - subordinated loan note	164,623	258,706
Interest expense - senior secured notes	201,207	197,998
Interest expense - preference shares	10,911	9,309
Interest rate swaps	1,480	20,574
Interest expense on deposits received	10,090	-
Other	5,904	-
Debt establishment costs	<u>-</u>	<u>4,358</u>
	<u>394,215</u>	<u>490,945</u>

8 Income tax expense

	Consolidated	
	2010	2009
	US\$'000	US\$'000
(a) Income tax (benefit)/expense		
Current tax	-	57,105
Deferred tax	24,939	120,451
Adjustments for current tax of prior periods	<u>(26,709)</u>	<u>(23,638)</u>
	<u>(1,770)</u>	<u>153,918</u>

8 Income tax expense (continued)

(b) Numerical reconciliation of income tax expense to prima facie tax payable

Profit from continuing operations before income tax expense	<u>579,176</u>	<u>661,960</u>
Tax at the Australian tax rate of 30% (2009 - 30%)	<u>(173,753)</u>	<u>(198,588)</u>
Tax effect of amounts which are not deductible/(taxable) in calculating taxable income:		
Sundry non-deductible/(deductible) expenses	(1,417)	3,440
Share based payments	(503)	(409)
Research and development	5,798	16,740
Investment allowance	-	1,261
Adjustment for prior periods - current tax	26,709	23,638
Effect of currency translation on tax base	61,523	-
Tax Losses previously not recognised	<u>83,413</u>	<u>-</u>
	<u>1,770</u>	<u>(153,918)</u>

(c) Tax consolidation legislation

Fortescue Metals Group Limited and its wholly-owned Australian controlled entities have implemented the tax consolidation legislation. The accounting policy in relation to this legislation is set out in note 1(g).

On adoption of the tax consolidation legislation, the entities in the tax consolidated group entered into a tax sharing agreement which, in the opinion of the directors, limits the joint and several liability of the wholly-owned entities in the case of a default by the head entity, Fortescue Metals Group Limited.

The entities have also entered into a tax funding agreement under which the wholly-owned entities fully compensate Fortescue Metals Group Limited for any current tax payable assumed and are compensated by Fortescue Metals Group Limited for any current tax receivable and deferred tax assets relating to unused tax losses or unused tax credits that are transferred to Fortescue Metals Group Limited under the tax consolidation legislation. The funding amounts are determined by reference to the amounts recognised in the wholly-owned entities' financial statements.

The amounts receivable/payable under the tax funding agreement are due upon receipt of the funding advice from the head entity, which is issued as soon as practicable after the end of each financial year. The head entity may also require payment of interim funding amounts to assist with its obligations to pay tax instalments. The funding amounts are recognised as current intercompany receivables or payables

9 Current assets - Cash and cash equivalents

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Cash on hand	8	21
Cash at bank	<u>1,235,530</u>	<u>654,921</u>
	<u>1,235,538</u>	<u>654,942</u>

10 Current assets - Trade and other receivables

	Consolidated	
	2010 US\$'000	2009 US\$'000
Trade debtors	158,992	109,163
GST receivables	16,048	14,678
Security deposits	84,993	56,119
Other receivables	8,712	3,229
	<u>268,745</u>	<u>183,189</u>

Information about Fortescue and its exposure to foreign currency risk, interest rate risk and price risk are disclosed in Note 3. Due to the short term nature of these receivables, their carrying value is assumed to approximate their fair value.

11 Current assets - Inventories

	Consolidated	
	2010 US\$'000	2009 US\$'000
Raw materials and stores - at cost	51,759	25,500
Iron ore stockpiles - at cost	136,532	95,622
	<u>188,291</u>	<u>121,122</u>

Inventories recognised as expense during the year ended 30 June 2010 amounted to US\$1,168.4 million (2009: US\$683.5 million)

12 Current assets - Other financial assets

	Consolidated	
	2010 US\$'000	2009 US\$'000
Listed investments - at fair value	95	31
	<u>95</u>	<u>31</u>

13 Current assets - Other current assets

	Consolidated	
	2010 US\$'000	2009 US\$'000
Prepayments	8,881	1,498
	<u>8,881</u>	<u>1,498</u>

14 Non-current assets - Receivables

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Amounts held pending arbitration of shipping contracts	2,848	2,657
Receivables from sale and leaseback transactions	1,030	10,728
Loan receivable	-	127
	3,878	13,512

15 Non-current assets - Property, plant and equipment

	Land and buildings US\$'000	Plant and equipment US\$'000	Furniture, fittings and equipment US\$'000	Motor vehicles US\$'000	Leasehold improvements US\$'000	Assets under construction US\$'000	Computer equipment US\$'000	Infrastructure assets US\$'000	Total US\$'000
Year ended 30 June 2009									
Opening net book amount	232	4,342	-	118	-	-	325	1,284,875	1,289,892
Additions	-	68	-	-	-	274,533	-	353,323	627,924
Disposals	-	-	-	-	-	-	-	(239,951)	(239,951)
Depreciation charge	(3)	(807)	-	(22)	-	-	(187)	(34,927)	(35,946)
Closing net book amount	<u>229</u>	<u>3,603</u>	<u>-</u>	<u>96</u>	<u>-</u>	<u>274,533</u>	<u>138</u>	<u>1,363,320</u>	<u>1,641,919</u>
At 30 June 2009									
Cost	236	7,249	-	147	-	274,533	1,611	1,399,452	1,683,228
Accumulated depreciation	(7)	(3,646)	-	(51)	-	-	(1,473)	(36,132)	(41,309)
Net book amount	<u>229</u>	<u>3,603</u>	<u>-</u>	<u>96</u>	<u>-</u>	<u>274,533</u>	<u>138</u>	<u>1,363,320</u>	<u>1,641,919</u>

15 Non-current assets - Property, plant and equipment (continued)

	Land and buildings US\$'000	Plant and equipment US\$'000	Furniture, fittings and equipment US\$'000	Motor vehicles US\$'000	Leasehold improvements US\$'000	Assets under construction US\$'000	Computer equipment US\$'000	Infrastructure assets US\$'000	Total US\$'000
Year ended 30 June 2010									
Opening net book amount	229	3,603	-	96	-	274,533	138	1,363,320	1,641,919
Impairment loss	(3)	(1,629)	(137)	(7)	(156)	-	(1,611)	-	(3,543)
Additions	-	14,954	-	-	-	363,659	-	-	378,613
Disposals	(7,696)	(17,098)	-	-	-	-	-	-	(24,794)
Transfers of assets - at cost	102,621	1,367,027	3,872	-	3,606	(90,396)	12,721	(1,399,451)	-
Transfer of accumulated depreciation	(2,581)	(33,033)	(184)	-	(13)	-	(320)	36,131	-
Depreciation charge	(4,749)	(66,873)	(679)	(32)	(1,510)	-	(6,455)	-	(80,298)
Closing net book amount	<u>87,821</u>	<u>1,266,951</u>	<u>2,872</u>	<u>57</u>	<u>1,927</u>	<u>547,796</u>	<u>4,473</u>	<u>-</u>	<u>1,911,897</u>
At 30 June 2010									
Cost or fair value	95,158	1,360,925	3,735	140	3,449	547,796	12,722	-	2,023,925
Accumulated depreciation	<u>(7,337)</u>	<u>(93,974)</u>	<u>(863)</u>	<u>(83)</u>	<u>(1,522)</u>	<u>-</u>	<u>(8,249)</u>	<u>-</u>	<u>(112,028)</u>
Net book amount	<u>87,821</u>	<u>1,266,951</u>	<u>2,872</u>	<u>57</u>	<u>1,927</u>	<u>547,796</u>	<u>4,473</u>	<u>-</u>	<u>1,911,897</u>

(a) Impairment loss

The impairment loss relates to certain assets no longer in use. The whole amount was recognised in the statement of comprehensive income as there was no amount included in the asset revaluation surplus relating to the assets

16 Non-current assets - Exploration and evaluation, development and mine properties

(a) Exploration and evaluation

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Exploration and evaluation		
Balance as at 1 July	11,889	2,790
Expenditure incurred	17,607	11,267
Less: expenditure transferred to development properties	<u>-</u>	<u>(2,168)</u>
Balance as at 30 June	<u>29,496</u>	<u>11,889</u>

The recoverability of the carrying amount of the exploration and evaluation assets is dependent on successful development and commercial exploitation, or alternatively, sale of the respective areas of interest.

(b) Development expenditure

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Development expenditure		
Balance as at 1 July	1,423,222	1,046,219
Expenditure	159,277	375,121
Additions of rehabilitation assets	-	52,261
Transfer from exploration	-	2,168
Transfer from intangible assets	820	-
Amortisation of development expenditure	<u>(71,302)</u>	<u>(52,547)</u>
Balance as at 30 June	<u>1,512,017</u>	<u>1,423,222</u>
Development expenditure at cost	1,636,831	1,476,734
Accumulated Depreciation	<u>(124,814)</u>	<u>(53,512)</u>
Net development expenditure	<u>1,512,017</u>	<u>1,423,222</u>

The recoverable amount of development expenditure is determined as the higher of its fair value less costs to sell and its value in use (discounted cash flows).

17 Non-current assets - Deferred tax assets

	Consolidated	
	2010 US\$'000	2009 US\$'000
The balance comprises temporary differences attributable to:		
Net unrealised foreign exchange gains	-	5,309
Borrowing costs	5,564	-
Senior secured notes	12,486	13,614
Subordinated loan notes	247,872	77,424
Accruals	1,912	-
Provisions	31,293	38,917
Business related costs	1,061	793
Other items	6,045	1,756
Revenue tax losses	208,668	194,636
Property, plant and equipment	30,258	-
Development	58,068	-
Inventories	519	-
Exploration and evaluation	73	-
Total deferred tax assets	<u>603,819</u>	<u>332,449</u>
Set-off of deferred tax liabilities pursuant to set-off provisions (note 24)	<u>(481,854)</u>	<u>(212,254)</u>
Net deferred tax assets	<u>121,965</u>	<u>120,195</u>

	Consolidated	
	2010 US\$'000	2009 US\$'000
Movements:		
Opening balance at 1 July	332,449	483,121
Credited/(charged) to the statement of comprehensive income (note 8)	271,370	(151,234)
Charged to equity	-	562
Closing balance at 30 June	<u>603,819</u>	<u>332,449</u>
Deferred tax assets expected to be recovered within 12 months	228,137	45,982
Deferred tax assets expected to be recovered after more than 12 months	<u>375,682</u>	<u>286,467</u>
	<u>603,819</u>	<u>332,449</u>

Movements - Consolidated

	Balance 1 July 2008 US\$'000	Recognised in profit or loss US\$'000	Recognised in equity US\$'000	Balance 30 June 2009 US\$'000
Property, plant and equipment	31,394	(31,394)	-	-
Net unrealised foreign exchange gains/losses	-	5,309	-	5,309
Senior secured notes	3,871	9,743	-	13,614
Subordinated loan note	357,452	(280,028)	-	77,424
Provisions	1,077	37,840	-	38,917
Business related costs	479	(248)	562	793
Other items	245	1,511	-	1,756
Revenue tax losses	88,603	106,033	-	194,636
	<u>483,121</u>	<u>(151,234)</u>	<u>562</u>	<u>332,449</u>

17 Non-current assets - Deferred tax assets (continued)

Movements - Consolidated

	Balance 1 July 2009 US\$'000	Recognised in profit or loss US\$'000	Recognised in equity US\$'000	Balance 30 June 2010 US\$'000
Exploration expenditure	-	73	-	73
Development	-	58,068	-	58,068
Property, plant and equipment	-	30,258	-	30,258
Inventories	-	519	-	519
Net unrealised foreign exchange gains/losses	5,309	(5,309)	-	-
Borrowing costs	-	5,564	-	5,564
Senior secured notes	13,614	(1,128)	-	12,486
Subordinated loan note	77,424	170,448	-	247,872
Accruals	-	1,912	-	1,912
Provisions	38,917	(7,624)	-	31,293
Business related costs	793	268	-	1,061
Other items	1,756	4,289	-	6,045
Revenue tax losses	<u>194,636</u>	<u>14,032</u>	-	<u>208,668</u>
At 30 June 2010	<u>332,449</u>	<u>271,370</u>	-	<u>603,819</u>

18 Non-current assets - Intangible assets

	Computer software US\$'000
Year ended 30 June 2009	
Opening net book amount	-
Additions - at cost	25,518
Amortisation	<u>(374)</u>
Closing net book amount	<u>25,144</u>
At 30 June 2009	
Computer software - at cost	25,518
Accumulated amortisation	<u>(374)</u>
Net book amount	<u>25,144</u>
Year ended 30 June 2010	
Opening net book amount	25,144
Transfer to development	(820)
Amortisation	<u>(1,574)</u>
Closing net book amount	<u>22,750</u>
At 30 June 2010	
Computer software - at cost	24,698
Accumulated amortisation and impairment	<u>(1,948)</u>
Net book amount	<u>22,750</u>

19 Current liabilities - Trade and other payables

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Trade payables	63,020	55,043
Other payables and accruals	<u>343,094</u>	<u>284,042</u>
	<u>406,114</u>	<u>339,085</u>

On 5 December 2008 Fortescue exercised suspension of all of its 10 long term CFR shipping Contracts of Afreightment and Consecutive Voyage. At 30 June 2010 the Company had negotiated settlements for all but one of these contracts. Fortescue has accrued an amount for the liability outstanding at 30 June 2010 that reflects the outstanding potential settlement remaining on the contract.

20 Current liabilities - Borrowings

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Secured		
Senior secured notes	200,716	206,240
Preference shares	<u>10,739</u>	<u>10,224</u>
Total secured current borrowings	<u>211,455</u>	<u>216,464</u>
Unsecured		
Subordinated loan note	<u>255,306</u>	<u>103,359</u>
Total unsecured current borrowings	<u>255,306</u>	<u>103,359</u>
Total current borrowings	<u>466,761</u>	<u>319,823</u>

All borrowings are interest bearing. Information about Fortescue and the Company's exposure to interest rate risk can be found in note 3.

21 Derivative at fair value - current

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Interest rate derivative held at fair value	<u>16,285</u>	<u>31,397</u>
	<u>16,285</u>	<u>31,397</u>

Risk exposure

Information about the Fortescue Group's exposure to credit risk, foreign exchange and price risk is provided in Note 3.

22 Non-current liabilities - Trade and other payables

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Deposits received	<u>371,792</u>	<u>349,602</u>

23 Non-current liabilities - Borrowings

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Secured		
Senior secured notes	1,828,376	1,867,625
Preference shares	<u>109,592</u>	<u>104,585</u>
Total secured non-current borrowings	<u>1,937,968</u>	<u>1,972,210</u>
Unsecured		
Subordinated loan note	<u>570,934</u>	<u>278,272</u>
Total unsecured non-current borrowings	<u>570,934</u>	<u>278,272</u>
 Total non-current borrowings	 <u>2,508,902</u>	 <u>2,250,482</u>
	Consolidated	
	2010	2009
	US\$'000	US\$'000
Current borrowings	466,761	319,823
Non-current borrowings	<u>2,508,902</u>	<u>2,250,482</u>
Total borrowings	<u>2,975,663</u>	<u>2,570,305</u>

	Preference shares US\$'000	Subordinated loan note US\$'000	Senior secured note US\$'000	Total US\$'000
2009				
Balance at 1 July 2008	-	1,247,336	1,589,299	2,836,635
Charged/(credited) to profit or loss				
Recognition of issue of preference shares	96,992	-	-	96,992
Interest expense	9,309	258,706	197,998	466,013
Interest repayments	(5,071)	-	(186,998)	(192,069)
Adjustment for change in estimate	-	(1,124,411)	-	(1,124,411)
Debt buy back	-	-	(81,197)	(81,197)
Foreign exchange (gain)/losses	13,579	-	554,763	568,342
Balance as at 30 June 2009	<u>114,809</u>	<u>381,631</u>	<u>2,073,865</u>	<u>2,570,305</u>
2010				
Balance at 1 July 2009	114,809	381,631	2,073,865	2,570,305
Recognition of issue of preference shares	-	-	-	-
Interest expense	10,911	164,623	201,207	376,741
Interest repayments	-	-	(193,254)	(193,254)
Adjustment for change in estimate	-	279,986	-	279,986
Debt buy back	-	-	-	-
Foreign exchange (gain)/loss	5,318	-	(52,726)	(47,408)
Interest repayments in form of ordinary shares	(10,707)	-	-	(10,707)
Balance as at 30 June 2010	<u>120,331</u>	<u>826,240</u>	<u>2,029,092</u>	<u>2,975,663</u>

23 Non-current liabilities - Borrowings (continued)

(a) Subordinated loan note (through its wholly owned subsidiary Chichester Metals Pty Limited - previously FMG Chichester Pty Limited)

The Company put in place a US\$100 million subordinated loan note during the 2007 financial year. The key terms and conditions of the facility are:

- Interest under the note is calculated as 4% of the revenue, net of government royalties, from the sale of iron ore FOB Port Hedland from the tenements of the Cloudbreak and Christmas Creek areas only. Accordingly the interest is only payable when Fortescue is in production and is only relevant to iron ore produced from these two tenement areas for a period of 13 years from 18 August 2006;
- The note is unsecured and deeply subordinated to any secured debt. In the event that an interest payment is earned but not payable due to secured lender restrictions, the amount unpaid will accrue interest at a market interest rate until payment is made.

The carrying amount of the note was re-estimated at 30 June 2010 to US\$826,240,000 (2009: US\$381,631,000) in line with changes in the following management estimates, prevailing market conditions and economic forecasts:

- Production was revised to reflect Fortescue's forecast production profile as at 30 June 2010 of production levels from Christmas Creek and Cloudbreak reaching a maximum run rate of 90mtpa in the 12 months to June 2014 (2009: forecast reaching a maximum 95mtpa in the 12 months to June 2012);
- Future iron ore prices were updated to reflect forecasts provided by Metalytics Pty Limited being an independent resource sector analyst of future iron ore prices;
- The discount rate has been applied since inception and reflects the implicit interest rate of 42% of the subordinated loan note;
- Expected royalty rates have not changed since 30 June 2009 and reflect current royalty rates payable to the Western Australian state government; and
- The total reserve estimate of Cloudbreak and Christmas Creek has not changed since 30 June 2009.

(b) Senior secured notes (through its wholly owned subsidiary FMG Resources (August 2006) Pty Limited - previously FMG Finance Pty Limited)

The Company raised US\$1,650 million in US dollar denominated and €315 million in Euro denominated senior secured notes in August 2006 to facilitate the construction and initial operation of the Pilbara Iron Ore and Infrastructure Project.

The key terms and conditions of the notes are:

- US\$320 million of senior secured notes due 2013 bearing interest at 10.000% per annum accruing from August 18, 2006. Interest is payable on March 1 and September 1 of each year, beginning on March 1, 2007.
- €315 million of senior secured notes due 2013 bearing interest at 9.750% per annum accruing from August 18, 2006. Interest is payable on March 1 and September 1 of each year, beginning on March 1, 2007.
- US\$1,080 million of senior secured notes due 2016 bearing interest at 10.625% per annum accruing from August 18, 2006. Interest is payable on March 1 and September 1 of each year, beginning on March 1, 2007.
- US\$250 million of senior secured notes due 2011 bearing interest at three-month LIBOR plus 4.000% per annum, accruing from August 18, 2006. Interest is payable on March 1, June 1, September 1 and December 1 of each year, beginning on December 1, 2006. Fortescue has a floating-to-fixed interest rate swap over its US\$250 million senior secured notes due 2011, swapping these notes to a fixed rate of 9% per annum.

Other key terms of the note are:

- They rank pari passu in right of payment with all existing and future senior indebtedness.

23 Non-current liabilities - Borrowings (continued)

- They are secured by, among other security documents, fixed and floating charges over the assets of FMG Resources (August 2006) Pty Limited, (previously FMG Finance Pty Limited), and the project-related assets of Chichester Metals Pty Limited (previously FMG Chichester Pty Limited), Pilbara Mining Alliance Pty Limited and The Pilbara Infrastructure Pty Limited (the "Project Guarantors"), a charge, assignment or pledge over the bank accounts in which proceeds of the senior secured notes were deposited, share mortgages over all of the shares in the capital of the Project Guarantors and FMG Resources (August 2006) Pty Limited, a featherweight charge over all of the assets and undertakings of Fortescue and mortgages of the real property leasehold rights of the Project and the Project mining tenements.
- They are listed on the Singapore Exchange Securities Trading Limited.

(c) Preference shares recognised as debt

The Company issued 1,400 fully paid non-converting, redeemable preference shares at a price of \$A100,000 per share on 30 September 2008. These preference shares have been recognised as debt in the financial statements as unlike ordinary shareholders there is not a right for preferential shareholders to share in the residual interests of the assets of Fortescue. A holder of Preference Shares is not entitled to share in the distribution of any surplus assets of the Company beyond its Redemption Amount. The Preference Shares rank in priority to FMG's ordinary shares for the payment of distributions in accordance with these terms.

The Preference Shares confer upon the holder the right in a winding up or return of capital to payment of an amount equal to the Redemption Amount, in priority to any other class of shares ranking behind it.

The Preference Shares shall rank *pari passu* with the most senior ranking preference shares of the Company and in priority to all other preference shares that are expressed to rank junior to the Preference Shares and the Company's ordinary shares, in a winding up of the Company.

The key terms for these preference shares are;

- Dividend coupon rate of 9% fixed p.a. payable six monthly either in cash, or where cash distributions are not able to be made by Fortescue, additional preference shares or ordinary shares (calculated on the basis of the volume weighted average share price) as elected by Fortescue;
- Term of 8.5 years
- Redeemable by Fortescue at any time subject to minimum 30 days notice;
- Preference shares to rank in priority to Fortescue's ordinary shares on a winding up and in relation to the payment of distributions; and
- Limited voting rights

24 Non-current liabilities - Deferred tax liabilities

	Consolidated	
	2010 US\$'000	2009 US\$'000
The balance comprises temporary differences attributable to:		
<i>Other</i>		
Exploration and evaluation	-	(4,813)
Development	(14,631)	-
Property, plant and equipment	(268,733)	(189,472)
Inventories	(11,448)	-
Net unrealised foreign exchange gains/losses	(34,229)	-
Senior secured notes	(66,692)	-
Subordinated loan note	(85,456)	-
Accruals	(95)	-
Provisions	(146)	-
Borrowing costs	-	(13,726)
Other items	(424)	(4,243)
Total deferred tax liabilities	<u>(481,854)</u>	<u>(212,254)</u>
Set-off of deferred tax liabilities pursuant to set-off provisions (note 17)	<u>481,854</u>	<u>212,254</u>
Net deferred tax liabilities	<u>-</u>	<u>-</u>
Deferred tax liabilities expected to be settled within 12 months	(20,070)	(17,969)
Deferred tax liabilities expected to be settled after more than 12 months	<u>(461,784)</u>	<u>(194,285)</u>
	<u>(481,854)</u>	<u>(212,254)</u>

Movements - Consolidated

	At 1 July 2008 US\$'000	Recognised in profit or loss US\$'000	Recognised in equity US\$'000	Balance 30 June 2009 US\$'000
Exploration expenditure	(1,246)	(3,567)	-	(4,813)
Property, plant and equipment	-	(189,472)	-	(189,472)
Net unrealised foreign exchange gains/losses	(117,053)	194,255	(77,202)	-
Borrowing costs	(11,845)	(1,881)	-	(13,726)
Other items	(2,221)	(2,022)	-	(4,243)
	<u>(132,365)</u>	<u>(2,687)</u>	<u>(77,202)</u>	<u>(212,254)</u>

24 Non-current liabilities - Deferred tax liabilities (continued)

Movements - Consolidated

	At 1 July 2009 US\$'000	Recognised in profit or loss US\$'000	Recognised in equity US\$'000	Balance 30 June 2010 US\$'000
Exploration expenditure	(4,813)	4,813	-	-
Development	-	(14,631)	-	(14,631)
Property, plant and equipment	(189,472)	(79,261)	-	(268,733)
Inventories	-	(11,448)	-	(11,448)
Net unrealised foreign exchange gains/losses	-	(34,229)	-	(34,229)
Borrowing costs	(13,726)	13,726	-	-
Senior secured notes	-	(66,692)	-	(66,692)
Subordinated loan note	-	(85,456)	-	(85,456)
Accruals	-	(95)	-	(95)
Provisions	-	(146)	-	(146)
Other items	(4,243)	3,819	-	(424)
	<u>(212,254)</u>	<u>(269,600)</u>	<u>-</u>	<u>(481,854)</u>

25 Non-current liabilities - Provisions

	Consolidated	
	2010 US\$'000	2009 US\$'000
Site rehabilitation	<u>57,034</u>	<u>55,582</u>

In accordance with State Government legislative requirements, a provision for site rehabilitation has been recognised in relation to Fortescue's iron ore operations. The provision has been made in full for all disturbed areas at the reporting date based on current estimates of costs to rehabilitate such areas, discounted to their present value based on expected future cash flows.

(a) Movements in provisions

Movements in provisions during the financial year are set out below:

	2010 US\$'000	2009 US\$'000
Carrying amount at 1 July	55,582	15,688
Accretion expense	1,452	-
Change in provision required	-	39,894
Carrying amount at 30 June	<u>57,034</u>	<u>55,582</u>

26 Contributed equity

	2010	2009
(a) Share capital		
Ordinary shares		
Fully paid	<u>3,107,196,989</u>	<u>3,089,596,699</u>

26 Contributed equity (continued)

(b) Movements in ordinary share capital:

Date	Details	Number of shares	Issue price	US\$'000
1 July 2008	Opening balance	2,804,363,760		746,791
	Shares issued	280,535,780	\$1.71	481,560
	Exercise of options issued under the Fortescue Metals Group Incentive Option Scheme (FMIOS)	4,697,159	\$0.29	1,379
	Transfer option expense from reserve for converted options			1,439
	Share issue cost			<u>(1,293)</u>
30 June 2009	Balance	<u>3,089,596,699</u>		<u>1,229,876</u>
1 July 2009	Opening balance	3,089,596,699		1,229,876
	Shares issued	10,682,660	\$3.83	40,977
	Exercise of options issued under the Fortescue Metals Group Incentive Option Scheme (FMGIOS)	6,917,630	\$0.33	2,211
	Transfer option expense from reserve for converted options			1,586
30 June 2010	Balance	<u>3,107,196,989</u>		<u>1,274,650</u>

(c) Ordinary shares

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.

Ordinary shares have no par value and the company does not have a limited amount of authorised capital.

27 Reserves and retained earnings

Consolidated	
2010	2009
US\$'000	US\$'000

(a) Reserves

Share-based payment reserve	2,155	1,970
Asset revaluation reserve	678	610
Foreign currency translation reserve	<u>(77,202)</u>	<u>(77,202)</u>
	<u>(74,369)</u>	<u>(74,622)</u>

Consolidated	
2010	2009
US\$'000	US\$'000

Movements:

Share-based payments reserve

Balance 1 July	1,970	2,045
Exercise of options	(1,586)	(1,474)
Forfeited options	(456)	(41)
Equity settled share based payment transactions	<u>2,227</u>	<u>1,440</u>
Balance 30 June	<u>2,155</u>	<u>1,970</u>

27 Reserves and retained earnings (continued)

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Movements:		
<i>Foreign currency translation reserve</i>		
Balance 1 July	(77,202)	-
Deferred tax translation to US Dollars	-	(77,202)
Balance 30 June	(77,202)	(77,202)

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Movements:		
<i>Asset revaluation reserve</i>		
Balance 1 July	610	610
Revaluation of available for sale financial assets	68	-
Balance 30 June	678	610

(b) Retained earnings

Movements in retained earnings were as follows:

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Balance 1 July 2009	(304,562)	(812,604)
Net profit for the year	580,946	508,042
Balance 30 June 2010	276,384	(304,562)

(c) Nature and purpose of reserves

(i) Share based payments reserve

The share based payments reserve records items recognised as expenses on valuation of employee share options. The movement in the share based payments reserve is disclosed in the Statements of Changes in Equity.

(ii) Asset revaluation reserve

The asset revaluation reserve records revaluations of non-current assets held at fair value and has a carrying value as at 30 June 2010 of US\$678,000.

(iii) Foreign currency translation reserve

Foreign currency differences arising on the revaluation of Australian deferred tax assets and liabilities to US dollar deferred tax assets and liabilities are recognised directly in equity in the foreign currency translation reserve.

28 Key management personnel disclosures

(a) Key management personnel remuneration

The Key Management Personnel remuneration included within 'administration expenses' in the Statement of Comprehensive Income are as follows:

28 Key management personnel disclosures (continued)

	Consolidated	
	2010	2009
	\$'000	\$'000
Short-term employee benefits	4,227,251	3,513,770
Post-employment benefits	303,020	417,298
Termination benefits	-	60,705
Equity compensation benefits	1,072,234	278,557
	<u>5,602,505</u>	<u>4,270,330</u>

Detailed remuneration disclosures are provided in the remuneration report on pages 11 to 20.

Balances above are recognised on a gross basis. Wages and salaries, disclosed as part of administration expenses in the Statement of Comprehensive Income, are recognised net of salary recoveries.

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.

(b) Equity instrument disclosures relating to key management personnel

(i) Options over equity instruments

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:

Name	Balance at start of the year	Granted as compensation	Exercised	Other changes during the year	Balance at end of the year	Vested	Unvested	Not exercisable
2010								
Directors of Fortescue Metals Group Limited								
A Forrest	-	-	-	-	-	-	-	-
R Scrimshaw	600,000	-	-	-	600,000	150,000	450,000	600,000
G Rowley	-	-	-	-	-	-	-	-
H Elliott	-	-	-	-	-	-	-	-
K Ambrecht	-	-	-	-	-	-	-	-
J Steinberg	-	-	-	-	-	-	-	-
G Brayshaw	-	-	-	-	-	-	-	-
O Hegarty	-	-	-	-	-	-	-	-
I Burston	-	-	-	-	-	-	-	-
L Xiaowei	-	-	-	-	-	-	-	-
M Barnaba	-	-	-	-	-	-	-	-
I Cumming	-	-	-	-	-	-	-	-
Other key management personnel of the Company								
P Hallam	600,000	-	-	-	600,000	150,000	450,000	600,000
S Pearce	-	-	-	-	-	-	-	-
W Ramsey	-	-	-	-	-	-	-	-
P Meurs	-	7,500,000	-	-	7,500,000	-	7,500,000	7,500,000
I Buitendag	-	-	-	-	-	-	-	-

28 Key management personnel disclosures (continued)

2009

Name	Balance at start of the year	Granted as compensation	Exercised	Other changes	Balance at end of the year	Vested	Unvested	Not exercisable
Directors of Fortescue Metals Group Limited								
A Forrest	-	-	-	-	-	-	-	-
R Scrimshaw	-	600,000	-	-	600,000	-	600,000	600,000
G Rowley	-	-	-	-	-	-	-	-
H Elliott	-	-	-	-	-	-	-	-
K Ambrecht	-	-	-	-	-	-	-	-
J Steinberg	-	-	-	-	-	-	-	-
G Brayshaw	-	-	-	-	-	-	-	-
O Hegarty	-	-	-	-	-	-	-	-
I Burston	-	-	-	-	-	-	-	-
L Xiaowei	-	-	-	-	-	-	-	-
M Barnaba	-	-	-	-	-	-	-	-
Other key management personnel of the Company								
P Hallam	-	600,000	-	-	600,000	-	600,000	600,000
M Minosora	-	600,000	-	-	600,000	-	600,000	600,000
C Catlow	1,000,000	-	-	-	1,000,000	750,000	250,000	250,000
A Watling	1,000,000	-	(500,000)	(500,000)*	-	-	-	-

* = Options forfeited upon resignation/cessation of employment

(ii) Share holdings

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.

28 Key management personnel disclosures (continued)

2010 Ordinary shares

Name	Held at 1 July 2009	Received on exercise of options	Purchases	Sales	Transfers	Other	Held at 30 June 2010
Directors of Fortescue Metals Group Limited							
A Forrest	972,828,300	-	-	-	-	1,915	972,830,215
R Scrimshaw	8,000,000	-	-	-	-	-	8,000,000
H Elliott	2,167,938	-	-	-	-	-	2,167,938
G Rowley	19,235,690	-	500,000 A	(500,000) A	-	-	19,235,690
K Ambrecht	6,313,130	-	-	-	-	-	6,313,130
G Brayshaw	33,149	-	11,000	-	-	-	44,149
O Hegarty	-	-	-	-	-	-	-
I Burston	-	-	-	-	-	-	-
L Xiaowei	-	-	-	-	-	-	-
M Barnaba	-	-	-	-	-	-	-
I Cumming	-	-	-	-	277,986,000 B	(277,986,000) B	-
J Steinberg	277,986,000	-	-	-	(277,986,000) B	-	-
Other key management personnel of the Company							
P Hallam	-	-	-	-	-	10,157	10,157
S Pearce	-	-	8,300	-	-	-	8,300
P Meurs	-	-	7,500,000	-	-	-	7,500,000
W Ramsey	-	-	-	-	-	-	-
I Buitendag	-	-	-	-	-	-	-

A = Graeme Rowley transferred 500,000 ordinary shares to the Rowley Foundation Pty Limited, a company in which he holds an indirect interest.

B = Ian Cumming and Joseph Steinberg have an oral agreement pursuant to which they consult with each other as to the election of a mutually acceptable Board of Directors of Leucadia National Corporation (which wholly owns LUK-Fortescue, LLC). As their collective voting powers in Leucadia National Corporation exceeded 20% they were taken to have a relative holding in any securities held by LUK-Fortescue. Due to the change in director during 2010, the relative holding was transferred to Mr Ian Cumming. Their collective voting powers in LUK-Fortescue is now less than 20% and so they do not have a relative interest in any securities held by LUK-Fortescue.

28 Key management personnel disclosures (continued)

2009 Ordinary shares

Name	Held at 1 July 2008	Received on exercise of options	Purchases	Sales	Other	Held at 30 June 2009
Directors of Fortescue Metals Group Limited						
A Forrest	1,005,493,300	-	-	(32,665,000)	-	972,828,300
G Rowley	20,235,690	-	-	(1,000,000)	-	19,235,690
H Elliott	2,540,689	-	27,249	(400,000)	-	2,167,938
R Scrimshaw	8,000,000	-	400,000	(400,000)	-	8,000,000
K Ambrecht	6,283,833	-	29,297	-	-	6,313,130
J Steinberg	277,986,000	-	-	-	-	277,986,000
G Brayshaw	17,225	-	15,924	-	-	33,149
O Hegarty	-	-	-	-	-	-
I Burston	-	-	-	-	-	-
L Xiaowei	-	-	-	-	-	-
Other key management personnel of the Company						
Ordinary shares						
P Hallam	-	-	-	-	-	-
M Minosora	-	-	-	-	-	-
C Catlow	8,000,000	-	-	(3,310,000)	-	4,690,000
A Watling	1,000,000	-	500,000	(1,500,000)	-	-
G Cowe	-	-	-	-	-	-

(c) Other transactions with directors and key management personnel

The Company has revised its estimate in relation to the liability to Leucadia National Corporation (Leucadia) under the terms of the subordinated loan note (see Note 28). The note was revalued at 30 June 2010 to US\$826.2 million (30 June 2009: US\$381.6 million). Leucadia is a company related to Mr Joseph Steinberg (resigned as a Director in August 2009) and Mr Ian Cumming, who is a Director of Fortescue Metals Group Limited.

At 30 June 2010 Mr Joseph Steinberg, who was a Director of Fortescue Metals Group Limited, held US\$500,000 9.75% senior secured notes due 2013. Interest paid and payable for the year was US\$67,665. The balance as at 30 June 2009 was US\$500,000.

Dr Ian Burston was appointed as a Non-Executive Director of Fortescue Metals Group Limited on 13 October 2008. He is also Chairman and Director of NRW Holdings Limited (NRW). NRW provide mining contracting services to Fortescue's Cloudbreak and Christmas Creek mines. Since his appointment Fortescue has incurred US\$142.9 million for services rendered by NRW. As at 30 June 2010 amounts owed to NRW by Fortescue were nil.

Sales of Iron Ore to Hunan Valin for the year ended 30 June 2010 totalled US\$98.3 million (2009: US\$58.8 million). Hunan Valin is a company related to a director Mr Li Xiaowei.

(i) Non-key management personnel disclosures 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 is non-interest bearing. During the financial year ended 30 June 2010, such loans to subsidiaries totalled US\$728.6 million receivable (2009: US\$492.9 million). These loans have been eliminated on consolidation.

29 Remuneration of auditors

	Consolidated	
	2010	2009
	US\$	US\$
Audit services		
BDO Audit (WA) Pty Ltd		
<i>Audit and other assurance services</i>		
Audit and review	342,257	251,035
Other assurance services	21,309	25,210
Services other than statutory audit		
BDO Consultants (WA) Pty Ltd		
<i>Other services</i>		
Financial due diligence	428	9,590
Total auditors' remuneration	363,994	285,835

30 Contingent liabilities

(a) Contingent liabilities

The Company had contingent liabilities at 30 June 2010 in respect of:

ASIC Proceedings

On December 23rd 2009 judgement was handed down by the Federal Court in the civil penalty proceedings brought by ASIC. Fortescue and Fortescue's co-defendant and CEO, Mr Andrew Forrest, were successful and all of the contraventions alleged by ASIC were dismissed by the Federal Court. Costs were also awarded in favour of Fortescue and Mr Forrest.

On February 4th, 2010 ASIC lodged a Notice of Appeal in the Federal Court of Western Australia.

Shipping contracts

During the six months ended 30 June 2010 a judgement was handed down in favour of Zodiac Maritime in relation to a suspended shipping contract. Damages were awarded to Zodiac and the conclusion of this dispute means that the contract was terminated. There is one suspended shipping contract remaining where the ship owner went into insolvency in 2009. The issue is being determined through an arbitration process which has been completed and the parties are awaiting the decision of the Arbiter

Cyclone George Fatalities

Following an investigation into events surrounding Cyclone George which occurred in March 2007, Fortescue was charged on 18 March 2009 with one offence and its subsidiary, The Pilbara Infrastructure Pty Limited, charged with 18 offences under the Occupational Safety & Health Act 1984. Each charge has a maximum penalty of A\$400,000 thus comprising a potential aggregate maximum penalty to Fortescue and its subsidiary of A\$7,200,000. Fortescue is defending the charges.

31 Commitments

(a) Capital commitments

As at 30 June 2010 Fortescue has commitments to capital expenditure contracted for at the reporting date but not recognised as liabilities for mobile mining equipment orders of US\$89.0 million (2009: US\$22.2 million) related to the development and production of its Pilbara Iron Ore and Infrastructure Project.

31 Commitments (continued)

(b) Lease commitments : Company as lessee

Non-cancellable operating lease rentals are payable as follows:

	Consolidated	
	2010 US\$'000	2009 US\$'000
Within one year	122,374	127,800
Between one and five years	291,517	328,738
Later than five years	-	1,660
	413,891	458,198

Fortescue leases various offices and other premises under non-cancellable operating leases expiring within one to seven years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated.

Fortescue also leases various motor vehicles, office equipment and plant and machinery under non-cancellable operating leases. The leases have varying terms.

(c) 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 US\$6.8 million over the next financial year (2009: US\$5.1 million).

Financial commitments for subsequent periods are contingent upon future exploration results and cannot 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.

32 Subsidiaries

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in note 1(b):

Name of entity	Country of incorporation	Class of shares	Equity holding		Investment	
			2010 %	2009 %	2010 US\$	2009 US\$
Fortescue Metals Group Limited	Australia	Ordinary	-	-	-	-
<i>Controlled entities</i>						
International Bulk Ports Pty Limited	Australia	Ordinary	100	100	1	1
The Pilbara Infrastructure Pty Limited *	Australia	Ordinary	100	100	-	-
FMG Resources Pty Limited	Australia	Ordinary	100	100	339	275
FMG Pilbara Pty Limited	Australia	Ordinary	100	100	1	1
Chichester Metals Pty Limited **	Australia	Ordinary	100	100	-	-
FMG Resources (AUG 2006) Pty Limited ***	Australia	Ordinary	100	100	-	-
Pilbara Mining Alliance Pty Limited	Australia	Ordinary	100	100	1	1
Karribi Developments Pty Limited	Australia	Ordinary	100	100	1	1
FMG Magnetite Pty Limited	Australia	Ordinary	100	100	1	1
FMG North Pilbara Pty Limited	Australia	Ordinary	100	100	1	1

32 Subsidiaries (continued)

Name of entity	Country of incorporation	Class of shares	Equity holding			
			2010 %	2009 %		
FMG Pacific Limited	New Zealand	Ordinary	100	100	1	1
FMG International Pte Limited	Singapore	Ordinary	100	100	1	1
Pilbara Housing Services Pty Limited	Australia	Ordinary	100	100	1	1
FMG Solomon Pty Limited **	Australia	Ordinary	100	100	-	-
Masters Way Homes Pty Limited ****	Australia	Ordinary	100	100	-	-
					348	284

* The Pilbara Infrastructure Pty Limited is a subsidiary of International Bulk Ports Pty Limited note 33.

** This entity is a subsidiary of FMG Pilbara Pty Limited

*** FMG Resources (August 2006) Pty Limited (previously FMG Finance Pty Limited) is a subsidiary of Chichester Metals Pty Limited

**** Master Way Homes Pty Limited is a subsidiary of Pilbara Housing Services Pty Limited

33 Deed of cross guarantee

Fortescue Metals Group Limited and its controlled entities, except FMG Pacific Limited and FMG International Pte Limited, are parties to a deed of cross guarantee under which each company guarantees the debts of the others:

Holding Entity

- Fortescue Metals Group Limited

Group Entities

- FMG Pilbara Pty Limited
- Chichester Metals Pty Limited (previously FMG Chichester Pty Limited)
- FMG Resources (Aug 2006) Pty Limited (previously FMG Finance Pty Limited)
- FMG Magnetite Pty Limited
- FMG North Pilbara Pty Limited
- Pilbara Mining Alliance Pty Limited
- Karribi Developments Pty Limited
- FMG Resources Pty Limited
- International Bulk Ports Pty Limited
- The Pilbara Infrastructure Pty Limited

33 Deed of cross guarantee (continued)

(a) Consolidated statement of comprehensive income and summary of movements in consolidated retained earnings

The 'Closed Group' represented by the above companies is the same as the consolidated group, and as there are no other parties to the Deed of Cross Guarantee that are controlled by the Company, they also represent the 'Extended Closed Group'. The statement of comprehensive income and summary movements in consolidated accumulated losses for the year ended 30 June 2010 along with the consolidated balance sheet as at 30 June 2010 for the Closed Group are materially the same as that of the consolidated group.

34 Subsequent events

On 15 July 2010 Fortescue announced a 160 million tonne increase to the Solomon resource portfolio. This brings the total Solomon resources portfolio to 2.86 billion tonnes up from 2.70 billion tonnes.

On 5 August 2010 Fortescue entered into a contract with Downer EDI Limited to provide mining services at its Christmas Creek operation. The contract is for a term of six years and is valued at approximately A\$3 billion.

On 10 August 2010 Fortescue announced a 1.23 billion tonnes Resource Estimate for its North Star tenement area. Of this Resource, 310 million tonnes or approximately 25 percent of the Resource is classified as indicated and 920 million tonnes as inferred.

There has been no other material event requiring disclosure subsequent to the period ended 30 June 2010.

35 Reconciliation of profit after income tax to net cash inflow from operating activities

	Consolidated	
	2010	2009
	US\$'000	US\$'000
Profit for the year	580,946	508,042
Depreciation of property, plant and equipment	80,296	35,946
Amortisation of intangible assets	1,574	353
Amortisation of development expenditure	71,520	52,547
Write off of assets no longer in use	3,543	-
Profit on disposal of non current assets	(3,612)	-
Profit on extinguishment of debt	-	(11,544)
Provision - rehabilitation	1,452	-
Provision - employee entitlements	17,247	3,700
Equity settled share based payment transactions	1,766	1,399
Net effective interest on borrowings	185,419	466,013
Debt establishment costs	-	4,358
Interest rate swaps	(15,221)	20,574
Fair value adjustment on subordinated loan note	279,986	(1,124,411)
Tax (benefit)/expense	(1,770)	153,918
Net exchange difference	(83,676)	414,058
Issue of bonus shares	2,267	-
Change in assets and liabilities during the year		
Increase in receivables and prepayments	(47,047)	(101,281)
Increase in inventory	(67,169)	(85,278)
Increase in payables	100,031	134,954
Net cash inflow from operating activities	<u>1,107,552</u>	<u>473,348</u>

36 Earnings per share

	Consolidated	
	2010 Cents	2009 Cents
(a) Basic earnings per share		
From continuing operations attributable to the ordinary equity holders of the company	18.85	17.77
(b) Diluted earnings per share		
From continuing operations attributable to the ordinary equity holders of the company	18.82	17.70
(c) Reconciliations of earnings used in calculating earnings per share		

	Consolidated	
	2010 US\$'000	2009 US\$'000
<i>Basic earnings per share</i>		
Profit attributable to the ordinary equity holders of the company used in calculating basic earnings per share		
From continuing operations	580,946	508,042
	580,946	508,042

<i>Diluted earnings per share</i>		
Profit from continuing operations attributable to the ordinary equity holders of the company:		
Used in calculating basic earnings per share	580,946	508,042
Profit attributable to the ordinary equity holders of the company used in calculating diluted earnings per share	580,946	508,042

(d) Weighted average number of shares used as the denominator

	Consolidated	
	2010 Number	2009 Number
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share	3,081,948,244	2,858,943,600
Adjustments for calculation of diluted earnings per share:		
Potential ordinary shares	4,909,872	12,129,926
Weighted average number of ordinary shares and potential ordinary shares used as the denominator in calculating diluted earnings per share	3,086,858,116	2,871,073,526

37 Share-based payments

(a) Employee Option Plan

During the financial year the Company issued 7,500,000 employee options under two equal tranches (3,750,000 options per tranche) to a key executive. Tranche 1 will vest over a three period, with 33.3% vested on each anniversary date. Tranche 2 will vest over a four year period, with 25% vested on each anniversary dated. In addition, Directors have imposed a further requirement that the exercise of options is conditional upon Fortescue shares trading above A\$7.00 for tranche 1 and A\$8.00 for tranche 2 for a period of 5 consecutive days. The options have been issued at an exercise price of A\$5.00, which is in accordance with the FMGIOS whereby the price must be at or greater than the volume weighted average price for the five days prior to the offer date, which was 13 May 2010.

37 Share-based payments (continued)

	Weighted average exercise price 2010 US\$	Number of options 2010 Number	Weighted average exercise price 2009 US\$	Number of options 2009 Number
Outstanding at 1 July	0.73	11,620,380	0.27	18,292,910
Exercised during the year	0.33	(6,917,630)	0.25	(4,772,790)
Forfeited during the year	2.14	(625,250)	0.33	(4,299,740)
Granted during the year	4.41	<u>7,500,000</u>	1.64	<u>2,400,000</u>
Outstanding at 30 June	3.32	<u>11,577,500</u>	0.73	<u>11,620,380</u>
Excercisable at 30 June	0.59	<u>2,277,500</u>	0.46	<u>7,896,005</u>

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

Fair value of options granted

The model inputs for options granted during the year ended 30 June 2010 included:

- (a) grant date: 13 May 2010
- (b) expiry date: 13 May 2015
- (c) fair value per option:
Tranche 1 - A\$2.66 (US\$2.40)
Tranche 2 - A\$2.65 (US\$2.40)
- (d) exercise price: A\$5.00
- (e) price of shares on grant date: A\$4.35
- (f) expected volatility: 76.40%
- (g) risk-free interest rate: 5%
- (h) dividend yield: nil

Expected volatility is calculated using the AGSM risk measurement for the period.

(b) Employee expenses

	Consolidated	
	2010 Number	2009 Number
Share options granted	2,227	1,440
Forfeited options	(459)	(41)
	<u>1,768</u>	<u>1,399</u>

38 Parent entity financial information

(a) Summary financial information

The individual financial statements for the parent entity show the following aggregate amounts:

38 Parent entity financial information (continued)

	Company	
	2010 US\$'000	2009 US\$'000
Balance sheet		
Current assets	1,173,557	966,235
Non-current assets	<u>773,636</u>	<u>325,469</u>
Total assets	<u>1,947,193</u>	<u>1,291,704</u>
Current liabilities	99,384	24,847
Non-current liabilities	<u>157,509</u>	<u>105,011</u>
Total liabilities	<u>256,893</u>	<u>129,858</u>
Net assets	<u>1,690,300</u>	<u>1,161,846</u>
<i>Shareholders' equity</i>		
Contributed equity	1,274,649	1,229,876
Reserves	(6,598)	(6,842)
Retained earnings	<u>422,249</u>	<u>(61,188)</u>
Total equity	<u>1,690,300</u>	<u>1,161,846</u>
Profit or loss for the year	<u>483,438</u>	<u>(44,148)</u>
Total comprehensive income	<u>483,506</u>	<u>(53,570)</u>

(b) Guarantees entered into by the parent entity

The parent entity has not provided any financial guarantees other than the cross guarantees given by Fortescue Metals Group Limited, as described in note 33. No deficiencies of assets exist in any of these companies.

No liability was recognised by the parent entity or the consolidated entity in relation to the cross guarantees, as the fair value of the guarantees is immaterial.

(c) Contingent liabilities of the parent entity

The parent entity did not have any contingent liabilities as at 30 June 2010 or 30 June 2009. For information about guarantees given by the parent entity, please see above.

In the directors' opinion:

- (a) the financial statements and notes set out on pages 23 to 78 are in accordance with the *Corporations Act 2001*, including:
 - (i) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements, and
 - (ii) giving a true and fair view of the group's financial position as at 30 June 2010 and of its performance for the financial year ended on that date, and
- (b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable, and
- (c) the remuneration disclosures included in the Directors' Report (as part of audited Remuneration Report) for the year ended 30 June 2010, comply with section 300A of the *Corporations Act 2001*.
- (d) Note 1(a) confirms that the financial statements also comply with the International Financial Reporting Standards as issued by the International Accounting Standards Board.

The directors have been given the declarations by the Chief Executive Officer and Chief Financial Officer required by section 295A of the *Corporations Act 2001*.

Parties identified in note 32 are parties to the deed of cross guarantee under which each company guarantees the debts of the others. At the date of this declaration there are reasonable grounds to believe that the companies which are parties to this deed of cross guarantee will as a consolidated entity be able to meet any obligations or liabilities to which they are, or may become, subject to, by virtue of the deed of cross guarantee described in note 33.

This declaration is made in accordance with a resolution of the Board of Directors and is signed for and on behalf of the Directors by:



Mr Herb Elliott
Chairman

Dated at Perth this 26th day of August 2010.

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INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FORTESCUE METALS GROUP LIMITED

Report on the Financial Report

We have audited the accompanying financial report of Fortescue Metals Group Limited, which comprises the balance sheet as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with *International Financial Reporting Standards*.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.



Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001* would be in the same terms if it had been given to the directors at the time that this auditor's report was made.

Auditor's Opinion

In our opinion:

- (a) the financial report of Fortescue Metals Group Limited is in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*; and
- (a) the financial report also complies with *International Financial Reporting Standards* as disclosed in Note 1.

Report on the Remuneration Report

We have audited the Remuneration Report included in the directors' report for the year ended 30 June 2010. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's Opinion

In our opinion, the Remuneration Report of Fortescue Metals Group Limited for the year ended 30 June 2010, complies with section 300A of the *Corporations Act 2001*.

BDO Audit (WA) Pty Ltd

Brad McVeigh
Director

Perth, Western Australia
Dated this 26th day of August 2010