

Supplementary information for US bond holders

The Group's financial statements are prepared in accordance with the accounting principles generally accepted applicable in Hong Kong ("HK GAAP"), which differ in certain significant respects from those applicable in the United States ("US GAAP"). The significant differences relate principally to the following items, and the adjustments considered necessary to restate profit ("net income") and shareholders' funds ("shareholders' equity") in accordance with US GAAP are shown in the tables set out below.

A Revenue recognition on property developments

Under HK GAAP, where the Group receives payments from developers at the commencement of the project, profits arising from such payments are recognised when the foundation and site enabling works are complete and acceptable for development, and after taking into account the outstanding risks and obligations, if any, retained by the Group in connection with the development. Also under HK GAAP, where the Group receives a distribution of the assets of the development upon completion of construction, profit is recognised based on the fair value of such assets at the time of receipt. Under US GAAP, such profits would be recognised during construction of the property on a percentage-of-completion basis.

B Telford headquarters redevelopment

Under HK GAAP, the redeveloped headquarters building retained by the Group was recorded as an addition of land and buildings at open market value. The shopping centre and cash received from the developer, net of related costs, were recognised as property development profits. Under US GAAP, the redevelopment would be accounted for as a non-monetary transaction and such redevelopment would be recorded at historical cost with no profit recognition thereon.

C Asset revaluations and depreciation

Under HK GAAP, investment properties are stated on the basis of appraised value, and depreciation expense is not provided on such properties. Also under HK GAAP, self-occupied land and buildings are stated at their open market values on the basis of their existing use at the date of revaluation less any subsequent accumulated depreciation. Under US GAAP, such revaluations are not permitted. Accordingly, the properties of the Group, which are stated at appraised or open market value, have been restated at historical cost less accumulated depreciation. Depreciation has been based on the historical cost of the properties and a useful life of 50 years. The approximate gross historical cost of investment properties subject to

depreciation under US GAAP which are not depreciated under HK GAAP amounted to HK\$3,039 million and HK\$3,234 million at 31 December 2000 and 2001, respectively.

D Depreciation of certain fixed assets

Prior to 1995, under HK GAAP, the historical cost of the Group's tunnel lining and underground civil structures was not depreciated. Under established industry practice in the United States for similar costs, depreciation is provided for financial accounting purposes over extended periods. For US GAAP purposes, the Group has depreciated such costs over a 100-year period.

With effect from 1 January 1995, under HK GAAP, the Group re-appraised the estimated useful life of the tunnel lining and underground civil structures. In accordance with such re-appraisal, such costs are being depreciated over the number of years remaining using an original life of 100 years. Such change in useful life was accounted for prospectively, with no cumulative adjustment recognised in 1995.

Additionally, prior to 1995 under HK GAAP, the cost of leasehold land was not amortised, based on assumed extensions of the leases. Under US GAAP, the amortisation of the historical cost of leasehold land is provided over the life of the leases, without any consideration of renewals.

With effect from 1 January 1995, under HK GAAP, all leasehold land is amortised over the unexpired terms of the leases. This change in accounting policy under HK GAAP was applied prospectively, with no cumulative adjustment recognised in 1995.

E Pension costs

Under HK GAAP, the provision for the defined benefit element of the MTR Corporation Limited Retirement Scheme is generally based on the contributions made to the Retirement Scheme. Such contributions are determined by the Board with reference to an actuarial valuation. Under US GAAP, the defined benefit element of the Retirement Scheme is recognised as a charge to income over the employees' approximate service period, in accordance with United States Statement of Financial Accounting Standards ("SFAS") No. 87, "Employers' Accounting for Pensions". SFAS No. 87 focuses on the Retirement Scheme's benefit formula as the basis for determining the benefit earned, and therefore the cost incurred, in each year. The determination of the benefit earned is actuarially determined and includes components for service cost, time value of money, return on plan assets and gains or losses from changes in previous assumptions.

F Income taxes

The Group's deferred taxation is provided using the liability method in respect of the taxation effect arising from all material timing differences which are expected with reasonable probability to become payable in the foreseeable future. With respect to deferred tax assets (a net deferred tax debit), HK GAAP includes recognition criteria providing for net deferred tax assets which are probable of recovery in the foreseeable future, with assurance beyond a reasonable doubt that taxable income will be generated in the future. Based on these recognition criteria, as disclosed in note 11, the Group had an unrecognised net deferred tax liability at 31 December 2001, which is not expected with reasonable probability to become payable.

US GAAP requires that full provision be made for all deferred taxes as they arise, except that a valuation allowance is provided on deferred tax assets to the extent that it is not "more likely than not" that such deferred tax assets will be realised. Under US GAAP, "more likely than not" is defined as a likelihood of more than 50 percent.

G Capitalisation of certain costs

Under HK GAAP, certain costs of a non-incremental nature are capitalised relative to the Airport Railway Project and other capital projects. Under US GAAP, it is not permissible to capitalise these non-incremental costs. The preponderance of the capitalised costs relating to the Airport Railway Project and other capital projects is incremental in nature and accordingly, is properly capitalised under both HK GAAP and US GAAP.

H Interest

Under HK GAAP, interest earned on funds obtained by the Group specifically for the construction of the Airport Railway prior to the date of expenditure for such purpose is credited to railway construction in progress related to the Airport Railway. Interest earned for this purpose includes notional interest on funds temporarily applied by the Group for purposes other than related to the construction of the Airport Railway. Under US GAAP, actual interest earned is included in the determination of profit for such period, and notional interest on funds temporarily applied is not recognised.

I Dividend

Prior to 1 January 2001, HK GAAP permits dividends declared subsequent to an accounting period to be recognised in that accounting period. Under US GAAP, a dividend is only recognised at its declaration date.

With effect from 1 January 2001, the Group adopted revised SSAP 9 "Events after the balance sheet date".

The adoption of revised SSAP 9 has resulted in dividends being recognised as a liability at its declaration date.

In previous years, dividends relating to an accounting period declared after the period end date were recognised in that accounting period. This change has been accounted for retrospectively with the opening balance of retained profits and the comparative information adjusted for the amounts relating to prior periods. The result of this change eliminated the prior year US GAAP difference on declared dividends.

J Stock based compensation

Under HK GAAP, share options granted by the Company and shares granted by the principal shareholder (defined as shareholding larger than 10%) for no consideration to the employees of the Company are not required to be recognised in the profit and loss account of the Company. Under US GAAP, such share options and shares granted are accounted for in accordance with Accounting Principles Board Opinion 25 as contributions to capital with the offsetting charge to the profit and loss account as compensation expense. The compensation expense for the share grants is measured based on the quoted market price of the shares and in case of share options, the difference between the quoted market price of the shares less the exercise price, at a defined measurement date. The measurement date is the first date on which both the number of shares that an individual employee is entitled to receive and the exercise price are known.

K Others

Other adjustments primarily represent the net effect of costs deferred under HK GAAP which are required to be recognised as expenses under US GAAP, and certain anticipated expenses recognised under HK GAAP which are not recognised as expenses under US GAAP until the related goods or services are received or provided.

L Derivative instruments

Under US GAAP, effective 1 January 2001, the Group adopted SFAS 133, "Accounting for Derivative Instruments and Hedging Activities", which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognised in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income and are recognised in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognised in earnings.

The adoption of SFAS 133 resulted in a pre-tax reduction in income of HK\$20 million (HK\$17 million after tax) and a pre-tax reduction in other comprehensive income ("OCI") of HK\$187 million (HK\$157 million after tax). The reduction to income is mostly attributable to losses of derivatives not qualified as hedging instruments. The reduction to OCI is mostly attributable to unrealised losses of approximately HK\$187 million on cash flow hedges. The cumulative effect of adopting SFAS 133 did not have a

material impact on the Group's financial condition and results of operation.

The Group uses derivative instruments to manage exposures to foreign currency and interest rate risks. The Group's objectives for holding derivatives are to minimize the risks using the most effective methods to eliminate or reduce the impacts of these exposures.

Under HK GAAP, derivative instruments are not required to be recorded on the balance sheet at fair value.

Reconciliation of net income to US GAAP

Year Ended 31 December <i>in \$ million</i>	2000 HK\$	2001 HK\$	2001 US\$*
Profit for the year in accordance with HK GAAP	4,055	4,284	549
Adjustments required under US GAAP			
Revenue recognition on property developments	(13)	1,216	156
Depreciation on revalued properties and redevelopment	(57)	(64)	(8)
Depreciation on certain fixed assets	10	10	1
Difference in periodic pension cost	182	112	14
Deferred tax accounting	(574)	(724)	(93)
Capitalisation of certain costs	(151)	(65)	(8)
Interest	(21)	(21)	(3)
Stock based compensation	(25)	(60)	(8)
Cumulative effect of adopting SFAS 133	–	(20)	(3)
Derivative instruments	–	(33)	(4)
Other	3	(1)	–
Tax effect of above adjustments	9	(160)	(20)
Net income for the year in accordance with US GAAP	3,418	4,474	573
Basic and diluted earnings per share	HK\$ 0.68	HK\$ 0.89	US\$ 0.11

Reconciliation of shareholders' equity to US GAAP

As of 31 December <i>in \$ million</i>	2000 HK\$	2001 HK\$	2001 US\$*
Shareholders' funds in accordance with HK GAAP	50,328	54,049	6,930
Adjustments required under US GAAP			
Revenue recognition on property developments	1,061	2,277	292
Accumulated depreciation on revalued properties and redevelopment	(234)	(298)	(38)
Asset revaluation reserves	(6,640)	(6,634)	(851)
Accumulated depreciation on certain fixed assets	(791)	(781)	(100)
Difference in periodic pension cost	(311)	(199)	(26)
Deferred tax accounting	(1,757)	(2,481)	(318)
Capitalisation of certain costs	(1,108)	(1,173)	(150)
Interest	697	676	87
Cumulative effect of adopting SFAS 133	–	(207)	(27)
Derivative instruments	–	(119)	(15)
Other	38	37	5
Tax effect of above adjustments	39	(121)	(16)
Shareholders' equity in accordance with US GAAP	41,322	45,026	5,773

* For the convenience of readers, the US dollars equivalent was translated at HK\$7.7989 which was the Hong Kong closing buying rate quoted from Reuters at 4 pm of 31 December 2001.