notes to the unaudited interim financial report

1 Basis of preparation

This interim financial report is unaudited, but has been reviewed by KPMG in accordance with Statement of Auditing Standards 700 'Engagements to review interim financial reports', issued by the Hong Kong Society of Accountants ('HKSA'). KPMG's independent review report to the Board of Directors is set out on page 28. In addition, this interim financial report has been reviewed by the Company's Audit Committee.

This interim financial report has been prepared in accordance with the requirements of the Main Board Listing Rules of The Stock Exchange of Hong Kong Limited, including compliance with Statement of Standard Accounting Practice ('SSAP') 25 (revised) 'Interim financial reporting' issued by the HKSA.

The financial information relating to the financial year ended 31 December 2001 included in the interim financial report does not constitute the Company's statutory accounts for that financial year but is derived from those accounts. Statutory accounts for the year ended 31 December 2001, on which the auditors have expressed an unqualified opinion on those accounts in their report dated 28 February 2002, are available from the Company's registered office.

The same accounting policies adopted in the 2001 annual accounts have been applied to the interim financial statements except as disclosed under note 14 below.

The notes on the interim financial report include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Group since the issuance of the 2001 annual accounts.

2 Dividends

in HK$ million	Half-year ended 30 June 2002	Half-year ended 30 June 2001
Dividend paid		
2001 final dividend of 28 cents *(2000: 10 cents)* per share approved and paid in 2002	1,415	500
Dividend declared		
Interim dividend declared after the balance sheet date of 14 cents *(2001: 14 cents)* per share	717	703

3 Earnings per share

The calculation of basic earnings per share is based on the profit for the half-year period ended 30 June 2002 attributable to shareholders of HK$1,865 million *(2001: HK$1,350 million, as restated)* and the weighted average number of ordinary shares of 5,062,329,930 *(2001: 5,000,527,531)*.

The calculation of diluted earnings per share is based on the profit for the half-year period ended 30 June 2002 attributable to shareholders of HK$1,865 million *(2001: HK$1,350 million, as restated)* and the weighted average number of ordinary shares of 5,072,272,412 *(2001: 5,018,501,461)* after adjusting for the number of dilutive potential ordinary shares under the employee share option scheme calculated as follows:

	Half-year ended 30 June 2002	Half-year ended 30 June 2001
Weighted average number of ordinary shares used in calculating basic earnings per share	5,062,329,930	5,000,527,531
Number of ordinary shares deemed to be issued for no consideration	9,942,482	17,973,930
Weighted average number of ordinary shares used for calculating the diluted earnings per share	5,072,272,412	5,018,501,461

4 Taxation

No provision for Hong Kong profits tax has been made in the consolidated profit and loss account in respect of the Company and its subsidiaries, as the Company and its subsidiaries either have substantial accumulated tax losses brought forward which are available for set off against current period's assessable profits or have tax losses for the half-year ended 30 June 2002.

5 Segmental information

The Group's results of major business activities for the half-year ended 30 June 2002, with comparative figures for the half-year ended 30 June 2001, are summarised below:

in HK$ million	Railway operations	Station commercial and other businesses	Property ownership and management	Total railway operations and related activities	Property developments	Total
Half-year ended 30 June 2002 (Unaudited)						
Revenue	2,752	473	491	3,716	–	3,716
Less: Operating expenses before depreciation	1,308	85	75	1,468	–	1,468
	1,444	388	416	2,248	–	2,248
Profit on property developments	–	–	–	–	1,314	1,314
Operating profit before depreciation	1,444	388	416	2,248	1,314	3,562
Less: Depreciation	1,085	44	1	1,130	–	1,130
	359	344	415	1,118	1,314	2,432
Unallocated corporate expenses						(207)
Interest and finance charges (net)						(380)
Share of profit of non-controlled subsidiary						20
Profit for the period ended 30 June 2002						1,865
Half-year ended 30 June 2001 (Unaudited)						
Revenue	2,795	476	435	3,706	–	3,706
Less: Operating expenses before depreciation	1,386	71	66	1,523	–	1,523
	1,409	405	369	2,183	–	2,183
Profit on property developments	–	–	–	–	827	827
Operating profit before depreciation	1,409	405	369	2,183	827	3,010
Less: Depreciation	1,004	47	1	1,052	–	1,052
	405	358	368	1,131	827	1,958
Unallocated corporate expenses						(174)
Interest and finance charges (net)						(451)
Share of profit of non-controlled subsidiary						17
Profit for the period ended 30 June 2001						1,350

No geographical analysis is shown as all the principal activities of the Group are carried out in Hong Kong.

Profit on property developments for the half-years ended 30 June 2001 and 2002 were mainly recognised from the deferred income account.

6 Investments in subsidiaries

The following are principal new subsidiary companies established or acquired during the half-year ended 30 June 2002:

Name of company	Issued ordinary / registered share capital	Interest in equity shares	Place of incorporation and operation	Activities
MTR Telecommunication Company Limited	HK$100,000,000	100%	Hong Kong	Radio communication services
Shanghai Hong Kong Metro Construction Management Co. Ltd.	HK$15,000,000	60%	The People's Republic of China	Railway construction management
Shenzhen Donghai Anbo Property Management Co. Ltd.	RMB3,000,000	51%	The People's Republic of China	Property management

7 Debtors, deposits and payments in advance

The Group's credit policy in respect of receivables arising from its principal activities is as follows:

i Rentals, advertising and telecommunications fees are billed monthly with due dates ranging from 7 to 50 days. Tenants of the Group's investment properties and station kiosks are required to pay three months' rental deposit upon the signing of lease agreements.

ii Amounts receivable under interest rate swap and currency swap agreements with financial institutions are due in accordance with the respective terms of the agreements.

iii Debtors in relation to capital works entrusted to the Group, subject to any agreed retentions, are due within 21 days upon the certification of work in progress.

The ageing of debtors relating to the above activities is analysed as follows:

in HK$ million	At 30 June 2002 (Unaudited)	At 31 December 2001 (Audited)
Amount not yet due	460	698
Overdue by 30 days	42	65
Overdue by 60 days	12	9
Overdue by 90 days	8	3
Overdue by more than 90 days	14	16
Total debtors	536	791
Deposits and payments in advance	55	39
	591	830

8 Creditors, accrued charges and provisions

Creditors, accrued charges and provisions are mainly related to capital projects which are settled upon certification of work in progress and swap interests payable. The Group has no significant balances of trade creditors resulting from its provision of transportation services.

The analysis of creditors by due dates is as follows:

in HK$ million	At 30 June 2002 (Unaudited)	At 31 December 2001 (Audited) (Note 14A)
Due within 30 days or on demand	716	595
Due after 30 days but within 60 days	825	1,106
Due after 60 days but within 90 days	76	44
Due after 90 days	1,014	971
	2,631	2,716
Rental and other refundable deposits	1,086	290
Accrued employee benefits	187	154
	3,904	3,160

9 Bonds and notes issued and repaid

Bonds and notes issued by the Group during the half-years ended 30 June 2002 and 2001 comprise:

	Half-year ended 30 June 2002		Half-year ended 30 June 2001	
	Principal Amount	Net consideration received	Principal Amount	Net consideration received
in HK$ million	(Unaudited)		(Unaudited)	
HK dollar retail bonds	3,500	3,553	–	–
HK dollar notes	–	–	2,850	2,846
	3,500	3,553	2,850	2,846

The notes and retail bonds issued during the half-years ended 30 June 2002 and 2001 were issued by a subsidiary, MTR Corporation (C.I.) Limited. The bonds and notes issued are unconditionally and irrevocably guaranteed by the Company, are direct, unsecured, unconditional and unsubordinated to other unsecured and unsubordinated obligations of MTR Corporation (C.I.) Limited. The obligations of the Company under the guarantee are direct, unsecured, unconditional, and unsubordinated to other unsecured and unsubordinated obligations of the Company. The net proceeds from the issues were on lent to the Company for general working capital, refinancing or other corporate purposes.

The Company has fully repaid the Samurai yen bonds of ¥15,000,000,000 during the half-year ended 30 June 2001.

10 Share capital, share premium and capital reserve

in HK$ million	At 30 June 2002 (Unaudited)	At 31 December 2001 (Audited)
Authorised:		
6,500,000,000 shares of HK$1.00 each	6,500	6,500
Issued and fully paid:		
5,120,922,712 shares *(2001: 5,055,229,742 shares)* of HK$1.00 each	5,121	5,055
Share premium	1,226	564
Capital reserve	27,188	27,188
	33,535	32,807

Pursuant to the Articles of Association of the Company, the capital reserve can only be applied in paying up in full unissued shares to be allotted and distributed as fully paid bonus shares to the shareholders of the Company.

Share premium represents the amount by which the issue price of shares exceeds the par value of those shares. The application of the share premium account is governed by section 48B of the Hong Kong Companies Ordinance.

New shares issued and fully paid up during the period comprise:

	Number of shares	Option / scrip price *HK$*	Proceeds credited to Share capital account *HK$ million*	Proceeds credited to Share premium account *HK$ million*
Employee share options exercised	2,370,000	8.44	2	18
Issued as 2001 final scrip dividends	63,322,970	11.17	64	644
	65,692,970		66	662

During the half-year ended 30 June 2002, 511,500 options to subscribe for shares were vested and 2,370,000 share options previously vested have been exercised. The weighted average closing price in respect of the share options exercised during the period was HK$11.18 per share. In addition, 1,616,500 share options lapsed as a result of the resignation of certain option holders during the period. As at 30 June 2002, total options to subscribe for 39,954,000 shares remained outstanding. Details of the movements in respect of the Employee Share Option Scheme during the half-year ended 30 June 2002 are set out under the Corporate Governance and Other Information section on page 10.

11 Other reserves

in HK$ million	Investment property revaluation reserve	Fixed asset revaluation reserve	Retained profits	Total
30 June 2002 (Unaudited)				
Balance as at 1 January 2002 as previously reported	6,518	116	14,608	21,242
Prior period adjustments in respect of annual leave and passage expenses (Note 14A)	–	–	(154)	(154)
	6,518	116	14,454	21,088
Prior period adjustments in respect of pension expenses (Note 14A)	–	–	(45)	(45)
Balance as at 1 January 2002 as restated	6,518	116	14,409	21,043
Dividend paid	–	–	(1,415)	(1,415)
Profit for the period	–	–	1,865	1,865
Balance as at 30 June 2002	6,518	116	14,859	21,493
31 December 2001 (Audited)				
Balance as at 1 January 2001 as previously reported	6,501	139	11,527	18,167
Prior period adjustments in respect of annual leave and passage expenses (Note 14A)	–	–	(148)	(148)
Balance as at 1 January 2001 as restated	6,501	139	11,379	18,019
Dividends paid	–	–	(1,203)	(1,203)
Surplus/(Deficit) on revaluation	17	(23)	–	(6)
Profit for the year	–	–	4,278	4,278
Balance as at 31 December 2001	6,518	116	14,454	21,088

The investment property and fixed asset revaluation reserves are not available for distribution to shareholders because they do not constitute realised profits. As at 30 June 2002, the total amount of reserves available for distribution to shareholders under the Hong Kong Companies Ordinance amounted to HK$14,766 million *(2001: HK$14,391 million, as restated)*.

12 Material related party transactions

The Financial Secretary Incorporated, which holds approximately 77% of the Company's issued share capital on trust for the Government of the Hong Kong SAR, is the majority shareholder of the Company. Transactions between the Group and Government departments, agencies or Government controlled entities, other than those transactions arising in the normal dealings between the Government and the Group, are considered to be related party transactions pursuant to SSAP 20 'Related party disclosures' and are identified separately in this interim financial report.

A The Group has had the following material transactions with Government and other related parties during the half-year ended 30 June 2002:

in HK$ million	Balance at 1 January 2002	Increased / (Decreased)	Balance at 30 June 2002
Amount due from related parties in respect of infrastructure entrustment works:			
– the Government	78	(27)	51
– the Housing Authority	65	30	95
– Kowloon-Canton Railway Corporation	3	7	10
Amount due from non-controlled subsidiary	6	(6)	–
	152	4	156
Amount due to related parties in respect of railway project works entrusted to:			
– the Government	282	(161)	121
– the Airport Authority	119	(37)	82
Amount due to non-controlled subsidiary	–	15	15
	401	(183)	218

in HK$ million	Half-year ended 30 June 2002 (Unaudited)	Half-year ended 30 June 2001 (Unaudited)
Dividend paid to Government	1,084	385

During the half-year ended 30 June 2002, the Group also had the following transactions with its non-controlled subsidiary, Octopus Cards Limited ('OCL'):

in HK$ million	Half-year ended 30 June 2002 (Unaudited)	Half-year ended 30 June 2001 (Unaudited)
Payment to OCL in respect of central clearing services	21	22
Fees received from OCL in respect of load agency services and management services	5	7

B In May 2002, the Group entered into the Agreement for the Lease for Tseung Kwan O Town Lot No. 70 with the Government. The leased property is the proposed development site over the MTR depot at Tseung Kwan O Area 86, which occupies a total area of 32.6 hectares and is planned to be divided into 14 development packages. The land granted is subject to land premium at full market value and the entire development will house approximately 58,000 residents when fully completed in 2012.

13 Capital commitments

i Outstanding capital commitments as at 30 June 2002 not provided for in the accounts were as follows:

in HK$ million	Railway operations	Tseung Kwan O Extension Project	Property development projects	Total
At 30 June 2002 (Unaudited)				
Authorised but not yet contracted for	695	3,249	1,929	5,873
Authorised and contracted for	1,537	152	83	1,772
	2,232	3,401	2,012	7,645
At 31 December 2001 (Audited)				
Authorised but not yet contracted for	854	4,142	1,985	6,981
Authorised and contracted for	1,760	1,025	154	2,939
	2,614	5,167	2,139	9,920

Included in the amounts authorised but not yet contracted for are costs that will not be subject to construction contracts such as staff costs, overhead expenses and capitalised interest.

ii The commitments under railway operations comprise the following:

in HK$ million	Improvement and enhancement works	Acquisition of property, plant and equipment	Total
At 30 June 2002 (Unaudited)			
Authorised but not yet contracted for	501	194	695
Authorised and contracted for	786	751	1,537
	1,287	945	2,232
At 31 December 2001 (Audited)			
Authorised but not yet contracted for	625	229	854
Authorised and contracted for	930	830	1,760
	1,555	1,059	2,614

iii Commitments in respect of jointly controlled operations have been included in the commitments for Property Development Projects above and were as follows:

in HK$ million	At 30 June 2002 (Unaudited)	At 31 December 2001 (Audited)
Authorised but not yet contracted for	1,927	1,983
Authorised and contracted for	55	38
	1,982	2,021

14 Adoption of new accounting standards in Hong Kong

The following new SSAPs issued by the Hong Kong Society of Accountants, which became effective for accounting period beginning on or after 1 January 2002, were adopted for preparation of the Group's financial statements for the six-month period ended 30 June 2002:

– SSAP 34, Employee Benefits
– SSAP 1 (revised), Presentation of Financial Statements
– SSAP 15 (revised), Cash Flow Statements

A Adoption of SSAP 34, Employee Benefits
As a result of the first time adoption of SSAP 34 and the transitional provisions prescribed in the Standard, the Group has made the following adjustments to its financial results for the six-month period ended 30 June 2002 which are relevant to the Group:

i Short-term benefits – accrued liabilities on unused annual leave and leave passage expenses
Prior to the issuance of SSAP 34, the Group did not provide for the liabilities in respect of its staffs' vested annual leave and leave passage entitlements. SSAP 34 requires that obligations in respect of these entitlements should be accrued as soon as services are rendered. In accordance with this change in accounting policy and pursuant to SSAP 2 (which outlines the disclosure requirements when a change in accounting policy has a material effect on the current or prior periods presented), the Group has retrospectively restated the opening balances of the retained profits as at 1 January 2001 and 2002. The previously reported net profit for the six-month ended 30 June 2001 and for the year ended 31 December 2001 have also been adjusted to reflect movements in the accrued annual leave and leave passage account during the periods. These effects are summarised as follows:

in HK$ million	Balance as at 1 January 2001	Net movements in entitlements: 6 months ended 30 June 2001	Net movements in entitlements: 6 months ended 31 December 2001	Balance as at 1 January 2002
Retained profit as previously reported	11,527			14,608
Prior period adjustments in respect of:				
– unused annual leave entitlement	(137)	(1)	(1)	(139)
– leave passage entitlement	(11)	–	(4)	(15)
Retained profit as restated	11,379			14,454

ii Post-employment benefits – defined benefit plans
The Group operates two defined benefit plans, the Hybrid Section of the MTR Corporation Limited ('MTRCL') Retirement Scheme and the MTRCL Retention Bonus Scheme (the 'Schemes'). SSAP 34 prescribes the valuation methodology and accounting treatments in respect of defined benefit plans, which differs from those adopted by the Group in previous accounts. On adoption of SSAP 34, actuarial valuations were reconducted by independent professionally qualified actuaries to ascertain the Schemes' position as of 1 January 2002 according to the requirements of the new Standard. The results indicated that the Schemes' present value of the defined benefit obligations exceeded the fair value of the Schemes' assets (transitional liabilities) by HK$44 million and HK$1 million respectively on the same date. Pursuant to the provisions of SSAP 34, the Group has chosen to recognise the entire transitional liabilities immediately at the time of first adoption. In accordance with this change in accounting policy and pursuant to SSAP 2, the total transitional liabilities of HK$45 million has been recognised retrospectively against the opening balance of the retained profits as at 1 January 2002 (note 11) and the liabilities has been carried in the balance sheet as accrued pension expenses. Comparative information has not been restated as an independent actuarial valuation has not been conducted to ascertain the Schemes' position as of 1 January 2001.

The valuation also indicated that the pension expenses required to be recognised under SSAP 34 for the half-year ended 30 June 2002 in relation to the Hybrid Section of the Retirement Scheme and the Retention Bonus Scheme were HK$106 million and HK$2 million respectively.

The actuaries have also conducted interim valuations on the Schemes' position as of 30 June 2002, using the following principal long-term assumptions which are largely similar to the last valuation as at 31 December 2001:

	Retirement Scheme (Hybrid Section)	Retention Bonus Scheme
Average discount rate	6.0% p.a.	2.5% p.a.
Expected rate of return on plan assets	6.0% p.a.	2.5% p.a.
Expected long-term rate of salary increases	4.0% p.a.	4.0% p.a.

The results confirmed that as at 30 June 2002, there were no material changes in the Schemes' position compared with the last valuation at 31 December 2001. No amendment to the actuarial recommendations as of 31 December 2001 is therefore required.

B Adoption of SSAP 1 (revised), Presentation of Financial Statements
In order to comply with the revised requirements of SSAP 1 (revised), the Group adopts the new statement 'Consolidated Statement of Changes in Equity' which replaces the 'Consolidated Statement of Recognised Gains and Losses' included in previous accounts. The new statement reconciles the movement of key components of the shareholders' fund, including share capital, reserves and retained earnings, from the beginning to end of a period.

C Adoption of SSAP 15 (revised), Cash Flow Statements
The format of the Consolidated Cash Flow Statement has been revised to follow the new requirements of SSAP 15 (revised).

15 Post balance sheet events

A Tung Chung Cable Car Project (the 'Cable Car Project')
On 3 July 2002, the Government announced its selection of the Group to take forward the building and operation of the Cable Car Project, which will be a 5.5-kilometre cable car line linking Ngong Ping, near the Great Buddha Statue, with the Tung Chung Town Centre. The Cable Car Project Agreement will include, subject to land premium at full market value, the granting of land for the construction of a new terminal complex adjacent to the MTR Tung Chung Station together with the planned development of a Theme Village at the Ngong Ping terminal. A provisional project agreement was signed with the Government on 31 July 2002. and the Project is targeted to complete in 2005 with an initial projected investment of about HK$750 million subject to the required land arrangements.

B Penny's Bay Rail Link Project (the 'PBL')
At a meeting of the Executive Council of Hong Kong Government held on 9 July 2002, the PBL was approved and a project agreement between the Group and the Government relating to the design, construction, financing and operation of the PBL by the Group was entered into on 24 July 2002. The PBL will comprise a 3.5-kilometre long single-track railway, providing a shuttle service between a new interchange station on the Tung Chung Line at Yam O, and a new station adjacent to the entrance of the Hong Kong Disneyland. The estimated construction costs of the PBL will be approximately HK$2 billion (money of the day) including capitalised interest and the project is required to complete by 1 July 2005.

In order to reach an appropriate commercial rate of return required on the Group's investment in the PBL, the Government has agreed to provide financial support through waivers of its beneficial entitlement to interim and final cash dividends in respect of its shareholdings in the Group. Such waivers would begin with dividends in respect of the financial year ending 31 December 2002 and thereafter as is equivalent to an amount of HK$798 million at net present value.

16 Comparative figures

Comparative figures have been restated and reclassified based on the change in accounting policy and adoption of new accounting standards as set out in note 14 in the interim financial report.

17 Approval of interim financial report

The interim financial report was approved by the Board on 1 August 2002.