Notes to the accounts

1 Principal accounting policies

A Basis of preparation of accounts

(i) These accounts have been prepared in compliance with the Hong Kong Companies Ordinance. These accounts have also been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (which include all Statements of Standard Accounting Practice ("SSAPs") and Interpretations) issued by the Hong Kong Society of Accountants ("HKSA"), accounting principles generally accepted in Hong Kong and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

(ii) The measurement basis used in the preparation of the accounts is historical cost modified by the revaluation of investment properties and self-occupied office land and buildings.

B Basis of consolidation

The consolidated accounts include the accounts of the Company and all its subsidiaries except for a non-controlled subsidiary (see note 1D) (the "Group") made up to 31 December each year. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from or to the date of their acquisition or disposal, as appropriate. All material inter-company transactions and balances are eliminated on consolidation.

C Subsidiaries

A subsidiary in accordance with the Hong Kong Companies Ordinance is a company in which the Group, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or controls the composition of the board of directors. Subsidiaries are considered to be controlled if the Company has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

Intra-group balances and transactions, and any unrealised profits arising from intra-group transactions, are eliminated in full in preparing the consolidated accounts. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet separately from liabilities and the shareholders' equity. Minority interests in the results of the Group for the year are also separately presented in the profit and loss account.

Where losses attributable to the minority exceed the minority interest in the net assets of a subsidiary, the excess, and any further losses attributable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. All subsequent profits of the subsidiary are allocated to the Group until the minority's share of losses previously absorbed by the Group has been recovered.

Investments in subsidiaries are carried in the Company's balance sheet at cost less any impairment losses (see note 1F).

D Non-controlled subsidiary

Octopus Cards Limited ("OCL") is regarded as a jointly controlled entity as the Group does not have effective control over the Board of OCL. The investment in OCL is accounted for in the consolidated accounts of the Company using the equity method which is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of OCL's net assets. The consolidated profit and loss account reflects the Group's share of the results of OCL for the year.

Unrealised profits and losses resulting from transactions between the Group and OCL are eliminated to the extent of the Group's interest in OCL, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in the profit and loss account.

In the Company's balance sheet, its investment in OCL is stated at cost less impairment losses, if any.

1 Principal accounting policies (continued)

E Fixed assets

(i) Investment properties with an unexpired lease term of more than 20 years are stated in the balance sheet at open market value as determined annually by independent professionally qualified valuers.

Changes in the value of investment properties arising upon revaluations are treated as movements in the investment property revaluation reserve, except:

- where the balance of the investment property revaluation reserve is insufficient to cover a revaluation deficit on a portfolio basis, the excess of the deficit is charged to the profit and loss account; and
- where a revaluation deficit had previously been charged to the profit and loss account and a revaluation surplus subsequently arises, this surplus is firstly credited to the profit and loss account to the extent of the deficit previously charged to the profit and loss account, and is thereafter taken to the investment property revaluation reserve.

On disposal of an investment property, the related portion of the investment property revaluation reserve is transferred to the profit and loss account.

(ii) Leasehold land and buildings comprise leasehold land for railway depots and self-occupied office land and buildings:

(a) Leasehold land for railway depots is stated at cost less accumulated depreciation and impairment losses.

(b) Self-occupied office land and buildings are stated in the balance sheet at open market value on the basis of their existing use at the date of revaluation less any subsequent accumulated depreciation. Revaluations are performed by independent qualified valuers every year. Changes in the value of self-occupied office land and buildings arising upon revaluations are treated as movements in the fixed asset revaluation reserve, except:

- where the balance of the fixed asset revaluation reserve relating to a self-occupied office land and building is insufficient to cover a revaluation deficit of that property, the excess of the deficit is charged to the profit and loss account; and
- where a revaluation deficit had previously been charged to the profit and loss account and a revaluation surplus subsequently arises, this surplus is firstly credited to the profit and loss account to the extent of the deficit previously charged to the profit and loss account, and is thereafter taken to the fixed asset revaluation reserve.

(iii) Civil works and plant and equipment are stated at cost less accumulated depreciation and impairment losses.

(iv) Assets under construction for the operational railway are stated at cost less impairment losses. Cost comprises direct costs of construction, such as materials, staff costs and overheads, together with interest expense capitalised during the period of construction or installation and testing. Capitalisation of these costs ceases and the asset concerned is transferred to fixed assets when substantially all the activities necessary to prepare the asset for its intended use are completed.

(v) Leases of assets under which the lessee assumes substantially all the risks and benefits of ownership are classified as finance leases. Where the Group acquires the use of assets under finance leases, the amounts representing the fair value of the leased asset, or, if lower, the present value of the minimum lease payments (computed using the rate of interest implicit in the lease), of such assets are included in fixed assets and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases.

Leases of assets under which the lessor has not transferred all the risks and benefits of ownership are classified as operating leases. Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies. Impairment losses are accounted for in accordance with the accounting policies on impairment of assets. Revenue arising from operating leases is recognised in accordance with the Group's revenue recognition policies as set out in note 1S.

(vi) Subsequent expenditure relating to an existing fixed asset is added to the carrying amount of the asset if it is probable that future economic benefit in excess of the originally assessed standard of performance of the asset will flow to the Group.

Expenditure on repairs or maintenance of an existing fixed asset to restore or maintain the originally assessed standard of performance of that asset is charged as an expense when incurred.

(vii) Gains or losses arising from the retirement or disposal of a fixed asset other than an investment property are determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the profit and loss account on the date of retirement or disposal. Any related revaluation surplus is transferred from the fixed asset revaluation reserve to retained profits.

1 Principal accounting policies (continued)

F Impairment of assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

- fixed assets (other than properties carried at revalued amounts);
- railway construction in progress;
- property development in progress;
- deferred expenditure; and
- investments in subsidiaries.

If any such indication exists, the asset's recoverable amount is estimated.

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (ie a cash-generating unit).

An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount.

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount of the asset.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the profit and loss account in the year in which the reversals are recognised.

G Depreciation

(i) Investment properties with an unexpired lease term of more than 20 years are not depreciated.

(ii) Fixed assets other than investment properties and assets under construction are depreciated on a straight line basis at rates sufficient to write off their cost or valuation over their estimated useful lives as follows:

Leasehold land and buildings

Self-occupied office land and buildings	the shorter of 50 years and the unexpired term of the lease
Leasehold land for railway depots	the unexpired term of the lease

Civil works

Rails (initial cost)	Indefinite *
Excavation and boring	Indefinite
Tunnel linings, underground civil structures, overhead structures and immersed tubes	100 years
Station building structures	80–100 years
Depot structures	80 years
Concrete kiosk structures	20 years
Station architectural finishes	20–30 years

* Replacement costs of rails are charged to the profit and loss account as revenue expenses.

1 Principal accounting policies (continued)

Plant and equipment

Rolling stock	7–40 years
Platform screen doors	35 years
Environmental control systems, lifts and escalators, fire protection and drainage system	20–30 years
Power supply systems	20–40 years
Automatic fare collection systems, metal station kiosks, and other mechanical equipment	20 years
Fixture and fitting	10–15 years
Train control and signalling equipment, station announcement systems, telecommunication systems and advertising panels	15 years
Maintenance equipment, office furniture and equipment	10 years
Computer software licences and applications	5–7 years
Cleaning equipment, computer equipment and tools	5 years
Motor vehicles	4 years

The useful lives of the various categories of fixed assets are reviewed regularly in the light of actual asset condition, usage experience and the current asset replacement programme. The depreciation charge for the current and future periods is adjusted if there are significant changes from previous estimates.

(iii) No depreciation is provided on assets under construction until construction is completed and the assets are ready for their intended use.

(iv) Depreciation on assets held under finance leases is provided at rates designed to write off the cost of the asset in equal annual amounts over the shorter of the lease term or the anticipated useful life of the asset as set out above, except in cases where title to the asset will be acquired by the Group at the end of the lease where depreciation is provided at rates designed to write off the cost of the asset in equal amounts over the anticipated useful life of the asset.

H Construction costs

(i) Costs incurred by the Group in respect of feasibility studies on proposed railway related construction projects (including consultancy fees, in-house staff costs and overheads) are dealt with as follows:

- where the proposed projects are at a preliminary review stage with no certainty of materialising, the costs concerned are written off to the profit and loss account; and
- where the proposed projects are at a detailed study stage, having been agreed in principle by the Board of Directors based on a feasible financial plan, the costs concerned are dealt with as deferred expenditure until such time as a project agreement is reached with the Government, whereupon the costs are transferred to railway construction in progress.

(ii) After entering into a project agreement with the Government, all costs incurred in the construction of the railway are dealt with as railway construction in progress until commissioning of the railway line, whereupon the relevant construction costs are transferred to fixed assets.

I Property development

(i) Costs incurred by the Group in the preparation of sites for property development are dealt with as property development in progress.

(ii) Payments received from developers in respect of developments are offset against the amounts in property development in progress attributable to that development. Any surplus amounts of payments received from developers in excess of the balance in property development in progress are transferred to deferred income. In these cases, further costs subsequently incurred by the Group in respect of that development are charged against deferred income.

(iii) Expenditure incurred on the development of properties for retention by the Group is transferred to fixed assets when the occupation permits are issued and the properties are put into use.

(iv) When agreement is reached with a developer to redevelop an existing self-occupied property, the relevant property is revalued on an existing use basis prior to commencement of redevelopment. The surplus arising on revaluation is credited to fixed asset revaluation reserve. On commencement of redevelopment, the net book value of the property is transferred to property development in progress.

1 Principal accounting policies (continued)

(v) Profits arising from the development of properties undertaken in conjunction with property developers are recognised in the profit and loss account as follows:

- 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;
- where the Group receives a share of proceeds from sale of the development, profits arising from such proceeds are recognised upon the issue of occupation permits provided the amounts of revenue and costs can be measured reliably; and
- 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.

Upon recognition of profit, the balance of deferred income or property development in progress related to that development is credited or charged to the profit and loss account, as the case may be.

(vi) Where the Group is liable to pay the developer consideration for the retention of part of a property to be redeveloped, profit attributable to the Group in respect of the redevelopment (including any payment received from the developer) will be recognised in the profit and loss account when the quantum of the obligation of the Group and the amount of realised profit can be determined with reasonable accuracy.

(vii) Where properties are received as a profit distribution upon completion of development and are held for sale, those properties are stated at their estimated net realisable value upon receipt. Net realisable value represents the estimated selling price less costs to be incurred in selling the properties. When properties are sold, the carrying amount of those properties is recognised as cost of properties sold in the period in which the related revenue is recognised. The amount of any write-down of properties to net realisable value is recognised as an expense in the period the write-down occurs. The amount of any reversal of any write-down of properties, arising from an increase in net realisable value, is recognised as a reduction in the cost of properties sold in the period in which the reversal occurs.

J Jointly controlled operations
The arrangements entered into by the Group with developers for property developments along the Airport Railway and the Tseung Kwan O Line are considered to be jointly controlled operations pursuant to SSAP 21 "Accounting for interests in joint ventures". Pursuant to the development arrangements, the Group is normally responsible for its own costs, including in-house staff costs and the costs of enabling works, and the developers normally undertake to pay for all other project costs such as land premium, construction costs, professional fees, etc. Such costs are deductible from the proceeds of sale before surplus proceeds are shared. In respect of its interests in such operations, the Group accounts for the costs of enabling works net of up-front payments received as property development in progress. In cases where up-front payments received from developers exceed the related expenditures incurred by the Group, such excess is recorded as deferred income. Expenses incurred by the Group on staff, overhead and consultancy fees in respect of these developments are also capitalised as property development in progress. The Group's share of income earned from such operations is recognised in the profit and loss account in accordance with note 1I after netting off any related balance in the property development in progress account at that time.

K Defeasance of long-term lease payments
Where commitments to make long-term lease payments have been defeased by the placement of securities, those commitments and securities (and income and charges arising therefrom) have been netted off in order to reflect the overall commercial effect of the arrangements. These transactions are not accounted for as leases and these liabilities and investment in securities are not recognised as obligations and assets. Any net amount of cash received from such transactions is accounted for as deferred income and is amortised over the terms of the respective lease.

L Stores and spares
Stores and spares used for railway and business operation are categorised as either revenue or capital. Revenue items are stated in the balance sheet at cost, using the weighted average cost method. Provision is made for obsolescence where appropriate. Capital items are included in fixed assets and stated at cost less aggregate depreciation and impairment losses. Depreciation is charged at the rates applicable to the relevant fixed assets against which the capital spares are held in reserve.

1 Principal accounting policies (continued)

M Long-term consultancy contracts

The accounting policy for contract revenue is set out in note 1S(iii). When the outcome of a fixed-price consultancy contract can be estimated reliably, contract costs are recognised as expense by reference to the stage of completion of the contract activity at the balance sheet date. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. When the outcome of a consultancy contract cannot be estimated reliably, contract costs are recognised as an expense in the period in which they are incurred.

Consultancy contracts in progress at the balance sheet date are recorded in the balance sheet at the net amount of costs incurred plus recognised profit less recognised losses and progress billings, and are presented in the balance sheet as the "Gross amount due from customers for contract work" (as an asset) or the "Gross amount due to customers for contract work" (as a liability), as applicable. Progress billings not yet paid by the customer are included in the balance sheet under "Debtors, deposits and payments in advance". Amounts received before the related work is performed are included in the balance sheet, as a liability, under "Creditors, accrued charges and provisions".

N Cash equivalents

Cash and cash equivalents comprise cash at banks and in hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

O Employee benefits

(i) Salaries, annual leave, leave passage allowance and other costs of non-monetary benefits are accrued and recognised as an expense in the year in which the associated services are rendered by employees of the Group, except those benefits incurred for project staff in respect of construction projects and capital works, which are capitalised as part of the cost of the qualifying assets.

(ii) Contributions to defined contribution retirement plans, including contributions to Mandatory Provident Funds ("MPF") as required under the Hong Kong Mandatory Provident Fund Schemes Ordinance, are recognised as an expense in the profit and loss account as incurred, except those contributions on project staff incurred in respect of construction projects and capital works, which are capitalised as part of the cost of the qualifying assets.

(iii) The Group's net obligation in respect of defined benefit retirement plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine the present value, and the fair value of any plan assets is deducted. The discount rate is the yield at balance sheet date on high quality corporate bond that have maturity dates approximating the terms of the Group's obligations. If there is no deep market in such bonds, the market yield on government bonds would be used. The calculation is performed by a qualified actuary using the projected unit credit method.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised either as an expense in the profit and loss account, or capitalised as part of the cost of the relevant construction projects or capital works in the case of project related employees, as the case may be, on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in a similar manner.

In calculating the Group's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds ten percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in the profit and loss account over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Where the calculation of the Group's net obligation results in a negative amount, the asset recognised is limited to the net total of any cumulative unrecognised net actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

1 Principal accounting policies (continued)

(iv) When the Group grants employees options to acquire shares of the Company, no employee benefit cost or obligation is recognised at the date of grant. When the options are exercised, equity is increased by the amount of the proceeds received.

(v) Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

P Retirement Schemes

The Group operates an Occupational Retirement Scheme (the "MTR Corporation Limited Retirement Scheme"), which is supplemented by a top-up scheme ("MTR Corporation Limited Retention Bonus Scheme") mainly for project staff to provide extra benefits in the event of redundancy.

In addition, the Group has set up a MPF Scheme by participating in a master trust scheme provided by an independent MPF service provider to comply with the requirements under the MPF Ordinance.

Employer's contributions to the defined contribution section of the MTR Corporation Limited Retirement Scheme and the MPF Scheme are recognised in the accounts in accordance with the policy set out in note 1O(ii).

The employer's contributions paid and payable in respect of employees of the hybrid benefit section of the MTR Corporation Limited Retirement Scheme, as calculated annually by independent actuaries in accordance with the Retirement Scheme Rules and provisions of the Occupational Retirement Schemes Ordinance, are used to satisfy the pension expenses recognised in the accounts according to note 1O(iii). Any deficit or surplus thereof will be dealt with in the balance sheet as accrued or prepaid benefit expenses, as the case may be.

Q Income tax

(i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Income tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

(ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

(iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination) and investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

1 Principal accounting policies (continued)

(iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if, and only if, the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
  - the same taxable entity; or
  - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

R Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Company or Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

S Revenue recognition

Provided it is probable that the economic benefits associated with the transactions will flow to the Group and the amount of revenue can be measured reliably, revenue is recognised in the profit and loss account as follows:

(i) Fare revenue is recognised when the journey is provided.

(ii) Advertising income and service fees from telecommunication services provided within the railway are recognised when the services are provided.

(iii) Contract revenue is recognised when the outcome of a consultancy contract can be estimated reliably. Contract revenue is recognised using the percentage of completion method, measured by reference to the percentage of contract costs incurred to date to estimated total contract costs for the contract. When the outcome of a consultancy contract cannot be estimated reliably, revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable.

(iv) Rental income from investment properties, station kiosks and other railway premises under operating leases is accounted for in accordance with the terms of the leases. Lease incentives granted are recognised in the profit and loss account as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognised as income in the accounting period in which they are earned. Property management income is recognised when the services are provided.

T Operating lease charges

Rentals payable under operating leases are charged on a straight-line basis over the period of the lease to the profit and loss account, except for rentals payable in respect of railway construction, property development in progress and proposed capital projects which are capitalised as part of railway construction in progress, property development in progress and deferred expenditure respectively.

1 Principal accounting policies (continued)

U Interest and finance charges

Interest expense directly attributable to the financing of assets under construction prior to their completion or commissioning is capitalised. Exchange differences arising from foreign currency borrowings related to the acquisition of assets are capitalised to the extent that they are regarded as an adjustment to interest costs. Interest expense attributable to other purposes is charged to the profit and loss account.

Finance charges implicit in the lease payments on assets held under finance leases are charged to the profit and loss account over the period of the lease so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

The differentials paid and received on interest rate swap agreements are accrued and recognised as adjustments to interest expense.

V Foreign currency translation

Foreign currency transactions during the year are translated into Hong Kong dollars and recorded at exchange rates ruling at the transaction dates. Foreign currency monetary assets and liabilities are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. Forward foreign exchange contracts, swaps and options used as a hedge against foreign currency liabilities are revalued at the balance sheet date at the exchange rates ruling at that date. Gains and losses on currency hedging transactions are used to offset gains and losses resulting from currency fluctuations inherent in the underlying foreign currency liabilities. Differences arising on foreign currency translation and revaluation of forward foreign exchange contracts, swaps and options are dealt with in the profit and loss account.

The results of foreign enterprises are translated into Hong Kong dollars at the average exchange rates for the year; balance sheet items are translated into Hong Kong dollars at the rates of exchange ruling at the balance sheet date. The resulting exchange differences are dealt with as a movement in reserves.

W Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format. As substantially all the principal activities of the Group are carried out in Hong Kong, no geographical segment information is provided.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group enterprises within a single segment.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one year.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, share of results of non-controlled subsidiary, corporate and financing expenses and minority interests.

X Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

1 Principal accounting policies (continued)

Y Government grants

Government grants are assistance by Government in the form of transfer of resources in return for the Company's compliance to the conditions attached to it. Government grant, which represents compensation for the cost of an asset, will be deducted from the cost of the asset in arriving at its carrying value to the extent of the amounts received and receivable as at the date of the balance sheet. Any excess of the amount of grant received or receivable over the cost of the asset at the balance sheet date will be carried forward as advance receipts to set off future cost of the asset.

2 Fare revenue

The MTR Lines comprise the Kwun Tong, Tsuen Wan, Island, Tung Chung and Tseung Kwan O Lines. The fare revenue attributable to the Tseung Kwan O Line relates to the period after the line commenced operation on 18 August 2002.

3 Non-fare revenue

A Station commercial and other revenue

in HK$ million	**2003**	2002
Station commercial and other revenue comprises:		
Advertising	**386**	399
Kiosk rental	**275**	238
Telecommunication income	**198**	186
Consultancy income	**143**	63
Miscellaneous business revenue	**115**	93
	1,117	979

B Rental and management income

in HK$ million	**2003**	2002
Rental income was attributable to:		
Telford Plaza	**365**	387
Luk Yeung Galleria	**114**	113
Paradise Mall	**119**	124
Maritime Square	**209**	200
Other properties	**81**	73
	888	897
Management income	**94**	85
Property agency income	**6**	5
	988	987

Included in rental income is service income of HK$63 million *(2002: HK$64 million)* relating to the provision of air conditioning services.

4 Operating expenses before depreciation

A Included in staff costs and related expenses are the following retirement expenses:

in HK$ million	**2003**	2002
Contributions to defined contribution plans and Mandatory Provident Fund	**13**	13
Increase in liability for defined benefit plans (Note 37C)	**156**	149
	169	162

Other staff costs and related expenses of HK$943 million *(2002: HK$1,150 million)* are included in construction projects, capital and revenue works, and non-fare related operations.

B Repairs and maintenance costs relate mainly to contracted maintenance and revenue works. Other routine repairs and maintenance works are performed by in-house operations, the costs of which are included under staff costs and stores and spares consumed.

C Project study and deferred expenditures written off comprise:

in HK$ million	**2003**	2002
West Island Link (Note 17)	**21**	–
Shatin Central Link (Note 17)	**–**	42
North Island Link (Note 17)	**–**	85
Airport Railway improvement works in connection with North Island Link	**–**	63
Others	**28**	28
	49	218

D Included in general and administration expenses and other expenses are the following charges:

in HK$ million	**2003**	2002
Auditors' remuneration		
– audit services	**3**	3
– other services	**1**	1
Deficit on revaluation of self-occupied office land and buildings (Note 14D)	**69**	–
Loss on disposal of fixed assets	**16**	17
Operating lease expenses:		
Office buildings and staff quarters	**12**	12
Less: Amount capitalised	**5**	9
	7	3

Other services under auditors' remuneration include an amount of HK$0.4 million *(2002: HK$0.5 million)* relating to tax compliance services provided during the year.

5 Remuneration of Members of the Board and the Executive Directorate

A Remuneration of Members of the Board and the Executive Directorate

(i) The aggregate emoluments of the Members of the Board and the Executive Directorate of the Company disclosed pursuant to section 161 of the Hong Kong Companies Ordinance were as follows:

in HK$ million	**2003**	2002
Fees	**2**	2
Salaries, housing allowances and other benefits-in-kind	**28**	29
Variable remuneration related to performance	**3**	3
Retirement scheme contributions	**4**	4
	37	38

The above emoluments do not include realised gains on exercise of share options amounting to HK$8.7 million *(2002: HK$0.2 million)* in respect of certain Members of the Executive Directorate, which are disclosed under the paragraph "Board Members and Executive Directorate's Interest in Shares" of the Report of the Members of the Board.

Non-executive directors of the Company are not appointed for a specific term but are subject (save as those appointed pursuant to Section 8 of the Mass Transit Railway Ordinance (Chapter 556 of the Laws of Hong Kong)) to retirement by rotation and re-election at the Company's annual general meetings in accordance with Articles 87 and 88 of the Company's Articles of Association.

(ii) The gross emoluments (excluding share option benefit) of the Members of the Board and the Members of the Executive Directorate were within the following bands:

Emoluments	**2003 Number**	2002 Number
HK$0 – HK$250,000	**8**	13
HK$500,001 – HK$1,000,000	**2**	1
HK$3,500,001 – HK$4,000,000	**–**	1
HK$4,000,001 – HK$4,500,000	**3**	1
HK$4,500,001 – HK$5,000,000	**2**	4
HK$5,000,001 – HK$5,500,000	**1**	–
HK$6,000,001 – HK$6,500,000	**1**	–
HK$7,500,001 – HK$8,000,000	**–**	1
	17	21

The information shown in the above table includes the five highest paid employees. The independent non-executive directors' emoluments are included in the first remuneration band except the non-executive Chairman, whose emolument is included in the second remuneration band. Emolument of the ex-Chairman, Jack C K So who resigned on 20 July 2003, is included under the highest remuneration band in both 2002 and 2003.

5 Remuneration of Members of the Board and the Executive Directorate (continued)

(iii) The remuneration details (excluding share option benefit) of the current members of the Executive Directorate are shown below:

in HK$ million	**2003** Base pay, allowance, retirement scheme contribution and benefits	Variable remuneration related to performance	Total	2002 Total
Chief Executive Officer ("CEO")*	**0.56**	**0.12**	**0.68**	–
Finance Director[#]	**3.88**	**0.42**	**4.30**	3.96
Human Resources Director	**4.03**	**0.42**	**4.45**	4.49
Legal Director and Secretary	**4.25**	**0.42**	**4.67**	4.72
Operations Director	**4.68**	**0.43**	**5.11**	4.78
Project Director	**4.22**	**0.43**	**4.65**	4.72
Property Director	**4.04**	**0.42**	**4.46**	4.52
	25.66	**2.66**	**28.32**	27.19

* Appointed in December 2003
[#] Appointed in February 2002

(iv) The CEO will be entitled to receive 700,000 shares in the Company (or their equivalent value in cash) on completion of his three-year contract (i.e. 30 November 2006). The final number of shares (or cash amount) delivered may be adjusted to reflect relevant changes (if any) in the Company's share capital after his appointment. This ensures that the CEO's compensation is closely tied to the Company's longer-term performance and aligns his interests with those of shareholders. In certain limited circumstances, the CEO may be entitled to receive some or all of the shares (or the cash amount) prior to completion of his contract.

The restricted shares were offered in order to provide a sufficiently competitive level of compensation and to ensure the CEO's total pay is more closely tied to the performance of the Company.

B Share options

Options exercised and outstanding in respect of each Member of the Executive Directorate as at 31 December 2003 are set out under the paragraph "Board Members and Executive Directorate's Interest in Shares" of the Report of the Members of the Board. Details of the options granted to Members of the Executive Directorate are as follows:

(i) Pre-Global Offering Share Option Scheme

Under the Company's Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") described in note 42A, Jack C K So (ex-Chairman) and each of the other Members of the Executive Directorate, except C K Chow and Lincoln K K Leong, were granted options on 20 September 2000 to acquire 1,599,000 and 1,066,000 shares respectively. C K Chow and Lincoln K K Leong joined the Company on 1 December 2003 and 1 February 2002 respectively and are not beneficiaries of the Pre-IPO Option Scheme.

Under the vesting terms of the Pre-IPO Option Scheme, each eligible Member of the Executive Directorate must continue to beneficially own (i) at all times after 26 October 2001, at least 40,000 shares in the case of the ex-Chairman and at least 23,000 shares in the case of other Members of the Executive Directorate, and (ii) at all times after 26 October 2002, at least 80,000 shares in the case of the ex-Chairman and at least 46,000 shares in the case of other Members of the Executive Directorate.

(ii) New Joiners Share Option Scheme

Under the New Joiners Share Option Scheme ("New Option Scheme") as described in note 42B, Lincoln K K Leong, a Member of the Executive Directorate, was granted options to acquire 1,066,000 shares on 1 August 2003.

The options will be vested in three equal annual instalments and under the vesting terms of the New Option Scheme, the grantee must continue to beneficially own (i) at all times on and after 4 August 2004, at least 23,000 shares; and (ii) at all times on and after 4 August 2005, at least 46,000 shares.

6 Profit on property developments

in HK$ million	**2003**	2002
Profit on property developments comprises:		
Transfer from deferred income (Note 16B)	**1,286**	2,548
Share of surplus from development	**7**	6
Profit on sale of properties held for sale	**44**	–
Profit recognised from sharing in kind	**4,034**	1,203
Other overhead costs	**(2)**	(2)
	5,369	3,755

Included in profit on sale of properties held for sale are write-down provision of properties held for sale of HK$16 million *(2002: HK$44 million)* and cost of properties sold of HK$243 million *(2002: HK$118 million)*.

7 Depreciation

A Depreciation

Depreciation for the year ended 31 December 2003 includes full year's charges relating to assets of the Tseung Kwan O Line capitalised upon commissioning in August 2002. Depreciation for the year comprised charges on:

in HK$ million	**2003**	2002
Railway operations		
– on fixed assets held under finance leases	**19**	19
– on other railway fixed assets	**2,251**	2,321
Assets relating to station advertising, kiosk and miscellaneous businesses	**109**	106
Unallocated corporate assets	**23**	24
	2,402	2,470

B Change in depreciation rates

In accordance with the Company's policy to conduct asset life review at regular intervals, a review of the estimated useful lives of the Company's fixed assets was carried out during the year, taking into account the assets' actual condition, level of technical obsolescence, future maintenance and replacement programmes as well as depreciation lives adopted by international rail transportation companies. As a result of the review, the estimated useful lives of certain assets were changed. The changes took effect from 1 January 2003 with the following resultant financial effects for the year:

	Typical useful life within asset category		Net decrease/ (increase) in depreciation charge
Asset category	Original life (years)	Revised life (years)	(HK$ million)
Rolling stock	10–40	7–40	20
Power supply and environmental control systems	20–30	20–40	71
Station architectural finishes	20–25	20–30	60
Fixture and fitting	10	10–15	30
Automatic fare collection systems	15	20	11
Fire protection and drainage systems	20–25	20–30	21
Station announcement and telecommunication systems	10	15	29
Computer software licences and applications	7	5–7	(10)
			232

8 Interest and finance charges

in HK$ million	**2003**	2002
Interest expenses in respect of:		
Bank loans and overdrafts, and capital market instruments wholly repayable within 5 years	**680**	823
Capital market instruments not wholly repayable within 5 years	**901**	867
Obligations under finance leases	**43**	53
Finance charges	**36**	28
Exchange gain	**(7)**	–
Interest expenses capitalised:		
Tseung Kwan O Extension Project	**–**	(423)
Property projects	**–**	(86)
Other capital projects	**(82)**	(81)
Assets under construction	**(20)**	(28)
	(102)	(618)
	1,551	1,153
Interest income in respect of:		
Deposits with banks and other financial institutions	**(10)**	(25)
Staff housing loans	**(2)**	(3)
	(12)	(28)
	1,539	1,125

Interest expenses have been capitalised at the average cost of funds to the Group calculated on a monthly basis. The average interest rates for each month varied from 4.0% to 5.5% per annum during the year *(2002: 5.2% to 5.4% per annum)*.

9 Profit attributable to shareholders

The consolidated profit attributable to shareholders includes a profit of HK$4,379 million *(2002: HK$3,512 million, as restated)* which has been dealt with in the accounts of the Company.

10 Dividends

Dividends paid and proposed during the year comprised:

in HK$ million	**2003**	2002
Dividend approved and paid		
– 2002 final dividend of 28 cents *(2001: 28 cents)* per share approved and paid in 2003	**1,444**	1,415
– 2003 interim dividend of 14 cents *(2002: 14 cents)* per share	**734**	717
	2,178	2,132
Dividend proposed		
– Final dividend proposed after the balance sheet date of 28 cents (2002: 28 cents) per share	**1,481**	1,444

The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

During the year, scrip dividend elections were offered to shareholders with Hong Kong addresses. The Company's majority shareholder, the Financial Secretary Incorporated ("FSI"), had elected to receive part of its entitlement to dividends in the form of scrip to the extent necessary to ensure that the amount payable in cash would not exceed 50% of the total dividend payable. Details of dividends paid to the FSI are disclosed in note 40J. On 26 February 2004, the Government agreed to extend the scrip dividend arrangement for the three financial years ending 31 December 2006.

Pursuant to the financing arrangement under the Penny's Bay Rail Link Project Agreement entered into between the Group and the Government, HK$675 million *(2002: HK$219 million)* cash dividend declared and payable to the Government during the year had been waived (Note 40E).

11 Earnings per share

The calculation of basic earnings per share is based on the profit for the year attributable to shareholders of HK$4,450 million *(2002: HK$3,579 million, as restated)* and the weighted average number of ordinary shares of 5,214,028,094 in issue during the year *(2002: 5,098,511,864)*.

The calculation of diluted earnings per share is based on the profit for the year attributable to shareholders of HK$4,450 million *(2002: HK$3,579 million, as restated)* and the weighted average number of ordinary shares of 5,217,462,182 *(2002: 5,105,400,689)* after adjusting for the number of dilutive potential ordinary shares under the employee share option schemes calculated as follows:

	2003	2002
Weighted average number of ordinary shares used in calculating basic earnings per share	**5,214,028,094**	5,098,511,864
Number of ordinary shares deemed to be issued for no consideration	**3,434,088**	6,888,825
Weighted average number of ordinary shares used for calculating the diluted earnings per share	**5,217,462,182**	5,105,400,689

12 Income tax

A Income tax in the consolidated profit and loss account represents:

in HK$ million	**2003**	2002
Current tax		
– overseas tax for the year	**4**	1
Deferred tax		
– origination and reversal of temporary differences	**443**	630
– effect of increase in tax rate on deferred tax balances at 1 January	**300**	–
	743	630
Share of non-controlled subsidiary's taxation	**1**	3
	748	634

No provision for current 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 year's assessable profits or have sustained tax losses for the year ended 31 December 2003. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

In March 2003, the Hong Kong Government announced an increase in the Profits Tax rate applicable to the Group's operations in Hong Kong from 16% to 17.5%. This increase is taken into account in the preparation of the Group's 2003 accounts.

B Reconciliation between tax expense and accounting profit at applicable tax rates

	2003		2002	
	HK$ million	%	*HK$ million*	%
Profit before tax	**5,198**		4,213	
Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned	**926**	**17.8**	691	16.4
Tax effect of non-deductible expenses	**53**	**1.0**	5	0.1
Tax effect of non-taxable revenue	**(531)**	**(10.2)**	(62)	(1.5)
Effect on opening deferred tax balances resulting from an increase in tax rate during the year	**300**	**5.8**	–	–
Actual tax expenses	**748**	**14.4**	634	15.0

13 Segmental information

The results of major business activities 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
2003						
Revenue	5,489	1,117	988	7,594	–	7,594
Less: Operating expenses before depreciation	2,878	351	198	3,427	–	3,427
	2,611	766	790	4,167	–	4,167
Profit on property developments	–	–	–	–	5,369	5,369
Operating profit before depreciation	2,611	766	790	4,167	5,369	9,536
Less: Depreciation	2,266	109	4	2,379	–	2,379
	345	**657**	**786**	**1,788**	**5,369**	7,157
Unallocated corporate expenses						(443)
Interest and finance charges (net)						(1,539)
Share of profit of non-controlled subsidiary						23
Income tax						(748)
Profit for the year ended 31 December 2003						**4,450**
Assets						
Operational assets	80,556	1,323	14,450	96,329	364	96,693
Railway construction in progress	181	–	–	181	–	181
Railway assets under construction	930	10	–	940	–	940
Property development in progress	–	–	–	–	2,309	2,309
Properties held for sale	–	–	–	–	812	812
	81,667	1,333	14,450	97,450	3,485	100,935
Interest in non-controlled subsidiary						110
Unallocated assets						1,321
Total assets						102,366
Liabilities						
Segmented liabilities	3,000	254	358	3,612	368	3,980
Deferred income	137	–	–	137	4,924	5,061
	3,137	254	358	3,749	5,292	9,041
Unallocated liabilities						36,025
Minority interests						8
Total liabilities						45,074
Other Information						
Capital expenditure on:						
Operational assets and assets under construction	2,586	179	3,629			
Railway construction in progress	719					
Property development in progress					161	
Non-cash expenses other than depreciation	19	2	–			

13 Segmental information (continued)

in HK$ million	Railway operations	Station commercial and other businesses	Property ownership and management	Total railway operations and related activities	Property developments	Total (Note 43A)
2002						
Revenue	5,720	979	987	7,686	–	7,686
Less: Operating expenses before depreciation	2,804	185	167	3,156	–	3,156
	2,916	794	820	4,530	–	4,530
Profit on property developments	–	–	–	–	3,755	3,755
Operating profit before depreciation	2,916	794	820	4,530	3,755	8,285
Less: Depreciation	2,339	106	1	2,446	–	2,446
	577	688	819	2,084	3,755	5,839
Unallocated corporate expenses						(540)
Interest and finance charges (net)						(1,125)
Share of profit of non-controlled subsidiary						39
Income tax						(634)
Profit for the year ended 31 December 2002						3,579
Assets						
Operational assets	80,216	1,327	10,380	91,923	104	92,027
Railway construction in progress	109	–	–	109	–	109
Railway assets under construction	2,453	1	–	2,454	–	2,454
Property development in progress	–	–	–	–	2,870	2,870
Properties held for sale	–	–	–	–	794	794
	82,778	1,328	10,380	94,486	3,768	98,254
Interest in non-controlled subsidiary						87
Unallocated assets						2,778
Total assets						101,119
Liabilities						
Segmented liabilities	3,690	182	367	4,239	312	4,551
Deferred income	–	–	–	–	6,226	6,226
	3,690	182	367	4,239	6,538	10,777
Unallocated liabilities						36,760
Minority interests						8
Total liabilities						47,545
Other Information						
Capital expenditure on:						
Operational assets and assets under construction	4,215	722	39			
Railway construction in progress	220					
Property development in progress					356	
Non-cash expenses other than depreciation	14	3	–			

No geographical analysis is shown as substantially all the principal activities of the Company and its subsidiaries are carried out in Hong Kong.

14 Fixed assets

The Group

in HK$ million	Investment properties	Leasehold land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation						
At 1 January 2003	10,267	1,638	45,092	52,519	2,454	111,970
Additions	3,626	52	–	66	1,148	4,892
Disposals/Write-offs	–	–	(11)	(265)	(4)	(280)
Surplus/(Deficit) on revaluation (Note 35)	276	(23)	–	–	–	253
Deficit on revaluation written off to Profit and Loss Account (Note 4D)	–	(69)	–	–	–	(69)
Reclassification	–	–	268	(268)	–	–
Other assets commissioned	–	–	391	2,267	(2,658)	–
At 31 December 2003	14,169	1,598	45,740	54,319	940	116,766
At Cost	–	731	45,740	54,319	940	101,730
At 31 December 2003 Valuation	14,169	867	–	–	–	15,036
Aggregate depreciation						
At 1 January 2003	–	84	2,324	15,292	–	17,700
Charge for the year	–	35	374	1,993	–	2,402
Written back on disposal	–	–	(3)	(233)	–	(236)
Written back on revaluation (Note 35)	–	(21)	–	–	–	(21)
Reclassification	–	–	10	(10)	–	–
At 31 December 2003	–	98	2,705	17,042	–	19,845
Net book value at 31 December 2003	**14,169**	**1,500**	**43,035**	**37,277**	**940**	**96,921**
Net book value at 31 December 2002	10,267	1,554	42,768	37,227	2,454	94,270

14 Fixed assets (continued)

The Company

in HK$ million	Investment properties	Leasehold land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation						
At 1 January 2003	10,267	1,638	45,092	51,907	2,450	111,354
Additions	3,626	52	–	61	1,138	4,877
Disposals/Write-offs	–	–	(11)	(265)	(4)	(280)
Transfer to subsidiary	–	–	–	(5)	(8)	(13)
Surplus/(Deficit) on revaluation (Note 35)	276	(23)	–	–	–	253
Deficit on revaluation written off to Profit and Loss Account (Note 4D)	–	(69)	–	–	–	(69)
Reclassification	–	–	268	(268)	–	–
Other assets commissioned	–	–	391	2,263	(2,654)	–
At 31 December 2003	14,169	1,598	45,740	53,693	922	116,122
At Cost	–	731	45,740	53,693	922	101,086
At 31 December 2003 Valuation	14,169	867	–	–	–	15,036
Aggregate depreciation						
At 1 January 2003	–	84	2,324	14,913	–	17,321
Charge for the year	–	35	374	1,929	–	2,338
Written back on disposal	–	–	(3)	(233)	–	(236)
Written back on transfer to subsidiary	–	–	–	(2)	–	(2)
Written back on revaluation (Note 35)	–	(21)	–	–	–	(21)
Reclassification	–	–	10	(10)	–	–
At 31 December 2003	–	98	2,705	16,597	–	19,400
Net book value at 31 December 2003	**14,169**	**1,500**	**43,035**	**37,096**	**922**	**96,722**
Net book value at 31 December 2002	10,267	1,554	42,768	36,994	2,450	94,033

A The analysis of the investment properties and leasehold land and buildings held in Hong Kong are as follows:

The Group and The Company

	Investment properties		Leasehold land and buildings: Leasehold land for railway depots		Leasehold land and buildings: Office land and buildings	
in HK$ million	**2003**	2002	**2003**	2002	**2003**	2002
At net book value or valuation						
– long leases	**1,283**	1,436	**166**	169	**15**	15
– medium-term leases	**12,886**	8,831	**468**	478	**852**	1,623
	14,169	10,267	**634**	647	**867**	1,638

None of the Group's investment properties carries an unexpired lease term of 20 years or less.

14 Fixed assets (continued)

B The lease of the land on which the civil works, plant and equipment are situated for the operation of the railway was granted to the Company under a running line lease for the period up to 30 June 2047, which has been extended to 29 June 2050. It is assumed that the lease will be renewed and that the operation of the railway will continue after 2050.

Under the terms of the lease, the Company undertakes to keep and maintain all the leased areas, including underground and overhead structures, at its own cost. With respect to parts of the railway situated in structures where access is shared with other users, such as the Lantau Fixed Crossing, the Company's obligation for maintenance is limited to the railway only. All maintenance costs incurred under the terms of the lease have been dealt with as railway operating costs in the profit and loss account.

C All the investment properties of the Group, other than the properties at Two International Finance Centre ("Two IFC") were revalued at 31 December 2003 by DTZ Debenham Tie Leung, Chartered Surveyors, at open market value. The majority of the valuations are based on the income capitalisation method, which capitalises the net income receivable at an appropriate capitalisation rate, taking into account the reversionary income potential. The investment properties at Two IFC were revalued at 31 December 2003 by Jones Lang LaSalle, Chartered Surveyors, at open market value based on, (i) the direct comparison method, which compares the properties to be valued directly with other comparable properties, and (ii) the income capitalisation method. The net revaluation surplus of HK$276 million *(2002: deficit of HK$112 million)* arising from the revaluation has been credited to the investment property revaluation reserve (note 35).

D All self-occupied office land and buildings were revalued at 31 December 2003 by DTZ Debenham Tie Leung and Jones Lang LaSalle, Chartered Surveyors, at open market value on an existing use basis. The valuation resulted in a net revaluation deficit of HK$71 million *(2002: HK$92 million)*. HK$2 million of the deficit arising from the revaluation has been transferred to the fixed asset revaluation reserve to offset against the balance of the prior period revaluation surpluses (note 35), the remaining HK$69 million has been charged to the profit and loss account according to the Company's policy (note 1E(ii)(b)).

The carrying amount of the self-occupied land and buildings at 31 December 2003 would have been HK$958 million *(2002: HK$928 million)* had the office land and buildings been stated at cost less accumulated depreciation.

E Fixed assets include the following assets held under agreements which are treated as finance leases:

The Group and The Company

in HK$ million	Cost **2003**	Aggregate depreciation **2003**	Net book value **2003**	Net book value 2002
Civil works				
– Eastern Harbour Crossing	**1,254**	**249**	**1,005**	1,024

The Company has entered into a Management Agreement (the "Agreement") with New Hong Kong Tunnel Company Limited to operate the Eastern Harbour Crossing until 2008. Included in the assets held under the Agreement are railway and ancillary works relating to the rail tunnel.

At the expiry of the Agreement, title to the assets will, pursuant to the Eastern Harbour Crossing Ordinance, be vested in the Government which has in turn entered into a Memorandum of Understanding dated 17 October 1986 with the Company to the effect that the assets will be vested in the Company on terms to be agreed between the Company and the Government. On 30 June 2000, the Company entered into a further agreement with the Government pursuant to which the relevant assets will be vested by the Government into the Company in 2008 for a nominal consideration and the Company agreed to indemnify the Government for certain amounts which are expected to be nominal. On this basis, the semi-annual payments made by the Company to New Hong Kong Tunnel Company Limited in respect of the Eastern Harbour Crossing are dealt with in these accounts as payments under a finance lease.

14 Fixed assets (continued)

F The Group leases out investment properties and station kiosks under operating leases. The leases typically run for an initial period of one to ten years, with an option to renew the lease after that date at which time all terms will be renegotiated. Lease payments are usually adjusted annually to reflect market rentals. Certain leases carry additional rental based on turnover and lease incentives granted are amortised in the profit and loss account as an integral part of the net lease payment receivable.

The gross carrying amounts of investment properties of the Group and the Company held for use in operating leases were HK$14,169 million *(2002: HK$10,267 million)*. The gross carrying amounts of station kiosks held for use in operating leases were HK$352 million *(2002: HK$314 million)* and the related accumulated depreciation charges were HK$65 million *(2002: HK$52 million)*.

The Group's total future minimum lease payments under non-cancellable operating leases are receivable as follows:

The Group and The Company

in HK$ million	**2003**	2002
Within 1 year	**925**	910
After 1 year but within 5 years	**1,121**	1,261
Later than 5 years	**355**	168
	2,401	2,339

G In March 2003, the Group entered into a series of structured transactions with unrelated third parties to lease out and lease back certain of its passenger cars ("Lease Transaction") involving a total original cost of HK$2,562 million and a total net book value of HK$1,674 million as at 31 March 2003. Under the Lease Transaction, the Group has leased the assets to institutional investors in the United States (the "Investors"), who have prepaid all the rentals in relation to the lease agreement. Simultaneously, the Group has leased the assets back from the Investors with obligation to pay rentals in accordance with a pre-determined payment schedule. The Group has an option to purchase the Investors' leasehold interest in the assets at pre-determined dates for fixed amounts. Part of the rental prepayments received from the Investors has been invested in debt securities which will be sufficient to meet the Group's rental obligations and the amount payable for exercising the purchase option under the Lease Transaction. In addition, the Group retains legal title to the assets and there are no restrictions on the Group's ability to utilise these assets in the operation of the railway business.

As a result of the Lease Transaction, the Group received total cash of approximately HK$3,688 million and committed to long-term lease payments with an estimated net present value of approximately HK$3,533 million, which have been defeased by purchase of debt securities to meet the payment obligations. The Group received cash amount of HK$141 million net of costs from the Lease Transaction.

As the Group is not able to control the investment account in pursuit of its own objectives and is not obligated to pay the lease payments, those liabilities and investments in debt securities are not recognised as obligations and assets of the Group. The net amount of cash received by the Group has been accounted for as deferred income and is being amortised to the Group's profit and loss account over the terms of the respective leases.

15 Railway construction in progress

The Group and The Company

in HK$ million	Balance at 1 Jan 2003	Transferred from deferred expenditure (Note 17)	Expenditure/ (Government grant)	Balance at 31 Dec 2003
Tseung Kwan O Extension Further Capital Works Project				
Construction costs	1	–	–	1
Consultancy fees	23	–	–	23
Staff costs and general expenses	15	–	1	16
Finance costs	4	–	–	4
	43	–	1	44
Penny's Bay Rail Link Project				
Construction costs	139	–	506	645
Consultancy fees	35	–	6	41
Staff costs and general expenses	109	–	85	194
Finance costs	2	–	1	3
	285	–	598	883
Government grant (Notes 40E and 40J)	(219)	–	(664)	(883)
	66	–	(66)	–
Tung Chung Cable Car Project				
Construction costs	–	3	79	82
Consultancy fees	–	4	20	24
Staff costs and general expenses	–	10	19	29
Finance costs	–	–	2	2
	–	17	120	137
Total	109	17	55	181

16 Property development in progress

Under the Airport Railway Agreement related to the construction of the Airport Railway, the Government had granted to the Company land on five station sites along the railway at full market value for property development. In preparing the sites for development, the Company incurs costs related to foundation and site enabling works and expects the costs to be reimbursed by property developers in the form of up-front cash payments when development packages are awarded. In accordance with the development agreements entered into with property developers, the developers are also responsible for the balance of the development costs.

Despite having entered into the development agreements with the developers, the Company being the grantee of the land remains primarily responsible for the fulfilment of all the conditions and obligations in the Land Grant. Such conditions and obligations include the type and quantity of the developments that must be built, public facilities to be provided, and the completion date of the project.

Costs of foundation and site enabling works incurred by the Company are capitalised as property development in progress and payments received from developers are credited to property development in progress to offset costs incurred in respect of the same development. In cases where payments received from developers exceed the related expenditure incurred by the Company, such excess is recorded as deferred income (note 16B). In these cases, any subsequent expenditure incurred by the Company in respect of that development will be charged against deferred income. It is expected that the majority of deferred income will be recognised as profits of the Company at the appropriate time after charging any remaining costs related to foundation and site enabling works, and after taking into account the outstanding risks and obligations retained by the Company relating to each development. Until such time as deferred income is recognised as profit, it is recorded as a liability of the Company in recognition of the Company's obligations under the Land Grant.

The TKE Project Agreement entered into between the then Secretary for Transport, for and on behalf of the Government, and the Company in respect of the construction of the Tseung Kwan O Extension provides the Company with the right to undertake property developments at four station and depot sites along the Tseung Kwan O Line ("Tseung Kwan O Extension Property Projects"). The basis of accounting for development costs incurred by the Company and payments received by the Company related thereto is consistent with that for the property developments along the Airport Railway ("Airport Railway Property Projects").

A Property development in progress

The Group and The Company

in HK$ million	Balance at 1 Jan	Expenditure	Offset against payments received from developers (Note 16B)	Transfer out on project completion	Balance at 31 Dec
2003					
Airport Railway Property Projects	**597**	**122**	**(63)**	**(656)**	**–**
Tseung Kwan O Extension and other property projects	**2,273**	**39**	**(3)**	**–**	**2,309**
	2,870	**161**	**(66)**	**(656)**	**2,309**
2002					
Airport Railway Property Projects	583	76	(62)	–	597
Tseung Kwan O Extension and other property projects	2,778	280	(785)	–	2,273
	3,361	356	(847)	–	2,870

16 Property development in progress (continued)

B Deferred income on property development

The Group and The Company

in HK$ million	Balance at 1 Jan	Payments received from developers	Offset against property development in progress (Note 16A)	Amount recognised as profit (Note 6)	Balance at 31 Dec (Note 32)
2003					
Airport Railway Property Projects	**6,216**	**50**	**(63)**	**(1,286)**	**4,917**
Tseung Kwan O Extension Property Projects	**10**	**–**	**(3)**	**–**	**7**
	6,226	**50**	**(66)**	**(1,286)**	**4,924**
2002					
Airport Railway Property Projects	8,401	425	(62)	(2,548)	6,216
Tseung Kwan O Extension Property Projects	10	785	(785)	–	10
	8,411	1,210	(847)	(2,548)	6,226

C Stakeholding funds

As stakeholder under certain Airport Railway Property Projects, the Company receives and manages deposit monies and sales proceeds in respect of sales of properties under those developments. These monies are placed in separate designated bank accounts and, together with any interest earned, will be released to the developers for the reimbursement of costs of the respective developments in accordance with the terms and conditions of the Government Consent Schemes and development agreements. Accordingly, the balances of the stakeholding funds and the corresponding bank balances have not been included in the Group's and the Company's balance sheets. Movements in stakeholding funds during the year were as follows:

The Group and The Company

in HK$ million	2003	2002
Balance as at 1 January	**3,231**	5,686
Stakeholding funds received and receivable	**13,472**	8,399
Add: Interest earned thereon	**25**	65
	16,728	14,150
Disbursements during the year	**(13,156)**	(10,919)
Balance as at 31 December	**3,572**	3,231
Represented by :		
Balances in designated bank accounts as at 31 December	**3,570**	3,229
Retention receivable	**2**	2
	3,572	3,231

17 Deferred expenditure

The Group and The Company

in HK$ million	Balance at 1 Jan	Transfer to railway construction in progress (Note 15)	Discount/ (Premium) on bond issue	Expenditure/ (Amortisation) during the year	Amount written off to profit and loss account (Note 4C)	Balance at 31 Dec
2003						
Deferred finance charges	**72**	**–**	**10**	**(6)**	**–**	**76**
Expenditure on proposed capital projects						
– Tung Chung Cable Car Project	**17**	**(17)**	**–**	**–**	**–**	**–**
– West Island Link	**16**	**–**	**–**	**5**	**(21)**	**–**
– South Island Line	**–**	**–**	**–**	**25**	**–**	**25**
– Airport Exhibition Centre Project	**–**	**–**	**–**	**3**	**–**	**3**
– Other	**1**	**–**	**–**	**–**	**(1)**	**–**
	106	**(17)**	**10**	**27**	**(22)**	**104**
2002						
Deferred finance charges	133	–	(53)	(8)	–	72
Expenditure on proposed capital projects						
– Penny's Bay Rail Link	68	(68)	–	–	–	–
– North Island Link	77	–	–	8	(85)	–
– Shatin Central Link	42	–	–	–	(42)	–
– Tung Chung Cable Car Project	6	–	–	11	–	17
– West Island Link	–	–	–	16	–	16
– Other	–	–	–	1	–	1
	326	(68)	(53)	28	(127)	106

Deferred expenditures relating to the Tung Chung Cable Car Project were transferred to Railway Construction in Progress upon signing of the Tung Chung Cable Car Project Agreement with the Government in November 2003.

18 Interest in non-controlled subsidiary

The Group and the Company had the following interest in a non-controlled subsidiary at 31 December 2003:

	The Group		The Company	
in HK$ million	**2003**	2002 (Note 43A)	**2003**	2002
Unlisted shares, *at cost*	**–**	–	**24**	24
Share of net assets	**110**	87	**–**	–
	110	87	**24**	24

Name of company	Issued and paid up ordinary share capital	Interest in equity shares held by the Company	Place of incorporation	Principal activities
Octopus Cards Limited	HK$42,000,000	57.4%	Hong Kong	Development and operation of smart card system

In June 1994, the Company entered into an agreement with four local transport companies, Kowloon-Canton Railway Corporation, The Kowloon Motor Bus Company (1933) Limited (subsequently replaced by KMB Public Bus Services Holdings Limited), Citybus Limited and The Hongkong and Yaumati Ferry Co., Limited (subsequently replaced by New World First Bus Services Limited and New World First Ferry Services Limited), to incorporate a company, Creative Star Limited, now Octopus Cards Limited ("OCL"), to undertake the development and operation of the "Octopus" contactless smart card ticketing system, which was initially used by the shareholding transport companies. Although the Company holds a majority interest in the issued shares of OCL, its appointees to the Board of Directors of OCL are limited to 49% of the voting rights at board meetings. The shareholders have agreed to provide the necessary funding to OCL for its operations and for the development of the "Octopus" system.

On 20 April 2000, OCL received approval from The Hong Kong Monetary Authority to become a deposit-taking company ("DTC") for purposes of extending the use of Octopus cards to a wider range of services, including those that are non-transport related. Prior to becoming a DTC, the Octopus card was exempted from the definition of "multi-purpose card" under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) on the basis that its use was restricted to transport related services only. In connection with the application, the Company and the other shareholders of OCL injected HK$28 million and HK$42 million in the form of subordinated loan and share capital respectively into OCL on 18 April 2000 in order to fulfill the capital requirements pursuant to the Banking Ordinance. The contributions were made in proportion to each shareholder's interest in the shares of OCL.

On 17 January 2001, the Company entered into a new Shareholders' Agreement with the other shareholders of OCL. Under this agreement, the Company disposed of a shareholding interest of 10.4% in OCL to certain other shareholders of OCL for a consideration of HK$16 million, together with a deferred consideration to be received in the event of OCL subsequently becoming a stock exchange listed company. In 2002, OCL fully repaid the Company's subordinated loans.

During the year ended 31 December 2003, a total amount of HK$46 million *(2002: HK$45 million)* was paid by the Company to OCL in respect of the central clearing services provided by OCL to the Company. During the same period, load agent fees and fees for handling Octopus card issuance and refund amounting to HK$10 million *(2002: HK$11 million)* and HK$5 million *(2002: Nil)* respectively were received from OCL in respect of services and facilities provided by the Company at various MTR stations.

In addition, services fees amounting to HK$2 million *(2002: HK$2 million)* were received from OCL in respect of rental of computer equipment and services and warehouse storage space payable to the Company under a service agreement.

18 Interest in non-controlled subsidiary (continued)

The condensed profit and loss account and the balance sheet for OCL are shown below:

Profit and loss account

Year ended 31 December *in HK$ million*	**2003** **(Audited)**	2002 (Audited and restated)
Turnover	**177**	170
Other operating income	**62**	58
	239	228
Staff costs	**(54)**	(53)
Load agent fees and bank charges for add value services	**(31)**	(28)
Other expenses	**(62)**	(48)
Operating profit before depreciation	**92**	99
Depreciation	**(80)**	(61)
Operating profit before interest and finance charges	**12**	38
Net interest income	**28**	30
Profit before taxation	**40**	68
Income tax	**(1)**	(4)
Profit for the year	**39**	64
Group's share of profit before taxation	**23**	39

Balance sheet

At 31 December *in HK$ million*	**2003** **(Audited)**	2002 (Audited and restated)
Assets		
Fixed assets	**243**	306
Investments	**704**	590
Cash at banks and in hand	**327**	236
Other assets	**91**	67
	1,365	1,199
Liabilities		
Card floats and card deposits due to cardholders	**(1,075)**	(996)
Amounts due to shareholders	**(22)**	(18)
Other liabilities	**(76)**	(33)
	(1,173)	(1,047)
Net assets	**192**	152
Shareholders' funds		
Share capital	**42**	42
Retained profits	**150**	110
	192	152
Group's share of net assets	**110**	87

19 Investments in subsidiaries

The Company

in HK$ million	**2003**	2002
Unlisted shares, *at cost*	**181**	166
Less: Impairment losses	**3**	3
	178	163

The following list contains details of subsidiaries as at 31 December 2003, other than the non-controlled subsidiary the relevant details of which are disclosed in note 18. All of these are controlled subsidiaries as defined under note 1C and have been consolidated into the Group's financial statements.

Name of company	Issued and paid up ordinary/registered share capital	Proportion of ownership interest: Group's effective interest	Held by the Company	Held by subsidiary	Place of incorporation and operation	Principal activities
Fasttrack Insurance Ltd.	HK$77,500,000	100%	100%	–	Bermuda	Insurance underwriting
MTR Corporation (C.I.) Limited	US$1,000	100%	100%	–	Cayman Islands	Finance
MTR Finance Lease (001) Limited	US$1	100%	100%	–	Cayman Islands	Finance
MTR Engineering Services Limited	HK$1,000	100%	100%	–	Hong Kong	Engineering services
MTR Property Agency Co. Limited	HK$2	100%	100%	–	Hong Kong	Property agency
MTR Travel Limited	HK$2,500,000	100%	100%	–	Hong Kong	Travel services
MTR Consulting (Shenzhen) Co. Ltd.	HK$1,000,000	100%	100%	–	The People's Republic of China (Incorporated)	Railway consultancy services
MTR Corporation (Singapore) Pte. Ltd.	S$50,000	100%	100%	–	Singapore	Railway consultancy services
MTR (Shanghai Consultancy) Company Limited	HK$1,000	100%	100%	–	Hong Kong	Railway consultancy services
MTR (Shanghai Project Management) Limited	HK$1,000	100%	100%	–	Hong Kong	Railway consultancy services
Shanghai Hong Kong Metro Construction Management Co. Ltd.	HK$15,000,000	60%	–	60%	The People's Republic of China (Incorporated)	Railway construction management
MTR China Property Limited	HK$1,000	100%	100%	–	Hong Kong	Property management
Shenzhen Donghai Anbo Property Management Co. Ltd.	RMB3,000,000	51%	–	51%	The People's Republic of China (Incorporated)	Property management
Beijing Premier Property Management Co. Ltd.	US$150,000	60%	–	60%	The People's Republic of China (Incorporated)	Property management
MTR Telecommunication Company Limited	HK$100,000,000	100%	100%	–	Hong Kong	Radio communication services
TraxComm Limited	HK$15,000,000	100%	100%	–	Hong Kong	Fixed telecommunication network services
Hong Kong Cable Car Limited	HK$1,000	100%	100%	–	Hong Kong	Dormant
Lantau Cable Car Limited	HK$1,000	100%	100%	–	Hong Kong	Dormant
MTR (Estates Management) Limited	HK$1,000	100%	100%	–	Hong Kong	Dormant
MTR (Shanghai Metro Management) Limited	HK$1,000	100%	100%	–	Hong Kong	Dormant

No dividend has been paid or is payable to the Company by the above subsidiaries for the year ended to 31 December 2003 *(2002: Nil)*.

20 Staff housing loans

The Group and The Company

in HK$ million	Balance at 1 Jan	Redemption	Repayment	Reduction in provision	Balance at 31 Dec
2003					
Housing loans receivable	**84**	**(9)**	**(8)**	**–**	**67**
Less: General provision	**–**	**–**	**–**	**–**	**–**
	84	**(9)**	**(8)**	**–**	**67**
2002					
Housing loans receivable	128	(34)	(10)	–	84
Less: General provision	1	–	–	(1)	–
	127	(34)	(10)	1	84

The Group and The Company

in HK$ million	**2003**	2002
Amount receivable:		
– within 1 year	**7**	9
– after 1 year	**60**	75
	67	84

The MTR Staff Housing Loan Scheme, a Company financed scheme, was introduced in 1997 to replace, on a phased basis, the previous arrangements whereby interest subsidies were paid by the Company to eligible employees. All housing loans granted to employees carry interest either at the prevailing Best Lending Rate less 1.75% per annum or at the Company's Average Cost of Borrowings plus 0.75% per annum, and are secured by mortgage over the relevant properties.

21 Properties held for sale

The Group and The Company

in HK$ million	**2003**	2002
Properties held for sale		
– at cost	**405**	271
– at net realisable value	**407**	523
	812	794

The properties held for sale at 31 December 2002 and 2003 comprised residential units, retail and car parking spaces at the Olympic Station and Kowloon Station developments. They are properties received by the Company, either as property sharing in kind or as part of the profit distribution upon completion of the development (note 6). The properties are stated in the balance sheet at the lower of cost, which is deemed to be their net realisable value upon recognition (note 1I(vii)), or their net realisable value at the balance sheet date. Net realisable value represents the estimated selling price less costs to be incurred in selling the properties. The net realisable values as at 31 December 2002 and 2003 are determined by reference to an open market valuation of the properties as at those dates, undertaken by DTZ Debenham Tie Leung, Chartered Surveyors.

Properties held for sale at net realisable value are stated net of general provision, made in order to state these properties at the lower of their cost and estimated net realisable value. The amount of write-down of properties to estimated net realisable value recognised in the consolidated profit and loss account is HK$16 million *(2002: HK$44 million)*.

22 Stores and spares

The Group and The Company

in HK$ million	**2003**	2002
Stores and spares expected to be consumed:		
– within 1 year	**126**	138
– after 1 year	**136**	127
	262	265
Less: Specific provision for obsolete stock	**13**	6
	249	259

Stores and spares expected to be consumed after 1 year comprise mainly contingency spares and stocks kept to meet cyclical maintenance requirements.

23 Debtors, deposits and payments in advance

	The Group		The Company	
in HK$ million	**2003**	2002	**2003**	2002
Debtors (net of specific allowances for bad and doubtful debts), deposits and payments in advance relate to:				
– Tseung Kwan O Extension Project	**–**	1	**–**	1
– Railway operations and other projects	**1,153**	726	**1,160**	717
	1,153	727	**1,160**	718

The Group's credit policy in respect of receivables arising from its principal activities are 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 and currency swap agreements with financial institutions are due in accordance with the respective terms of the agreements.

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

Fare revenue is collected either in cash for single and two-ride tickets or through Octopus Cards with daily settlement.

The ageing analysis of debtors included above is as follows:

	The Group		The Company	
in HK$ million	**2003**	2002	**2003**	2002
Amount not yet due	**775**	548	**772**	546
Overdue by 30 days	**67**	82	**65**	80
Overdue by 60 days	**16**	10	**16**	10
Overdue by 90 days	**9**	4	**8**	4
Overdue by more than 90 days	**10**	13	**9**	12
Total debtors	**877**	657	**870**	652
Deposits and payments in advance	**276**	70	**290**	66
	1,153	727	**1,160**	718

23 Debtors, deposits and payments in advance (continued)

As at 31 December 2003, all debtors, deposits and payments in advance were expected to be recovered within one year except for HK$238 million *(2002: HK$25 million)* included in the amounts relating to railway operations and other projects, which were expected to be recovered after one year.

Included in amount not yet due are HK$328 million *(2002: HK$70 million)* receivable from property purchasers, which are due for payment in accordance with the terms of individual agreements on sales and purchases.

24 Amounts due from the Government and other related parties

	The Group		The Company	
in HK$ million	**2003**	2002	**2003**	2002
Amounts due from:				
– the Government	**68**	57	**68**	57
– the Housing Authority	**11**	30	**11**	30
– the Kowloon-Canton Railway Corporation ("KCRC")	**3**	8	**3**	8
– non-controlled subsidiary	**2**	–	**2**	–
– other subsidiaries of the Company (net of provision for losses)	**–**	–	**91**	198
	84	95	**175**	293

The amount due from the Government relates to outstanding receivable and retention, as well as provision for contract claims recoverable from the Government, in connection with infrastructure works entrusted to the Company.

The amount due from the Housing Authority relates to site formation works entrusted to the Company by the Housing Authority in respect of the Tseung Kwan O Extension Project. The entrustment enabled early possession of a site by the Group to facilitate railway construction.

The amount due from KCRC relates to works entrusted to the Company in connection with the provision of interchange stations between the MTR and KCRC systems.

As at 31 December 2003, the contract retentions on the above entrusted works due for release after one year were HK$6 million *(2002: HK$7 million)*. All other amounts due from the Government and other related parties were expected to be received within 12 months.

25 Cash and cash equivalents

	The Group		The Company	
in HK$ million	**2003**	2002	**2003**	2002
Deposits with banks and other financial institutions	**135**	1,651	**135**	1,524
Cash at banks and in hand	**241**	67	**40**	39
Cash and cash equivalents in the balance sheet	**376**	1,718	**175**	1,563
Bank overdrafts (Note 26B)	**(12)**	(34)	**(12)**	(34)
Cash and cash equivalents in the cash flow statement	**364**	1,684	**163**	1,529

During the year, the Group recognised property development profit out of deferred income and received properties as sharing in kind totalling HK$5,320 million *(2002: HK$3,751 million)*, which were transactions not involving movements of cash or cash equivalents.

26 Loans and obligations under finance leases

A By type

The Group

in HK$ million	Balance at year end closing rate **2003**	Exchange (gain)/loss on related forward exchange contracts **2003**	Balance **2003**	Balance 2002
Capital market instruments				
Listed or publicly traded:				
US dollar Yankee notes due 2005	**2,329**	**(5)**	**2,324**	2,324
US dollar Global notes due 2009	**5,823**	**11**	**5,834**	5,835
US dollar Global notes due 2010	**4,658**	**19**	**4,677**	4,679
Debt issuance programme notes due 2005	**194**	**–**	**194**	195
	13,004	**25**	**13,029**	13,033
Unlisted:				
Debt issuance programme notes due 2003 to 2018	**6,726**	**4**	**6,730**	7,534
HK dollar note issuance programme notes due 2003	–	**–**	**–**	500
HK dollar notes due 2004 to 2008	**2,350**	**–**	**2,350**	2,350
HK dollar retail bonds due 2004 to 2006	**3,500**	**–**	**3,500**	3,500
	12,576	**4**	**12,580**	13,884
Total capital market instruments	**25,580**	**29**	**25,609**	26,917
Bank loans and overdrafts	**5,928**	**(17)**	**5,911**	5,983
	31,508	**12**	**31,520**	32,900
Obligations under finance leases (Note 26C)	**505**	**–**	**505**	608
Total	**32,013**	**12**	**32,025**	33,508

The Company

in HK$ million	Balance at year end closing rate **2003**	Exchange (gain)/loss on related forward exchange contracts **2003**	Balance **2003**	Balance 2002
Capital market instruments				
Listed or publicly traded:				
US dollar Yankee notes due 2005	**2,329**	**(5)**	**2,324**	2,324
US dollar Global notes due 2009	**5,823**	**11**	**5,834**	5,835
US dollar Global notes due 2010	**4,658**	**19**	**4,677**	4,679
Debt issuance programme notes due 2005	**194**	**–**	**194**	195
	13,004	**25**	**13,029**	13,033
Unlisted:				
Debt issuance programme notes due 2003 to 2018	**1,631**	**–**	**1,631**	4,884
HK dollar note issuance programme notes due 2003	–	**–**	**–**	500
	1,631	**–**	**1,631**	5,384
Total capital market instruments	**14,635**	**25**	**14,660**	18,417
Bank loans and overdrafts	**5,928**	**(17)**	**5,911**	5,983
	20,563	**8**	**20,571**	24,400
Obligations under finance leases (Note 26C)	**505**	**–**	**505**	608
Total	**21,068**	**8**	**21,076**	25,008

26 Loans and obligations under finance leases (continued)

As at 31 December 2003, the Group had available undrawn committed bank loan facilities amounting to HK$6,700 million *(2002: HK$6,000 million)*. In addition, the Group had a number of uncommitted facilities with undrawn amounts totalling HK$12,728 million *(2002: HK$11,943 million)*, comprising a multi-currency debt issuance programme and short-term bank loan facilities.

B By repayment terms

The Group

in HK$ million	Capital market instruments **2003**	Bank loans and overdrafts **2003**	Obligations under finance leases **2003**	Total **2003**	Total 2002
Long-term loans and obligations under finance leases					
Amounts repayable beyond 5 years	**14,076**	**182**	**–**	**14,258**	11,737
Amounts repayable within a period of between 2 and 5 years	**2,950**	**5,218**	**272**	**8,440**	8,380
Amounts repayable within a period of between 1 and 2 years	**4,318**	**73**	**121**	**4,512**	8,600
Amounts repayable within 1 year	**4,265**	**73**	**112**	**4,450**	4,757
	25,609	**5,546**	**505**	**31,660**	33,474
Bank overdrafts	**–**	**12**	**–**	**12**	34
Short-term loans	**–**	**353**	**–**	**353**	–
	25,609	**5,911**	**505**	**32,025**	33,508

The Company

in HK$ million	Capital market instruments **2003**	Bank loans and overdrafts **2003**	Obligations under finance leases **2003**	Total **2003**	Total 2002
Long-term loans and obligations under finance leases					
Amounts repayable beyond 5 years	**10,977**	**182**	**–**	**11,159**	11,237
Amounts repayable within a period of between 2 and 5 years	**–**	**5,218**	**272**	**5,490**	4,330
Amounts repayable within a period of between 1 and 2 years	**2,718**	**73**	**121**	**2,912**	5,150
Amounts repayable within 1 year	**965**	**73**	**112**	**1,150**	4,257
	14,660	**5,546**	**505**	**20,711**	24,974
Bank overdrafts	**–**	**12**	**–**	**12**	34
Short-term loans	**–**	**353**	**–**	**353**	–
	14,660	**5,911**	**505**	**21,076**	25,008

The amounts repayable within 1 year in respect of long-term loans and obligations under finance leases are included in long-term loans as these amounts are intended to be refinanced on a long-term basis.

26 Loans and obligations under finance leases (continued)

C Obligations under finance leases

As at 31 December 2003, the Group and the Company had obligations under finance leases repayable as follows:

The Group and The Company

in HK$ million	Present value of the minimum lease payments **2003**	Interest expense relating to future periods **2003**	Total minimum lease payments **2003**	Present value of the minimum lease payments 2002	Interest expense relating to future periods 2002	Total minimum lease payments 2002
Amounts repayable within a period of between 2 and 5 years	**272**	**28**	**300**	393	57	450
Amounts repayable within a period of between 1 and 2 years	**121**	**29**	**150**	112	38	150
Amounts repayable within 1 year	**112**	**38**	**150**	103	47	150
	505	**95**	**600**	608	142	750

Obligations under finance lease are the Group's and the Company's commitments to make future payments to New Hong Kong Tunnel Company Limited under the management agreement for the Eastern Harbour Crossing which is treated as a finance lease (note 14E).

D Bonds and notes issued and redeemed

Bonds and notes issued during the year ended 31 December 2002 and 2003 comprise:

The Group

	2003		2002	
in HK$ million	Principal amount	Net consideration received	Principal amount	Net consideration received
Debt issuance programme notes	**3,099**	**3,091**	–	–
HK dollar retail bonds	**–**	**–**	3,500	3,553
	3,099	**3,091**	3,500	3,553

All the above bonds and notes were issued by a subsidiary, MTR Corporation (C.I.) Limited. The bonds and notes issued are unconditionally and irrevocably guaranteed by the Company; and 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 received from the issues were on lent to the Company for general working capital, refinancing or other corporate purposes.

During the year, the Group redeemed HK$500 million *(2002: Nil)* unlisted Hong Kong dollar notes upon maturity.

E Guarantees

There were no guarantees given by the Government in respect of loan facilities as at 31 December 2003 and 2002.

26 Loans and obligations under finance leases (continued)

F Interest rates

The total borrowings, excluding obligations under finance leases, of HK$31,520 million *(2002: HK$32,900 million)* comprise:

The Group

	2003		2002	
	Loan amount HK$ million	Interest rate % p.a.	Loan amount HK$ million	Interest rate % p.a.
Fixed rate loans and loans swapped to fixed rates	**19,358**	**2.2 – 8.4**	20,325	4.3 – 8.4
Variable rate loans and loans swapped from fixed rate	**12,162**	**(Note)**	12,575	(Note)
	31,520		32,900	

The Company

	2003		2002	
	Loan amount HK$ million	Interest rate % p.a.	Loan amount HK$ million	Interest rate % p.a.
Fixed rate loans and loans swapped to fixed rates	**8,659**	**2.2 – 8.4**	12,075	4.3 – 8.4
Variable rate loans and loans swapped from fixed rate	**11,912**	**(Note)**	12,325	(Note)
	20,571		24,400	

Note: Interest rates are determined by reference to either the Hong Kong prime rate, the Hong Kong Interbank Offered Rate or the London Interbank Offered Rate.

27 Off-balance sheet financial instruments

The Group has employed off-balance sheet derivative instruments such as interest rate swaps and currency swaps to manage its interest rate and foreign exchange exposure. These instruments are used solely to reduce or eliminate the financial risk associated with the Group's liabilities and not for trading or speculation purposes.

The contracted notional amounts of derivative instruments outstanding by maturity and type at 31 December 2003 are as follows:

The Group and The Company

	2003				2002
	Maturing in				
Notional amount *in HK$ million*	Less than 2 years	2-5 years	Over 5 years	Total	Total
Foreign exchange forwards	**844**	**77**	**–**	**921**	495
Cross currency and interest rate swaps	**4,542**	**60**	**8,777**	**13,379**	13,514
Interest rate swaps and options	**11,950**	**5,600**	**3,021**	**20,571**	22,910
	17,336	**5,737**	**11,798**	**34,871**	36,919

There are four main categories of risk related to using derivative instruments, namely market risk, credit risk, operational risk and legal risk. Since the Group employs derivative instruments purely for hedging purposes, it is not exposed to market risk because any change in market values will be offset by an opposite change in the market values of the underlying liabilities being hedged.

The Group manages credit risk by assigning limits to counter-parties and by dealing only with financial institutions with acceptable credit ratings. The Group further monitors its credit exposure by estimating the fair market values plus any potential adverse movement in the values of the derivative instruments employed. The Group has not experienced non-performance by any counter-party.

The Group has internal control measures to safeguard compliance with policies and procedures to minimise operational risk. Standardised or master agreements are used whenever practicable to reduce legal risk and credit exposure.

28 Creditors, accrued charges and provisions

	The Group		The Company	
in HK$ million	**2003**	2002	**2003**	2002
Creditors, accrued charges and provisions				
– Airport Railway Project	**242**	282	**242**	282
– Tseung Kwan O Extension Project	**256**	814	**256**	814
– Property Projects	**359**	281	**359**	281
– Railway operations and other projects	**2,495**	2,379	**2,408**	2,301
Gross amount due to customers for contract work	**68**	4	**7**	4
	3,420	3,760	**3,272**	3,682

The above amounts are mainly related to capital projects which are settled upon certification of work in progress and swap interest payable. The Group has no significant balances of trade creditors resulting from its provision of transportation services.

The aggregate amount of costs incurred plus recognised profits less recognised losses to date, included in the gross amount due to customers for contract work at 31 December 2003, is HK$121 million *(2002: Nil)*.

The gross amount due to customers for contract work at 31 December 2003 that is expected to be settled after more than one year is HK$56 million *(2002: Nil)*.

The analysis of creditors included above by due dates is as follows:

	The Group		The Company	
in HK$ million	**2003**	2002	**2003**	2002
Due within 30 days or on demand	**541**	547	**516**	531
Due after 30 days but within 60 days	**590**	667	**559**	654
Due after 60 days but within 90 days	**75**	50	**74**	47
Due after 90 days	**1,767**	2,043	**1,681**	2,006
	2,973	3,307	**2,830**	3,238
Rental and other refundable deposits	**297**	295	**292**	286
Accrued employee benefits	**150**	158	**150**	158
Total	**3,420**	3,760	**3,272**	3,682

Creditors, accrued charges and provisions in respect of the Airport Railway and Tseung Kwan O Extension projects include provisions for claims on completed contracts, which were capitalised as part of the railway assets upon commissioning of the Tung Chung and Airport Express Lines in 1998 and the Tseung Kwan O Line in August 2002. Most of these claims have been resolved and it is anticipated that, subject to unforeseen circumstances, the remaining amount required to be paid will be sufficiently covered by the above mentioned provisions of the respective projects. The carrying amounts of such claim provisions and their movements are not separately disclosed in view of their commercial sensitivity.

As at 31 December 2003, all creditors, accrued charges and provisions were expected to be settled within one year except for HK$729 million *(2002: HK$382 million)* included in the amounts relating to railway operations and other projects, which were expected to be settled after one year. The amounts due after one year are mainly rental deposits received from shop and station kiosk tenants and advance income received from telecommunication services operators.

29 Contract retentions

The Group and The Company

in HK$ million	Due for release after 12 months	Due for release within 12 months	Total
2003			
Tseung Kwan O Extension Project	**–**	**99**	**99**
Property Projects	**–**	**9**	**9**
Railway operations and other projects	**89**	**114**	**203**
	89	**222**	**311**
2002			
Tseung Kwan O Extension Project	–	237	237
Property Projects	–	31	31
Railway operations and other projects	62	166	228
	62	434	496

30 Amounts due to the Government and other related parties

The following are amounts due to the Government and Airport Authority in respect of works entrusted to them by the Group and the amounts due to the subsidiaries:

	The Group		The Company	
in HK$ million	**2003**	2002	**2003**	2002
Amounts due to:				
– the Government	**113**	129	**113**	129
– the Airport Authority	**48**	76	**48**	76
– non-controlled subsidiary	**–**	4	**–**	4
– the Company's subsidiaries	**–**	–	**11,074**	8,590
	161	209	**11,235**	8,799

As at 31 December 2003, HK$100 million *(2002: HK$209 million)* due to the Government and Airport Authority and HK$125 million *(2002: HK$90 million)* due to the subsidiaries are expected to be settled within one year.

31 Deferred liabilities

The Group and The Company

in HK$ million	**2003**	2002
Estate management funds		
– Refundable deposits on managed properties	**33**	31
– Building maintenance and asset replacement reserve funds	**53**	54
	86	85

32 Deferred income

The Group and The Company

in HK$ million	**2003**	2002
Deferred income on property development (note 16B)	**4,924**	6,226
Deferred income on lease out and lease back transaction (note 14G)	**141**	–
Less: Amount recognised as income	**4**	–
	137	–
	5,061	6,226

33 Income tax in the balance sheet

A Taxes payable in the consolidated balance sheet comprised overseas tax liabilities in respect of consultancy services income earned offshore, chargeable at the appropriate current tax rates of taxation ruling in the relevant countries.

B Deferred tax assets and liabilities recognised

The components of deferred tax assets and liabilities recognised in the balance sheet and the movements during the year are as follows:

The Group and The Company

	Deferred tax arising from				
in HK$ million	Depreciation allowances in excess of related depreciation	Revaluation of properties	Provision and other temporary differences	Tax losses	Total
2003					
At 1 January 2003					
– as previously reported	**–**	**–**	**–**	**–**	**–**
– prior period adjustments	**7,684**	**–**	**(83)**	**(4,349)**	**3,252**
– as restated	**7,684**	**–**	**(83)**	**(4,349)**	**3,252**
Charged/(credited) to consolidated profit and loss account	**1,069**	**–**	**(28)**	**(297)**	**744**
Charged to reserves (Note 35)	**–**	**4**	**–**	**–**	**4**
At 31 December 2003	**8,753**	**4**	**(111)**	**(4,646)**	**4,000**
2002					
At 1 January 2002					
– as previously reported	–	–	–	–	–
– prior period adjustments	7,151	–	(79)	(4,450)	2,622
– as restated	7,151	–	(79)	(4,450)	2,622
Charged/(credited) to consolidated profit and loss account	533	–	(4)	101	630
At 31 December 2002	7,684	–	(83)	(4,349)	3,252

The Group and The Company

in HK$ million	**2003**	2002
Net deferred tax liability recognised in the balance sheet	**4,000**	3,252

34 Share capital, share premium and capital reserve

in HK$ million	**2003**	2002
Authorised:		
6,500,000,000 shares of HK$1.00 each	**6,500**	6,500
Issued and fully paid:		
5,288,695,393 shares *(2002: 5,158,748,655 shares)* of HK$1.00 each	**5,289**	5,159
Share premium	**2,609**	1,563
Capital reserve	**27,188**	27,188
	35,086	33,910

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 year comprise:

			Proceeds credited to		
	Number of shares	Option/ scrip price *HK$*	Share capital account *HK$ million*	Share premium account *HK$ million*	Total *HK$ million*
Employee share options exercised	10,489,500	8.44	10	78	88
Issued as 2002 final scrip dividends	82,018,666	8.80	82	640	722
Issued as 2003 interim scrip dividends	37,438,572	9.79	38	328	366
	129,946,738		130	1,046	1,176

Outstanding share options under the Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme as at 31 December 2003 are disclosed in note 42.

35 Other reserves

The Group

in HK$ million	Investment property revaluation reserve	Fixed asset revaluation reserve	Retained profits	Total
2003				
Balance as at 1 January 2003 as previously reported	**6,406**	**24**	**16,487**	**22,917**
Prior period adjustment in respect of deferred tax (Note 43A)	**–**	**–**	**(3,253)**	**(3,253)**
Balance as at 1 January 2003 as restated	**6,406**	**24**	**13,234**	**19,664**
Dividends paid	**–**	**–**	**(2,178)**	**(2,178)**
Surplus/(Deficits) on revaluation, net of deferred tax (Notes 14 and 33)	**276**	**(6)**	**–**	**270**
Profit for the year	**–**	**–**	**4,450**	**4,450**
Balance as at 31 December 2003	**6,682**	**18**	**15,506**	**22,206**
2002				
Balance as at 1 January 2002 as previously reported	6,518	116	14,407	21,041
Prior period adjustment in respect of deferred tax (Note 43A)	–	–	(2,620)	(2,620)
Balance as at 1 January 2002 as restated	6,518	116	11,787	18,421
Dividends paid	–	–	(2,132)	(2,132)
Deficits on revaluation	(112)	(92)	–	(204)
Profit for the year (as restated)	–	–	3,579	3,579
Balance as at 31 December 2002	6,406	24	13,234	19,664

The Company

in HK$ million	Investment property revaluation reserve	Fixed asset revaluation reserve	Retained profits	Total
2003				
Balance as at 1 January 2003 as previously reported	**6,406**	**24**	**16,356**	**22,786**
Prior period adjustment in respect of deferred tax (Note 43A)	**–**	**–**	**(3,252)**	**(3,252)**
Balance as at 1 January 2003 as restated	**6,406**	**24**	**13,104**	**19,534**
Dividends paid	**–**	**–**	**(2,178)**	**(2,178)**
Surplus/(Deficits) on revaluation, net of deferred tax (Notes 14 and 33)	**276**	**(6)**	**–**	**270**
Profit for the year	**–**	**–**	**4,379**	**4,379**
Balance as at 31 December 2003	**6,682**	**18**	**15,305**	**22,005**
2002				
Balance as at 1 January 2002 as previously reported	6,518	116	14,346	20,980
Prior period adjustment in respect of deferred tax (Note 43A)	–	–	(2,622)	(2,622)
Balance as at 1 January 2002 as restated	6,518	116	11,724	18,358
Dividends paid	–	–	(2,132)	(2,132)
Deficits on revaluation	(112)	(92)	–	(204)
Profit for the year (as restated)	–	–	3,512	3,512
Balance as at 31 December 2002	6,406	24	13,104	19,534

35 Other reserves (continued)

The investment property and fixed asset revaluation reserves were set up to deal with the surpluses or deficits arising from the revaluation of investment properties and self-occupied office land and buildings respectively (note 1E).

The investment property and fixed asset revaluation reserves are not available for distribution to shareholders because they do not constitute realised profits. As at 31 December 2003, the total amount of reserves available for distribution to shareholders under the Hong Kong Companies Ordinance amounted to HK$15,305 million *(2002: HK$13,104 million, as restated)*.

Included in the Group's retained profits as at 31 December 2003 is an amount of HK$86 million *(2002: HK$64 million)*, being the retained profits attributable to the non-controlled subsidiary.

36 Retirement Schemes

The Company operates two occupational retirement schemes, the MTR Corporation Limited Retirement Scheme (the "Retirement Scheme") and a top-up scheme, the MTR Corporation Limited Retention Bonus Scheme (the "RBS"). In addition, in accordance with the Mandatory Provident Fund ("MPF") Schemes Ordinance, the Company has set up an MPF Scheme on 1 December 2000 by participating in a master trust scheme provided by an independent MPF service provider. Employees eligible to join the Retirement Scheme can choose between the Retirement Scheme and the MPF Scheme while temporary employees are required to join the MPF Scheme.

The assets of these schemes are held under the terms of separate trust arrangements. These trusts ensure that the assets are kept separate from those of the Company.

A Retirement Scheme

The Retirement Scheme was established under trust at the beginning of 1977. The Retirement Scheme contains both defined benefit and defined contribution elements. The Retirement Scheme was registered under the Occupational Retirement Schemes Ordinance (Chapter 426 of the Laws of Hong Kong) ("ORSO") with effect from 31 October 1994. On 3 July 2000, exemption was granted by the MPF Authority to maintain the Retirement Scheme and offer it as an alternative to the MPF Scheme.

The Retirement Scheme provides both a hybrid benefit section and a defined contribution benefit section, offering benefits on retirement, permanent disability, death and leaving service to its members. The hybrid benefit section provides benefits based on the greater of a multiple of final salary and accumulated contributions with investment returns. The defined contribution benefit section, which was implemented on 1 April 1999, is a member choice plan which provides retirement benefits based on accumulated contributions and investment returns only. Promotees who are promoted after 1 April 1999 can choose to join either the defined contribution benefit section or to remain in the hybrid benefit section. As the hybrid benefit section was closed to new entrants on 31 March 1999, staff joining the Company on or after 1 April 1999 who would be eligible to join the Retirement Scheme can choose to join either the defined contribution benefit section or, commencing 1 December 2000, the MPF Scheme.

(a) The hybrid benefit section

Members' contributions to the hybrid benefit section are based on a fixed percentage of basic salary. The Company's contributions are determined by the Executive Directorate with reference to an actuarial valuation. At 31 December 2003, the total membership was 6,093 *(2002: 6,397)*. In 2003, members contributed HK$70 million *(2002: HK$75 million)* and the Company contributed HK$238 million *(2002: HK$256 million)* to the hybrid benefit section. The net asset value of the hybrid benefit section as at 31 December 2003 was HK$4,639 million *(2002: HK$3,769 million)*.

(b) The defined contribution benefit section

Both members' and the Company's contributions to the defined contribution benefit section are based on fixed percentages of members' basic salary. As at 31 December 2003, the total membership under this section was 405 *(2002: 363)*. In 2003, total members' contributions were HK$5.3 million *(2002: HK$5.2 million)* and the total contribution from the Company was HK$11.1 million *(2002: HK$10.6 million)*. The net asset value as at 31 December 2003 was HK$49.5 million *(2002: HK$28.6 million)*.

According to the terms of the trust deed, forfeitures were transferred to the reserve account to be utilised at the discretion of the Company.

36 Retirement Schemes (continued)

(c) Actuarial valuations

Actuarial valuations are carried out annually in accordance with the ORSO. A full actuarial valuation of the Retirement Scheme, comprising both the hybrid and the defined contribution benefit sections, was carried out at 31 December 2003 by Towers, Perrin, Forster & Crosby, Inc., an independent firm of consulting actuaries, using the Attained Age Method. The principal actuarial assumptions used included a long-term rate of investment return net of salary increases of 2.0% *(2002: 2.25%)* per annum, together with appropriate allowances for expected rates of mortality, turnover, redundancy and retirement and an adjustment for salary increases expected over the short term. The actuary confirmed that, at the valuation date:

(i) the Scheme was solvent, with assets more than adequate to cover the aggregate value of members' vested benefits had all members left the Scheme; and

(ii) the value of the Scheme's assets was more than sufficient to cover the aggregate past service liability on the assumption that the Scheme continued in force.

B RBS

The RBS was established under trust as of 1 January 1995. The RBS is a defined benefit scheme and applies to all employees classified by the Company as staff working on designated projects and who are not on gratuity terms. The RBS provides for benefits to be payable only in the event of redundancy for accrued service up to 31 December 2002. The RBS was registered under the Occupational Retirement Schemes Ordinance with effect from 1 December 1995. As at 31 December 2003, there were 424 members *(2002: 520)* under the RBS.

The RBS is non-contributory for members. The Company's contributions are determined by the Executive Directorate with reference to an actuarial valuation and are charged as part of the staff costs to various projects on the basis of the amount contributed. During 2003, the Company's contributions amounted to HK$2 million *(2002: HK$2 million)*. The net asset value of the RBS as at 31 December 2003 was HK$14 million *(2002: HK$23 million)*.

Actuarial valuations are carried out annually. A full actuarial valuation of the RBS was carried out at 31 December 2003 by Towers, Perrin, Forster & Crosby, Inc. using the Attained Age Method. The principal actuarial assumptions used included an expected weighted rate of investment return net of salary increases, of approximately 0% *(2002: 1.25%)* per annum, together with appropriate allowance for expected rates of redundancy. The actuary confirmed that, at the valuation date:

(i) due to the nature of the RBS which provides for benefits only on redundancy, there was no aggregate vested liability, and thus the RBS was technically solvent; and

(ii) the value of the RBS assets, together with the future contributions recommended by the actuary and to be adopted by the Company, would be sufficient to meet the liabilities of the RBS on an on-going basis.

C MPF Scheme

Effective from the MPF commencement date of 1 December 2000, the Company joined The Bank Consortium MPF Plan which has been registered with the Mandatory Provident Fund Schemes Authority and authorised by the Securities and Futures Commission.
As at 31 December 2003, the total number of employees of the Company participating in the MPF Scheme was 504 *(2002: 502)*. In 2003, total members' contributions were HK$1.7 million *(2002: HK$2.0 million)* and total contribution from the Company was HK$2.0 million *(2002: HK$2.3 million)*.

37 Defined benefit retirement plan obligations

The Group makes contributions to two defined benefit plans that provide benefits for employees upon retirement or termination of services for other reasons (note 36). The movements in respect of these defined benefit plans during the year are summarised as follows:

A The amounts recognised in the balance sheets:

The Group and The Company

in HK$ million	Retirement Scheme **2003**	RBS **2003**	Total **2003**	Retirement Scheme 2002	RBS 2002	Total 2002
Present value of funded obligations	**4,277**	**14**	**4,291**	3,775	31	3,806
Fair value of plan assets	**(4,638)**	**(14)**	**(4,652)**	(3,768)	(23)	(3,791)
Net unrecognised actuarial gains/(losses)	**322**	**2**	**324**	(6)	(6)	(12)
Net (asset)/liability	**(39)**	**2**	**(37)**	1	2	3

The plans had no investment in shares or debt securities issued by the Company.

B Movements in the net (asset)/liability recognised in the balance sheets:

The Group and The Company

in HK$ million	Retirement Scheme **2003**	RBS **2003**	Total **2003**	Retirement Scheme 2002	RBS 2002	Total 2002
At 1 January	**1**	**2**	**3**	44	1	45
Contributions paid to the Schemes	**(238)**	**(2)**	**(240)**	(256)	(2)	(258)
Expense recognised (Note 37C)	**198**	**2**	**200**	213	3	216
At 31 December	**(39)**	**2**	**(37)**	1	2	3

C Expense recognised in the consolidated profit and loss account:

in HK$ million	Retirement Scheme **2003**	RBS **2003**	Total **2003**	Retirement Scheme 2002	RBS 2002	Total 2002
Current service cost	**235**	**–**	**235**	220	3	223
Interest cost	**195**	**1**	**196**	220	1	221
Expected return on plan assets	**(232)**	**(1)**	**(233)**	(227)	(1)	(228)
Net actuarial loss recognised	**–**	**2**	**2**	–	–	–
Expense recognised (Note 37B)	**198**	**2**	**200**	213	3	216
Less: Amount capitalised	**42**	**2**	**44**	64	3	67
	156	**–**	**156**	149	–	149

The retirement expense is recognised under staff costs and related expenses in the consolidated profit and loss account.

37 Defined benefit retirement plan obligations (continued)

D Actual gain/(loss) on plan assets

in HK$ million	**2003**	2002
MTRCL Retirement Scheme	**791**	(60)
MTRCL Retention Bonus Scheme	–	1

E The principal actuarial assumptions used as at 31 December 2003 (expressed as weighted average) are as follows:

	Retirement Scheme **2003**	RBS **2003**	Retirement Scheme 2002	RBS 2002
Discount rate at 31 December	**5.25%**	**1.25%**	5.25%	1.50%
Expected rate of return on plan assets	**6.00%**	**1.50%**	6.00%	2.00%
Future salary increases	**4.00%**	**1.50%**	3.75%	0.75%

38 Construction projects

A Penny's Bay Rail Link

The Project Agreement between the Government and the Company for the design, construction, financing and operation of the Penny's Bay Rail Link was signed on 24 July 2002.

Since the signing of the Agreement, all major contracts of the project have been awarded and the construction works are well underway. The project is on programme and scheduled to be completed and opened for service on 1 July 2005.

In view of most of the contracts being awarded at prices within the engineer's estimate, it is expected that the capital cost estimate of the project will not exceed the original budget of HK$2 billion.

At 31 December 2003, the Company had incurred expenditure of HK$883 million *(2002: HK$285 million)* on the project and had authorised outstanding commitments on contracts totalling HK$446 million *(2002: HK$825 million)* related to the project.

B Tung Chung Cable Car Project

The Project Agreement between the Government and the Company for the design, construction, financing and operation of the Tung Chung Cable Car Project was signed on 19 November 2003.

The opening of Cable Car service to the Public is planned for early 2006. The capital cost estimate for the project based on the defined scope of works and programme is HK$950 million.

Subsequent to the signing of the Project Agreement, a contract for the building and civil engineering works was awarded. Construction will commence in early 2004.

At 31 December 2003, the Company had incurred expenditure of HK$137 million *(2002: HK$17 million regarded as deferred expenditure)* on the project and had authorised outstanding commitments on contracts totalling HK$495 million *(2002: HK$192 million)* related to the project.

39 Interests in jointly controlled operations

The Group has the following jointly controlled operations in respect of its property development projects as at 31 December 2003.

Location/ development package	Land use	Total gross floor area (sq. m.)	Actual or expected completion date
Hong Kong Station	Office / Retail / Hotel	415,894	By phases from 1998 – 2005
Kowloon Station			
Package One	Residential	147,547	Completed in 2000
Package Two	Residential	210,319	Completed by phases from 2002 – 2003
Package Three	Residential	105,886	2005
Package Four	Residential	128,845	Completed in 2003
Package Five, Six and Seven	Residential / Office / Retail / Hotel / Serviced Apartment	504,350	By phases from 2006 – 2008
Olympic Station			
Package One	Residential / Office / Retail	309,069	Fully completed in 2000
Package Two	Residential / Retail	268,650	Completed by phases from 2001 – 2002
Package Three	Residential	104,452	2005
Tsing Yi Station	Residential / Retail	292,795	Fully completed in 1999
Tung Chung Station			
Package One	Residential / Office / Retail / Hotel	361,686	By phases from 1999 – 2005
Package Two	Residential / Retail	255,949	By phases from 2002 – 2007
Package Three	Residential / Retail	413,154	By phases from 2002 – 2007
Hang Hau Station	Residential / Retail	142,152	2005
Tiu Keng Leng Station	Residential / Retail	253,765	2006
Tseung Kwan O Station			
Area 55b	Residential / Retail	96,797	2006
Area 57a	Residential / Retail	29,642	2005
Choi Hung Park-and-Ride	Residential / Retail	21,582	2005

The Group's assets held in relation to these joint venture operations include various site foundation works and related staff and overhead costs. The costs incurred by the Group on each development package are set off against any up-front payments received from developers in relation to that development package, and the balance is shown on the balance sheet either as property development in progress or deferred income (note 16) as the case may be. As at 31 December 2003, total property development in progress in respect of these jointly controlled operations was HK$540 million *(2002: HK$1,126 million)* and total deferred income was HK$4,924 million *(2002: HK$6,226 million)*.

As the Group is not involved in the financing of the construction of the developments, the only financial liability in respect of these developments as at 31 December 2003 was HK$108 million *(2002: HK$56 million)* in respect of accruals related to property enabling works.

During the year ended 31 December 2003, profits of HK$5,369 million *(2002: HK$3,755 million)* were recognised (note 6).

40 Material related party transactions

The Financial Secretary Incorporated, which holds approximately 76% 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 such as the payment of fees, taxes, leases and rates, etc. that arise 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 these accounts.

Members of the Board and Members of the Executive Directorate, and parties related to them, are also considered to be related parties of the Group. Transactions with these parties, except for those involving a Member of the Board or his related parties where the relevant Member abstains from voting, are separately disclosed in the accounts.

Major related party transactions entered into by the Group in prior years which are still relevant for the current year include:

A The Company entered into the Airport Railway Agreement with the Government on 5 July 1995 for the construction of the Airport Railway. In addition to specifying the parameters for the design, construction and operation of the Tung Chung and Airport Express Lines, the Agreement also included provisions for the granting of land to the Company for property development (note 16).

B The Company entered into the TKE Project Agreement with the Government on 4 November 1998 for the design, construction, financing and operation of the Tseung Kwan O Extension and the granting of land for commercial and residential property developments along the railway extension.

C On 30 June 2000, the Appointed Day for the purposes of the Mass Transit Railway Ordinance, the Company was granted a franchise, for an initial period of 50 years, to operate the existing mass transit railway, and to operate and construct any extension to the railway. On the same day, the Company entered into an Operating Agreement with the Government which detailed provisions for the design, construction, maintenance and operation of the railway under the franchise. The Government has also acknowledged in the Operating Agreement that the Company will require an appropriate commercial rate of return on its investment in any new railway project (which would ordinarily be between 1% to 3% above the estimated weighted average cost of capital of the Company) and that financial and other support from the Government may be required.

D On 14 July 2000, the Company received a comfort letter from the Government pursuant to which Government agreed to extend the period of certain of the Company's land interests so that they are coterminous with the Company's initial 50-year franchise.

E On 24 July 2002, the Company entered into an agreement with the Government specifying the parameters for the design, construction, financing and operation of the Penny's Bay Rail Link (the "PBL Agreement"). In connection with the financing of the PBL Project, the Government agreed to provide financial support to the Company in order to bridge the funding gap between the Company's required rate of return of 11.25% per annum in respect of the PBL Project, and the projected return of the PBL pursuant to the terms of the Operating Agreement (note 40C). Such financial support, which amounted to HK$798 million at net present value on 1 January 2002, has been provided through the Government waivers of its entitlement to cash dividends in respect of its shareholding, commencing from the financial year ended 31 December 2002 and thereafter as is equivalent to the funding gap.

During the year, the Group has had the following material related party transactions:

F In connection with the construction of various railway projects, certain essential project works are embedded within the infrastructure works to be undertaken by the Government or certain of its related parties. These works have been entrusted to the Government and its related parties and are payable on an actual cost basis according to architectural certifications. The Government and certain of its related parties, on the other hand, have entered into entrustment agreements with the Company for the construction of various other infrastructure works that are also reimbursable according to actual costs certified. Details of the amounts paid and the amounts receivable and payable as at 31 December 2003 are provided in notes 15, 24 and 30 respectively.

G On 19 November 2003, the Company entered into a formal project agreement with the Government to develop, on a build, operate and transfer basis, the Tung Chung Cable Car System together with a Theme Village at Ngong Ping on the Lantau Island under a franchise granted by the Government for a period of 30 years commencing on 24 December 2003. Details of the project are set out in note 38B.

40 Material related party transactions (continued)

H The Company has business transactions with its non-controlled subsidiary in the normal course of operations, details of which are disclosed in note 18.

I The Group has paid remuneration to the Members of the Board and Members of the Executive Directorate. Details of these transactions are described in note 5A. In addition, the Members of the Executive Directorate were granted share options under the Company's Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme. Details of these directors' options are disclosed in note 5B and under the paragraph "Board Members and Executive Directorate's interests in shares" in the Report of the Members of the Board.

J During the year, the following dividends were paid to or waived by the Government:

in HK$ million	**2003**	2002
Cash dividends paid	**–**	470
Cash dividends waived (Note 40E)	**675**	219
Shares allotted in respect of scrip dividends	**986**	944
	1,661	1,633

Out of the HK$675 million *(2002: HK$219 million)* cash dividends waived by the Government, HK$664 million *(2002: HK$219 million)* have been offset against the construction costs of the PBL Project (note 15). The remaining HK$11 million *(2002: Nil)* has been included in creditors, accrued charges and provisions.

41 Commitments

A Capital commitments

(i) Outstanding capital commitments as at 31 December 2003 not provided for in the accounts were as follows:

The Group and The Company

in HK$ million	Railway operations	Penny's Bay Rail Link and Tung Chung Cable Car Projects	Property development projects	Total
2003				
Authorised but not yet contracted for	**470**	**–**	**1,817**	**2,287**
Authorised and contracted for	**892**	**941**	**70**	**1,903**
	1,362	**941**	**1,887**	**4,190**
2002				
Authorised but not yet contracted for	499	–	1,934	2,433
Authorised and contracted for	1,321	1,017	67	2,405
	1,820	1,017	2,001	4,838

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

41 Commitments (continued)

(ii) The commitments under railway operations comprise the following:

The Group and The Company

in HK$ million	Improvement and enhancement works	Acquisition of property, plant and equipment	Total
2003			
Authorised but not yet contracted for	**348**	**122**	**470**
Authorised and contracted for	**394**	**498**	**892**
	742	**620**	**1,362**
2002			
Authorised but not yet contracted for	338	161	499
Authorised and contracted for	665	656	1,321
	1,003	817	1,820

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

The Group and The Company

in HK$ million	**2003**	2002
Authorised but not yet contracted for	**1,817**	1,931
Authorised and contracted for	**61**	57
	1,878	1,988

B Operating lease commitments

The Group had operating leases on office buildings and staff quarters as at 31 December 2003. The total future minimum lease payments under non-cancellable operating leases are payable as follows:

The Group and The Company

in HK$ million	**2003**	2002
Payable within one year		
Leases expiring within one year	**3**	3
Leases expiring between one to five years	**3**	4
	6	7
Payable after one but within five years	**1**	2
	7	9

The above includes HK$3 million *(2002: HK$6 million)* in respect of the office accommodation and quarters for construction project staff. The majority of the leases are subject to rent reviews.

41 Commitments (continued)

C Liabilities and commitments in respect of property management contracts

The Group had, over the years, jointly developed with outside property developers certain properties above or adjacent to railway depots and stations. Under most of the development agreements, the Group retained the right to manage these properties after their completion. The Group, as manager of these properties, enters into services contracts with outside contractors for the provision of security, cleaning, maintenance and other services on behalf of the managed properties. The Group is primarily responsible for these contracts, but any contract costs incurred will be reimbursed by the owners and tenants of the managed properties from the management funds as soon as they are paid.

As at 31 December 2003, the Group had total outstanding liabilities and contractual commitments of HK$490 million *(2002: HK$445 million)* in respect of these works and services. Cash funds totalling HK$568 million *(2002: HK$530 million)* obtained through monthly payments of management service charges from the managed properties are held by the Group on behalf of those properties for settlement of works and services provided.

42 Employee Share Option Schemes

A Pre-Global Offering Share Option Scheme

In connection with the Initial Public Offering ("IPO") and Stock Exchange listing of the Company's shares in October 2000, a Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") was established. Under the Pre-IPO Option Scheme, a total of 769 employees including all the Members of the Executive Directorate, except C K Chow and Lincoln K K Leong who were appointed on 1 December 2003 and 1 February 2002 respectively, were granted on 20 September 2000 options to purchase an aggregate of 48,338,000 shares, representing 0.9% of the issued share capital of the Company as at 31 December 2003. The options carry an exercise price of HK$8.44 per share, which was equivalent to 90% of the IPO offer price of HK$9.38 per share. The options may be exercised prior to 11 September 2010, subject to the vesting provisions under the Scheme. As of 31 December 2003, all options granted under the Pre-IPO Option Scheme have been vested.

In 2003, 15,999,500 options to subscribe for shares were vested and 10,489,500 share options vested have been exercised. The weighted average closing price in respect of the share options exercised during the year was HK$9.97 per share. In addition, 1,044,500 share options lapsed as a result of the resignation of certain option holders during the year. As at 31 December 2003, total options to subscribe for 25,229,500 *(2002: 36,763,500)* shares remained outstanding.

B New Joiners Share Option Scheme

In May 2002, the New Joiners Share Option Scheme (the "New Option Scheme") was adopted at the 2002 Annual General Meeting to provide share options to new members of the top and senior management of the Company who did not participate in the Pre-IPO Option Scheme. Under the Rules of the New Option Scheme, a maximum of 5,056,431 shares, which represent 0.1% of the issued share capital of the Company as at 31 December 2003, may be issued pursuant to the exercise of options granted under the New Option Scheme. Options granted will be evenly vested in respect of their underlying shares over a period of three years from the date on which the relevant option is offered. The exercise price of any option granted under the New Option Scheme is to be determined by the Company upon the offer of grant of the option and which should not be less than the greatest of (i) the average closing price of an MTR share for the five business days immediately preceding the day of offer of such option; (ii) the closing price of an MTR share on the day of offer of such option, which must be a business day; and (iii) the nominal value of an MTR share.

On 1 August 2003, a total of 5 employees, including Lincoln K K Leong, a Member of the Executive Directorate, were granted options to purchase an aggregate of 1,561,200 shares at an exercise price of HK$9.75 per share, being the closing price of an MTR share on the day of offer. Subject to the vesting provisions under the New Option Scheme, the options will be vested starting from 14 July 2004 and are exercisable on or prior to 14 July 2013.

43 Adoption of new accounting policies

A Deferred tax

The Hong Kong Society of Accountants issued SSAP 12 "Income taxes" in August 2002, which supercedes the previous SSAP 12 "Accounting for deferred taxes". The new standard became effective for accounting period beginning on or after 1 January 2003. The Group has therefore adopted the new standard for preparation of the Group's financial statements for the years ended 31 December 2002 and 2003.

The revised SSAP 12 requires deferred tax assets and liabilities to be provided in full using the liability method, on temporary differences arising between the tax base of an asset or a liability and its carrying value in the financial statements at the balance sheet date. Deferred tax assets or liabilities arising from temporary differences need to be measured at the tax rates enacted or substantively enacted by the balance sheet date. The principal temporary differences in respect of the Company arise from depreciation of fixed assets, various expense provisions and tax losses carried forward.

Deferred tax liabilities are provided in full on all taxable temporary differences while deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the deductible temporary difference can be utilised.

In accordance with the previous deferred tax standard, the Group did not provide for deferred taxation on timing differences unless they are expected to crystallise in the foreseeable future. Adoption of the revised SSAP 12 therefore constituted a 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 2002 and 2003. The previously reported net profit for the year ended 31 December 2002 have also been adjusted to reflect movements in the deferred income taxes account during the year. These effects are summarised as follows:

	The Group			The Company		
	Net movements in deferred income taxes			Net movements in deferred income taxes		
in HK$ million	Balance as at 1 January 2002	Year ended 31 December 2002	Balance as at 1 January 2003	Balance as at 1 January 2002	Year ended 31 December 2002	Balance as at 1 January 2003
Retained profit as previously reported	14,407		16,487	14,346		16,356
Prior period adjustments in respect of:						
Deferred tax	(2,622)	(630)	(3,252)	(2,622)	(630)	(3,252)
Share of non-controlled subsidiary's deferred tax	2	(3)	(1)	–	–	–
Retained profit as restated	11,787		13,234	11,724		13,104

B Lease out and lease back transactions

During the year, the Group entered into a series of structured transactions with unrelated third parties to lease out and lease back certain of its passenger cars ("Lease Transaction"). Details of the Lease Transaction and the accounting treatment relating to the transaction are disclosed in note 14G.

44 Subsequent events

A Railway project in Shenzhen, The People's Republic of China ("PRC")

On 15 January 2004, the Company entered into an Agreement in Principle (the "Agreement") for a "Build, Operate and Transfer" project with the Shenzhen Municipal Government, PRC to construct Phase 2 of Line 4 of the proposed Shenzhen Metro System and to operate Line 4 for a term of 30 years.

The Agreement sets out the principles upon which the Company and the Shenzhen Municipal Government will negotiate an Authorised Operating Agreement, subject to the National Development and Reform Commission's approval, to allow a project company to be established by the Company in PRC with the right to construct Phase 2 of Line 4 and to operate Line 4, and the right to use the facilities of Phase 1 of Line 4. The Agreement also provides that the project company will acquire land along Line 4 with an aggregate gross floor area of 2.9 million sq.m. for the purpose of property development.

The total investment of the project company will be approximately RMB6 billion with a registered capital of approximately RMB2.4 billion.

B Debt issuance

On 20 January 2004, MTR Corporation (C.I.) Limited successfully completed the issuance of US$600 million 10-year Eurobonds (the "Bonds"). The Bonds are unconditionally and irrevocably guaranteed by the Company and carry a coupon of 4.75% per annum, as well as a maturity date of 21 January 2014. The net proceeds from the MTR Corporation (C.I.) Limited's issue were on-lent to the Company for use by it for general corporate purposes, which may include working capital, capital expenditures, refinancing and the repayment of existing debts. The bonds are listed on the London Stock Exchange.

C Possible merger with the KCRC

On 24 February 2004, the Government announced its invitation to the Company and KCRC to commence discussions on the possible merger between the two companies. Conclusion of the negotiations is required to be reported to the Government by 31 August 2004.

D Extension of scrip dividend arrangement

On 26 February 2004, the Government agreed to extend the scrip dividend arrangement (its agreement to elect to receive all or part of its entitlement to dividends in the form of new shares under any scrip dividend election to be offered by the Company to its shareholders in respect of a financial year to the extent necessary to ensure that a maximum of 50% of the total dividend paid by the Company to its shareholders in respect of the relevant financial year will be paid in the form of cash) to each of the three financial years ending 31 December 2006.

45 Comparative figures

Certain comparative figures have been restated and reclassified based on the requirement of the new accounting standards adopted as set out in note 43.

46 Approval of accounts

The accounts were approved by the Board on 2 March 2004.