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 Institute of Certified Public Accountants ("HKICPA") (previously known as Hong Kong Society of Accountants), 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 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 1T.

(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 (i.e. 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
Train control and signalling equipment, station announcement systems, telecommunication systems and advertising panels	15 years
Fixture and fitting	10–15 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, whereupon the costs are transferred to railway construction in progress.

(ii) After entering into a project agreement, 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.

1 Principal accounting policies (continued)

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.

(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, profit is recognised based on the fair value of such assets at the time of receipt and after taking into account any outstanding risks and obligations retained by the Group in connection with the development.

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.

(viii) Where properties under construction are received as a sharing in kind from a development, these properties are initially recognised in assets under construction at fair value. Further costs incurred in the construction of those assets are capitalised into the assets under construction, which are transferred to fixed assets when substantially all the activities necessary to prepare the assets for their intended use have been completed.

1 Principal accounting policies (continued)

J Jointly controlled operations

The arrangements entered into by the Group with developers for property developments along the railway lines 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 property development in progress at that time.

K Investments in held-to-maturity securities

The Group's policies for investments in held-to-maturity securities other than investments in its subsidiaries and non-controlled subsidiary are as follows:

(i) Dated debt securities that the Group and/or the Company have the ability and intention to hold to maturity are classified as held-to-maturity securities. Held-to-maturity securities are stated in the balance sheet at amortised cost less any provisions for diminution in value. Provisions are made when carrying amounts are not expected to be fully recovered and are recognised as expenses in the profit and loss account, such provisions being determined for each investment individually.

(ii) Provisions against the carrying value of held-to-maturity securities are written back when the circumstances and events that led to the write-down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

(iii) Profits or losses on disposal of investments in held-to-maturity securities are determined as the difference between the estimated net disposal proceeds and the carrying amount of the investments and are accounted for in the profit and loss account as they arise.

L 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.

M 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.

N Long-term consultancy contracts

The accounting policy for contract revenue is set out in note 1T(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".

1 Principal accounting policies (continued)

O 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.

P 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 for 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 bonds 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.

(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.

Q 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 1P(ii).

1 Principal accounting policies (continued)

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 1P(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.

R 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.

(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.

1 Principal accounting policies (continued)

S 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.

T 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.

U 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.

V Interest and finance charges

Interest expense directly attributable to the financing of capital projects 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.

1 Principal accounting policies (continued)

W 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.

X 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.

Y 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.

Z 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 thereto. 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

in HK$ million	**2004**	2003
Fare revenue comprises:		
MTR Lines	**5,417**	5,064
Airport Express Line	**515**	425
	5,932	5,489

The MTR Lines comprise the Kwun Tong, Tsuen Wan, Island, Tung Chung and Tseung Kwan O Lines.

3 Non-fare revenue

A Station commercial and other revenue

in HK$ million	**2004**	2003
Station commercial and other revenue comprises:		
Advertising	**467**	386
Kiosk rental	**298**	275
Telecommunication income	**238**	198
Consultancy income	**182**	143
Miscellaneous business revenue	**126**	115
	1,311	1,117

B Rental and management income

in HK$ million	**2004**	2003
Rental income was attributable to:		
Telford Plaza	**388**	365
Luk Yeung Galleria	**117**	114
Paradise Mall	**115**	119
Maritime Square	**224**	209
International Finance Centre	**77**	10
Other properties	**73**	71
	994	888
Management income	**108**	94
Property agency income	**6**	6
	1,108	988

Included in rental income is service income of HK$63 million *(2003: HK$63 million)* relating to the provision of air conditioning services. The leasing of Two International Finance Centre commenced in September 2003.

4 Operating expenses before depreciation

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

in HK$ million	**2004**	2003
Contributions to defined contribution plans and Mandatory Provident Fund	**16**	13
Expense recognised in respect of defined benefit plans (Note 38C)	**138**	156
	154	169

Other staff costs and related expenses of HK$902 million *(2003: HK$943 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 business development expenses comprise:

in HK$ million	**2004**	2003
Tseung Kwan O Extension Further Capital Works Project (Note 15)	**49**	–
West Island Line / South Island Line (Note 17)	**15**	21
New business development expenses	**103**	28
	167	49

New business development expenses relate mainly to studies on business opportunities in China and Europe in line with the Group's business strategy.

D Included in general and administration expenses and other expenses are the following charges/(credits):

in HK$ million	**2004**	2003
Auditors' remuneration		
– audit services	**4**	3
– other services	**1**	1
(Write-back)/Write-off of deficit on revaluation of self-occupied office land and buildings (Note 14D)	**(69)**	69
Loss on disposal of fixed assets	**19**	16
Operating lease expenses:		
Office buildings and staff quarters	**10**	12
Less: Amount capitalised	**3**	5
	7	7

Other services under auditors' remuneration include an amount of HK$0.4 million *(2003: HK$0.4 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	**2004**	2003
Fees	**3**	2
Salaries, housing allowances and other benefits-in-kind	**28**	28
Variable remuneration related to performance	**8**	3
Retirement scheme contributions	**3**	4
	42	37

The above emoluments do not include realised gains on exercise of share options amounting to HK$5.1 million *(2003: HK$8.7 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	**2004 Number**	2003 Number
HK$0 – HK$500,000	**9**	8
HK$500,001 – HK$1,000,000	**1**	2
HK$4,000,001 – HK$4,500,000	**–**	3
HK$4,500,001 – HK$5,000,000	**4**	2
HK$5,000,001 – HK$5,500,000	**2**	1
HK$6,000,001 – HK$6,500,000	**–**	1
HK$9,000,001 – HK$9,500,000	**1**	–
	17	17

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 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	2004 Base pay, allowance, retirement scheme contribution and other benefits	2004 Variable remuneration related to performance	2004 Total	2003 Total
Chief Executive Officer ("CEO")*	**5.61**	**3.44**	**9.05**	0.68
Finance Director	**3.89**	**0.75**	**4.64**	4.30
Human Resources Director	**4.11**	**0.75**	**4.86**	4.45
Legal Director and Secretary	**4.26**	**0.75**	**5.01**	4.67
Managing Director – Operations & Business Development	**4.50**	**0.81**	**5.31**	5.11
Project Director	**4.10**	**0.77**	**4.87**	4.65
Property Director	**4.10**	**0.75**	**4.85**	4.46
	30.57	**8.02**	**38.59**	28.32

* Appointed in December 2003

(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 in order 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 competitive level of compensation and to enable the CEO's total pay to be 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 2004 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 43A, 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, in each case, up to and including the date on which he has exercised his option in full or the date on which his option lapses (whichever is earlier).

(ii) New Joiners Share Option Scheme

Under the New Joiners Share Option Scheme ("New Option Scheme") as described in note 43B, Lincoln K K Leong, a Member of the Executive Directorate, was granted options to acquire 1,066,000 shares on 1 August 2003.

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, up to and including the date on which he has exercised his option in full or the date on which his option lapses (whichever is earlier).

6 Profit on property developments

in HK$ million	**2004**	2003
Profit on property developments comprises:		
Transfer from deferred income on up-front payments (Note 16B(i))	**1,601**	1,286
Share of surplus from development	**1,665**	7
Profit on sale of properties held for sale	**301**	44
Profit recognised from sharing in kind (Note 16B(ii))	**1,008**	4,034
Other overhead costs	**(7)**	(2)
	4,568	5,369

Included in profit on sale of properties held for sale are write-back of prior year provision amounting to HK$16 million *(2003: write-down of HK$16 million)* and cost of properties sold of HK$422 million *(2003: HK$243 million)*.

7 Depreciation

in HK$ million	**2004**	2003
Depreciation comprised charges on:		
Railway operations		
– on fixed assets held under finance leases	**19**	19
– on other railway fixed assets	**2,354**	2,251
Assets relating to station advertising, kiosk and miscellaneous businesses	**117**	109
Unallocated corporate assets	**22**	23
	2,512	2,402

8 Interest and finance charges

in HK$ million	**2004**	2003
Interest expenses in respect of:		
Bank loans and overdrafts, and capital market instruments wholly repayable within 5 years	**668**	680
Capital market instruments not wholly repayable within 5 years	**764**	901
Obligations under finance leases	**35**	43
Finance charges	**35**	36
Exchange loss/(gain)	**2**	(7)
Interest expenses capitalised:		
Disneyland Resort Line Project	**(7)**	(1)
Tung Chung Cable Car Project	**(12)**	(2)
AsiaWorld-Expo Station Project	**(1)**	(1)
Other capital projects	**(13)**	(78)
Assets under construction	**(14)**	(20)
	(47)	(102)
	1,457	1,551
Interest income in respect of:		
Deposits with banks and other financial institutions	**(5)**	(10)
Staff housing loans	**(2)**	(2)
	(7)	(12)
	1,450	1,539

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 4.1% to 5.2% per annum during the year *(2003: 4.0% to 5.5% per annum)*.

9 Income tax

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

in HK$ million	**2004**	2003
Current tax		
– overseas tax for the year	**4**	4
Deferred tax		
– origination and reversal of temporary differences	**691**	443
– effect of increase in tax rate on deferred tax balances at 1 January 2003	**–**	300
	691	743
Share of non-controlled subsidiary's taxation	**5**	1
	700	748

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 2004. 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 was taken into account in the preparation of the Group's 2003 accounts.

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

	2004		2003	
	HK$ million	%	*HK$ million*	%
Profit before tax	**5,196**		5,198	
Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned	**905**	**17.4**	926	17.8
Tax effect of non-deductible expenses	**24**	**0.5**	53	1.0
Tax effect of non-taxable revenue	**(220)**	**(4.2)**	(531)	(10.2)
Tax effect of unused tax losses not recognised	**2**	**–**	–	–
Tax effect of tax losses not recognised in previous years	**(11)**	**(0.2)**	–	–
Effect on opening deferred tax balances resulting from an increase in tax rate during the year	**–**	**–**	300	5.8
Actual tax expenses	**700**	**13.5**	748	14.4

10 Profit attributable to shareholders

The consolidated profit attributable to shareholders includes a profit of HK$4,479 million *(2003: HK$4,379 million)* which has been dealt with in the accounts of the Company.

11 Dividends

Dividends paid and proposed during the year comprised:

in HK$ million	2004	2003
Dividend approved and paid		
– 2003 final dividend of 28 cents *(2002: 28 cents)* per share approved and paid in 2004	**1,481**	1,444
– 2004 interim dividend of 14 cents *(2003: 14 cents)* per share	**750**	734
	2,231	2,178
Dividend proposed		
– Final dividend proposed after the balance sheet date of 28 cents *(2003: 28 cents)* per share	**1,509**	1,481

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 41J. 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 Disneyland Resort Line (previously known as Penny's Bay Rail Link) Project Agreement entered into between the Group and the Government, HK$37 million *(2003: HK$675 million)* cash dividend declared and payable to the Government during the year has been waived (note 41E).

12 Earnings per share

The calculation of basic earnings per share is based on the profit for the year attributable to shareholders of HK$4,496 million *(2003: HK$4,450 million)* and the weighted average number of ordinary shares of 5,331,253,996 in issue during the year *(2003: 5,214,028,094)*.

The calculation of diluted earnings per share is based on the profit for the year attributable to shareholders of HK$4,496 million *(2003: HK$4,450 million)* and the weighted average number of ordinary shares of 5,337,217,673 in issue during the year *(2003: 5,217,462,182)* after adjusting for the number of dilutive potential ordinary shares under the employee share option schemes calculated as follows:

	2004	2003
Weighted average number of ordinary shares used in calculating basic earnings per share	**5,331,253,996**	5,214,028,094
Number of ordinary shares deemed to be issued for no consideration	**5,963,677**	3,434,088
Weighted average number of ordinary shares used for calculating the diluted earnings per share	**5,337,217,673**	5,217,462,182

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
2004						
Revenue	**5,932**	**1,311**	**1,108**	**8,351**	**–**	**8,351**
Less: Operating expenses before depreciation	**2,889**	**315**	**207**	**3,411**	**–**	**3,411**
	3,043	**996**	**901**	**4,940**	**–**	**4,940**
Profit on property developments	–	–	–	–	**4,568**	**4,568**
Operating profit before depreciation	**3,043**	**996**	**901**	**4,940**	**4,568**	**9,508**
Less: Depreciation	**2,369**	**117**	**4**	**2,490**	**–**	**2,490**
	674	**879**	**897**	**2,450**	**4,568**	**7,018**
Unallocated corporate expenses						**(416)**
Interest and finance charges						**(1,450)**
Share of profit of non-controlled subsidiary						**44**
Income tax						**(700)**
Profit for the year ended 31 December 2004						**4,496**
Assets						
Operational assets	**79,021**	**1,304**	**17,045**	**97,370**	**282**	**97,652**
Railway construction in progress	**962**	**–**	**–**	**962**	**–**	**962**
Assets under construction	**869**	**5**	**–**	**874**	**2,177**	**3,051**
Property development in progress	**–**	**–**	**–**	**–**	**2,088**	**2,088**
Investments in held-to-maturity securities	**–**	**202**	**–**	**202**	**–**	**202**
Properties held for sale	**–**	**–**	**–**	**–**	**815**	**815**
	80,852	**1,511**	**17,045**	**99,408**	**5,362**	**104,770**
Interest in non-controlled subsidiary						**63**
Unallocated assets						**1,841**
Total assets						**106,674**
Liabilities						
Segmented liabilities	**2,087**	**354**	**463**	**2,904**	**483**	**3,387**
Deferred income	**132**	**–**	**–**	**132**	**4,506**	**4,638**
	2,219	**354**	**463**	**3,036**	**4,989**	**8,025**
Unallocated liabilities						**35,142**
Minority interests						**8**
Total liabilities						**43,175**
Other Information						
Capital expenditure on:						
Operational assets and assets under construction	**729**	**130**	**33**			
Railway construction in progress	**875**					
Property development in progress					**184**	
Non-cash expenses other than depreciation	**19**	**6**	**–**			

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
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						(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	–			

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

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 2004	**14,169**	**1,598**	**45,740**	**54,319**	**940**	**116,766**
Additions	**32**	**–**	**–**	**49**	**3,245**	**3,326**
Capitalisation adjustments*	**–**	**–**	**(124)**	**(156)**	**–**	**(280)**
Disposals/Write-offs	**–**	**–**	**(1)**	**(172)**	**(4)**	**(177)**
Surplus on revaluation (Note 36)	**2,486**	**311**	**–**	**–**	**–**	**2,797**
Write back of revaluation deficit (Note 4D)	**–**	**69**	**–**	**–**	**–**	**69**
Reclassification	**–**	**–**	**82**	**(82)**	**–**	**–**
Other assets commissioned	**–**	**–**	**7**	**1,123**	**(1,130)**	**–**
At 31 December 2004	**16,687**	**1,978**	**45,704**	**55,081**	**3,051**	**122,501**
At Cost	**–**	**732**	**45,704**	**55,081**	**3,051**	**104,568**
At 31 December 2004 Valuation	**16,687**	**1,246**	**–**	**–**	**–**	**17,933**
Aggregate depreciation						
At 1 January 2004	**–**	**98**	**2,705**	**17,042**	**–**	**19,845**
Charge for the year	**–**	**33**	**392**	**2,107**	**–**	**2,532**
Capitalisation adjustments*	**–**	**–**	**(3)**	**(17)**	**–**	**(20)**
Written back on disposal	**–**	**–**	**(1)**	**(148)**	**–**	**(149)**
Written back on revaluation (Note 36)	**–**	**(20)**	**–**	**–**	**–**	**(20)**
At 31 December 2004	**–**	**111**	**3,093**	**18,984**	**–**	**22,188**
Net book value at 31 December 2004	**16,687**	**1,867**	**42,611**	**36,097**	**3,051**	**100,313**
Net book value at 31 December 2003	14,169	1,500	43,035	37,277	940	96,921

Depreciation charge for the year was HK$2,512 million, comprising depreciation for the year of HK$2,532 million less adjustments for the capitalisation of HK$20 million.

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 2004	**14,169**	**1,598**	**45,740**	**53,693**	**922**	**116,122**
Additions	**32**	**–**	**–**	**43**	**3,222**	**3,297**
Capitalisation adjustments*	**–**	**–**	**(124)**	**(156)**	**–**	**(280)**
Disposals/Write-offs	**–**	**–**	**(1)**	**(172)**	**(4)**	**(177)**
Surplus on revaluation (Note 36)	**2,486**	**311**	**–**	**–**	**–**	**2,797**
Write back of revaluation deficit (Note 4D)	**–**	**69**	**–**	**–**	**–**	**69**
Reclassification	**–**	**–**	**82**	**(82)**	**–**	**–**
Other assets commissioned	**–**	**–**	**7**	**1,088**	**(1,095)**	**–**
At 31 December 2004	**16,687**	**1,978**	**45,704**	**54,414**	**3,045**	**121,828**
At Cost	**–**	**732**	**45,704**	**54,414**	**3,045**	**103,895**
At 31 December 2004 Valuation	**16,687**	**1,246**	**–**	**–**	**–**	**17,933**
Aggregate depreciation						
At 1 January 2004	**–**	**98**	**2,705**	**16,597**	**–**	**19,400**
Charge for the year	**–**	**33**	**392**	**2,039**	**–**	**2,464**
Capitalisation adjustments*	**–**	**–**	**(3)**	**(17)**	**–**	**(20)**
Written back on disposal	**–**	**–**	**(1)**	**(148)**	**–**	**(149)**
Written back on revaluation (Note 36)	**–**	**(20)**	**–**	**–**	**–**	**(20)**
At 31 December 2004	**–**	**111**	**3,093**	**18,471**	**–**	**21,675**
Net book value at 31 December 2004	**16,687**	**1,867**	**42,611**	**35,943**	**3,045**	**100,153**
Net book value at 31 December 2003	14,169	1,500	43,035	37,096	922	96,722

* Capitalisation adjustments relate to certain railway assets capitalised at time of commissioning based on contractors' claimed values. Such assets' final values have been adjusted downward following finalisation of contract claims with contractors at lower final contract values during the year.

Depreciation charge for the year was HK$2,444 million, comprising depreciation for the year of HK$2,464 million less adjustments for the capitalisation of HK$20 million.

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

The Group and The Company

			Leasehold land and buildings			
	Investment properties		Leasehold land for railway depots		Office land and buildings	
in HK$ million	**2004**	2003	**2004**	2003	**2004**	2003
At net book value or valuation						
– long leases	**1,431**	1,283	**163**	166	**23**	15
– medium-term leases	**15,256**	12,886	**458**	468	**1,223**	852
	16,687	14,169	**621**	634	**1,246**	867

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 were revalued at 31 December 2004 by an independent firm of surveyors, DTZ Debenham Tie Leung, who have among their staff Members of the Hong Kong Institute of Surveyors, at open market value. The valuations are based on a "term and reversion basis", which capitalises the existing and reversionary net rental income having regard to market valuation checks on comparable sale and yields. The net revaluation surplus of HK$2,486 million *(2003: HK$276 million)* arising from the revaluation has been credited to the investment property revaluation reserve (note 36).

D All self-occupied office land and buildings were revalued at 31 December 2004 by an independent firm of surveyors, DTZ Debenham Tie Leung, who have among their staff Members of the Hong Kong Institute of Surveyors, at open market value on an existing use basis. The valuation resulted in a net revaluation surplus of HK$400 million *(2003: deficit of HK$71 million)*. According to the Company's policy under note 1E(ii)(b), HK$69 million of the surplus has been credited to the profit and loss account in respect of deficit previously charged in respect of the same property (note 4D). The remaining HK$331 million of the surplus, net of deferred tax of HK$58 million (note 34B), has been transferred to the fixed asset revaluation reserve account (note 36).

The carrying amount of the self-occupied land and buildings at 31 December 2004 would have been HK$936 million *(2003: HK$958 million)* had the office land and buildings been stated at cost less accumulated depreciation.

E Assets under construction include an unrenovated shell of the retail shopping centre at Union Square, Kowloon Station and its car parking spaces received by the Company as a sharing in kind from the development. The properties under construction are stated at cost, which is deemed to be the fair value upon receipt (note 1I(viii)) which is determined by reference to an open market valuation undertaken by an independent firm of surveyors, Jones Lang LaSalle, who have among their staff Members of the Hong Kong Institute of Surveyors.

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

The Group and The Company

in HK$ million	Cost **2004**	Aggregate depreciation **2004**	Net book value **2004**	Net book value 2003
Civil works				
– Eastern Harbour Crossing	**1,254**	**269**	**985**	1,005

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)

G 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. 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$16,687 million *(2003: HK$14,169 million)*. The gross carrying amounts of station kiosks held for use in operating leases were HK$416 million *(2003: HK$352 million)* and the related accumulated depreciation charges were HK$80 million *(2003: HK$65 million)*.

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

The Group and The Company

in HK$ million	**2004**	2003
Within 1 year	**1,156**	925
After 1 year but within 5 years	**1,742**	1,121
Later than 5 years	**332**	355
	3,230	2,401

H 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 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 in March 2003 of approximately HK$3,533 million, which have been defeased by purchase of debt securities to meet the payment obligations. The Group received in 2003 the 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 2004	Transferred from deferred expenditure (Note 17)	Expenditure/ (Government grant)	Costs written off to profit and loss account (Note 4C)	Balance at 31 Dec 2004
Tseung Kwan O Extension Further Capital Works Project					
Construction costs	1	–	–	–	1
Consultancy fees	23	–	7	(29)	1
Staff costs and general expenses	16	–	5	(16)	5
Finance costs	4	–	–	(4)	–
	44	–	12	(49)	7
Disneyland Resort Line Project					
Construction costs	645	–	429	–	1,074
Consultancy fees	41	–	5	–	46
Staff costs and general expenses	194	–	85	–	279
Finance costs	3	–	7	–	10
	883	–	526	–	1,409
Government grant (Notes 41E and 41J)	(883)	–	(48)	–	(931)
	–	–	478	–	478
Tung Chung Cable Car Project					
Construction costs	82	–	254	–	336
Consultancy fees	24	–	13	–	37
Staff costs and general expenses	29	–	28	–	57
Finance costs	2	–	12	–	14
	137	–	307	–	444
AsiaWorld-Expo Station Project					
Construction costs	–	–	16	–	16
Staff costs and general expenses	–	3	13	–	16
Finance costs	–	–	1	–	1
	–	3	30	–	33
Total	181	3	827	(49)	962

Costs written off to profit and loss account relates to certain station design costs in respect of the future Tseung Kwan O South Station, which became abortive following the submission of a revised station design plan and its approval by the Town Planning Board during the year.

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 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.

Notwithstanding 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(i)). In these cases, any subsequent expenditure incurred by the Company in respect of that development will be charged against deferred income. Deferred income is to 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 Tseung Kwan O Extension ("TKE") Project Agreement entered into in 1998 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").

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(i))	Transfer out on project completion	Transfer to assets under construction	Balance at 31 Dec
2004						
Airport Railway Property Projects	**–**	**116**	**(39)**	**–**	**(77)**	**–**
Tseung Kwan O Extension Projects	**2,266**	**66**	**(2)**	**(287)**	**–**	**2,043**
Other property projects	**43**	**2**	**–**	**–**	**–**	**45**
	2,309	**184**	**(41)**	**(287)**	**(77)**	**2,088**
2003						
Airport Railway Property Projects	597	122	(63)	(656)	–	–
Tseung Kwan O Extension Projects	2,232	37	(3)	–	–	2,266
Other property projects	41	2	–	–	–	43
	2,870	161	(66)	(656)	–	2,309

16 Property development in progress (continued)

B Deferred income on property development

The Group and The Company

in HK$ million	**2004**	2003
Deferred income on property development comprises:		
– Up-front payments received from developers (Note 16B(i))	**3,414**	4,924
– Sharing in kind (Note 16B(ii))	**1,092**	–
	4,506	4,924

(i) Deferred income on up-front payments

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 33)
2004					
Airport Railway Property Projects	**4,917**	**132**	**(39)**	**(1,601)**	**3,409**
Tseung Kwan O Extension Property Projects	**7**	**–**	**(2)**	**–**	**5**
	4,924	**132**	**(41)**	**(1,601)**	**3,414**
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

(ii) Deferred income on sharing in kind

Under the property development agreement in respect of an Airport Railway development package, the Company received during 2004 the shell of a retail centre at Union Square, Kowloon Station and its car parking spaces as sharing in kind. Part of the property development profit is deferred as the Company has an obligation under the development agreement to complete the fitting-out works. Accordingly, a portion of the fair value of the retail shell equivalent to estimated cost of the outstanding fitting-out works has been withheld as deferred income. On this basis, movements of the deferred income on this sharing in kind during the year are set out below:

The Group and The Company

in HK$ million	**2004**	2003
Balance as at 1 January	**–**	–
Sharing in kind received from developer	**2,100**	–
Less: Amount recognised as profit (Note 6)	**(1,008)**	–
Balance as at 31 December	**1,092**	–

16 Property development in progress (continued)

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	**2004**	2003
Balance as at 1 January	**3,572**	3,231
Stakeholding funds received and receivable	**13,958**	13,472
Add: Interest earned thereon	**8**	25
	17,538	16,728
Disbursements during the year	**(13,474)**	(13,156)
Balance as at 31 December	**4,064**	3,572
Represented by :		
Balances in designated bank accounts as at 31 December	**4,062**	3,570
Retention receivable	**2**	2
	4,064	3,572

17 Deferred expenditure

The Group

in HK$ million	Balance at 1 Jan	Transfer to railway construction in progress (Note 15)	Discount on bond issue	Expenditure/ (Amortisation) during the year	Costs written off to profit and loss account (Note 4C)	Balance at 31 Dec
2004						
Deferred finance charges	**76**	**–**	**50**	**(17)**	**–**	**109**
Merger studies	**–**	**–**	**–**	**56**	**–**	**56**
Expenditure on proposed capital projects						
– West Island Line / South Island Line	**25**	**–**	**–**	**17**	**(15)**	**27**
– Shenzhen Metro Line 4 Project	**–**	**–**	**–**	**51**	**–**	**51**
– AsiaWorld-Expo Station Project	**3**	**(3)**	**–**	**–**	**–**	**–**
	104	**(3)**	**50**	**107**	**(15)**	**243**
2003						
Deferred finance charges	72	–	10	(6)	–	76
Expenditure on proposed capital projects						
– Tung Chung Cable Car Project	17	(17)	–	–	–	–
– West Island Line / South Island Line	16	–	–	30	(21)	25
– AsiaWorld-Expo Station Project	–	–	–	3	–	3
– Other	1	–	–	–	(1)	–
	106	(17)	10	27	(22)	104

17 Deferred expenditure (continued)

The Company

in HK$ million	Balance at 1 Jan	Transfer to railway construction in progress (Note 15)	Discount on bond issue	Expenditure/ (Amortisation) during the year	Costs written off to profit and loss account (Note 4C)	Balance at 31 Dec
2004						
Deferred finance charges	**76**	**–**	**50**	**(17)**	**–**	**109**
Merger studies	**–**	**–**	**–**	**56**	**–**	**56**
Expenditure on proposed capital projects						
– West Island Line / South Island Line	**25**	**–**	**–**	**17**	**(15)**	**27**
– AsiaWorld-Expo Station Project	**3**	**(3)**	**–**	**–**	**–**	**–**
	104	**(3)**	**50**	**56**	**(15)**	**192**
2003						
Deferred finance charges	72	–	10	(6)	–	76
Expenditure on proposed capital projects						
– Tung Chung Cable Car Project	17	(17)	–	–	–	–
– West Island Line / South Island Line	16	–	–	30	(21)	25
– AsiaWorld-Expo Station Project	–	–	–	3	–	3
– Other	1	–	–	–	(1)	–
	106	(17)	10	27	(22)	104

Merger studies comprise external consultancy, direct staff costs and expenses in relation to the studies on the potential merger between the Company and Kowloon-Canton Railway Corporation ("KCRC"). On 24 February 2004, the Government announced its decision to invite the Company and KCRC to commence discussions on a possible merger for which a joint proposal was submitted to the Government on 16 September 2004. Concurrent with the submission of the proposal, the Company has been negotiating with the Government on the terms of the possible merger. Presently, the joint merger proposal is being considered by the Government, whilst the Company's discussion with the Government on the terms of the merger is continuing.

The expenditure incurred on the proposed Shenzhen Metro Line 4 ("Line 4") Project was capitalised as deferred expenditure following the signing of an Agreement in Principle to construct Phase 2 of Line 4 and to operate Line 4 for a term of 30 years with the Shenzhen Municipal People's Government in January 2004 (note 42D(i)).

Deferred expenditure relating to the AsiaWorld-Expo Station Project was transferred to Railway Construction in Progress upon signing of the project agreement with Hong Kong IEC Limited in March 2004.

18 Interest in non-controlled subsidiary

The Group and the Company had the following interest in a non-controlled subsidiary at 31 December 2004:

	The Group		The Company	
in HK$ million	**2004**	2003	**2004**	2003
Unlisted shares, *at cost*	**–**	–	**24**	24
Share of net assets	**63**	110	**–**	–
	63	110	**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.

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.

During the year ended 31 December 2004, OCL declared a dividend of HK$150 million out of its retained earnings, of which the Company's entitlement of HK$86 million has been included in amount due from non-controlled subsidiary. In addition, a total amount of HK$51 million *(2003: HK$46 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 *(2003: HK$10 million)* and HK$6 million *(2003: HK$5 million)* respectively were received from OCL in respect of services and facilities provided by the Company at various MTR stations.

During the year, services fees amounting to HK$2 million *(2003: HK$2 million)* were also 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*	**2004 (Audited)**	2003 (Audited)
Turnover	**207**	177
Other operating income	**77**	62
	284	239
Staff costs	**(66)**	(54)
Load agent fees and bank charges for add value services	**(41)**	(31)
Other expenses	**(47)**	(62)
Operating profit before depreciation	**130**	92
Depreciation	**(81)**	(80)
Operating profit before interest and finance charges	**49**	12
Net interest income	**28**	28
Profit before taxation	**77**	40
Income tax	**(8)**	(1)
Profit for the year	**69**	39
Group's share of profit before taxation	**44**	23
Dividend	**150**	–
Group's share of dividend	**86**	–

Balance sheet

at 31 December *in HK$ million*	**2004 (Audited)**	2003 (Audited)
Assets		
Fixed assets	**201**	243
Investments	**993**	704
Cash at banks and in hand	**259**	327
Other assets	**101**	91
	1,554	1,365
Liabilities		
Card floats and card deposits due to cardholders	**(1,208)**	(1,075)
Amounts due to shareholders	**(167)**	(22)
Other liabilities	**(68)**	(76)
	(1,443)	(1,173)
Net assets	**111**	192
Shareholders' funds		
Share capital	**42**	42
Retained profits	**69**	150
	111	192
Group's share of net assets	**63**	110

19 Investments in subsidiaries

The Company

in HK$ million	**2004**	2003
Unlisted shares, *at cost*	**185**	181
Less: Impairment losses	**3**	3
	182	178

The following list contains details of subsidiaries as at 31 December 2004, 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.

		Proportion of ownership interest				
Name of company	Issued and paid up ordinary/registered share capital	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 China Consultancy Company Limited	HK$1,000	100%	100%	–	Hong Kong	Railway consultancy services
MTR Consulting (Shenzhen) Co. Ltd. (Incorporated)	HK$1,000,000	100%	100%	–	The People's Republic of China	Railway consultancy services
MTR Consultancy (Beijing) Co. Ltd. (Incorporated)	HK$1,000,000	100%	100%	–	The People's Republic of China	Railway consultancy services
MTR Corporation (Singapore) Pte. Ltd. (Note i)	S$50,000	100%	100%	–	Singapore	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. (Incorporated)	HK$15,000,000	60%	–	60%	The People's Republic of China	Railway construction management
Candiman Limited *	US$1	100%	100%	–	British Virgin Islands	Investment holding
MTR Corporation (Shenzhen) Limited (Incorporated) (Note ii)	HK$100,000,000	100%	–	100%	The People's Republic of China	Conduct early-stage preparatory work for Shenzhen Metro Line 4 project
MTR China Property Limited	HK$1,000	100%	100%	–	Hong Kong	Property management

19 Investments in subsidiaries (continued)

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
Beijing Premier Property Management Co. Ltd. * (Incorporated)	US$150,000	60%	–	60%	The People's Republic of China	Property management
Chongqing Premier Property Management Co. Ltd. * (Incorporated)	US$150,000	70%	–	70%	The People's Republic of China	Property management
Shenzhen Donghai Anbo Property Management Co. Ltd. * (Incorporated)	RMB3,000,000	51%	–	51%	The People's Republic of China	Property management
MTR (Beijing) Property Services Co. Limited * (Incorporated)	RMB3,000,000	100%	100%	–	The People's Republic of China	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
Rail Sourcing Solutions (International) Limited	HK$2	100%	100%	–	Hong Kong	Global railway supply and sourcing services
MTR Corporation (UK) Limited *	GBP29	100%	100%	–	United Kingdom	Investment holding
MTR Corporation (IKF) Limited *	GBP29	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (No. 2) Limited *	GBP1	100%	–	100%	United Kingdom	Investment holding
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

* Subsidiaries not audited by KPMG. The financial statements of the subsidiaries not audited by KPMG reflect total net assets and total turnover constituting less than 1% of the respective consolidated totals.

(i) MTR Corporation (Singapore) Pte. Ltd. has been in dormant status since January 2005 and is currently in the process of de-registration.

(ii) The registered share capital of MTR Corporation (Shenzhen) Limited is HK$100 million and is to be paid up in four quarterly instalments of equal amount commencing from 4 March 2004. As of 31 December 2004, HK$75 million of MTR Corporation (Shenzhen) Limited's registered share capital has been paid up.

(iii) No dividend has been paid or is payable to the Company by the above subsidiaries for the year ended 31 December 2004 *(2003: Nil)*.

20 Investments in held-to-maturity securities

Investments in held-to-maturity securities represents debt securities held by an overseas subsidiary for investment purpose and comprising:

The Group

in HK$ million	**2004**	2003
Held-to-maturity debt securities (All listed overseas):		
– maturing within 1 year	**68**	–
– maturing after 1 year	**134**	–
	202	–
Market value of listed held-to-maturity debt securities	**201**	–

21 Staff housing loans

The Group and The Company

in HK$ million	**2004**	2003
Balance at 1 January	**67**	84
Redemption	**(13)**	(9)
Repayment	**(7)**	(8)
Balance at 31 December	**47**	67

The Group and The Company

in HK$ million	**2004**	2003
Amounts receivable:		
– within 1 year	**5**	7
– after 1 year	**42**	60
	47	67

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.

22 Properties held for sale

The Group and The Company

in HK$ million	**2004**	2003
Properties held for sale		
– at cost	**597**	405
– at net realisable value	**218**	407
	815	812

The properties held for sale at 31 December 2003 and 2004 comprised residential units, retail and car parking spaces at the Olympic Station, Kowloon Station and Hang Hau Station developments. They are properties received by the Company, either as 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 2003 and 2004 are determined by reference to an open market valuation of the properties as at those dates, undertaken by an independent firm of surveyors, DTZ Debenham Tie Leung, who have among their staff Members of the Hong Kong Institute of Surveyors.

Properties held for sale at net realisable value are stated net of provision, made in order to state these properties at the lower of their cost and estimated net realisable value. Properties held for sale at year-end included reversal of prior periods' write-down of inventories to estimated net realisable value, amounting to HK$16 million *(2003: write-down of HK$16 million)*, recognised as an increase in the carrying value of inventories due to a rise in their estimated net realisable value.

23 Stores and spares

The Group and The Company

in HK$ million	**2004**	2003
Stores and spares expected to be consumed:		
– within 1 year	**142**	126
– after 1 year	**116**	136
	258	262
Less: Specific provision for obsolete stock	**10**	13
	248	249

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

24 Debtors, deposits and payments in advance

	The Group		**The Company**	
in HK$ million	**2004**	2003	**2004**	2003
Debtors (net of specific allowances for bad and doubtful debts), deposits and payments in advance relate to:				
– Property development projects	**282**	364	**282**	364
– Railway operations and other projects	**994**	789	**989**	796
	1,276	1,153	**1,271**	1,160

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.

24 Debtors, deposits and payments in advance (continued)

(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	**2004**	2003	**2004**	2003
Amounts not yet due	**690**	775	**681**	772
Overdue by 30 days	**106**	67	**103**	65
Overdue by 60 days	**20**	16	**14**	16
Overdue by 90 days	**6**	9	**6**	8
Overdue by more than 90 days	**70**	10	**70**	9
Total debtors	**892**	877	**874**	870
Deposits and payments in advance	**286**	237	**299**	251
Prepaid pension costs	**98**	39	**98**	39
	1,276	1,153	**1,271**	1,160

As at 31 December 2004, all debtors, deposits and payments in advance were expected to be recovered within one year except for HK$161 million *(2003: HK$238 million)* included in the amounts relating to railway operations and other projects, which were expected to be recovered after one year.

Included in amounts not yet due are HK$263 million *(2003: HK$328 million)* receivable from property purchasers, which are due for payment in accordance with the terms of individual agreements on sales and purchases.

25 Amounts due from the Government and other related parties

	The Group		The Company	
in HK$ million	**2004**	2003	**2004**	2003
Amounts due from:				
– the Government	**36**	68	**36**	68
– the Housing Authority	**10**	11	**10**	11
– the Kowloon-Canton Railway Corporation ("KCRC")	**–**	3	**–**	3
– non-controlled subsidiary	**87**	2	**87**	2
– other subsidiaries of the Company (net of provision for losses)	**–**	–	**142**	91
	133	84	**275**	175

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 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 2004, the contract retentions on the above entrusted works due for release after one year were HK$4 million *(2003: HK$6 million)*. All other amounts due from the Government and other related parties were expected to be received within 12 months.

26 Cash and cash equivalents

in HK$ million	The Group 2004	2003	The Company 2004	2003
Deposits with banks and other financial institutions	**84**	135	**84**	135
Cash at banks and in hand	**185**	241	**53**	40
Cash and cash equivalents in the balance sheet	**269**	376	**137**	175
Bank overdrafts (Note 27B)	**(11)**	(12)	**(11)**	(12)
Cash and cash equivalents in the cash flow statement	**258**	364	**126**	163

During the year, the Group recognised property development profit out of deferred income and received properties as sharing in kind totalling HK$2,609 million *(2003: HK$5,320 million)*, which were transactions not involving movements of cash or cash equivalents.

27 Loans and obligations under finance leases

A By type

The Group

in HK$ million	Balance at year end closing rate 2004	Exchange (gain)/loss on related forward exchange contracts 2004	Balance 2004	Balance 2003
Capital market instruments				
Listed or publicly traded:				
US dollar Yankee notes due 2005	**2,332**	**(8)**	**2,324**	2,324
US dollar Global notes due 2009	**5,832**	**2**	**5,834**	5,834
US dollar Global notes due 2010	**4,665**	**14**	**4,679**	4,677
Debt issuance programme notes due 2005	**194**	**–**	**194**	194
Debt issuance programme (Eurobond due 2014)	**4,665**	**(2)**	**4,663**	–
	17,688	**6**	**17,694**	13,029
Unlisted:				
Debt issuance programme notes due 2004 to 2019	**4,918**	**–**	**4,918**	6,730
HK dollar notes due 2004 to 2008	**1,500**	**–**	**1,500**	2,350
HK dollar retail bonds due 2004 to 2006	**2,250**	**–**	**2,250**	3,500
	8,668	**–**	**8,668**	12,580
Total capital market instruments	**26,356**	**6**	**26,362**	25,609
Bank loans and overdrafts	**3,649**	**(26)**	**3,623**	5,911
	30,005	**(20)**	**29,985**	31,520
Obligations under finance leases (Note 27C)	**393**	**–**	**393**	505
Total	**30,398**	**(20)**	**30,378**	32,025

27 Loans and obligations under finance leases (continued)

The Company

in HK$ million	Balance at year end closing rate **2004**	Exchange (gain)/loss on related forward exchange contracts **2004**	Balance **2004**	Balance 2003
Capital market instruments				
Listed or publicly traded:				
US dollar Yankee notes due 2005	**2,332**	**(8)**	**2,324**	2,324
US dollar Global notes due 2009	**5,832**	**2**	**5,834**	5,834
US dollar Global notes due 2010	**4,665**	**14**	**4,679**	4,677
Debt issuance programme notes due 2005	**194**	**–**	**194**	194
	13,023	**8**	**13,031**	13,029
Unlisted:				
Debt issuance programme notes due 2004 to 2018	**667**	**(2)**	**665**	1,631
	667	**(2)**	**665**	1,631
Total capital market instruments	**13,690**	**6**	**13,696**	14,660
Bank loans and overdrafts	**3,649**	**(26)**	**3,623**	5,911
	17,339	**(20)**	**17,319**	20,571
Obligations under finance leases (Note 27C)	**393**	**–**	**393**	505
Total	**17,732**	**(20)**	**17,712**	21,076

As at 31 December 2004, the Group had available undrawn committed bank loan facilities amounting to HK$5,815 million *(2003: HK$6,700 million)*. In addition, the Group had a number of uncommitted facilities with undrawn amounts totalling HK$10,536 million *(2003: HK$12,728 million)*, comprising a debt issuance programme and short-term bank loan facilities.

B By repayment terms

The Group

in HK$ million	Capital market instruments **2004**	Bank loans and overdrafts **2004**	Obligations under finance leases **2004**	Total **2004**	Total 2003
Long-term loans and obligations under finance leases					
Amounts repayable beyond 5 years	**13,410**	**92**	**–**	**13,502**	14,258
Amounts repayable within a period of between 2 and 5 years	**6,334**	**2,595**	**141**	**9,070**	8,440
Amounts repayable within a period of between 1 and 2 years	**2,450**	**605**	**131**	**3,186**	4,512
Amounts repayable within 1 year	**4,168**	**320**	**121**	**4,609**	4,450
	26,362	**3,612**	**393**	**30,367**	31,660
Bank overdrafts	**–**	**11**	**–**	**11**	12
Short-term loans	**–**	**–**	**–**	**–**	353
	26,362	**3,623**	**393**	**30,378**	32,025

27 Loans and obligations under finance leases (continued)

The Company

in HK$ million	Capital market instruments **2004**	Bank loans and overdrafts **2004**	Obligations under finance leases **2004**	Total **2004**	Total 2003
Long-term loans and obligations under finance leases					
Amounts repayable beyond 5 years	**5,144**	**92**	**–**	**5,236**	11,159
Amounts repayable within a period of between 2 and 5 years	**5,834**	**2,595**	**141**	**8,570**	5,490
Amounts repayable within a period of between 1 and 2 years	**–**	**605**	**131**	**736**	2,912
Amounts repayable within 1 year	**2,718**	**320**	**121**	**3,159**	1,150
	13,696	**3,612**	**393**	**17,701**	20,711
Bank overdrafts	**–**	**11**	**–**	**11**	12
Short-term loans	**–**	**–**	**–**	**–**	353
	13,696	**3,623**	**393**	**17,712**	21,076

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.

C Obligations under finance leases

As at 31 December 2004, 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 **2004**	Interest expense relating to future periods **2004**	Total minimum lease payments **2004**	Present value of the minimum lease payments 2003	Interest expense relating to future periods 2003	Total minimum lease payments 2003
Amounts repayable within a period of between 2 and 5 years	**141**	**9**	**150**	272	28	300
Amounts repayable within a period of between 1 and 2 years	**131**	**19**	**150**	121	29	150
Amounts repayable within 1 year	**121**	**29**	**150**	112	38	150
	393	**57**	**450**	505	95	600

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 agreement for the Eastern Harbour Crossing which is treated as a finance lease (note 14F).

27 Loans and obligations under finance leases (continued)

D Bonds and notes issued and redeemed

Bonds and notes issued during the year ended 31 December 2003 and 2004 comprise:

The Group

in HK$ million	**2004** Principal amount	**2004** Net consideratio received	2003 Principal amount	2003 Net consideration received
Debt issuance programme notes	**5,158**	**5,109**	3,099	3,091

The above notes were issued by a subsidiary, MTR Corporation (C.I.) Limited. The 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$4,415 million *(2003: HK$500 million)* unlisted Hong Kong dollar notes upon maturity.

None of the Group's listed debt securities was redeemed during the year ended 31 December 2004.

E Guarantees

There were no guarantees given by the Government in respect of loan facilities as at 31 December 2004 and 2003.

F Interest rates

The total borrowings, excluding obligations under finance leases, of HK$29,985 million *(2003: HK$31,520 million)* comprise:

The Group

	2004 Loan amount *HK$ million*	**2004** Interest rate *% p.a.*	2003 Loan amount *HK$ million*	2003 Interest rate *% p.a.*
Fixed rate loans and loans swapped to fixed rates	**21,959**	**2.2 – 8.4**	19,358	2.2 – 8.4
Variable rate loans and loans swapped from fixed rate	**8,026**	**(Note)**	12,162	(Note)
	29,985		31,520	

The Company

	2004 Loan amount *HK$ million*	**2004** Interest rate *% p.a.*	2003 Loan amount *HK$ million*	2003 Interest rate *% p.a.*
Fixed rate loans and loans swapped to fixed rates	**9,293**	**2.2 – 8.4**	8,659	2.2 – 8.4
Variable rate loans and loans swapped from fixed rate	**8,026**	**(Note)**	11,912	(Note)
	17,319		20,571	

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.

28 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 2004 are as follows:

The Group and The Company

	2004				2003
	Maturing in				
Notional amount *in HK$ million*	Less than 2 years	2-5 years	Over 5 years	Total	Total
Foreign exchange forwards	**402**	**30**	**–**	**432**	921
Cross currency and interest rate swaps	**2,754**	**5,896**	**10,617**	**19,267**	13,379
Interest rate swaps and options	**9,950**	**2,527**	**2,246**	**14,723**	20,571
	13,106	**8,453**	**12,863**	**34,422**	34,871

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's policy is to employ 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 designed 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.

29 Creditors, accrued charges and provisions

	The Group		**The Company**	
in HK$ million	**2004**	2003	**2004**	2003
Creditors, accrued charges and provisions				
– Airport Railway Project	**89**	242	**89**	242
– Tseung Kwan O Extension Project	**223**	256	**223**	256
– Property Projects	**483**	359	**483**	359
– Railway operations and other projects	**2,192**	2,495	**1,960**	2,408
Gross amount due to customers for contract work	**47**	68	**–**	7
	3,034	3,420	**2,755**	3,272

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 2004, is HK$58 million *(2003: HK$121 million).*

The gross amount due to customers for contract work at 31 December 2004 that is expected to be settled after more than one year is HK$47 million *(2003: HK$56 million).*

29 Creditors, accrued charges and provisions (continued)

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

	The Group		The Company	
in HK$ million	**2004**	2003	**2004**	2003
Due within 30 days or on demand	**563**	541	**414**	516
Due after 30 days but within 60 days	**509**	590	**474**	559
Due after 60 days but within 90 days	**106**	75	**105**	74
Due after 90 days	**1,356**	1,767	**1,262**	1,681
	2,534	2,973	**2,255**	2,830
Rental and other refundable deposits	**369**	297	**369**	292
Accrued employee benefits	**131**	150	**131**	150
Total	**3,034**	3,420	**2,755**	3,272

Creditors, accrued charges and provisions in respect of the capital projects and other construction works include provisions for claims on completed contracts, which were capitalised as part of the related assets. 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 2004, all creditors, accrued charges and provisions were expected to be settled within one year except for HK$529 million *(2003: HK$729 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.

30 Contract retentions

The Group and The Company

in HK$ million	Due for release after 12 months	Due for release within 12 months	Total
2004			
Tseung Kwan O Extension Project	**–**	**41**	**41**
Property Projects	**–**	**–**	**–**
Railway operations and other projects	**71**	**128**	**199**
	71	**169**	**240**
2003			
Tseung Kwan O Extension Project	–	99	99
Property Projects	–	9	9
Railway operations and other projects	89	114	203
	89	222	311

31 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	**2004**	2003	**2004**	2003
Amounts due to:				
– the Government	**–**	113	**–**	113
– the Airport Authority	**–**	48	**–**	48
– KCRC	**1**	–	**1**	–
– the Company's subsidiaries	**–**	–	**12,870**	11,074
	1	161	**12,871**	11,235

As at 31 December 2004, HK$1 million *(2003: HK$100 million)* due to the Government, Airport Authority and KCRC and HK$205 million *(2003: HK$125 million)* due to the subsidiaries are expected to be settled within one year.

The majority of the amounts due to the Company's subsidiaries relate to amount due to a subsidiary, MTR Corporation (C.I.) Limited, in respect of proceeds from bonds and notes issued by the subsidiary which were on-lent to the Company for its general corporate purposes (note 27D).

32 Deferred liabilities

The Group and The Company

in HK$ million	**2004**	2003
Estate management funds		
– Refundable deposits on managed properties	**50**	33
– Building maintenance and asset replacement reserve funds	**59**	53
	109	86

33 Deferred income

The Group and The Company

in HK$ million	**2004**	2003
Deferred income on property development (Note 16B)	**4,506**	4,924
Deferred income on lease out and lease back transaction (Note 14H)	**137**	141
Less: Amount recognised as income	**5**	4
	132	137
	4,638	5,061

34 Income tax in the balance sheet

A Current taxation 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

in HK$ million	Depreciation allowances in excess of related depreciation	Revaluation of properties	Deferred tax arising from Provision and other temporary differences	Tax losses	Total
2004					
At 1 January 2004	**8,753**	**4**	**(111)**	**(4,646)**	**4,000**
Charged/(credited) to consolidated profit and loss account	**270**	**–**	**(20)**	**441**	**691**
Charged to reserves (Note 36)	**–**	**58**	**–**	**–**	**58**
At 31 December 2004	**9,023**	**62**	**(131)**	**(4,205)**	**4,749**
2003					
At 1 January 2003	7,684	–	(83)	(4,349)	3,252
Charged/(credited) to consolidated profit and loss account	1,069	–	(28)	(297)	744
Charged to reserves (Note 36)	–	4	–	–	4
At 31 December 2003	8,753	4	(111)	(4,646)	4,000

The Company

in HK$ million	Depreciation allowances in excess of related depreciation	Revaluation of properties	Deferred tax arising from Provision and other temporary differences	Tax losses	Total
2004					
At 1 January 2004	**8,753**	**4**	**(111)**	**(4,646)**	**4,000**
Charged/(credited) to profit and loss account	**259**	**–**	**(20)**	**467**	**706**
Charged to reserves (Note 36)	**–**	**58**	**–**	**–**	**58**
At 31 December 2004	**9,012**	**62**	**(131)**	**(4,179)**	**4,764**
2003					
At 1 January 2003	7,684	–	(83)	(4,349)	3,252
Charged/(credited) to profit and loss account	1,069	–	(28)	(297)	744
Charged to reserves (Note 36)	–	4	–	–	4
At 31 December 2003	8,753	4	(111)	(4,646)	4,000

34 Income tax in the balance sheet (continued)

in HK$ million	The Group **2004**	The Group 2003	The Company **2004**	The Company 2003
Net deferred tax asset recognised in the balance sheet	**(15)**	–	**–**	–
Net deferred tax liability recognised in the balance sheet	**4,764**	4,000	**4,764**	4,000
	4,749	4,000	**4,764**	4,000

35 Share capital, share premium and capital reserve

in HK$ million	**2004**	2003
Authorised:		
6,500,000,000 shares of HK$1.00 each	**6,500**	6,500
Issued and fully paid:		
5,389,999,974 shares *(2003: 5,288,695,393 shares)* of HK$1.00 each	**5,390**	5,289
Share premium	**3,691**	2,609
Capital reserve	**27,188**	27,188
	36,269	35,086

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:

	Number of shares	Option/ scrip price *HK$*	Proceeds credited to: Share capital account *HK$ million*	Proceeds credited to: Share premium account *HK$ million*	Total *HK$ million*
Employee share options exercised	8,023,500	8.44	8	60	68
Issued as 2003 final scrip dividends	62,069,342	11.93	62	678	740
Issued as 2004 interim scrip dividends	31,211,739	12.00	31	344	375
	101,304,581		101	1,082	1,183

Outstanding share options under the Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme as at 31 December 2004 are disclosed in note 43.

36 Other reserves

The Group

in HK$ million	Investment property revaluation reserve	Fixed asset revaluation reserve	Retained profits	Total
2004				
Balance as at 1 January 2004	**6,682**	**18**	**15,506**	**22,206**
Dividends paid	**–**	**–**	**(2,231)**	**(2,231)**
Surplus on revaluation, net of deferred tax (Notes 14 and 34)	**2,486**	**273**	**–**	**2,759**
Profit for the year	**–**	**–**	**4,496**	**4,496**
Balance as at 31 December 2004	**9,168**	**291**	**17,771**	**27,230**
2003				
Balance as at 1 January 2003	6,406	24	13,234	19,664
Dividends paid	–	–	(2,178)	(2,178)
Surplus/(Deficits) on revaluation, net of deferred tax	276	(6)	–	270
Profit for the year	–	–	4,450	4,450
Balance as at 31 December 2003	6,682	18	15,506	22,206

The Company

in HK$ million	Investment property revaluation reserve	Fixed asset revaluation reserve	Retained profits	Total
2004				
Balance as at 1 January 2004	**6,682**	**18**	**15,305**	**22,005**
Dividends paid	**–**	**–**	**(2,231)**	**(2,231)**
Surplus on revaluation, net of deferred tax (Notes 14 and 34)	**2,486**	**273**	**–**	**2,759**
Profit for the year	**–**	**–**	**4,479**	**4,479**
Balance as at 31 December 2004	**9,168**	**291**	**17,553**	**27,012**
2003				
Balance as at 1 January 2003	6,406	24	13,104	19,534
Dividends paid	–	–	(2,178)	(2,178)
Surplus/(Deficits) on revaluation, net of deferred tax	276	(6)	–	270
Profit for the year	–	–	4,379	4,379
Balance as at 31 December 2003	6,682	18	15,305	22,005

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 2004, the total amount of reserves available for distribution to shareholders under the Hong Kong Companies Ordinance amounted to HK$17,553 million *(2003: HK$15,305 million)*.

Included in the Group's retained profits as at 31 December 2004 is an amount of HK$39 million *(2003: HK$86 million)*, being the retained profits attributable to the non-controlled subsidiary.

37 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 so 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 2004, the total membership was 5,966 *(2003: 6,093)*. In 2004, members contributed HK$67 million *(2003: HK$70 million)* and the Company contributed HK$224 million *(2003: HK$238 million)* to the hybrid benefit section. The net asset value of the hybrid benefit section as at 31 December 2004 was HK$5,365 million *(2003: HK$4,639 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 2004, the total membership under this section was 406 *(2003: 405)*. In 2004, total members' contributions were HK$6.4 million *(2003: HK$5.3 million)* and the total contribution from the Company was HK$13.3 million *(2003: HK$11.1 million)*. The net asset value as at 31 December 2004 was HK$74.8 million *(2003: HK$49.5 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.

37 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 2004 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% *(2003: 2.0%)* 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 2004, there were 397 members *(2003: 424)* 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 2004, the Company's contributions amounted to HK$2 million *(2003: HK$2 million)*. The net asset value of the RBS as at 31 December 2004 was HK$14 million *(2003: HK$14 million)*.

Actuarial valuations are carried out annually. A full actuarial valuation of the RBS was carried out at 31 December 2004 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 -1.25% *(2003: 0%)* 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 2004, the total number of employees of the Company participating in the MPF Scheme was 478 *(2003: 504)*. In 2004, total members' contributions were HK$1.6 million *(2003: HK$1.7 million)* and total contribution from the Company was HK$2.5 million *(2003: HK$2.0 million)*.

38 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 37). 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 **2004**	RBS **2004**	Total **2004**	Retirement Scheme 2003	RBS 2003	Total 2003
Present value of funded obligations	**5,456**	**7**	**5,463**	4,277	14	4,291
Fair value of plan assets	**(5,365)**	**(14)**	**(5,379)**	(4,638)	(14)	(4,652)
Net unrecognised actuarial gains/(losses)	**(188)**	**6**	**(182)**	322	2	324
Net (asset)/liability	**(97)**	**(1)**	**(98)**	(39)	2	(37)

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 **2004**	RBS **2004**	Total **2004**	Retirement Scheme 2003	RBS 2003	Total 2003
At 1 January	**(39)**	**2**	**(37)**	1	2	3
Contributions paid to the Schemes	**(224)**	**(2)**	**(226)**	(238)	(2)	(240)
Expense recognised (Note 38C)	**166**	**(1)**	**165**	198	2	200
At 31 December	**(97)**	**(1)**	**(98)**	(39)	2	(37)

C Expense recognised in the consolidated profit and loss account:

in HK$ million	Retirement Scheme **2004**	RBS **2004**	Total **2004**	Retirement Scheme 2003	RBS 2003	Total 2003
Current service cost	**228**	**–**	**228**	235	–	235
Interest cost	**222**	**1**	**223**	195	1	196
Expected return on plan assets	**(284)**	**(1)**	**(285)**	(232)	(1)	(233)
Net actuarial (gain)/loss recognised	**–**	**(1)**	**(1)**	–	2	2
Expense recognised (Note 38B)	**166**	**(1)**	**165**	198	2	200
Less: Amount capitalised	**28**	**(1)**	**27**	42	2	44
	138	**–**	**138**	156	–	156

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

38 Defined benefit retirement plan obligations (continued)

D Actual gain/(loss) on plan assets

in HK$ million	**2004**	2003
MTRCL Retirement Scheme	**527**	791
MTRCL Retention Bonus Scheme	**–**	–

E The principal actuarial assumptions used as at 31 December 2004 (expressed as weighted average) are as follows:

	Retirement Scheme **2004**	RBS **2004**	Retirement Scheme 2003	RBS 2003
Discount rate at 31 December	**4.25%**	**1.00%**	5.25%	1.25%
Expected rate of return on plan assets	**6.00%**	**1.50%**	6.00%	1.50%
Future salary increases	**4.00%**	**2.75%**	4.00%	1.50%

39 Construction projects

A Disneyland Resort Line

The Project Agreement between the Government and the Company for the design, construction, financing and operation of the Disneyland Resort Line was signed on 24 July 2002.

With the progress made on construction and equipment installation, the project is currently scheduled to complete on target on or before 1 July 2005. It is also currently forecast that the capital cost estimate of the project will not exceed the original budget of HK$2 billion.

At 31 December 2004, the Company had incurred expenditure of HK$1,409 million *(2003: HK$883 million)* on the project and had authorised outstanding commitments on contracts totalling HK$94 million *(2003: HK$446 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 project is currently on programme and is scheduled to be completed and opened for service in early 2006. The capital cost estimate for the project based on the defined scope of works and programme is currently estimated at HK$1 billion.

At 31 December 2004, the Company had incurred expenditure of HK$444 million *(2003: HK$137 million)* on the project and had authorised outstanding commitments on contracts totalling HK$367 million *(2003: HK$495 million)* related to the project.

C AsiaWorld-Expo Station Project

The Project Agreement between the Hong Kong IEC Limited and the Company for the design, construction, financing and operation of the AsiaWorld-Expo Station Project was signed on 17 March 2004.

Following the Agreement, the Company has carried out certain construction works and target completion is at the end of 2005. It is currently estimated that the Company will contribute approximately HK$0.2 billion to the capital cost of the project.

At 31 December 2004, the Company had incurred expenditure of HK$33 million *(2003: HK$3 million included in deferred expenditure)* on the project and had authorised outstanding commitments on contracts totalling HK$87 million *(2003: Nil)* related to the project.

40 Interests in jointly controlled operations

The Group has the following jointly controlled operations in respect of its property development projects as at 31 December 2004.

Location/ development package	Land use	Total gross floor area (sq. m.)	Actual or expected date of completion of construction works *
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 in 2003
Package Three	Residential / Cross Border Bus Terminus	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 2007 – 2010
Olympic Station			
Package One	Residential / Office / Retail	309,069	Completed in 2000
Package Two	Residential / Retail	268,650	Completed in 2001
Package Three	Residential / Kindergarten	104,452	By phases from 2005 – 2006
Tsing Yi Station	Residential / Retail	292,795	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	Completed in 2004
Tiu Keng Leng Station	Residential / Retail	253,765	By phases from 2006 – 2007
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	21,538	2005

* Completion based on issuance of occupation permit

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 2004, total property development in progress in respect of these jointly controlled operations was HK$388 million *(2003: HK$540 million)* and total deferred income was HK$4,506 million *(2003: HK$4,924 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 2004 was HK$265 million *(2003: HK$108 million)* in respect of accruals related to property enabling works.

During the year ended 31 December 2004, profits of HK$4,568 million *(2003: HK$5,369 million)* were recognised (note 6).

41 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 Disneyland Resort Line (the "DRL Agreement"). In connection with the financing of the DRL 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 DRL Project, and the projected return of the DRL pursuant to the terms of the Operating Agreement (note 41C). 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. Such financial support has been paid-up following Government's waiver of HK$37 million in respect of the final dividend for the financial year ended 31 December 2003 in this year (note 41J).

41 Material related party transactions (continued)

F 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 39B.

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

G 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 2004 are provided in notes 15, 25 and 31 respectively.

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	**2004**	2003
Cash dividends paid	**652**	–
Cash dividends waived (Note 41E)	**37**	675
Shares allotted in respect of scrip dividends	**1,014**	986
	1,703	1,661

During the year, HK$37 million *(2003: HK$675 million)* cash dividends were waived by the Government. Such amount *(2003: HK$664 million)*, together with HK$11 million *(2003: Nil)* brought forward from previous year, have been offset against the construction costs of the DRL Project (note 15).

42 Commitments

A Capital commitments

(i) Outstanding capital commitments as at 31 December 2004 not provided for in the accounts were as follows:

The Group and The Company

in HK$ million	Railway operations	Railway extension projects	Property development projects	Total
2004				
Authorised but not yet contracted for	**518**	**–**	**1,762**	**2,280**
Authorised and contracted for	**927**	**558**	**213**	**1,698**
	1,445	**558**	**1,975**	**3,978**
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

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.

(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
2004			
Authorised but not yet contracted for	**388**	**130**	**518**
Authorised and contracted for	**232**	**695**	**927**
	620	**825**	**1,445**
2003			
Authorised but not yet contracted for	348	122	470
Authorised and contracted for	394	498	892
	742	620	1,362

(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	**2004**	2003
Authorised but not yet contracted for	**1,762**	1,817
Authorised and contracted for	**204**	61
	1,966	1,878

42 Commitments (continued)

B Operating lease commitments

The Group had operating leases on office buildings and staff quarters as at 31 December 2004. The total future minimum lease payments under non-cancellable operating leases are payable as follows:

The Group and The Company

in HK$ million	**2004**	2003
Payable within one year		
Leases expiring within one year	**5**	3
Leases expiring between one to five years	**2**	3
	7	6
Payable after one but within five years	**1**	1
	8	7

The above includes HK$2 million *(2003: HK$3 million)* in respect of the office accommodation and quarters for construction project staff. The majority of the leases are subject to rent reviews.

C Liabilities and commitments in respect of property management contracts

The Group has, 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 2004, the Group had total outstanding liabilities and contractual commitments of HK$613 million *(2003: HK$490 million)* in respect of these works and services. Cash funds totalling HK$665 million *(2003: HK$568 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.

D Investments in China

(i) Investment in Line 4 of Shenzhen Metro System ("Shenzhen Line 4")

In January 2004, the Company entered into an Agreement in Principle for a Build-Operate-Transfer ("BOT") project with the Shenzhen Municipal People's Government in respect of the construction of Phase 2 of Shenzhen Line 4 of the proposed Shenzhen Metro System and the operation of the entire line for a term of 30 years. The project is subject to a Concession Agreement with the Shenzhen Municipal People's Government and the necessary government approvals, including that from the Central Government.

Shenzhen Line 4 is a 21-kilometre urban railway running from Huanggang to Longhua New Town in Shenzhen, forming the major north-south railway corridor of the Shenzhen Special Economic Zone. Phase 2 of Shenzhen Line 4 is targeted to complete in late 2008 and upon completion, both Phases 1 and 2 will be operated by the Company's subsidiary established in Shenzhen. Total investment of the project is estimated at RMB 6 billion (HK$5.66 billion) which will be financed by equity capital of RMB 2.4 billion (HK$2.26 billion) and the balance by non-recourse bank loans in RMB. The project will be implemented with associated property developments comprising 2.9 million square metres of commercial and residential space along the railway.

As of 31 December 2004, total costs of HK$51 million *(2003: Nil)* incurred for the project have been included in deferred expenditure and the Company had further commitment on contracts totalling HK$10 million *(2003: Nil)* in relation to this project.

42 Commitments (continued)

(ii) Investment in Beijing Metro Line 4 Project ("Beijing Line 4")
In December, an Agreement in Principle was entered into between the Company, Beijing Infrastructure Investment Co Ltd. ("BIIC") and Beijing Capital Group ("BCG"), both are subsidiaries of the Beijing Municipal People's Government, to form a Public-Private-Partnership company ("PPP") for the investment in the Beijing Line 4 project, which involves the investment, construction and operation of the line for a term of 30 years. The project is subject to a Concession Agreement with the Beijing Municipal People's Government and approval from the Central Government.

Beijing Metro Line 4 project is a 29-kilometre new underground metro line running from Majialou Station to Longbeicun Station, forming a main north-south traffic artery of Beijing. The total investment for the Beijing Line 4 project is about RMB 15.3 billion (HK$14.4 billion), 70% of which will be funded by the Beijing Municipal People's Government. The PPP's investment will be approximately RMB 5 billion (HK$4.7 billion), contributing to approximately one-third of the total investment in the project. Both the Company and BCG will each own 49% of the PPP whilst BIIC will own the remaining 2% interest. The PPP has a registered capital of approximately RMB 1.5 billion (HK$1.42 billion), about RMB 735 million (HK$693 million) of which will be owned by the Company. The remaining two-thirds of the PPP's investment is expected to be funded by non-recourse bank loans.

43 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 2004. 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 2004, all options granted under the Pre-IPO Option Scheme have been vested.

In 2004, no options were vested and a total of 8,023,500 previously vested share options have been exercised. The weighted average closing price in respect of the share options exercised during the year was HK$12.09 per share. In addition, no share options lapsed as a result of the resignation of option holders during the year. As at 31 December 2004, total options to subscribe for 17,206,000 *(2003: 25,229,500)* 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 2004, 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. The options are exercisable on or prior to 14 July 2013.

In 2004, 521,000 options to subscribe for shares were vested. However, none of the share options vested so far have been exercised and no share options lapsed during the year. As at 31 December 2004, total options to subscribe for 1,561,200 *(2003: 1,561,200)* shares remained outstanding.

44 Subsequent events

A On 24 January 2005, the Company accepted an offer from the Government to allow the Company to proceed with the proposed development on Site F of Tseung Kwan O Town Lot No. 70, Area 86, at an assessed land premium of HK$2,319 million together with other ancillary terms and conditions as specified in the modification letter to be entered into between the Company and the Government. On 8 February 2005, a Development Agreement was entered into between the Company and City Investments Limited, a subsidiary of Cheung Kong (Holdings) Ltd. to jointly develop this site under which the Company will pay half of the land premium. The site involves accommodation and facilities with a total gross floor area of not less than 136,540 square metres comprising 2,096 residential flats, a 31,000-square metre home for the aged and about 500 square metres of retail space. The development is expected to be completed in 2008.

B On 7 February 2005, the Company and its PPP partners initialed the Concession Agreement for the Beijing Metro Line 4 project (note 42D(ii)) with the Beijing Municipal People's Government.

45 Recently issued accounting standards

The HKICPA has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("new HKFRSs") which are effective for accounting periods beginning on or after 1 January 2005. The Group did not apply early adoption of these new HKFRSs to its financial statements for the year ended 31 December 2004. However, the Group has been carrying out an assessment of the impact of these new HKFRSs and has so far concluded that the adoption of the revised standards may have significant impact to its consolidated accounts as described below:

A Hong Kong Accounting Standard 40 ("HKAS 40") on investment property

The adoption of HKAS 40 would require all revaluation gains or losses of investment properties to be taken directly to the Profit and Loss Account ("P&L"), whereas under the old standards such changes are generally taken to the revaluation reserve account on a portfolio basis. The volatility of property prices therefore could have significant impact on the level and consistency of the Company's future operating profits.

B Hong Kong Accounting Standards 32 & 39 ("HKASs 32 & 39") on financial instruments

The adoption of HKASs 32 and 39 would require all financial instruments which the Company is using to hedge the interest rate and currency risks of its borrowings to be marked to market, with change in their fair values recognised in the P&L directly. The standard allows the application of hedge accounting, that is, to use the change in fair value of the underlying hedged items to offset this impact. Should there be inefficiency in the hedging relationship to the extent that the opposing impacts do not cancel each other out, there will be a net residual impact to the P&L. Given that hedge efficiency is affected by a number of factors including the nature of the hedging relationship, direction of interest rates and changes in foreign exchange rates, it is difficult to forecast and control this residual impact.

It should be noted, however, that both of these accounting changes are non-cash items and hence do not affect cash flow.

The Group will continue to assess the impact of other new HKFRSs and other changes may be identified as a result. However, it is not expected that these will have a significant impact on the Group's consolidated accounts.

46 Approval of accounts

The accounts were approved by the Board on 1 March 2005.