Notes to the accounts

1 Statement of compliance

These accounts have been prepared in compliance with the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

With effect from 1 January 2005, all Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") have been converged with International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB"). As a result, the HKICPA has aligned HKFRSs with the requirements of IFRSs in all material respects from the same date. These accounts have been prepared in accordance with all HKFRSs, which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKAS"), Interpretations issued by HKICPA and accounting principles generally accepted in Hong Kong. Changes in accounting policies from those adopted in the 2004 annual accounts are disclosed in note 3.

2 Principal accounting policies

A Basis of preparation of accounts

(i) The measurement basis used in the preparation of the accounts is historical cost basis except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- investment properties (see note 2F(i));
- other leasehold land and buildings, for which the fair values cannot be measured separately at the inception of the lease and the entire lease is classified as a finance lease (see note 2F(ii));
- financial instruments classified as investments in securities (see note 2L); and
- derivative financial instruments (see note 2T);

(ii) The preparation of the accounts in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements and estimations about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRSs that have significant effect on the accounts and estimates are discussed in note 50.

B Basis of consolidation

The consolidated accounts include the accounts of the Company and its subsidiaries (collectively refer to as the "Group") and the Group's interest in associates except for non-controlled subsidiaries (see note 2D) 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.

2 Principal accounting policies (continued)

C Subsidiaries (continued)

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 and statement of changes in equity within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated profit and loss account as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.

Where losses attributable to the minority exceed the minority interest in the equity 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 2G(ii)).

D Non-controlled subsidiaries

Non-controlled subsidiaries are not consolidated to the accounts as the Group does not have effective control over their Boards. The investments in non-controlled subsidiaries are accounted for in the consolidated accounts of the Company using the equity method and are initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of their net assets. The consolidated profit and loss account reflects the Group's share of the results of those subsidiaries for the year.

Unrealised profits and losses resulting from transactions between the Group and the non-controlled subsidiaries are eliminated to the extent of the Group's interest in those subsidiaries, 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 investments in non-controlled subsidiaries are stated at cost less impairment losses (see note 2G(ii)).

E Associates and jointly controlled entities

An associate is an entity over which the Group or the Company has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

A jointly controlled entity is an entity which operates under a contractual arrangement between the Group or the Company and other parties, where the contractual arrangement establishes that the Group or the Company and one or more of the other parties share joint control over the economic activity of the entity.

An investment in an associate or a jointly controlled entity is accounted for in the consolidated accounts of the Company using the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's or the jointly controlled entity's net assets. The consolidated profit and loss account reflects the Group's share of the post acquisition results of the associates and jointly controlled entities for the year.

When the Group's share of losses equals or exceeds its interest in the associate or the jointly controlled entity, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate or the jointly controlled entity. For this purpose, the Group's interest in the associate and the jointly controlled entity is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate or the jointly controlled entity.

Unrealised profits and losses resulting from transactions between the Group and its associates and jointly controlled entities are eliminated to the extent of the Group's interest in the associates and jointly controlled entities, 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 investments in associates and jointly controlled entities are stated at cost less impairment losses (see note 2G(ii)).

2 Principal accounting policies (continued)

F Fixed assets

(i) Investment properties are land and/or buildings which are owned or held under a leasehold interest to earn rental income and/or for capital appreciation.

Investment properties are stated in the balance sheet at fair value as determined annually by independent professionally qualified valuers. Gains or losses arising from changes in the fair value are recognised as profit or loss in the year in which they arise.

Property that is being constructed or developed for future use as investment property is classified as asset under construction within property, plant and equipment and stated at cost until construction or development is complete, at which time it is reclassified as investment property at fair value. Any difference between the fair value of the property at that date and its previous carrying amount is recognised in the profit and loss account.

(ii) Land held for own use under operating leases and buildings thereon, where the fair values of the leasehold interest in the land and buildings cannot be measured separately at the inception of the lease are accounted for as being held under a finance lease, unless the buildings are also clearly held under an operating lease. The self-occupied land and buildings are stated in the balance sheet at their fair values 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, with changes in the value arising on revaluations 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 (see note 2G(ii)).

(iv) Assets under construction are stated at cost less impairment losses (see note 2G(ii)). 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 the appropriate fixed assets category when substantially all the activities necessary to prepare the asset for its intended use are completed.

(v) Leased assets

(a) Leases of assets under which the lessee assumes substantially all the risks and rewards 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. Depreciation and impairment losses are accounted for in accordance with the accounting policy as set out in notes 2H(iv) and 2G(ii) respectively. Finance charges implicit in the lease payments are charged to profit or loss over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

(b) Leases of assets, other than that mentioned in note 2F(v)(c) below, under which the lessor has not transferred substantially all the risks and rewards 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 (see note 2G(ii)). Revenue arising from operating leases is recognised in accordance with the Group's revenue recognition policies as set out in note 2Y.

(c) Land held for own use under an operating lease where its fair value cannot be measured separately from the fair value of a building situated thereon at the inception of the lease, is accounted for as being held under a finance lease, unless the building is also clearly held under an operating lease (see note 2F(ii)). For these purposes, the inception of the lease is the time that the lease was first entered into by the Group, or taken over from the previous lessee, or at the date of construction of those buildings, if later.

2 Principal accounting policies (continued)

F Fixed assets (continued)

(vi) Subsequent expenditure relating to the replacement of certain parts of an existing fixed asset is recognised in the carrying amount of the asset if it is probable that future economic benefit will flow to the Group and the cost of the item can be measured reliably. The carrying amount of those parts that are replaced is derecognised, with gain or loss arising therefrom dealt with in the profit and loss account.

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.

G Impairment of assets

(i) Impairment of debtors and other receivables

Debtors and other current and non-current receivables are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets) where the effect of discounting is material.

If in a subsequent period the amount of an impairment loss decreases, the impairment loss is reversed through the profit and loss account.

(ii) Impairment of other 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;
- prepaid land lease payments;
- property development in progress;
- deferred expenditure; and
- investments in subsidiaries, associates and jointly controlled entities.

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 in the profit and loss account whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, 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.

2 Principal accounting policies (continued)

H Depreciation

(i) Investment properties 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:

Land and Buildings

Self-occupied office land and buildings	the shorter of 50 years and the unexpired term of the lease

Civil Works

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

Plant and Equipment

Rolling stock	10 – 40 years
Platform screen doors	35 years
Rail track	7 – 30 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
Station architectural finishes	20 – 30 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

Where parts of an item of property, plant and equipment have different useful lives, each part is depreciated separately. The useful lives of the various categories of fixed assets are reviewed annually in the light of actual asset condition, usage experience and the current asset replacement programme.

(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.

I 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.

2 Principal accounting policies (continued)

J Property development

(i) Costs incurred by the Group in respect of site preparation and land costs paid 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 self-occupation 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.

K Jointly controlled operations

The arrangements entered into by the Group with developers for property developments without establishing separate entities are considered to be jointly controlled operations pursuant to HKAS 31 "Investments in joint ventures". Under 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 and land costs paid 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 2J(v) after netting off any related balance in property development in progress at that time.

2 Principal accounting policies (continued)

L Investments in securities

The Group's policies for investments in securities (other than investments in its subsidiaries, non-controlled subsidiaries, associates and jointly controlled entities), which are held for trading purpose, are as follows:

(i) Investments in securities are initially stated at fair value. At each balance sheet date the fair value is remeasured, with any resultant unrealised gain or loss being recognised in the profit and loss account.

(ii) Investments are recognised/derecognised on the date the Group commits to purchase/sell the investments or they expire.

(iii) Profit or loss on disposal of investments in 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.

M 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.

N 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.

O Long-term consultancy contracts

The accounting policy for contract revenue is set out in note 2Y(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".

P 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.

2 Principal accounting policies (continued)

Q Debtors, deposits and payments in advance

Debtors, deposits and payments in advance are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 2G(i)), except where the effect of discounting would be immaterial or the discount is not measurable as the receivables are interest-free loans made to related parties without any fixed repayment terms. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts (see note 2G(i)).

R Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised costs; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest method.

S Creditors, accrued charges and provisions

Creditors, accrued charges and provisions are stated at amortised cost if the effect of discounting would be material, otherwise they are stated at cost.

T Derivative financial instruments and hedging activities

The Group uses derivative financial instruments such as interest rate swaps and currency swaps to manage its interest rate and foreign exchange exposure. Based on Group policy, these instruments are used solely for reducing or eliminating financial risks associated with the Group's liabilities and not for trading or speculation purposes.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value at each balance sheet date. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and the nature of the item being hedged.

Where hedge accounting applies, the Group designates derivatives employed as either: (1) a fair value hedge: to hedge the fair value of recognised liabilities; or (2) a cash flow hedge: to hedge the variability in cash flows of a recognised liability or the foreign currency risk of a firm commitment.

(i) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the profit and loss account, together with any changes in the fair value of the hedged assets or liabilities that are attributable to the hedged risk.

(ii) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised directly in equity. The gain or loss relating to the ineffective portion is recognised immediately in the profit and loss account.

When a hedging instrument used to hedge the variability in cash flows of a recognised liability expires or is sold, terminated or exercised, or no longer meets the criteria for hedge accounting; or the Group revokes designation of the hedge relationship, the associated gain or loss is removed from equity and recognised in the profit and loss account.

When a hedge of a firm commitment subsequently results in the recognition of a fixed asset, the associated gain or loss is removed from equity and included in the initial cost or other carrying amount of the asset.

When the hedging instrument expires or is sold, terminated or exercised, or the entity revokes designation of the hedge relationship but the hedged commitment is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs.

(iii) Derivatives that do not qualify for hedge accounting

Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the profit and loss account.

2 Principal accounting policies (continued)

U 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) Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is recognised as a staff cost, unless the original employee expenses qualify for recognition as an asset, on a straight-line basis over the vesting period and taking into account the probability that the options will vest, with a corresponding increase in the employee share-based capital reserve within equity. Fair value is measured by use of a Black-Scholes model, taking into account the terms and conditions upon which the options were granted. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

During the vesting period, the number of share options that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged/credited to the profit and loss account for the year of the review, unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of share options that vest (with a corresponding adjustment to the capital reserve). The equity amount is recognised in the capital reserve until either the option is exercised (when it is transferred to the share premium account) or the option expires (when it is released directly to retained profits).

For cash-settled share-based payments, a liability equal to the portion of the services received is recognised at the fair value of the shares determined at each balance sheet date.

(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.

2 Principal accounting policies (continued)

V 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 2U(ii).

The employer's contributions paid and payable in respect of employees of the hybrid benefit section of the MTR Corporation Limited Retirement Scheme, as calculated annually by independent actuaries in accordance with the Retirement Scheme Rules and provisions of the Occupational Retirement Schemes Ordinance, are used to satisfy the pension expenses recognised in the accounts according to note 2U(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.

W 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.

2 Principal accounting policies (continued)

X 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.

Y 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.

Z Operating lease charges

(i) 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.

(ii) Prepaid land lease payments for land are stated at cost and are amortised on a straight-line basis over the period of the lease terms to the profit and loss account as land lease expenses.

AA 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.

BB 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. Exchange gains and losses are recognised in 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.

2 Principal accounting policies (continued)

CC 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 operating 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 derivative financial assets and liabilities, corporate assets, interest-bearing loans, borrowings, share of results of non-controlled subsidiaries, associates and jointly controlled entities, corporate and financing expenses and minority interests.

DD 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 (being members of key management personnel, significant shareholders and/or their close family members) or other entities including entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

EE 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.

3 Adoption of new Hong Kong Financial Reporting Standards

A The Group has adopted all HKFRSs (which include all HKASs, Interpretations issued by the Standing Interpretations Committee of IASB ("HK(SIC)-Ints") and Interpretations issued by the HKICPA ("HK-Ints")) issued up to 31 December 2005 pertinent to its operations. The applicable HKFRSs are set out below and the accounts for the year ended 31 December 2004 has been restated in accordance with the relevant requirements except for HKASs 32 and 39 which have been adopted prospectively as of 1 January 2005.

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 11	Construction Contracts
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 20	Accounting for Government Grants and Disclosure of Government Assistance
HKAS 21	The Effects of Changes in Foreign Exchange Rates

3 Adoption of new Hong Kong Financial Reporting Standards (continued)

HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 31	Investments in Joint Ventures
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings Per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 40	Investment Property
HKFRS 2	Share-based Payment
HKFRS 3	Business Combinations
HK(SIC)-Int 15	Operating Leases – Incentives
HK(SIC)-Int 21	Income Taxes – Recovery of Revalued Non-Depreciable Assets
HK(SIC)-Int 27	Evaluating the Substance of Transaction Involving the Legal Forms of a Lease
HK-Int 2	The Appropriate Accounting Policies for Hotel Properties
HK-Int 3	Revenue – Pre-completion Contracts for the Sale of Development Properties
HK-Int 4	Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases

The adoption of the above new HKFRSs has the following impacts on the Group's accounting policies:

(i) The adoption of HKASs 2, 7, 8, 10, 11, 12, 14, 16, 18, 19, 20, 21, 23, 27, 28, 31, 33, 36, 37, HKFRS 3, HK(SIC)-Ints 15, 27 and HK-Ints 3, 4 do not result in substantial changes to the Group's accounting policies. In summary:

- HKASs 2, 8, 16, 27 and 28 affect certain disclosure of the accounts; and
- HKASs 7, 10, 11, 12, 14, 18, 19, 20, 21, 23, 31, 33, 36, 37, HKFRS 3, HK(SIC)-Ints 15, 27 and HK-Ints 3, 4 do not have any impact as the Group's accounting policies already comply with those standards.

(ii) The adoption of HKAS 1 has resulted in changes in presentation of shares of non-controlled subsidiaries' taxation and minority interests as follow:

- in prior years, the Group's share of taxation of non-controlled subsidiaries accounted for using the equity method was included as part of the Group's income tax in the consolidated profit and loss account. With effect from 1 January 2005, the Group has changed the presentation and includes the share of taxation of non-controlled subsidiaries accounted for using the equity method in the respective shares of profit or loss reported in the consolidated profit and loss account before arriving at the Group's profit or loss before tax; and
- in prior years, minority interests at the balance sheet date were presented in the consolidated balance sheet separately from liabilities and as deduction from net assets. Minority interests in the results of the Group for the year were also separately presented in the profit and loss account as a deduction before arriving at the profit attributable to equity shareholders (the equity shareholders of the Company). With effect from 1 January 2005, in order to comply with HKASs 1 and 27, the Group has changed its accounting policy relating to presentation of minority interests. Under the new policy, minority interests are presented as part of equity, separately from interests attributable to the equity shareholders of the Company.

These changes in presentation have been applied retrospectively with comparatives restated.

(iii) The adoption of HKAS 17 has resulted in a change in accounting policy relating to leasehold land. Leasehold land and buildings were previously accounted for as finance leases and were stated at cost or valuation less accumulated depreciation. In accordance with HKAS 17, a leasehold interest in land is accounted for as an operating lease where the fair value of the interest in any buildings situated on the leasehold land could be measured separately from the fair value of the leasehold interest in the land at the time the lease was first entered into by the Group, or taken over from the previous lessee, or at the date of construction of those buildings, if later. Pursuant to these requirements, the land premium paid for distinguishable leasehold land is accounted for as an operating lease and amortised over its unexpired lease term, whereas indistinguishable leasehold land and building is stated collectively at valuation less accumulated depreciation. The new accounting policies have been adopted retrospectively and the adjustments for each financial statement line item affected for 31 December 2005 and 2004 are set out in note 3B(i).

3 Adoption of new Hong Kong Financial Reporting Standards (continued)

(iv) The adoption of HKAS 24 resulted in an expanded definition of related parties to include post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group, in addition to entities that are under the significant influence of a related party that is an individual (i.e. key management personnel, significant shareholders and / or their close family members). This revised definition has not resulted in any material changes to the previously reported disclosures of related party transactions nor has it had any material effect on the disclosures made in the current period.

(v) The adoption of HKASs 32 and 39 has resulted in a change in accounting policy for recognition, measurement and disclosure of financial instruments. Prior to 1 January 2005, derivatives of the Group were not recorded on the balance sheet based on the then prevailing accounting standards. In accordance with the provisions of HKAS 39, all derivatives have been recognised at their fair value on the balance sheet on 1 January 2005. Subject to meeting the requirements to qualify for hedge accounting, those underlying financial liabilities, such as loans that are designated as hedged items for fair value hedges, have been revalued at their fair values with corresponding adjustments made to their carrying amounts on the balance sheet. Depending on the type of hedging relationship, subsequent changes in fair value of derivatives and hedged items are to be charged to the profit and loss account or directly transferred to hedging reserve. The changes in accounting policies relating to accounting for financial instruments were adopted by way of opening balance adjustments to other reserves as at 1 January 2005. Comparative amounts have not been restated as the Company has adopted HKASs 32 and 39 prospectively. The adjustments for each financial statement line affected for the year ended 31 December 2005 are set out in note 3B(i).

(vi) The adoption of HKAS 40 has resulted in a change in accounting policy for the Group's investment properties. In prior years, increases in the valuation of investment property were credited to the investment property revaluation reserve except when, on a portfolio basis, the reserve was insufficient to cover a deficit on the portfolio, or when a deficit previously recognised in the profit and loss account had reversed, or when an individual investment property was disposed of. In these limited circumstances, movements in the fair value were recognised in the profit and loss account. Following the adoption of HKAS 40, all changes in valuation of the investment property are to be recognised in the profit and loss account.

The adoption of HK(SIC)-Int 21 has resulted in a change in accounting policy for the deferred tax treatment on the Group's investment properties. Prior to 1 January 2005, deferred tax on changes in fair value of investment properties arising from revaluation was not provided on the basis that the recovery of the carrying amount would be through sale and was calculated at the tax rate applicable on eventual sale, which in Hong Kong is nil. Following the adoption of HK(SIC)-Int 21, the deferred tax arising from revaluation of the investment properties is required to be valued on the basis that the recovery of the carrying amount of the properties would be through use and calculated at the profits tax rate and is charged to the profit and loss account.

All the above changes in accounting policies relating to investment property have been adopted retrospectively. The adjustments for each financial statement line affected for 31 December 2005 and 2004 are set out in note 3B(i).

(vii) The adoption of HKFRS 2 has resulted in a change in accounting policy for employee share options and other share-based payments. Prior to this, no amounts were recognised when employees were granted share options over shares in the Company. If the employees chose to exercise the options, the nominal amount of share capital and share premium were credited only to the extent of the option's exercise price receivable. Following the adoption of HKFRS 2:

- the fair value of share options at grant date are amortised over the relevant vesting periods to the profit and loss account with corresponding increases recognised in an employee share-based capital reserve within equity; and
- the fair value of cash-settled share-based payments are charged to profit and loss account, with corresponding amount recorded in liabilities.

The new accounting policies have been applied retrospectively with comparatives restated, except that the Group has taken advantage of the transitional provisions set out in HKFRS 2, under which the new recognition and measurement policies have not been applied to all options granted to employees on or before 7 November 2002. The adjustments for each financial statement line affected for the years ended 31 December 2005 and 2004 are set out in note 3B(i).

(viii) The introduction of HK-Int 2 has resulted in a change in accounting policy on depreciation of the Group's rails assets. In prior years, certain rails assets subject to continuous repair and maintenance had been carried at historical cost without depreciation as those assets were considered to be maintained in full working condition, while the related repair and maintenance and replacement cost of which was charged to the profit and loss account as revenue expenses. Following the introduction of HK-Int 2, depreciation is provided on such rails assets and charged to the profit and loss account while rail replacement cost is capitalised and depreciated.

Comparative figures have not been adjusted on adoption of the new policies as the financial impact of a retrospective adjustment is not material.

3 Adoption of new Hong Kong Financial Reporting Standards (continued)

B (i) Pursuant to HKAS 8 (which outlines the disclosure requirements when a change in accounting policy has a material effect on the current and prior periods presented), the Group has retrospectively restated the opening balances of the retained profits as at 1 January 2004 and 2005 to take into account the effects of changes in the above accounting policies, except for HKASs 32 and 39 (note 3B(iii)) which are applied prospectively and HK-Int 2 (note 3B(iv)) as explained in notes 3A(v) and (viii) above. The previously reported net profit for the year ended 31 December 2004 has also been adjusted. These effects on the financial statements are summarised as follows:

Consolidated profit and loss account

	Effects of adopting				
in HK$ million	HKAS 17	HKAS 40	HKFRS 2	HK(SIC)-Int 21	Total
Effects on periods prior to 2004					
Decrease in depreciation	98	–	–	–	98
Increase in other expenses	(98)	–	–	–	(98)
Revaluation gain on investment properties	–	6,682	–	–	6,682
Increase in deferred tax	–	–	–	(1,169)	(1,169)
Increase in retained profits	–	6,682	–	(1,169)	5,513
Effects on year ended 31 December 2004					
Decrease in depreciation	13	–	–	–	13
Increase in other expenses	(13)	–	–	–	(13)
Revaluation gain on investment properties	–	2,486	–	–	2,486
Increase in deferred tax	–	–	–	(435)	(435)
Increase in staff costs and related expenses for share option schemes	–	–	(4)	–	(4)
Increase in profit for the year ended 31 December 2004 *	–	2,486	(4)	(435)	2,047
Increase in retained profits as at 31 December 2004	–	9,168	(4)	(1,604)	7,560

* *Restated profit for the year ended 31 December 2004 is HK$6,543 million, after taking into account the prior year adjustments of HK$2,047 million due to changes in accounting policies (note 41).*

Balance sheet

The Group and The Company

	Effects of adopting				
in HK$ million	HKAS 17	HKAS 40	HKFRS 2	HK(SIC)-Int 21	Total
Effects as at 31 December 2004					
Assets					
Decrease in other property, plant and equipment	(621)	–	–	–	(621)
Increase in prepaid land lease payments	621	–	–	–	621
	–	–	–	–	–
Liabilities					
Increase in creditors, accrued charges and provisions	–	–	3	–	3
Increase in deferred tax liabilities	–	–	–	1,604	1,604
	–	–	3	1,604	1,607
Net assets	–	–	(3)	(1,604)	(1,607)
Equity					
Decrease in investment property revaluation reserve	–	(9,168)	–	–	(9,168)
Increase in employee share-based capital reserve	–	–	1	–	1
Increase/(decrease) in retained profits	–	9,168	(4)	(1,604)	7,560
	–	–	(3)	(1,604)	(1,607)

3 Adoption of new Hong Kong Financial Reporting Standards (continued)

(ii) The following tables provide estimates of the extent to which each of the line items in the consolidated profit and loss account, and the Group's and the Company's balance sheets for the year ended 31 December 2005 is higher or lower than it would have been had the previous policies still been applied in the year, where it is practicable to make such estimates.

Consolidated profit and loss account

	Estimated effects of adopting					
in HK$ million	HKAS 17	HKASs 32 & 39	HKAS 40	HKFRS 2	HK(SIC)-Int 21	Total
Estimated effects on year ended 31 December 2005						
Decrease in depreciation	13	–	–	–	–	13
Increase in other expenses	(13)	(9)	–	–	–	(22)
Revaluation gain on investment properties	–	–	2,800	–	–	2,800
Increase in interest and finance charges	–	(6)	–	–	–	(6)
Decrease/(increase) in deferred tax	–	3	–	1	(490)	(486)
Increase in staff costs and related expenses for share option schemes	–	–	–	(5)	–	(5)
Increase in profit for the year ended 31 December 2005	–	(12)	2,800	(4)	(490)	2,294

Balance sheet

The Group and The Company

	Estimated effects of adopting					
in HK$ million	HKAS 17	HKASs 32 & 39	HKAS 40	HKFRS 2	HK(SIC)-Int 21	Total
Estimated effects as at 31 December 2005						
Assets						
Decrease in other property, plant and equipment	(608)	–	–	–	–	(608)
Decrease in deferred expenditure	–	(109)	–	–	–	(109)
Increase in prepaid land lease payments	608	–	–	–	–	608
Increase in derivative financial assets	–	234	–	–	–	234
	–	125	–	–	–	125
Liabilities						
Increase in creditors, accrued charges and provisions	–	–	–	7	–	7
Decrease in loans	–	(410)	–	–	–	(410)
Increase in derivative financial liabilities	–	307	–	–	–	307
Increase/(decrease) in deferred tax liabilities	–	2	–	(1)	2,094	2,095
	–	(101)	–	6	2,094	1,999
Net assets	–	226	–	(6)	(2,094)	(1,874)
Equity						
Decrease in investment property revaluation reserve	–	–	(11,968)	–	–	(11,968)
Increase in hedging reserve	–	24	–	–	–	24
Increase in employee share-based capital reserve	–	–	–	2	–	2
Increase/(decrease) in retained profits	–	202	11,968	(8)	(2,094)	10,068
	–	226	–	(6)	(2,094)	(1,874)

3 Adoption of new Hong Kong Financial Reporting Standards (continued)

(iii) Following the prospective adoption of HKAS 39 from 1 January 2005, the following adjustments were made on the same date:

- recognise derivatives at fair value on the balance sheet on 1 January 2005 and adjust the balance to retained profits, except for those qualified for effective cash flow hedges which are recognised in the hedging reserve directly; and
- revalue those financial assets or financial liabilities that should be valued at fair value and those that should be valued at amortised cost and adjust the balance to retained profits at 1 January 2005.

As a result, the balances of retained profits and hedging reserve on 1 January 2005 have been increased by HK$190 million and decreased by HK$66 million respectively (note 41).

(iv) With regard to HK-Int 2, the Company has conducted an assessment of the financial implications of this new interpretation to its accounts and concluded that the impact was not significant and thus no prior period adjustment was considered necessary.

4 Fare revenue

in HK$ million	**2005**	2004
Fare revenue comprises:		
MTR Lines	**5,721**	5,417
Airport Express Line	**561**	515
	6,282	5,932

The MTR Lines comprise the Kwun Tong, Tsuen Wan, Island, Tung Chung and Tseung Kwan O Lines and, effective from 1 August 2005, the Disneyland Resort Line.

5 Non-fare revenue

A Station commercial and other revenue

in HK$ million	**2005**	2004
Station commercial and other revenue comprises:		
Advertising	**510**	467
Kiosk rental	**344**	298
Telecommunication income	**334**	238
Consultancy income	**211**	182
Miscellaneous business revenue	**156**	126
	1,555	1,311

B Rental and management income

in HK$ million	**2005**	2004
Rental income was attributable to:		
Telford Plaza	**470**	388
Luk Yeung Galleria	**120**	117
Paradise Mall	**111**	115
Maritime Square	**252**	224
International Finance Centre	**122**	77
Other properties	**108**	73
	1,183	994
Management income	**126**	108
Property agency income	**7**	6
	1,316	1,108

Included in rental income is service income of HK$63 million *(2004: HK$63 million)* relating to the provision of air conditioning services.

6 Operating expenses before depreciation

A Staff costs comprise:

in HK$ million	**2005**	2004 (Restated)
Amount charged to profit and loss account under:		
– staff costs and related expenses	**1,614**	1,546
– repairs and maintenance	**50**	46
– expenses relating to station commercial and other businesses	**145**	129
– property ownership and management expenses	**40**	32
– project study and business development expenses	**32**	28
– other line items	**51**	54
Amount capitalised in:		
– railway construction in progress	**136**	158
– property development in progress	**76**	74
– assets under construction and other projects	**261**	247
– amount recoverable	**166**	134
Total staff costs	**2,571**	2,448

Included in operating expenses are the following:

in HK$ million	**2005**	2004 (Restated)
Share options granted to directors and employees	**5**	4
Contributions to defined contribution plans and Mandatory Provident Fund	**12**	16
Expense recognised in respect of defined benefit plans (note 44C)	**134**	138
	151	158

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	**2005**	2004
New business development expenses	**142**	103
Tseung Kwan O South Station Project (note 18)	**–**	49
South Island Line (note 20)	**–**	15
	142	167

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

6 Operating expenses before depreciation (continued)

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

in HK$ million	**2005**	2004 (Restated)
Auditors' remuneration		
– audit services	**4**	4
– tax services	**1**	1
– other services	**2**	–
Write-back of deficit on revaluation of self-occupied office land and buildings (note 17C)	**–**	(69)
Loss on disposal of fixed assets	**40**	19
Derivative financial instruments:		
– foreign exchange contracts – ineffective portion of cash flow hedges	**6**	–
– transfer from hedging reserve	**3**	–
Amortisation of land lease expenses (note 21)	**13**	13
Unrealised loss on revaluation of investment in securities	**–**	1
Operating lease expenses:		
Office buildings and staff quarters	**10**	10
Less: Amount capitalised	**2**	3
	8	7

7 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	Fees	Base pay, allowances, and benefits in kind	Retirement scheme contribution	Variable remuneration related to performance	Total
2005					
Members of the Board					
– Raymond Ch'ien Kuo-fung	**1.0**	–	–	–	**1.0**
– Cheung Yau-kai	**0.2**	–	–	–	**0.2**
– David Gordon Eldon	**0.2**	–	–	–	**0.2**
– Christine Fang Meng-sang	**0.2**	–	–	–	**0.2**
– Edward Ho Sing-tin	**0.3**	–	–	–	**0.3**
– Lo Chung-hing	**0.2**	–	–	–	**0.2**
– T. Brian Stevenson	**0.3**	–	–	–	**0.3**
– Robert Charles Law Footman (retired on 18 June 2005)	**0.1**	–	–	–	**0.1**
– Sarah Liao Sau-tung	**0.2**	–	–	–	**0.2**
– Frederick Ma Si-hang	**0.2**	–	–	–	**0.2**
– Alan Wong Chi-kong (appointed on 18 June 2005)	**0.1**	–	–	–	**0.1**
Members of the Executive Directorate					
– Chow Chung-kong	–	**5.7**	–*	**4.2**	**9.9**
– Russell John Black	–	**3.5**	**0.3**	**1.0**	**4.8**
– William Chan Fu-keung	–	**3.5**	**0.3**	**0.9**	**4.7**
– Philip Gaffney (retired on 5 December 2005)	–	**3.9**	**0.3**	**1.1**	**5.3**
– Thomas Ho Hang-kwong	–	**3.5**	**0.3**	**1.0**	**4.8**
– Lincoln Leong Kwok-kuen	–	**3.4**	**0.5**	**1.0**	**4.9**
– Francois Lung Ka-kui (appointed on 26 September 2005)	–	**0.9**	**0.1**	**0.2**	**1.2**
– Andrew McCusker (appointed on 1 October 2005)	–	**0.9**	**0.1**	**0.2**	**1.2**
– Leonard Bryan Turk	–	**3.5**	**0.3**	**0.9**	**4.7**
	3.0	**28.8**	**2.2**	**10.5**	**44.5**

* C K Chow is a member of the Company's Mandatory Provident Fund Scheme. The total contributions paid by the Company in each of the years 2004 and 2005 were HK$12,000.

In December 2005, Philip Gaffney received a lump sum benefit payment of HK$11.6 million from the MTR Corporation Limited Retirement Scheme upon retirement.

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

in HK$ million	Fees	Base pay, allowances, and benefits in kind	Retirement scheme contribution	Variable remuneration related to performance	Total
2004					
Members of the Board					
– Raymond Ch'ien Kuo-fung	1.0	–	–	–	1.0
– Cheung Yau-kai	0.2	–	–	–	0.2
– David Gordon Eldon	0.2	–	–	–	0.2
– Christine Fang Meng-sang	0.2	–	–	–	0.2
– Edward Ho Sing-tin	0.3	–	–	–	0.3
– Lo Chung-hing	0.2	–	–	–	0.2
– T. Brian Stevenson	0.3	–	–	–	0.3
– Robert Charles Law Footman	0.2	–	–	–	0.2
– Sarah Liao Sau-tung	0.2	–	–	–	0.2
– Frederick Ma Si-hang	0.2	–	–	–	0.2
Members of the Executive Directorate					
– Chow Chung-kong	–	5.6	–*	3.4	9.0
– Russell John Black	–	3.6	0.5	0.8	4.9
– William Chan Fu-keung	–	3.6	0.5	0.8	4.9
– Philip Gaffney	–	3.9	0.6	0.8	5.3
– Thomas Ho Hang-kwong	–	3.6	0.5	0.8	4.9
– Lincoln Leong Kwok-kuen	–	3.4	0.4	0.8	4.6
– Leonard Bryan Turk	–	3.7	0.5	0.8	5.0
	3.0	27.4	3.0	8.2	41.6

(ii) The above emoluments do not include the fair value of share options granted to Lincoln K K Leong and Francois K K Lung under the Company's New Joiners Share Option Scheme, as estimated at the date of grant. The fair value of share-based payments for Lincoln K K Leong and Francois K K Lung for the year ended 31 December 2005 were HK$0.6 million *(2004: HK$0.6 million)* and HK$0.3 million *(2004: nil)* respectively. The details of directors' interest in the Company's shares are disclosed under the paragraph "Board Members and Executive Directorate's Interest in Shares" of the Report of the Members of the Board and note 42.

(iii) 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. Dr. Raymond Ch'ien Kuo-fung, a Member of the Board, was appointed as the non-executive Chairman of the Company with effect from 21 July 2003 for a term of three years. All of the five individuals with the highest emoluments are Members of the Executive Directorate whose emoluments are disclosed above.

(iv) C K Chow has a derivative interest in respect of 700,000 shares within the meaning of Part XV of the Securities and Futures Ordinance. That derivative interest represents C K Chow's entitlement to receive an equivalent value in cash of 700,000 shares on completion of his three-year contract (i.e. 30 November 2006).

The arrangement was offered in order to provide a competitive level of compensation and to enable C K Chow's total pay to be closely tied to the performance of the Company.

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

B Share options

Options exercised and outstanding in respect of each Member of the Executive Directorate as at 31 December 2005 are set out under the paragraph "Board Members and Executive Directorate's Interest in Shares" of the Report of the Members of the Board. Details of the options granted to Members of the Executive Directorate are as follows:

(i) Pre-Global Offering Share Option Scheme

Under the Company's Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") described in note 42A(i), each Member of the Executive Directorate, except C K Chow, Lincoln K K Leong, Francois K K Lung and Andrew McCusker, were granted options on 20 September 2000 to acquire 1,066,000 shares. C K Chow, Lincoln K K Leong and Francois K K Lung joined the Company on 1 December 2003, 1 February 2002 and 26 September 2005 respectively, and are not beneficiaries of the Pre-IPO Option Scheme. Andrew McCusker was granted 266,500 options on 20 September 2000 under the Pre-IPO Option Scheme and no additional share options were granted upon his appointment as a Member of the Executive Directorate on 1 October 2005.

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 23,000 shares; and (ii) at all times after 26 October 2002, at least 46,000 shares, 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 42A(ii), Lincoln K K Leong and Francois K K Lung, Members of the Executive Directorate, were granted options to acquire 1,066,000 shares on 1 August 2003 and 27 September 2005 respectively.

Under the vesting terms of the New Option Scheme, Lincoln K K Leong 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).

Under the vesting terms of the New Option Scheme, Francois K K Lung must continue to beneficially own (i) at all times on and after 17 October 2006, at least 23,000 shares; and (ii) at all times on and after 17 October 2007, 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).

8 Profit on property developments

in HK$ million	**2005**	2004
Profit on property developments comprises:		
Transfer from deferred income on		
– upfront payments (note 19B(i))	**1,794**	1,601
– sharing in kind (note 19B(ii))	**95**	1,008
Share of surplus from development	**3,062**	1,665
Profit on sale of properties held for sale	**234**	301
Profit recognised from sharing in kind	**971**	–
Other overhead costs	**(11)**	(7)
	6,145	4,568

Included in profit on sale of properties held for sale are write-back of prior year provision amounting to HK$4 million *(2004: HK$16 million)* and cost of properties sold of HK$551 million *(2004: HK$422 million)*.

9 Depreciation

in HK$ million	**2005**	2004 (Restated)
Depreciation comprised charges on:		
Railway operations		
– on fixed assets held under finance leases	**19**	19
– on other railway fixed assets	**2,502**	2,341
Assets relating to station commercial and other businesses	**126**	117
Unallocated corporate assets	**35**	22
	2,682	2,499

10 Interest and finance charges

in HK$ million	**2005**	2004
Interest expenses in respect of:		
Bank loans and overdrafts, and capital market instruments wholly repayable within 5 years	**934**	668
Capital market instruments not wholly repayable within 5 years	**485**	764
Obligations under finance leases	**25**	35
Finance charges	**33**	35
Exchange loss	**7**	2
Derivative financial instruments:		
Fair value hedges	**107**	–
Cash flow hedges:		
– transfer from hedging reserve	**29**	–
– ineffective portion	**1**	–
Derivatives not qualified as hedges	**(130)**	–
	7	–
Interest expenses capitalised:		
Disneyland Resort Line Project	**(13)**	(7)
Tung Chung Cable Car Project	**(34)**	(12)
AsiaWorld-Expo Station Project	**(4)**	(1)
Tseung Kwan O Area 86 Project	**(43)**	–
Other capital projects	**(10)**	(13)
Assets under construction	**(10)**	(14)
	(114)	(47)
	1,377	1,457
Interest income in respect of:		
Deposits with banks and other financial institutions	**(15)**	(5)
Staff housing loans	**(1)**	(2)
	(16)	(7)
	1,361	1,450

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 4.8% to 5.6% per annum during the year *(2004: 4.1% to 5.2% per annum)*.

11 Share of profits less losses of non-controlled subsidiaries and associates

Share of profits less losses of non-controlled subsidiaries and associates comprises:

in HK$ million	**2005**	2004 (Restated)
Share of profit before taxation of non-controlled subsidiaries (note 22)	**47**	44
Share of loss of associates	**(31)**	–
	16	44
Share of income tax of non-controlled subsidiaries (note 22)	**(7)**	(5)
	9	39

12 Income tax

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

in HK$ million	**2005**	2004 (Restated)
Current tax		
– overseas tax for the year	**1**	4
Deferred tax		
– origination and reversal of temporary differences on:		
– change in fair value of investment properties	**490**	435
– others	**1,058**	691
	1,548	1,126
	1,549	1,130

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 2005. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

Provision for deferred tax on temporary differences arising in Hong Kong is calculated at Hong Kong Profits Tax rate at 17.5% *(2004: 17.5%)*.

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

	2005		2004 (Restated)	
	HK$ million	%	*HK$ million*	%
Profit before tax	**10,012**		7,673	
Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned	**1,737**	**17.3**	1,330	17.3
Tax effect of non-deductible expenses	**30**	**0.3**	23	0.3
Tax effect of non-taxable revenue	**(228)**	**(2.3)**	(214)	(2.8)
Tax effect of unused tax losses not recognised	**10**	**0.1**	2	–
Tax effect of tax losses not recognised in previous years	**–**	**–**	(11)	(0.1)
Actual tax expenses	**1,549**	**15.4**	1,130	14.7

13 Profit attributable to equity shareholders

The consolidated profit attributable to equity shareholders includes a profit of HK$8,364 million *(2004: HK$6,526 million, as restated)* which has been dealt with in the accounts of the Company.

14 Dividends

Dividends paid and proposed during the year comprised:

in HK$ million	**2005**	2004
Dividend approved and paid		
– 2004 final dividend of 28 cents *(2003: 28 cents)* per share approved and paid in 2005	**1,509**	1,481
– 2005 interim dividend of 14 cents *(2004: 14 cents)* per share	**764**	750
	2,273	2,231
Dividend proposed		
– Final dividend proposed after the balance sheet date of 28 cents *(2004: 28 cents)* per share	**1,535**	1,509

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 46M. 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 Project Agreement entered into between the Group and the Government, HK$37 million cash dividend declared and payable to the Government in 2004 has been waived (note 46E).

15 Earnings per share

The calculation of basic earnings per share is based on the profit for the year attributable to equity shareholders of HK$8,450 million *(2004: HK$6,543 million, as restated)* and the weighted average number of ordinary shares of 5,430,594,654 in issue during the year *(2004: 5,331,253,996)*.

The calculation of diluted earnings per share is based on the profit for the year attributable to equity shareholders of HK$8,450 million *(2004: HK$6,543 million, as restated)* and the weighted average number of ordinary shares of 5,436,752,536 in issue during the year *(2004: 5,337,217,673)* after adjusting for the number of dilutive potential ordinary shares under the employee share option schemes calculated as follows:

	2005	2004
Weighted average number of ordinary shares used in calculating basic earnings per share	**5,430,594,654**	5,331,253,996
Number of ordinary shares deemed to be issued for no consideration	**6,157,882**	5,963,677
Weighted average number of ordinary shares used for calculating the diluted earnings per share	**5,436,752,536**	5,337,217,673

Both basic and diluted earnings per share would have been HK$1.13 *(2004: HK$0.84, as restated)* if the calculation is based on profit from underlying businesses attributable to equity shareholders, i.e. excluding increase in fair value of investment properties net of related deferred tax, adjusted as follows:

in HK$ million	**2005**	2004 (Restated)
Profit attributable to equity shareholders	**8,450**	6,543
Increase in fair value of investment properties	**(2,800)**	(2,486)
Deferred tax on change in fair value of investment properties (note 12A)	**490**	435
Profit from underlying businesses attributable to equity shareholders	**6,140**	4,492

16 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
2005						
Revenue	6,282	1,555	1,316	9,153	–	9,153
Less: Operating expenses before depreciation	3,005	358	238	3,601	–	3,601
	3,277	1,197	1,078	5,552	–	5,552
Profit on property developments	–	–	–	–	6,145	6,145
Operating profit before depreciation	3,277	1,197	1,078	5,552	6,145	11,697
Less: Depreciation	2,517	126	4	2,647	–	2,647
	760	1,071	1,074	2,905	6,145	9,050
Unallocated corporate expenses						(486)
Operating profit before interest and finance charges						8,564
Interest and finance charges						(1,361)
Change in fair value of investment properties			2,800			2,800
Share of profits less losses of non-controlled subsidiaries and associates						9
Income tax			(490)			(1,549)
Profit for the year ended 31 December 2005			2,310			8,463
Assets						
Operational assets *	77,697	1,525	20,243	99,465	2,042	101,507
Railway construction in progress	1,006	–	–	1,006	–	1,006
Assets under construction	739	24	–	763	2,898	3,661
Property development in progress	–	–	–	–	2,756	2,756
Deferred expenditure	209	–	–	209	–	209
Prepaid land lease payments	608	–	–	608	–	608
Investments in securities	183	–	–	183	–	183
Properties held for sale	–	–	–	–	1,311	1,311
	80,442	1,549	20,243	102,234	9,007	111,241
Interests in non-controlled subsidiaries						103
Unallocated assets						2,322
Total assets						113,666
Liabilities						
Segmented liabilities	2,173	373	499	3,045	559	3,604
Deferred income	126	–	–	126	3,458	3,584
	2,299	373	499	3,171	4,017	7,188
Unallocated liabilities						36,582
Total liabilities						43,770
Other Information						
Capital expenditure on:						
Operational assets	30	14	405	449	–	449
Assets under construction	768	238	–	1,006	721	1,727
Railway construction in progress	983	–	–	983	–	983
Property development in progress	–	–	–	–	1,455	1,455
Non-cash expenses other than depreciation	40	4	–	44	–	44

* Operational assets include property, plant and equipment and other assets employed in the operations of individual business segments.

16 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
2004 (restated)						
Revenue	5,932	1,311	1,108	8,351	–	8,351
Less: Operating expenses before depreciation	2,906	315	207	3,428	–	3,428
	3,026	996	901	4,923	–	4,923
Profit on property developments	–	–	–	–	4,568	4,568
Operating profit before depreciation	3,026	996	901	4,923	4,568	9,491
Less: Depreciation	2,356	117	4	2,477	–	2,477
	670	879	897	2,446	4,568	7,014
Unallocated corporate expenses						(416)
Operating profit before interest and finance charges						6,598
Interest and finance charges						(1,450)
Change in fair value of investment properties			2,486			2,486
Share of profit of non-controlled subsidiaries						39
Income tax			(435)			(1,130)
Profit for the year ended 31 December 2004			2,051			6,543
Assets						
Operational assets *	78,356	1,352	17,048	96,756	282	97,038
Railway construction in progress	962	–	–	962	–	962
Railway assets under construction	868	6	–	874	2,177	3,051
Property development in progress	–	–	–	–	2,088	2,088
Deferred expenditure	78	–	–	78	–	78
Prepaid land lease payments	621	–	–	621	–	621
Investments in securities	202	–	–	202	–	202
Properties held for sale	–	–	–	–	815	815
	81,087	1,358	17,048	99,493	5,362	104,855
Interests in non-controlled subsidiaries						63
Unallocated assets						1,756
Total assets						106,674
Liabilities						
Segmented liabilities	2,079	365	463	2,907	483	3,390
Deferred income	132	–	–	132	4,506	4,638
	2,211	365	463	3,039	4,989	8,028
Unallocated liabilities						36,746
Total liabilities						44,774
Other Information						
Capital expenditure on:						
Operational assets	43	6	32	81	–	81
Assets under construction	918	150	–	1,068	2,177	3,245
Railway construction in progress	875	–	–	875	–	875
Property development in progress	–	–	–	–	184	184
Non-cash expenses other than depreciation	19	6	–	25	–	25

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

17 Fixed assets

The Group

in HK$ million	Investment properties	Self-occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation						
At 1 January 2005, as previously reported	**16,687**	**1,978**	**45,704**	**55,081**	**3,051**	**122,501**
Prior period adjustments on adoption of HKAS 17 (note 21)	**–**	**(732)**	**–**	**–**	**–**	**(732)**
At 1 January 2005, as restated	**16,687**	**1,246**	**45,704**	**55,081**	**3,051**	**121,769**
Additions	**405**	**–**	**–**	**44**	**1,727**	**2,176**
Capitalisation adjustments *	**–**	**–**	**(2)**	**(76)**	**–**	**(78)**
Disposals/Write-offs	**–**	**–**	**(2)**	**(275)**	**(3)**	**(280)**
Change in fair value	**2,800**	**–**	**–**	**–**	**–**	**2,800**
Surplus on revaluation (note 41)	**–**	**459**	**–**	**–**	**–**	**459**
Reclassification	**–**	**–**	**175**	**(175)**	**–**	**–**
Disneyland Resort Line and AsiaWorld-Expo Station Projects commissioned (note 18)	**–**	**–**	**176**	**763**	**–**	**939**
Assets commissioned	**–**	**–**	**137**	**977**	**(1,114)**	**–**
At 31 December 2005	**19,892**	**1,705**	**46,188**	**56,339**	**3,661**	**127,785**
At Cost	**–**	**–**	**46,188**	**56,339**	**3,661**	**106,188**
At 31 December 2005 Valuation	**19,892**	**1,705**	**–**	**–**	**–**	**21,597**
Aggregate depreciation						
At 1 January 2005, as previously reported	**–**	**111**	**3,093**	**18,984**	**–**	**22,188**
Prior period adjustments on adoption of HKAS 17 (note 21)	**–**	**(111)**	**–**	**–**	**–**	**(111)**
At 1 January 2005, as restated	**–**	**–**	**3,093**	**18,984**	**–**	**22,077**
Charge for the year	**–**	**33**	**395**	**2,258**	**–**	**2,686**
Capitalisation adjustments *	**–**	**–**	**–**	**(4)**	**–**	**(4)**
Written back on disposal	**–**	**–**	**(1)**	**(215)**	**–**	**(216)**
Written back on revaluation (note 41)	**–**	**(33)**	**–**	**–**	**–**	**(33)**
Reclassification	**–**	**–**	**5**	**(5)**	**–**	**–**
At 31 December 2005	**–**	**–**	**3,492**	**21,018**	**–**	**24,510**
Net book value at 31 December 2005	**19,892**	**1,705**	**42,696**	**35,321**	**3,661**	**103,275**

* 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$2,682 million *(2004: HK$2,499 million, as restated)*, comprising depreciation for the year of HK$2,686 million *(2004: HK$2,519 million, as restated)* less capitalisation adjustments of HK$4 million *(2004: HK$20 million)*.

17 Fixed assets (continued)

The Group

in HK$ million	Investment properties	Self-occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation						
At 1 January 2004, as previously reported	14,169	1,598	45,740	54,319	940	116,766
Prior period adjustments on adoption of HKAS 17 (note 21)	–	(732)	–	–	–	(732)
At 1 January 2004, as restated	14,169	866	45,740	54,319	940	116,034
Additions	32	–	–	49	3,245	3,326
Capitalisation adjustments *	–	–	(124)	(156)	–	(280)
Disposals/Write-offs	–	–	(1)	(172)	(4)	(177)
Change in fair value	2,486	–	–	–	–	2,486
Surplus on revaluation (note 41)	–	311	–	–	–	311
Write back of revaluation deficit (note 6D)	–	69	–	–	–	69
Reclassification	–	–	82	(82)	–	–
Assets commissioned	–	–	7	1,123	(1,130)	–
At 31 December 2004, as restated	16,687	1,246	45,704	55,081	3,051	121,769
At Cost (restated)	–	–	45,704	55,081	3,051	103,836
At 31 December 2004 Valuation	16,687	1,246	–	–	–	17,933
Aggregate depreciation						
At 1 January 2004, as previously reported	–	98	2,705	17,042	–	19,845
Prior period adjustments on adoption of HKAS 17 (note 21)	–	(98)	–	–	–	(98)
At 1 January 2004, as restated	–	–	2,705	17,042	–	19,747
Charge for the year (restated)	–	20	392	2,107	–	2,519
Capitalisation adjustments *	–	–	(3)	(17)	–	(20)
Written back on disposal	–	–	(1)	(148)	–	(149)
Written back on revaluation (note 41)	–	(20)	–	–	–	(20)
Reclassification	–	–	–	–	–	–
At 31 December 2004, as restated	–	–	3,093	18,984	–	22,077
Net book value at 31 December 2004, as restated	16,687	1,246	42,611	36,097	3,051	99,692

17 Fixed assets (continued)

The Company

in HK$ million	Investment properties	Self-occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation						
At 1 January 2005, as previously reported	16,687	1,978	45,704	54,414	3,045	121,828
Prior period adjustments on adoption of HKAS 17 (note 21)	–	(732)	–	–	–	(732)
At 1 January 2005, as restated	16,687	1,246	45,704	54,414	3,045	121,096
Additions	405	–	–	30	1,709	2,144
Capitalisation adjustments *	–	–	(2)	(76)	–	(78)
Disposals/Write-offs	–	–	(2)	(257)	(3)	(262)
Change in fair value	2,800	–	–	–	–	2,800
Surplus on revaluation (note 41)	–	459	–	–	–	459
Reclassification	–	–	175	(175)	–	–
Disneyland Resort Line and AsiaWorld-Expo Station Projects commissioned (note 18)	–	–	176	763	–	939
Assets commissioned	–	–	137	977	(1,114)	–
At 31 December 2005	19,892	1,705	46,188	55,676	3,637	127,098
At Cost	–	–	46,188	55,676	3,637	105,501
At 31 December 2005 Valuation	19,892	1,705	–	–	–	21,597
Aggregate depreciation						
At 1 January 2005, as previously reported	–	111	3,093	18,471	–	21,675
Prior period adjustments on adoption of HKAS 17 (note 21)	–	(111)	–	–	–	(111)
At 1 January 2005, as restated	–	–	3,093	18,471	–	21,564
Charge for the year	–	33	395	2,180	–	2,608
Capitalisation adjustments *	–	–	–	(4)	–	(4)
Written back on disposal	–	–	(1)	(214)	–	(215)
Written back on revaluation (note 41)	–	(33)	–	–	–	(33)
Reclassification	–	–	5	(5)	–	–
At 31 December 2005	–	–	3,492	20,428	–	23,920
Net book value at 31 December 2005	19,892	1,705	42,696	35,248	3,637	103,178

* 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$2,604 million *(2004: HK$2,431 million, as restated)*, comprising depreciation for the year of HK$2,608 million *(2004: HK$2,451 million, as restated)* less capitalisation adjustments of HK$4 million *(2004: HK$20 million)*.

17 Fixed assets (continued)

The Company

in HK$ million	Investment properties	Self-occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation						
At 1 January 2004, as previously reported	14,169	1,598	45,740	53,693	922	116,122
Prior period adjustments on adoption of HKAS 17 (note 21)	–	(732)	–	–	–	(732)
At 1 January 2004, as restated	14,169	866	45,740	53,693	922	115,390
Additions	32	–	–	43	3,222	3,297
Capitalisation adjustments *	–	–	(124)	(156)	–	(280)
Disposals/Write-offs	–	–	(1)	(172)	(4)	(177)
Change in fair value	2,486	–	–	–	–	2,486
Surplus on revaluation (note 41)	–	311	–	–	–	311
Write back of revaluation deficit (note 6D)	–	69	–	–	–	69
Reclassification	–	–	82	(82)	–	–
Assets commissioned	–	–	7	1,088	(1,095)	–
At 31 December 2004, as restated	16,687	1,246	45,704	54,414	3,045	121,096
At Cost (restated)	–	–	45,704	54,414	3,045	103,163
At 31 December 2004 Valuation	16,687	1,246	–	–	–	17,933
Aggregate depreciation						
At 1 January 2004, as previously reported	–	98	2,705	16,597	–	19,400
Prior period adjustments on adoption of HKAS 17 (note 21)	–	(98)	–	–	–	(98)
At 1 January 2004, as restated	–	–	2,705	16,597	–	19,302
Charge for the year (restated)	–	20	392	2,039	–	2,451
Capitalisation adjustments *	–	–	(3)	(17)	–	(20)
Written back on disposal	–	–	(1)	(148)	–	(149)
Written back on revaluation (note 41)	–	(20)	–	–	–	(20)
Reclassification	–	–	–	–	–	–
At 31 December 2004, as restated	–	–	3,093	18,471	–	21,564
Net book value at 31 December 2004, as restated	16,687	1,246	42,611	35,943	3,045	99,532

17 Fixed assets (continued)

A The analysis of the Group's properties, all of which are held in Hong Kong and carried at fair value, is as follows:

The Group and The Company

in HK$ million	Investment properties 2005	Investment properties 2004	Self-occupied land and buildings 2005	Self-occupied land and buildings 2004
Long leases	**1,441**	1,431	**–**	–
Medium-term leases	**18,451**	15,256	**1,705**	1,246
	19,892	16,687	**1,705**	1,246

B All investment properties of the Group were revalued at open market value at 31 December 2005 by an independent firm of surveyors, DTZ Debenham Tie Leung, who have among their staff Members of the Hong Kong Institute of Surveyors. 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 increase in fair value of HK$2,800 million *(2004: HK$2,486 million)* arising from the revaluation has been credited to the profit and loss account.

C All self-occupied land and buildings were revalued at open market value on an existing use basis at 31 December 2005 by an independent firm of surveyors, DTZ Debenham Tie Leung, who have among their staff Members of the Hong Kong Institute of Surveyors. The valuation resulted in a net revaluation surplus of HK$492 million *(2004: HK$400 million)*. The net revaluation surplus of HK$492 million *(2004: HK$331 million, excluding HK$69 million, which was credited to the profit and loss account in respect of deficit previously recognised for the same property (note 6D))*, net of deferred tax of HK$86 million *(2004: HK$58 million)* (note 39B), has been transferred to the fixed asset revaluation reserve account (note 41).

The carrying amount of the self-occupied land and buildings at 31 December 2005 would have been HK$914 million *(2004: HK$936 million)* had the office land and buildings been stated at cost less accumulated depreciation.

D Assets under construction include a partially renovated 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 2J(viii)) 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.

E In addition to the self-occupied land and buildings treated as being held under finance leases in note 17A above, the Group has the following assets held under agreements which are treated as finance leases:

The Group and The Company

in HK$ million	Civil works Eastern Harbour Crossing 2005	Civil works Eastern Harbour Crossing 2004
Cost	**1,254**	1,254
Aggregate depreciation	**288**	269
Net book value	**966**	985

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.

The Group's total non-cancellable future minimum lease payments payable to New Hong Kong Tunnel Company Limited are set out in note 33C.

17 Fixed assets (continued)

F The Group leases out investment properties and station kiosks under operating leases. The leases typically run for an initial period of one to ten years, with an option to renew the lease after that date at which time all terms will be renegotiated. Lease payments are usually adjusted annually to reflect market rentals. Certain leases carry additional rental based on turnover. 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$19,892 million *(2004: HK$16,687 million)*. The gross carrying amounts of station kiosks held for use in operating leases were HK$446 million *(2004: HK$416 million)* and the related accumulated depreciation charges were HK$95 million *(2004: HK$80 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	**2005**	2004
Within 1 year	**1,295**	1,156
After 1 year but within 5 years	**2,025**	1,742
Later than 5 years	**214**	332
	3,534	3,230

G In March 2003, the Group entered into a series of structured transactions with unrelated third parties to lease out and lease back certain of its passenger cars ("Lease Transaction") involving a total original cost of HK$2,562 million and a total net book value of HK$1,674 million as at 31 March 2003. Under the Lease Transaction, the Group has leased the assets to institutional investors in the United States (the "Investors"), who have prepaid all the rentals in relation to the lease agreement. Simultaneously, the Group has leased the assets back from the Investors with obligation to pay rentals in accordance with a pre-determined payment schedule. The Group has an option to purchase the Investors' leasehold interest in the assets at pre-determined dates for fixed amounts. Part of the rental prepayments received from the Investors has been invested in debt securities 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 its obligations to pay the lease payments are funded by the proceeds of the above investments, those liabilities and investments in debt securities are not recognised in March 2003 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.

18 Railway construction in progress

The Group and The Company

in HK$ million	Balance at 1 Jan	Transferred from deferred expenditure (note 20)	Expenditure	Costs written off to profit and loss account (note 6C)	Capitalised on commissioning (note 17)	Balance at 31 Dec
2005						
Tseung Kwan O South Station Project						
Construction costs	1	–	17	–	–	18
Consultancy fees	1	–	7	–	–	8
Staff costs and other expenses	5	–	11	–	–	16
Finance costs	–	–	1	–	–	1
	7	–	36	–	–	43
Disneyland Resort Line Project						
Construction costs	1,074	–	185	–	(1,259)	–
Consultancy fees	46	–	5	–	(51)	–
Staff costs and other expenses	279	–	74	–	(353)	–
Finance costs	10	–	14	–	(24)	–
	1,409	–	278	–	(1,687)	–
Government grant (notes 46E and 46M)	(931)	–	–	–	931	–
	478	–	278	–	(756)	–
Tung Chung Cable Car Project						
Construction costs	336	–	419	–	–	755
Consultancy fees	37	–	14	–	–	51
Staff costs and other expenses	57	–	22	–	–	79
Finance costs	14	–	34	–	–	48
	444	–	489	–	–	933
AsiaWorld-Expo Station Project						
Construction costs	16	–	124	–	(140)	–
Staff costs and other expenses	16	–	23	–	(39)	–
Finance costs	1	–	3	–	(4)	–
	33	–	150	–	(183)	–
SkyPlaza Platform Project						
Construction costs	–	–	24	–	–	24
Staff costs and other expenses	–	–	6	–	–	6
Finance costs	–	–	–	–	–	–
	–	–	30	–	–	30
Total	962	–	983	–	(939)	1,006

18 Railway construction in progress (continued)

in HK$ million	Balance at 1 Jan	Transferred from deferred expenditure (note 20)	Expenditure/ (Government grant)	Costs written off to profit and loss account (note 6C)	Capitalised on commissioning (note 17)	Balance at 31 Dec
2004						
Tseung Kwan O South Station Project						
Construction costs	1	–	–	–	–	1
Consultancy fees	23	–	7	(29)	–	1
Staff costs and other 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 other expenses	194	–	85	–	–	279
Finance costs	3	–	7	–	–	10
	883	–	526	–	–	1,409
Government grant (notes 46E and 46M)	(883)	–	(48)	–	–	(931)
	–	–	478	–	–	478
Tung Chung Cable Car Project						
Construction costs	82	–	254	–	–	336
Consultancy fees	24	–	13	–	–	37
Staff costs and other expenses	29	–	28	–	–	57
Finance costs	2	–	12	–	–	14
	137	–	307	–	–	444
AsiaWorld-Expo Station Project						
Construction costs	–	–	16	–	–	16
Staff costs and other expenses	–	3	13	–	–	16
Finance costs	–	–	1	–	–	1
	–	3	30	–	–	33
Total	181	3	827	(49)	–	962

A Tseung Kwan O South Station Project

The construction of future railway stations along the Tseung Kwan O Line is covered by the Project Agreement with the Government signed on 4 November 1998.

Advanced works and detailed design are being undertaken for the development of a new station in Tseung Kwan O South. The capital cost estimate for the project based on the defined scope of works and programme is estimated at approximately HK$1 billion.

At 31 December 2005, the Company had incurred expenditure of HK$43 million *(2004: HK$7 million)* on the project and had authorised outstanding commitments on contracts totalling HK$12 million *(2004: Nil)* related to the project.

In 2004, 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.

18 Railway construction in progress (continued)

B Disneyland Resort Line Project

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.

The project was completed on schedule and service commenced to the public on 1 August 2005. Although the final accounts of a few contracts are under negotiation with the contractors, it is anticipated that the total cost estimate of the project will be finalised within the original budget of approximately HK$2 billion (before deducting Government grant of HK$931 million).

C 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 under construction with target completion in mid 2006. The current forecast shows the capital cost estimate of the project will be approximately HK$1.2 billion.

At 31 December 2005, the Company had incurred expenditure of HK$933 million *(2004: HK$444 million)* on the project and had authorised outstanding commitments on contracts totalling HK$25 million *(2004: HK$367 million)* related to the project.

D 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.

The project met the completion target and started to serve the public on 20 December 2005. Negotiation on the final accounts with various contractors is being performed. It is anticipated that the total cost estimate of the project will be approximately the same as the original budget of approximately HK$0.2 billion.

E SkyPlaza Platform Project

The Project Agreement between Airport Authority and the Company for the design, construction, financing and operation of the SkyPlaza Platform Project was signed on 18 July 2005.

After signing the Agreement, the Company has commenced the construction works with target completion in mid 2006. The capital cost estimate for the project based on the defined scope of works and programme is estimated at approximately HK$0.1 billion.

At 31 December 2005, the Company had incurred expenditure of HK$30 million on the project and had authorised outstanding commitments on contracts totalling HK$14 million related to the project.

19 Property development in progress

Under the Airport Railway Agreement related to the construction of the Airport Railway, the Government had granted to the Company development right on the land ("Land Grant") over the 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.

19 Property development in progress (continued)

Costs of foundation, site enabling works and land costs 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 19B(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") under separate land grant agreements. The basis of accounting for development costs incurred by the Company and payment related thereto is consistent with that for the property developments along the Airport Railway.

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 19B(i))	Transfer out on project completion	Transfer to assets under construction	Balance at 31 Dec
2005						
Airport Railway Property Projects	**–**	**210**	**(152)**	**(58)**	**–**	**–**
Tseung Kwan O Extension Projects	**2,043**	**1,241**	**(528)**	**–**	**–**	**2,756**
Other property projects	**45**	**4**	**(27)**	**(22)**	**–**	**–**
	2,088	**1,455**	**(707)**	**(80)**	**–**	**2,756**
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

Included in the expenditure of Tseung Kwan O Extension Projects is a payment of HK$1,160 million *(2004: Nil)* in respect of the Company's one-half share of the land premium for the Package One development of the Tseung Kwan O Area 86 site.

B Deferred income on property development

The Group and The Company

in HK$ million	**2005**	2004
Deferred income on property development comprises:		
– Up-front payments received from developers (note 19B(i))	**2,461**	3,414
– Sharing in kind (note 19B(ii))	**997**	1,092
	3,458	4,506

19 Property development in progress (continued)

(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 19A)	Amount recognised as profit (note 8)	Balance at 31 Dec
2005					
Airport Railway Property Projects	**3,409**	**956**	**(152)**	**(1,794)**	**2,419**
Tseung Kwan O Extension Property Projects	**5**	**565**	**(528)**	**–**	**42**
Other property projects	**–**	**27**	**(27)**	**–**	**–**
	3,414	**1,548**	**(707)**	**(1,794)**	**2,461**
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

(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. Part of the property development profit is deferred as the Company has an obligation under the development agreement to complete the fitting-out works. 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	**2005**	2004
Balance as at 1 January	**1,092**	–
Sharing in kind received from developer	**–**	2,100
Less: Amount recognised as profit (note 8)	**(95)**	(1,008)
Balance as at 31 December	**997**	1,092

C Stakeholding funds

As stakeholder under certain Airport Railway and Tseung Kwan O Extension 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	**2005**	2004
Balance as at 1 January	**4,064**	3,572
Stakeholding funds received and receivable	**15,599**	13,958
Add: Interest earned thereon	**111**	8
	19,774	17,538
Disbursements during the year	**(16,296)**	(13,474)
Balance as at 31 December	**3,478**	4,064
Represented by:		
Balances in designated bank accounts as at 31 December	**3,476**	4,062
Retention receivable	**2**	2
	3,478	4,064

20 Deferred expenditure

The Group

in HK$ million	Balance at 1 Jan, as previously reported	Effect of adoption of new accounting policy with respect to financial instruments (note 3)	Balance at 1 Jan, as restated	Transfer to railway construction in progress (note 18)	Discount on bond issue	Expenditure/ (Amortisation) during the year	Costs written off to profit and loss account (note 6C)	Balance at 31 Dec
2005								
Deferred finance charges	**109**	**(109)**	**–**	**–**	**–**	**–**	**–**	**–**
Merger studies	**56**	**–**	**56**	**–**	**–**	**16**	**–**	**72**
Expenditure on proposed capital projects								
– West Island Line/South Island Line	**27**	**–**	**27**	**–**	**–**	**16**	**–**	**43**
– Shenzhen Metro Line 4 Project	**51**	**–**	**51**	**–**	**–**	**115**	**–**	**166**
	243	**(109)**	**134**	**–**	**–**	**147**	**–**	**281**
2004								
Deferred finance charges	76	–	76	–	50	(17)	–	109
Merger studies	–	–	–	–	–	56	–	56
Expenditure on proposed capital projects								
– West Island Line/South Island Line	25	–	25	–	–	17	(15)	27
– Shenzhen Metro Line 4 Project	–	–	–	–	–	51	–	51
– AsiaWorld-Expo Station Project	3	–	3	(3)	–	–	–	–
	104	–	104	(3)	50	107	(15)	243

The Company

in HK$ million	Balance at 1 Jan, as previously reported	Effect of adoption of new accounting policy with respect to financial instruments (note 3)	Balance at 1 Jan, as restated	Transfer to railway construction in progress (note 18)	Discount on bond issue	Expenditure/ (Amortisation) during the year	Costs written off to profit and loss account (note 6C)	Balance at 31 Dec
2005								
Deferred finance charges	**109**	**(109)**	**–**	**–**	**–**	**–**	**–**	**–**
Merger studies	**56**	**–**	**56**	**–**	**–**	**16**	**–**	**72**
Expenditure on proposed capital projects								
– West Island Line/South Island Line	**27**	**–**	**27**	**–**	**–**	**16**	**–**	**43**
	192	**(109)**	**83**	**–**	**–**	**32**	**–**	**115**
2004								
Deferred finance charges	76	–	76	–	50	(17)	–	109
Merger studies	–	–	–	–	–	56	–	56
Expenditure on proposed capital projects								
– West Island Line/South Island Line	25	–	25	–	–	17	(15)	27
– AsiaWorld-Expo Station Project	3	–	3	(3)	–	–	–	–
	104	–	104	(3)	50	56	(15)	192

Merger studies comprise external consultancy, incremental 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. As of 31 December 2005, 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 47D(i)).

21 Prepaid land lease payments

The Group and The Company

in HK$ million	**2005**	2004 (Restated)
Cost		
At 1 January, as previously reported	**–**	–
Prior period adjustments on adoption of HKAS 17 (note 17)	**732**	732
At 1 January, as restated	**732**	732
Addition	**–**	–
At 31 December	**732**	732
Accumulated amortisation		
At 1 January, as previously reported	**–**	–
Prior period adjustments on adoption of HKAS 17 (note 17)	**111**	98
At 1 January, as restated	**111**	98
Charge for the year	**13**	13
At 31 December	**124**	111
Net book value at 31 December	**608**	621

A The above prepaid land lease payments, all of which relate to land held for railway depots in Hong Kong, is analysed as follows:

The Group and The Company

in HK$ million	**2005**	2004
At net book value		
– long leases	**160**	163
– medium-term leases	**448**	458
	608	621

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 29 June 2050 which can be extended for further periods of 50 years at nominal payment (note 46C).

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.

22 Interests in non-controlled subsidiaries

	The Group		The Company	
in HK$ million	**2005**	2004	**2005**	2004
Unlisted shares, *at cost*	**–**	–	**24**	24
Share of net assets	**103**	63	**–**	–
	103	63	**24**	24

The following list contains the particulars of all non-controlled subsidiaries of the Group:

Name of company	Issued and paid up ordinary share capital	Proportion of ownership interest: Group's effective interest	Held by the Company	Held by subsidiary	Place of incorporation and operation	Principal activities
Octopus Holdings Limited	HK$42,000,000	57.4%	57.4%	–	Hong Kong	Investment holding
Octopus Cards Limited	HK$42,000,000	57.4%	–	100%	Hong Kong	Operate a contactless smartcard ticketing system in Hong Kong
Octopus Knowledge Limited	HK$2	57.4%	–	100%	Hong Kong	International automatic fare collection consultancy project
Octopus Netherlands Limited	HK$1	57.4%	–	100%	Hong Kong	Consultancy services on introducing a smart card system in the Netherlands
Octopus Cards (NL) B.V.	EUR18,000	57.4%	–	100%	Netherlands	Project management on introducing a smart card system in the Netherlands
Octopus Connect Limited	HK$2	57.4%	–	100%	Hong Kong	Customer relationship management service
Octopus Rewards Limited	HK$1	57.4%	–	100%	Hong Kong	Develop and operate a common loyalty programme
Octopus Investments Limited	HK$2	57.4%	–	100%	Hong Kong	Investment holding

22 Interests in non-controlled subsidiaries (continued)

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 57.4% 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 ("HKMA") 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.

On 21 October 2005, the Company and the other shareholders of OCL entered into a number of agreements to adjust the arrangements relating to OCL, in order to make the non-payment businesses of OCL into new, separate subsidiaries independent of the payment business of OCL that is regulated by the HKMA. Accordingly, a new holding company, Octopus Holdings Limited ("OHL"), has been set up to hold the entire issued share capital of each of these new companies as well as OCL. The Company's effective interest in OHL and its subsidiaries is 57.4%.

At the same time, the shareholders of OHL made a loan in aggregate amounting to HK$150 million to OHL pursuant to a Subordinated Loan Agreement, with each shareholder lending an amount in proportion to its shareholding in OHL. The Company has therefore lent HK$86 million to OHL (or 57.4% of the total amount of the loan). The loan is for a term of five years and is unsecured, the rights of the lenders are subordinated in all respects to the rights of the other unsubordinated creditors of OHL in respect of all other unsubordinated liabilities, and interest on the loan is payable at a rate of 5.5% per annum.

During the year ended 31 December 2005, a total amount of HK$54 million *(2004: HK$51 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$9 million *(2004: HK$10 million)* and HK$5 million *(2004: HK$6 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 *(2004: 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.

22 Interests in non-controlled subsidiaries (continued)

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

Profit and loss account

Year ended 31 December *in HK$ million*	**2005 (Audited)**	2004 (Audited and restated)
Turnover	**279**	262
Other operating income	**76**	55
	355	317
Staff costs	**(78)**	(66)
Load agent fees and bank charges for add value services	**(47)**	(41)
Other expenses	**(101)**	(80)
Operating profit before depreciation	**129**	130
Depreciation	**(89)**	(81)
Operating profit before interest and finance charges	**40**	49
Net interest income	**41**	28
Profit before taxation	**81**	77
Income tax	**(12)**	(8)
Profit for the year	**69**	69
Group's share of profit before taxation (note 11)	**47**	44
Group's share of income tax (note 11)	**(7)**	(5)
Dividend	**–**	150
Group's share of dividend	**–**	86

Balance sheet

at 31 December *in HK$ million*	**2005 (Audited)**	2004 (Audited)
Assets		
Fixed assets	**158**	201
Investments	**1,210**	993
Cash at banks and in hand	**336**	259
Other assets	**129**	101
	1,833	1,554
Liabilities		
Card floats and card deposits due to cardholders	**(1,311)**	(1,208)
Amounts due to shareholders	**(41)**	(167)
Other liabilities	**(301)**	(68)
	(1,653)	(1,443)
Net assets	**180**	111
Equity		
Share capital	**42**	42
Retained profits	**138**	69
	180	111
Group's share of net assets	**103**	63

23 Investments in subsidiaries

The Company

in HK$ million	**2005**	2004
Unlisted shares, *at cost*	**185**	185
Less: Impairment losses	**3**	3
	182	182

The following list contains details of subsidiaries as at 31 December 2005, other than the non-controlled subsidiaries the relevant details of which are disclosed in note 22. All of these are controlled subsidiaries as defined under note 2C 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, marketing and promotion
MTR (Shanghai Project Management) Limited	HK$1,000	100%	100%	–	Hong Kong	Railway consultancy services, property investment and development
Shanghai Hong Kong Metro Construction Management Co. Ltd. (Incorporated)	HK$15,000,000	60%	–	60%	The People's Republic of China	Railway construction management and development
Candiman Limited *	US$1	100%	100%	–	British Virgin Islands	Investment holding
MTR Corporation (Shenzhen) Limited (Incorporated)	HK$250,000,000	100%	–	100%	The People's Republic of China	Conduct early-stage preparatory work for Shenzhen Metro Line 4 project
MTR Beijing Line 4 Investment Company Limited	HK$1	100%	100%	–	Hong Kong	Investment holding
MTR China Property Limited	HK$1,000	100%	100%	–	Hong Kong	Property management
Chongqing Premier Property Management Co. Ltd. * (Incorporated)	US$150,000	70%	–	70%	The People's Republic of China	Property management

23 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
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
Glory Goal Limited *	HK$1	100%	100%	–	Hong Kong	Investment holding
MTR (Beijing) Commercial Facilities Management Co. Ltd. (Incorporated)	HK$49,228,000	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
Rail Sourcing Solutions (UK) Limited *	GBP1	100%	–	100%	United Kingdom	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
MTR Corporation (SWT) Limited *	GBP1	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (Silverlink) 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.

The registered share capital of MTR Corporation (Shenzhen) Limited was increased to HK$250 million on 8 June 2005, of which HK$200 million has been paid up as of 31 December 2005. The remaining registered share capital was paid up in January 2006.

The registered share capital of MTR (Beijing) Commercial Facilities Management Co. Ltd. is HK$49 million, of which 15% or about HK$7 million has been paid up as of 31 December 2005.

A final distribution of HK$1 million was received upon de-registration of MTR Corporation (Singapore) Pte. Ltd. in November 2005. During the year, Beijing Premier Property Management Co. Ltd. has been disposed of at a consideration of HK$1.4 million resulting in a net loss of HK$0.1 million.

24 Interests in associates

The Group and the Company had interests in the following associates at 31 December 2005:

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
Great South Eastern Railway Limited *	GBP100	29%	–	29%	United Kingdom	Bidding vehicle
MTR Laing Railway Company Limited *	GBP2	50%	–	50%	United Kingdom	Bidding vehicle
Great South Western Railway Limited *	GBP2	50%	–	50%	United Kingdom	Bidding vehicle

* Companies not audited by KPMG.

The summary financial information of the Group's effective interests on the associates is as follows:

in HK$ million	**2005**	2004
Non-current assets	**–**	–
Current assets	**2**	–
Non-current liabilities	**–**	–
Current liabilities	**(33)**	–
Net assets	**(31)**	–
Income	**–**	–
Expenses	**(31)**	–
Profit for the year	**(31)**	–

25 Investments in securities

Investments in securities represents debt securities held by an overseas insurance underwriting subsidiary comprising:

The Group

in HK$ million	**2005**	2004
Debt securities listed overseas, at fair value (2004: at cost):		
– maturing within 1 year	**23**	68
– maturing after 1 year	**160**	134
	183	202

These securities were originally acquired with an intention to hold to maturity and were classified as held to maturity securities stated at cost in 2004. In 2005, management changed its intention to allow trading of securities held to enable more effective portfolio management. The investments were reclassified as trading securities and were stated at their fair value as at 31 December 2005. No prior period adjustment on the 2004 comparative figure has been made as the adjustment, which amounting to HK$1 million, was considered insignificant.

26 Staff housing loans

The Group and The Company

in HK$ million	**2005**	2004
Balance at 1 January	**47**	67
Redemption	**(8)**	(13)
Repayment	**(5)**	(7)
Balance at 31 December	**34**	47

The Group and The Company

in HK$ million	**2005**	2004
Amounts receivable:		
– within 1 year	**5**	5
– after 1 year	**29**	42
	34	47

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.

The Company considers that the nominal value of housing loans are not significantly different from their fair values.

27 Properties held for sale

The Group and The Company

in HK$ million	**2005**	2004
Properties held for sale		
– at cost	**1,090**	597
– at net realisable value	**221**	218
	1,311	815

The properties held for sale at 31 December 2004 and 2005 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 8). The properties are stated in the balance sheet at the lower of cost, which is deemed to be their fair value upon receipt as determined by reference to an independent open market valuation at date of receipt (note 2J(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 2004 and 2005 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$4 million *(2004: HK$16 million)*, recognised as an increase in the carrying value of inventories due to a rise in their estimated net realisable value in line with recovery of the property market.

28 Derivative financial assets and liabilities

A Fair value

The contracted notional amounts, fair values and maturities of derivative instruments outstanding are as follows:

The Group and The Company

in HK$ million	Notional amount	Fair values Maturing in Less than 1 year	1–2 years	2–5 years	Over 5 years	Total
2005						
Derivative financial assets						
Foreign exchange forwards						
– cash flow hedges	**478**	**1**	**–**	**–**	**–**	**1**
Cross currency swaps						
– fair value hedges	**2,517**	**1**	**1**	**68**	**6**	**76**
Interest rate swaps						
– fair value hedges	**4,219**	**5**	**–**	**84**	**32**	**121**
– cash flow hedges	**2,000**	**14**	**–**	**13**	**–**	**27**
– not qualified as hedges	**900**	**8**	**–**	**1**	**–**	**9**
	10,114	**29**	**1**	**166**	**38**	**234**
Derivative financial liabilities						
Foreign exchange forwards						
– cash flow hedges	**25**	**1**	**–**	**–**	**–**	**1**
– not qualified as hedges	**95**	**5**	**–**	**–**	**–**	**5**
Cross currency swaps						
– fair value hedges	**14,015**	**–**	**–**	**128**	**153**	**281**
Interest rate swaps						
– fair value hedges	**750**	**–**	**–**	**3**	**12**	**15**
– cash flow hedges	**100**	**–**	**1**	**–**	**–**	**1**
– not qualified as hedges	**650**	**–**	**4**	**–**	**–**	**4**
	15,635	**6**	**5**	**131**	**165**	**307**
Total	**25,749**					

The Group and The Company

in HK$ million	Total	Notional amount Maturing in Less than 1 year	1–2 years	2–5 years	Over 5 years
2004					
Foreign exchange forwards	432	351	51	30	–
Cross currency swaps	19,267	2,734	20	5,896	10,617
Interest rate swaps	14,723	6,100	3,850	2,527	2,246
	34,422	9,185	3,921	8,453	12,863

Discounted cash flow method, which discounts the future contractual cash flows at the current market interest and foreign exchange rates that are available to the Group for similar financial instruments, is the main valuation technique used to determine the fair value of the Group's borrowings and derivative financial instruments such as interest rate swaps and cross currency swaps. The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the balance sheet date.

The Group's derivative financial instruments consist predominantly of interest rate and cross currency swaps, and the Group used the relevant interest rate swap curves as of 31 December 2005 to discount financial instruments. For Hong Kong dollars, interest rates used ranged from 3.925% to 4.594%, U.S dollars from 4.334% to 5.106% and Euro from 2.384% to 3.853%.

28 Derivative financial assets and liabilities (continued)

B Financial risks

The Group's operating activities and financing activities expose it to three main types of financial risks, namely interest rate risk, foreign exchange risk and credit risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge its exposure to interest rate and foreign exchange risks. These instruments are employed solely for hedging and not for trading or speculation purposes.

Risk management is carried out under policies approved by the Board of Directors. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investing excess liquidity. The Board regularly reviews these polices and authorizes changes if necessary based on operating and market conditions and other relevant factors.

(i) Interest rate risk

The Group's interest rate risk arises from borrowings. Borrowings issued at fixed rates expose the Group to fair value interest rate risk whilst borrowings based on floating rates expose the Group to cash flow interest rate risk. The Group manages its exposure to interest rate risk by using mostly interest rate swaps.

(ii) Foreign exchange risk

Foreign exchange risk arises when recognised assets and liabilities are denominated in a currency that is not the Group's functional currency.

The Group manages its exposure to the foreign exchange risk by using mostly cross currency swaps and forward foreign exchange contracts.

(iii) Credit risk

The Group's exposure to credit risk arises mainly from the derivatives financial instruments that it has entered into with various counter-parties to hedge its exposure to interest rate and foreign exchange risks.

The Group manages this risk on an ongoing basis 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 movement in the values of the derivatives financial instruments employed.

As at balance sheet date, the maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instrument.

29 Stores and spares

The Group and The Company

in HK$ million	**2005**	2004
Stores and spares expected to be consumed:		
– within 1 year	**137**	142
– after 1 year	**121**	116
	258	258
Less: Specific provision for obsolete stock	**10**	10
	248	248

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

30 Debtors, deposits and payments in advance

in HK$ million	The Group **2005**	The Group 2004	The Company **2005**	The Company 2004
Debtors (net of specific impairment losses for bad and doubtful debts), deposits and payments in advance relate to:				
– Property development projects	**2,042**	282	**2,042**	282
– Railway operations and other projects	**1,053**	994	**933**	989
	3,095	1,276	**2,975**	1,271

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

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

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

(iii) Consultancy services income are billed monthly and are due within 30 days.

(iv) 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:

in HK$ million	The Group **2005**	The Group 2004	The Company **2005**	The Company 2004
Amounts not yet due	**2,461**	690	**2,448**	681
Overdue by 30 days	**107**	106	**61**	103
Overdue by 60 days	**26**	20	**24**	14
Overdue by 90 days	**35**	6	**6**	6
Overdue by more than 90 days	**17**	70	**12**	70
Total debtors	**2,646**	892	**2,551**	874
Deposits and payments in advance	**348**	286	**323**	299
Prepaid pension costs	**101**	98	**101**	98
	3,095	1,276	**2,975**	1,271

Included in amounts not yet due are HK$1,991 million *(2004: HK$263 million)* receivable in respect of property developments.

As at 31 December 2005, all debtors, deposits and payments in advance were expected to be recovered within one year except for HK$168 million *(2004: HK$161 million)* included in the amounts relating to deposits and receivables in respect of railway operations and other projects, which were expected to be recovered between one to three years. The nominal values less impairment losses for bad and doubtful debts are not discounted as it is considered that the effect of discounting would not be significant.

Included in debtors, deposits and payments in advance are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

in $ million	The Group **2005**	The Group 2004	The Company **2005**	The Company 2004
Euro	**2**	1	**2**	1
Japanese Yen	**1**	–	**1**	–
New Taiwan dollar	**13**	4	**13**	4
Pataca	**2**	9	**2**	9
United States dollar	**22**	24	**22**	24

31 Amounts due from the Government and other related parties

	The Group		The Company	
in HK$ million	**2005**	2004	**2005**	2004
Amounts due from:				
– the Government	**27**	36	**27**	36
– the Housing Authority	**22**	10	**22**	10
– the Kowloon-Canton Railway Corporation ("KCRC")	**2**	–	**2**	–
– non-controlled subsidiary	**88**	87	**88**	87
– other subsidiaries of the Company (net of impairment losses)	**–**	–	**285**	142
Loan to an associate	**15**	–	**–**	–
	154	133	**424**	275

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 2005, all contract retentions on the above entrusted works were due for release within one year *(2004: HK$20 million)*. All other amounts due from the Government and other related parties were expected to be received within 12 months.

The nominal values of amounts due from the Government and other related parties are considered not significantly different from their fair values as the amounts due are expected to be substantially settled within 24 months. The loan to an associate is interest bearing at floating market rate, which is similar to the Company's discount rate. The carrying value of the loan is considered to approximate its fair values.

32 Cash and cash equivalents

	The Group		The Company	
in HK$ million	**2005**	2004	**2005**	2004
Deposits with banks and other financial institutions	**53**	84	**53**	84
Cash at banks and in hand	**306**	185	**63**	53
Cash and cash equivalents in the balance sheet	**359**	269	**116**	137
Bank overdrafts (note 33B)	**(14)**	(11)	**(14)**	(11)
Cash and cash equivalents in the cash flow statement	**345**	258	**102**	126

During the year, the Group recognised property development profit out of deferred income and received properties as sharing in kind totalling HK$2,860 million *(2004: HK$2,609 million)*, which were transactions not involving movements of cash or cash equivalents.

Included in cash and cash equivalents in the balance sheet are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
in $ million	**2005**	2004	**2005**	2004
Euro	**2**	7	**2**	7
New Taiwan dollar	**63**	31	**63**	31
Pound sterling	**–**	2	**–**	2
Swiss franc	**2**	–	**2**	–
United States dollar	**14**	4	**2**	–

33 Loans and obligations under finance leases

A By type

The Group

in HK$ million	Carrying amount **2005**	Fair value **2005**	Repayable amount **2005**	Repayable amount 2004
Capital market instruments				
Listed or publicly traded:				
US dollar Yankee notes due 2005	–	–	–	2,324
US dollar Global notes due 2009	5,711	6,253	5,834	5,834
US dollar Global notes due 2010	4,582	5,176	4,679	4,679
Debt issuance programme notes due 2005	–	–	–	194
Debt issuance programme (Eurobond due 2014)	4,514	4,605	4,663	4,663
	14,807	16,034	15,176	17,694
Unlisted:				
Debt issuance programme notes due 2005 to 2020	5,976	6,226	6,021	4,918
HK dollar notes due 2006 to 2008	1,526	1,520	1,500	1,500
HK dollar retail bonds due 2005 to 2006	1,002	1,003	1,000	2,250
	8,504	8,749	8,521	8,668
Total capital market instruments	23,311	24,783	23,697	26,362
Bank loans	4,282	4,315	4,306	3,612
Obligations under finance leases (note 33C)	272	272	272	393
Loans and obligations under finance leases	27,865	29,370	28,275	30,367
Bank overdrafts	14	14	14	11
Short-term loans	385	385	385	–
Total	28,264	29,769	28,674	30,378

The Company

in HK$ million	Carrying amount **2005**	Fair value **2005**	Repayable amount **2005**	Repayable amount 2004
Capital market instruments				
Listed or publicly traded:				
US dollar Yankee notes due 2005	–	–	–	2,324
US dollar Global notes due 2009	5,711	6,253	5,834	5,834
US dollar Global notes due 2010	4,582	5,176	4,679	4,679
Debt issuance programme notes due 2005	–	–	–	194
	10,293	11,429	10,513	13,031
Unlisted:				
Debt issuance programme notes due 2005 to 2018	443	614	480	665
	443	614	480	665
Total capital market instruments	10,736	12,043	10,993	13,696
Bank loans	4,282	4,315	4,306	3,612
Obligations under finance leases (note 33C)	272	272	272	393
Loans and obligations under finance leases	15,290	16,630	15,571	17,701
Bank overdrafts	14	14	14	11
Short-term loans	385	385	385	–
Total	15,689	17,029	15,970	17,712

33 Loans and obligations under finance leases (continued)

As at 31 December 2005, the Group had available undrawn committed bank loan facilities amounting to HK$5,300 million *(2004: HK$5,815 million)*. In addition, the Group had a number of uncommitted facilities with undrawn amounts totalling HK$8,851 million *(2004: HK$10,536 million)*, comprising a debt issuance programme and short-term bank loan facilities.

The fair values are based on the discounted cash flows method which discounts the future contractual cash flows at the current market interest and foreign exchange rates that is available to the Group for similar financial instruments.

The Group's derivative financial instruments consist predominantly of interest rate and cross currency swaps, and the Group used the relevant interest rate swap curves as of 31 December 2005 to discount financial instruments. For Hong Kong dollars, interest rates used ranged from 3.925% to 4.594%, U.S dollars from 4.334% to 5.106% and Euro from 2.384% to 3.853%.

The carrying amounts of short-term loans and overdrafts approximated their fair values.

The amounts of borrowings, denominated in a currency other than the functional currency of the entity to which they relate, before and after currency hedging activities are as follows:

The Group

	Before hedging activities		After hedging activities	
in $ million	**2005**	2004	**2005**	2004
Euro	**13**	15	**–**	–
United States dollar	**2,120**	2,447	**10**	12

The Company

	Before hedging activities		After hedging activities	
in $ million	**2005**	2004	**2005**	2004
Euro	**13**	15	**–**	–
United States dollar	**1,420**	1,747	**10**	12

33 Loans and obligations under finance leases (continued)

B By repayment terms

The Group

in HK$ million	Capital market instruments **2005**	Bank loans and overdrafts **2005**	Obligations under finance leases **2005**	Total **2005**	Total 2004
Long-term loans and obligations under finance leases					
Amounts repayable beyond 5 years	**10,084**	**916**	**–**	**11,000**	13,502
Amounts repayable within a period of between 2 and 5 years	**11,163**	**2,178**	**–**	**13,341**	9,070
Amounts repayable within a period of between 1 and 2 years	**–**	**606**	**141**	**747**	3,186
Amounts repayable within 1 year	**2,450**	**606**	**131**	**3,187**	4,609
	23,697	**4,306**	**272**	**28,275**	30,367
Bank overdrafts	**–**	**14**	**–**	**14**	11
Short-term loans	**–**	**385**	**–**	**385**	–
	23,697	**4,705**	**272**	**28,674**	30,378
Less: Unamortised discount/premium/ finance charges outstanding	**(118)**	**(5)**	**–**	**(123)**	
Adjustment due to fair value change of financial instruments	**(268)**	**(19)**	**–**	**(287)**	
Total carrying amount of debt	**23,311**	**4,681**	**272**	**28,264**	

The Company

in HK$ million	Capital market instruments **2005**	Bank loans and overdrafts **2005**	Obligations under finance leases **2005**	Total **2005**	Total 2004
Long-term loans and obligations under finance leases					
Amounts repayable beyond 5 years	**480**	**916**	**–**	**1,396**	5,236
Amounts repayable within a period of between 2 and 5 years	**10,513**	**2,178**	**–**	**12,691**	8,570
Amounts repayable within a period of between 1 and 2 years	**–**	**606**	**141**	**747**	736
Amounts repayable within 1 year	**–**	**606**	**131**	**737**	3,159
	10,993	**4,306**	**272**	**15,571**	17,701
Bank overdrafts	**–**	**14**	**–**	**14**	11
Short-term loans	**–**	**385**	**–**	**385**	–
	10,993	**4,705**	**272**	**15,970**	17,712
Less: Unamortised discount/premium/ finance charges outstanding	**(65)**	**(5)**	**–**	**(70)**	
Adjustment due to fair value change of financial instruments	**(192)**	**(19)**	**–**	**(211)**	
Total carrying amount of debt	**10,736**	**4,681**	**272**	**15,689**	

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.

33 Loans and obligations under finance leases (continued)

C Obligations under finance leases

As at 31 December 2005, 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 **2005**	Interest expense relating to future periods **2005**	Total minimum lease payments **2005**	Present value of the minimum lease payments 2004	Interest expense relating to future periods 2004	Total minimum lease payments 2004
Amounts repayable within a period of between 2 and 5 years	**–**	**–**	**–**	141	9	150
Amounts repayable within a period of between 1 and 2 years	**141**	**9**	**150**	131	19	150
Amounts repayable within 1 year	**131**	**19**	**150**	121	29	150
	272	**28**	**300**	393	57	450

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 17E).

D Bonds and notes issued and redeemed

Bonds and notes issued during the year ended 31 December 2005 and 2004 comprise:

The Group

	2005		2004	
in HK$ million	Principal amount	Net consideration received	Principal amount	Net consideration received
Debt issuance programme notes	**1,500**	**1,491**	5,158	5,109

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$1,650 million *(2004: HK$4,415 million)* unlisted Hong Kong dollar notes upon maturity.

During the year, the Group redeemed HK$2,518 million *(2004: Nil)* listed debt securities upon maturities, including:

(i) Yankee Notes USD300 million due 2005; and

(ii) Medium Term USD25 million Notes due 2005 issued under Debt Issuance Programme.

E Guarantees

There were no guarantees given by the Government in respect of loan facilities as at 31 December 2005 and 2004.

33 Loans and obligations under finance leases (continued)

F Interest rates

Outstanding amount of total borrowings, excluding obligations under finance leases, of HK$27,992 million *(2004: HK$29,985 million)* comprise:

The Group

	Fixed rate borrowings and borrowings swapped to fixed rates		Variable rate borrowings and borrowings swapped from fixed rate	
	Carrying amount *HK$ million*	Interest rate *% p.a.*	Carrying amount *HK$ million*	Interest rate *% p.a.*
2005				
Amounts repayable beyond 5 years	**6,635**	**4.3 – 8.4**	**4,169**	**(Note)**
Amounts repayable within a period of between 2 and 5 years	**7,528**	**3.1 – 7.5**	**5,594**	
Amounts repayable within a period of between 1 and 2 years	**557**	**4.9 – 5.5**	**45**	
Amounts repayable within 1 year	**3,409**	**2.2 – 5.5**	**55**	
	18,129		**9,863**	**3.3 – 6.2**

The Company

	Fixed rate borrowings and borrowings swapped to fixed rates		Variable rate borrowings and borrowings swapped from fixed rate	
	Carrying amount *HK$ million*	Interest rate *% p.a.*	Carrying amount *HK$ million*	Interest rate *% p.a.*
2005				
Amounts repayable beyond 5 years	**447**	**5.5 – 8.4**	**911**	**(Note)**
Amounts repayable within a period of between 2 and 5 years	**7,528**	**3.1 – 7.5**	**4,928**	
Amounts repayable within a period of between 1 and 2 years	**557**	**4.9 – 5.5**	**45**	
Amounts repayable within 1 year	**2,407**	**2.2 – 5.5**	**(1,406)**	
	10,939		**4,478**	**3.3 – 6.2**

The Group

	Fixed rate loans and loans swapped to fixed rates		Variable rate loans and loans swapped from fixed rate	
	Outstanding amount *HK$ million*	Interest rate *% p.a.*	Outstanding amount *HK$ million*	Interest rate *% p.a.*
2004				
Amounts repayable beyond 5 years	9,225	4.5 – 8.4	4,277	(Note)
Amounts repayable within a period of between 2 and 5 years	4,382	3.1 – 7.5	4,547	
Amounts repayable within a period of between 1 and 2 years	3,408	2.2 – 5.5	(353)	
Amounts repayable within 1 year	4,944	4.4 – 8.0	(445)	
	21,959		8,026	0.3 – 3.7

The Company

	Fixed rate loans and loans swapped to fixed rates		Variable rate loans and loans swapped from fixed rate	
	Outstanding amount *HK$ million*	Interest rate *% p.a.*	Outstanding amount *HK$ million*	Interest rate *% p.a.*
2004				
Amounts repayable beyond 5 years	958	5.5 – 8.4	4,278	(Note)
Amounts repayable within a period of between 2 and 5 years	3,883	3.1 – 7.5	4,546	
Amounts repayable within a period of between 1 and 2 years	958	2.2 – 5.5	(353)	
Amounts repayable within 1 year	3,494	4.4 – 8.0	(445)	
	9,293		8,026	0.3 – 3.7

Note: In respect of the variable rate borrowings and borrowings swapped from fixed rate, the interest rates quoted are their contract rates as at balance sheet date subject to repricing in less than one year.

34 Creditors, accrued charges and provisions

	The Group		The Company	
in HK$ million	**2005**	2004 (Restated)	**2005**	2004 (Restated)
Creditors, accrued charges and provisions				
– Airport Railway Project	**87**	89	**87**	89
– Tseung Kwan O Extension Project	**155**	223	**155**	223
– Property Projects	**559**	483	**559**	483
– Railway operations and other projects	**2,446**	2,195	**2,173**	1,963
Gross amount due to customers for contract work	**56**	47	**–**	–
	3,303	3,037	**2,974**	2,758

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 2005, is HK$130 million *(2004: HK$58 million)*.

The gross amount due to customers for contract work at 31 December 2005 that is expected to be settled after more than one year is HK$56 million *(2004: HK$47 million)*.

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

	The Group		The Company	
in HK$ million	**2005**	2004 (Restated)	**2005**	2004 (Restated)
Due within 30 days or on demand	**591**	563	**459**	414
Due after 30 days but within 60 days	**643**	509	**601**	474
Due after 60 days but within 90 days	**116**	106	**104**	105
Due after 90 days	**1,370**	1,356	**1,233**	1,262
	2,720	2,534	**2,397**	2,255
Rental and other refundable deposits	**446**	369	**440**	369
Accrued employee benefits	**137**	134	**137**	134
Total	**3,303**	3,037	**2,974**	2,758

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 2005, all creditors, accrued charges and provisions were expected to be settled within one year except for HK$658 million *(2004: HK$532 million, as restated)* 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, majority of which are due to be repaid within three years. The Group considers the effect of discounting these deposits would be immaterial.

The nominal values of creditors, accrued charges and provisions less estimated credit adjustments of creditors are not significantly different from their fair values.

34 Creditors, accrued charges and provisions (continued)

Included in creditors, accrued charges and provisions are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
in $ million	**2005**	2004	**2005**	2004
Euro	**3**	5	**3**	5
Japanese Yen	**2**	1	**2**	1
New Taiwan dollar	**–**	1	**–**	1
Pound sterling	**1**	–	**1**	–
Swiss franc	**1**	2	**1**	2
United States dollar	**51**	55	**37**	40
Won	**2**	–	**2**	–

35 Contract retentions

The Group and The Company

in HK$ million	Due for release after 12 months	Due for release within 12 months	Total
2005			
Tseung Kwan O Extension Project	**–**	**7**	**7**
Railway operations and other projects	**16**	**147**	**163**
	16	**154**	**170**
2004			
Tseung Kwan O Extension Project	–	41	41
Railway operations and other projects	71	128	199
	71	169	240

The effect of discounting these contract retentions is considered immaterial as these amounts are substantially due to be released within 24 months.

Included in contract retentions are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

	The Group		The Company	
in $ million	**2005**	2004	**2005**	2004
Swiss franc	**3**	3	**3**	3

36 Amounts due to related parties

The followings are amount due to KCRC in respect of entrustment works and amounts due to the subsidiaries and associates:

	The Group		The Company	
in HK$ million	**2005**	2004	**2005**	2004
Amounts due to:				
– KCRC	**–**	1	**–**	1
– subsidiaries	**–**	–	**12,773**	12,870
– associates	**17**	–	**–**	–
	17	1	**12,773**	12,871

As at 31 December 2005, HK$17 million *(2004: HK$1 million)* due to associates are expected to be settled within one year. Amounts due to the subsidiaries of HK$12,773 million *(2004: HK$12,665 million)* are expected to be settled after one year.

All amounts due to the Company's subsidiaries *(2004: HK$12,863 million)* relates to amounts due to 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 with specified repayment dates and interest rates (note 33D). These amounts are stated at their fair values. The remaining balances due to subsidiaries and associates are non-interest bearing and have not been discounted as they do not have any fixed repayment terms and the amount is not material.

37 Deferred liabilities

The Group and The Company

in HK$ million	**2005**	2004
Estate management funds		
– Refundable deposits on managed properties	**52**	50
– Building maintenance and asset replacement reserve funds	**60**	59
	112	109

Refundable deposits on managed properties are substantially due within three years and the effect of discounting these deposits would be immaterial. Building maintenance and asset replacement reserve funds are withdrawable on demand.

38 Deferred income

The Group and The Company

in HK$ million	**2005**	2004
Deferred income on property development (note 19B)	**3,458**	4,506
Deferred income on lease out and lease back transaction (note 17G)	**132**	137
Less: Amount recognised as income	**6**	5
	126	132
	3,584	4,638

39 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

	Deferred tax arising from					
in HK$ million	Depreciation allowances in excess of related depreciation	Revaluation of properties	Provision and other temporary differences	Cash flow hedges	Tax losses	Total
2005						
At 1 January 2005, as previously reported	**9,023**	**62**	**(131)**	**–**	**(4,205)**	**4,749**
Prior period adjustments on effects of changes in accounting policy (note 3)	**–**	**1,604**	**–**	**–**	**–**	**1,604**
At 1 January 2005, as restated	**9,023**	**1,666**	**(131)**	**–**	**(4,205)**	**6,353**
Charged/(credited) to consolidated profit and loss account	**232**	**490**	**(1)**	**–**	**827**	**1,548**
Charged to reserves (note 41)	**–**	**86**	**–**	**5**	**–**	**91**
At 31 December 2005	**9,255**	**2,242**	**(132)**	**5**	**(3,378)**	**7,992**
2004						
At 1 January 2004, as previously reported	8,753	4	(111)	–	(4,646)	4,000
Prior period adjustments on effects of changes in accounting policy (note 3)	–	1,169	–	–	–	1,169
At 1 January 2004, as restated	8,753	1,173	(111)	–	(4,646)	5,169
Charged/(credited) to consolidated profit and loss account (restated)	270	435	(20)	–	441	1,126
Charged to reserves (note 41)	–	58	–	–	–	58
At 31 December 2004, as restated	9,023	1,666	(131)	–	(4,205)	6,353

The Company

	Deferred tax arising from					
in HK$ million	Depreciation allowances in excess of related depreciation	Revaluation of properties	Provision and other temporary differences	Cash flow hedges	Tax losses	Total
2005						
At 1 January 2005, as previously reported	**9,012**	**62**	**(131)**	**–**	**(4,179)**	**4,764**
Prior period adjustments on effects of changes in accounting policy (note 3)	**–**	**1,604**	**–**	**–**	**–**	**1,604**
At 1 January 2005, as restated	**9,012**	**1,666**	**(131)**	**–**	**(4,179)**	**6,368**
Charged/(credited) to profit and loss account	**244**	**490**	**(1)**	**–**	**819**	**1,552**
Charged to reserves (note 41)	**–**	**86**	**–**	**5**	**–**	**91**
At 31 December 2005	**9,256**	**2,242**	**(132)**	**5**	**(3,360)**	**8,011**
2004						
At 1 January 2004, as previously reported	8,753	4	(111)	–	(4,646)	4,000
Prior period adjustments on effects of changes in accounting policy (note 3)	–	1,169	–	–	–	1,169
At 1 January 2004, as restated	8,753	1,173	(111)	–	(4,646)	5,169
Charged/(credited) to profit and loss account (restated)	259	435	(20)	–	467	1,141
Charged to reserves (note 41)	–	58	–	–	–	58
At 31 December 2004, as restated	9,012	1,666	(131)	–	(4,179)	6,368

39 Income tax in the balance sheet (continued)

in HK$ million	The Group 2005	The Group 2004 (Restated)	The Company 2005	The Company 2004 (Restated)
Net deferred tax asset recognised in the balance sheet	**(19)**	(15)	**–**	–
Net deferred tax liability recognised in the balance sheet	**8,011**	6,368	**8,011**	6,368
	7,992	6,353	**8,011**	6,368

C In accordance with tax accounting policy set out in note 2W, the Group has not recognised deferred tax assets in respect of its subsidiaries' cumulative tax losses of HK$77 million *(2004: HK$24 million)* as it is not probable that future taxable profits against which the losses can be utilised will be available in the relevant tax jurisdictions and entities.

40 Share capital, share premium and capital reserve

in HK$ million	2005	2004
Authorised:		
6,500,000,000 shares of HK$1.00 each	**6,500**	6,500
Issued and fully paid:		
5,481,856,439 shares *(2004: 5,389,999,974 shares)* of HK$1.00 each	**5,482**	5,390
Share premium	**4,780**	3,691
Capital reserve	**27,188**	27,188
	37,450	36,269

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					
– Pre-Global Offering Share Option Scheme	**5,282,500**	**8.44**	**5**	**40**	**45**
– New Joiners Share Option Scheme	**117,500**	**9.75**	**–**	**1**	**1**
Issued as 2004 final scrip dividends	**62,121,448**	**12.14**	**62**	**692**	**754**
Issued as 2005 interim scrip dividends	**24,335,017**	**15.66**	**25**	**356**	**381**
	91,856,465		**92**	**1,089**	**1,181**

Outstanding share options under the Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme as at 31 December 2005 are disclosed in note 42.

41 Other reserves

The Group

in HK$ million	Investment property revaluation reserve	Fixed asset revaluation reserve	Hedging reserve	Employee share-based capital reserve	Exchange reserve	Retained profits	Total
	Attributable to equity shareholders of the Company						
2005							
Balance as at 1 January 2005, as previously reported	**9,168**	**291**	**–**	**–**	**–**	**17,771**	**27,230**
Prior period adjustments on effects of changes in accounting policies (note 3)	**(9,168)**	**–**	**–**	**1**	**–**	**7,560**	**(1,607)**
	–	**291**	**–**	**1**	**–**	**25,331**	**25,623**
Effect of prospective adoption of new accounting policy with respect to financial instruments (note 3)	**–**	**–**	**(66)**	**–**	**–**	**190**	**124**
Balance as at 1 January 2005, as restated	**–**	**291**	**(66)**	**1**	**–**	**25,521**	**25,747**
Cash flow hedges:							
Effective portion of changes in fair value, net of deferred tax	**–**	**–**	**69**	**–**	**–**	**–**	**69**
Transfer from equity							
– to profit and loss account	**–**	**–**	**32**	**–**	**–**	**–**	**32**
– to initial carrying amount of non-financial hedged items	**–**	**–**	**(21)**	**–**	**–**	**–**	**(21)**
– to deferred tax	**–**	**–**	**10**	**–**	**–**	**–**	**10**
Dividends approved/paid	**–**	**–**	**–**	**–**	**–**	**(2,273)**	**(2,273)**
Surplus on revaluation, net of deferred tax (notes 17 and 39)	**–**	**406**	**–**	**–**	**–**	**–**	**406**
Employee share-based payments	**–**	**–**	**–**	**1**	**–**	**–**	**1**
Exchange difference on translation of accounts of overseas subsidiaries	**–**	**–**	**–**	**–**	**4**	**–**	**4**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**8,450**	**8,450**
Balance as at 31 December 2005	**–**	**697**	**24**	**2**	**4**	**31,698**	**32,425**
2004							
Balance as at 1 January 2004, as previously reported	6,682	18	–	–	–	15,506	22,206
Prior period adjustments on effects of changes in accounting policies (note 3)	(6,682)	–	–	–	–	5,513	(1,169)
Balance as at 1 January 2004, as restated	–	18	–	–	–	21,019	21,037
Dividends approved/paid	–	–	–	–	–	(2,231)	(2,231)
Surplus on revaluation, net of deferred tax (restated) (notes 17 and 39)	–	273	–	–	–	–	273
Employee share-based payments (restated) (note 3)	–	–	–	1	–	–	1
Profit for the year, as previously reported	–	–	–	–	–	4,496	4,496
Effects of changes in accounting policies (note 3)	–	–	–	–	–	2,047	2,047
Profit for the year, as restated	–	–	–	–	–	6,543	6,543
Balance as at 31 December 2004, as restated	–	291	–	1	–	25,331	25,623

41 Other reserves (continued)

The Company

in HK$ million	Investment property revaluation reserve	Fixed asset revaluation reserve	Hedging reserve	Employee share-based capital reserve	Retained profits	Total
2005						
Balance as at 1 January 2005, as previously reported	**9,168**	**291**	**–**	**–**	**17,553**	**27,012**
Prior period adjustments on effects of changes in accounting policies (note 3)	**(9,168)**	**–**	**–**	**1**	**7,560**	**(1,607)**
	–	**291**	**–**	**1**	**25,113**	**25,405**
Effect of prospective adoption of new accounting policy with respect to financial instruments (note 3)	**–**	**–**	**(66)**	**–**	**190**	**124**
Balance as at 1 January 2005, as restated	**–**	**291**	**(66)**	**1**	**25,303**	**25,529**
Cash flow hedges:						
Effective portion of changes in fair value, net of deferred tax	**–**	**–**	**69**	**–**	**–**	**69**
Transfer from equity						
– to profit and loss account	**–**	**–**	**32**	**–**	**–**	**32**
– to initial carrying amount of non-financial hedged items	**–**	**–**	**(21)**	**–**	**–**	**(21)**
– to deferred tax	**–**	**–**	**10**	**–**	**–**	**10**
Dividends approved/paid	**–**	**–**	**–**	**–**	**(2,273)**	**(2,273)**
Surplus on revaluation, net of deferred tax (notes 17 and 39)	**–**	**406**	**–**	**–**	**–**	**406**
Employee share-based payments	**–**	**–**	**–**	**1**	**–**	**1**
Profit for the year	**–**	**–**	**–**	**–**	**8,364**	**8,364**
Balance as at 31 December 2005	**–**	**697**	**24**	**2**	**31,394**	**32,117**
2004						
Balance as at 1 January 2004, as previously reported	6,682	18	–	–	15,305	22,005
Prior period adjustments on effects of changes in accounting policies (note 3)	(6,682)	–	–	–	5,513	(1,169)
Balance as at 1 January 2004, as restated	–	18	–	–	20,818	20,836
Dividends approved/paid	–	–	–	–	(2,231)	(2,231)
Surplus on revaluation, net of deferred tax (restated) (notes 17 and 39)	–	273	–	–	–	273
Employee share-based payments (restated) (note 3)	–	–	–	1	–	1
Profit for the year, as previously reported	–	–	–	–	4,479	4,479
Effects of changes in accounting policies (note 3)	–	–	–	–	2,047	2,047
Profit for the year, as restated	–	–	–	–	6,526	6,526
Balance as at 31 December 2004, as restated	–	291	–	1	25,113	25,405

The fixed asset revaluation reserve was set up to deal with the surpluses or deficits arising from the revaluation of self-occupied land and buildings (note 2F(ii)).

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition of the hedged cash flow in accordance with the accounting policy adopted for cash flow hedges in note 2T(ii).

The employee share-based capital reserve comprises the fair value of share options granted which are yet to be exercised, as explained in accounting policy under note 2U(iv). The amount will either be transferred to the share premium account when the option is exercised, or be released directly to retained profits if the option is expired or forfeited.

41 Other reserves (continued)

Apart from retained profits, the other reserves are not available for distribution to shareholders because they do not constitute realised profits. In addition, the Company considers the cumulative surpluses on revaluation of investment properties, net of tax of HK$9,874 million *(2004: HK$7,564 million, as restated)* included in retained profits are non-distributable as they also do not constitute realised profits. As at 31 December 2005, the Company considers that the total amount of reserves available for distribution to equity shareholders amounted to HK$21,520 million *(2004: HK$17,549 million, as restated)*.

Included in the Group's retained profits as at 31 December 2005 is an amount of HK$48 million *(2004: HK$39 million)*, being the retained profits attributable to the non-controlled subsidiaries and associates.

42 Share-based payments

A Equity-settled share-based payments

The Group granted equity-settled share options to its Members of the Executive Directorate (except CEO) and certain employees under two share option schemes, the Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme. Details of the schemes are as follows:

(i) 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, Lincoln K K Leong and Francois K K Lung who were appointed on 1 December 2003, 1 February 2002 and 26 September 2005 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 2005. 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 2005, all options granted under the Pre-IPO Option Scheme have been vested.

In 2005, no options were vested and a total of 5,282,500 previously vested share options have been exercised. The weighted average closing price in respect of the share options exercised during the year was HK$13.77 per share. In addition, no share options were lapsed as a result of the resignation of option holders during the year. As at 31 December 2005, total options to subscribe for 11,923,500 *(2004: 17,206,000)* shares remained outstanding.

As the options under Pre-IPO Option Scheme were granted before 7 November 2002, no share-based payment was required to be recognised in accordance with HKFRS 2 "Share-based payment".

(ii) 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 2005, 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.

The following table summarises the share options granted under the New Option Scheme since inception:

	Number of share options	Exercise price *HK$*	Exercisable period
Options granted on:			
– 1 August 2003	1,561,200	9.75	on or prior to 14 July 2013
– 13 September 2005	94,000	15.97	on or prior to 9 September 2015
– 23 September 2005	213,000	15.97	on or prior to 9 September 2015
– 27 September 2005	1,066,000	15.75	on or prior to 26 September 2015
– 17 October 2005	94,000	16.05	on or prior to 6 October 2015

42 Share-based payments (continued)

Movements in the number of share options outstanding and their related weighted average exercise prices were as follows:

	2005 Number of options	**2005** Weighted average exercise price *HK$*	2004 Number of options	2004 Weighted average exercise price *HK$*
Outstanding at 1 January	**1,561,200**	**9.75**	1,561,200	9.75
Granted during the year	**1,467,000**	**15.82**	–	–
Exercised during the year	**(117,500)**	**9.75**	–	–
Outstanding at 31 December	**2,910,700**	**12.81**	1,561,200	9.75
Exercisable at 31 December	**924,500**	**9.75**	521,000	9.75

The weighted average closing price in respect of the share options exercised during the year was HK$15.21 *(2004: N/A)*.

Share options outstanding at 31 December 2005 had the following exercise prices and remaining contractual lives:

	2005 Number of options	**2005** Remaining contractual life *years*	2004 Number of options	2004 Remaining contractual life *years*
Exercise price:				
– HK$9.75	**1,443,700**	**7.53**	1,561,200	8.53
– HK$15.97	**307,000**	**9.69**	–	–
– HK$15.75	**1,066,000**	**9.74**	–	–
– HK$16.05	**94,000**	**9.76**	–	–
	2,910,700	**8.64**	1,561,200	8.53

According to the Black-Scholes pricing model, the fair values of options granted during the year ended 31 December 2005 were as follows:

	Date of grant: 13 September 2005	23 September 2005	27 September 2005	17 October 2005
Fair value of options granted	**HK$2.61**	**HK$2.69**	**HK$2.82**	**HK$2.34**
Inputs into the Black-Scholes pricing model:				
Share price at grant date	**HK$15.55**	**HK$15.70**	**HK$15.70**	**HK$15.10**
Exercise price	**HK$15.97**	**HK$15.97**	**HK$15.75**	**HK$16.05**
Expected volatility	**0.2**	**0.2**	**0.2**	**0.2**
Expected life	**5 years**	**5 years**	**5 years**	**5 years**
Risk-free interest rate	**3.91%**	**3.91%**	**4.08%**	**4.08%**
Expected dividend per share	**HK$0.42**	**HK$0.42**	**HK$0.42**	**HK$0.42**

When computing fair values of the options granted, expected volatility was determined by calculating the historical volatility of the Group's share price over the previous 5 years and the expected life adopted was assumed to be the mid-exercisable period of the options, with expected dividends based on historical dividends. In addition, vesting terms under the grants have been taken into account whilst no market conditions associated with the share option grants have been considered. Changes in the subjective input assumptions could materially affect the fair value estimate.

During the year ended 31 December 2005, the Group recognised total expenses of HK$1 million *(2004: HK$1 million)* related to equity-settled share-based payments.

42 Share-based payments (continued)

B Cash-settled share-based payments

The CEO will be entitled to receive an equivalent value in cash of 700,000 shares in the Company on completion of his three-year contract (i.e. 30 November 2006). As at 31 December 2005, the Group has recorded liabilities of HK$7 million *(2004: HK$3 million)* in respect of the arrangement. During the year ended 31 December 2005, the Group recorded total expenses of HK$4 million *(2004: HK$3 million)*. Fair value of this entitlement is calculated based on the closing price of the Company's shares at year-end date. As at 31 December 2005, the fair value of these shares was HK$15.25 per share *(2004: HK$12.45)*.

43 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.

(i) 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 2005, the total membership was 5,844 *(2004: 5,966)*. In 2005, members contributed HK$65 million *(2004: HK$67 million)* and the Company contributed HK$165 million *(2004: HK$224 million)* to the hybrid benefit section. The net asset value of the hybrid benefit section as at 31 December 2005 was HK$5,899 million *(2004: HK$5,365 million)*.

(ii) 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 2005, the total membership under this section was 501 *(2004: 406)*. In 2005, total members' contributions were HK$5.5 million *(2004: HK$6.4 million)* and the total contribution from the Company was HK$9.6 million *(2004: HK$13.3 million)*. The net asset value as at 31 December 2005 was HK$97.7 million *(2004: HK$74.8 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.

(iii) 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 2005 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% *(2004: 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:

(a) 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

(b) 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.

43 Retirement Schemes (continued)

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 2005, there were 366 members *(2004: 397)* 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 2005, the Company was not required to make any contributions to the Scheme *(2004: HK$2 million)*. The net asset value of the RBS as at 31 December 2005 was HK$13 million *(2004: HK$14 million)*.

Actuarial valuations are carried out annually. A full actuarial valuation of the RBS was carried out at 31 December 2005 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 -1.35% *(2004: -1.25%)* per annum, together with appropriate allowance for expected rates of redundancy. The actuary confirmed that, at the valuation date:

(a) 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

(b) 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 2005, the total number of employees of the Company participating in the MPF Scheme was 520 *(2004: 478)*. In 2005, total members' contributions were HK$1.5 million *(2004: HK$1.6 million)* and total contribution from the Company was HK$1.9 million *(2004: HK$2.5 million)*.

44 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 43). 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 **2005**	RBS **2005**	Total **2005**	Retirement Scheme 2004	RBS 2004	Total 2004
Present value of funded obligations	**5,974**	**7**	**5,981**	5,456	7	5,463
Fair value of plan assets	**(5,899)**	**(13)**	**(5,912)**	(5,365)	(14)	(5,379)
Net unrecognised actuarial gains/(losses)	**(172)**	**2**	**(170)**	(188)	6	(182)
Net (asset)/liability	**(97)**	**(4)**	**(101)**	(97)	(1)	(98)

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

44 Defined benefit retirement plan obligations (continued)

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

The Group and The Company

in HK$ million	Retirement Scheme **2005**	RBS **2005**	Total **2005**	Retirement Scheme 2004	RBS 2004	Total 2004
At 1 January	**(97)**	**(1)**	**(98)**	(39)	2	(37)
Contributions paid to the Schemes	**(165)**	**–**	**(165)**	(224)	(2)	(226)
Expense recognised (note 44C)	**165**	**(3)**	**162**	166	(1)	165
At 31 December	**(97)**	**(4)**	**(101)**	(97)	(1)	(98)

C Expense recognised in the consolidated profit and loss account:

in HK$ million	Retirement Scheme **2005**	RBS **2005**	Total **2005**	Retirement Scheme 2004	RBS 2004	Total 2004
Current service cost	**261**	**–**	**261**	228	–	228
Interest cost	**230**	**–**	**230**	222	1	223
Expected return on plan assets	**(326)**	**–**	**(326)**	(284)	(1)	(285)
Net actuarial (gain)/loss recognised	**–**	**(3)**	**(3)**	–	(1)	(1)
Expense recognised (note 44B)	**165**	**(3)**	**162**	166	(1)	165
Less: Amount capitalised	**31**	**(3)**	**28**	28	(1)	27
	134	**–**	**134**	138	–	138

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

D Actual return on plan assets

in HK$ million	**2005**	2004
MTRCL Retirement Scheme	**445**	527
MTRCL Retention Bonus Scheme	**–**	–

E The principal actuarial assumptions used as at 31 December 2005 (expressed as weighted average) are as follows:

	Retirement Scheme **2005**	RBS **2005**	Retirement Scheme 2004	RBS 2004
Discount rate at 31 December	**4.25%**	**4.00%**	4.25%	1.00%
Expected rate of return on plan assets	**6.00%**	**2.25%**	6.00%	1.50%
Future salary increases	**4.00%**	**3.60%**	4.00%	2.75%

45 Interests in jointly controlled operations

The Group has the following jointly controlled operations in respect of its property development projects as at 31 December 2005.

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	Completed in 2005
Package Four	Residential	128,845	Completed in 2003
Package Five, Six and Seven	Residential / Office / Retail / Hotel / Serviced Apartment	504,350	By phases from 2006 – 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	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 – 2008
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	Completed in 2005
Tseung Kwan O South Station			
Area 86 Package One	Residential / Retail / Residential Care Home for the Elderly	139,840	2009
Choi Hung Park-and-Ride	Residential / Retail	21,538	Completed in 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 19) as the case may be. As at 31 December 2005, total property development in progress in respect of these jointly controlled operations was HK$1,087 million *(2004: HK$388 million)* and total deferred income was HK$3,458 million *(2004: HK$4,506 million)*.

During the year ended 31 December 2005, profits of HK$6,145 million *(2004: HK$4,568 million)* were recognised (note 8).

46 Material related party transactions

The Financial Secretary Incorporated, which holds approximately 76.5% 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 HKAS 24 "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 including their close family members, 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 19).

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 ("OA") with the Government which detailed provisions for the design, construction, maintenance and operation of the railway under the franchise. Pursuant to the terms of the OA, the Company's franchise will be extended for further periods of 50 years upon satisfying certain capital expenditure requirements at no payment and without any change in the terms of the franchise. The OA also provides that upon extension of the franchise and subject to the Government's prevailing land policy on the date on which the franchise is extended, certain consequential amendments will be made to agreements between the Government and the Company in relation to the mass transit railway, including the renewal of various railway running line leases and land leases at nominal cost.

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 ("DRL"). In connection with the financing of the DRL Project, the Government agreed to provide financial support through the Government waivers of its entitlement to cash dividends in respect of its shareholding. Such committed financial support has been met in 2004. The DRL was completed in June 2005 and commenced operation on 1 August 2005.

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 18C.

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

G 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. Upon award of the development package on 8 February 2005, the agreed land premium, of which one-half or HK$1,160 million was paid by the Company, was settled.

H On 18 July 2005, the Company entered into a project agreement with the Airport Authority for the procurement of MTR station extension works and related railway facilities to serve the SkyPlaza currently under construction at the Hong Kong International Airport. Details of the project are described in note 18E.

I 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 2005 are provided in notes 18, 31 and 36 respectively.

J The Company has business transactions with its non-controlled subsidiaries in the normal course of operations, details of which are disclosed in note 22.

46 Material related party transactions (continued)

K 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 7A. 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 7B and under the paragraph "Board Members and Executive Directorate's interests in shares" in the Report of the Members of the Board. Their gross remuneration is summarised as follows:

in HK$ million	**2005**	2004
Short-term employee benefits	**42.3**	38.6
Post-employment benefits	**2.2**	3.0
Equity compensation benefits	**5.2**	3.5
	49.7	45.1

These above remuneration is included in staff costs and related expenses.

L In December 2005, a lump sum retirement benefit payment of HK$11.6 million was paid to Philip Gaffney, a Member of the Executive Directorate who retired on 5 December 2005, out of the MTR Corporation Limited Retirement Scheme.

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

in HK$ million	**2005**	2004
Cash dividends paid	**760**	652
Cash dividends waived	**–**	37
Shares allotted in respect of scrip dividends	**978**	1,014
	1,738	1,703

In 2004, HK$37 million cash dividends were waived by the Government. Such amount, together with HK$11 million brought forward from previous year, have been offset against the construction costs of the DRL Project (note 18).

47 Commitments

A Capital commitments

(i) Outstanding capital commitments as at 31 December 2005 not provided for in the accounts were as follows:

The Group

in HK$ million	Railway operations	Railway extension projects	Property development projects	New businesses	Total
2005					
Authorised but not yet contracted for	**543**	**–**	**408**	**8**	**959**
Authorised and contracted for	**598**	**67**	**1,336**	**97**	**2,098**
	1,141	**67**	**1,744**	**105**	**3,057**
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

47 Commitments (continued)

The Company

in HK$ million	Railway operations	Railway extension projects	Property development projects	Total
2005				
Authorised but not yet contracted for	**543**	**–**	**408**	**951**
Authorised and contracted for	**598**	**67**	**1,336**	**2,001**
	1,141	**67**	**1,744**	**2,952**
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

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
2005			
Authorised but not yet contracted for	**479**	**64**	**543**
Authorised and contracted for	**259**	**339**	**598**
	738	**403**	**1,141**
2004			
Authorised but not yet contracted for	388	130	518
Authorised and contracted for	232	695	927
	620	825	1,445

(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	**2005**	2004
Authorised but not yet contracted for	**408**	1,762
Authorised and contracted for	**1,324**	204
	1,732	1,966

47 Commitments (continued)

B Operating lease commitments

The Group had operating leases on office buildings and staff quarters as at 31 December 2005. The total future minimum lease payments under non-cancellable operating leases are payable as follows:

The Group and The Company

in HK$ million	**2005**	2004
Payable within one year		
Leases expiring within one year	**3**	5
Leases expiring between one to five years	**5**	2
	8	7
Payable after one but within five years	**3**	1
	11	8

The above includes HK$1 million *(2004: HK$2 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 2005, the Group had total outstanding liabilities and contractual commitments of HK$619 million *(2004: HK$613 million)* in respect of these works and services. Cash funds totalling HK$695 million *(2004: HK$665 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. In May 2005, the Company and the Shenzhen Municipal People's Government initialed the project Concession Agreement. The project is subject to approval 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. Upon completion of Phase 2 of Shenzhen Line 4, 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$5.8 billion) which will be financed by equity capital contributed by the Company of RMB 2.4 billion (HK$2.3 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.

No significant construction contracts have been awarded as to-date. As of 31 December 2005, total costs of HK$166 million *(2004: HK$51 million)* incurred for the project have been included in deferred expenditure and the Company had other contract commitments totalling HK$105 million *(2004: HK$10 million)* in relation to this project.

(ii) Investment in Beijing Metro Line 4 Project ("Beijing Line 4")

In December 2004, 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. In February 2005, the Company and the other PPP partners initialed the project Concession Agreement with Beijing Municipal People's Government. In September 2005, approval from Central Government was obtained for the PPP project and the PPP company was formally established in January 2006.

47 Commitments (continued)

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 estimated at RMB 15.3 billion (HK$14.7 billion), 70% of which will be funded by the Beijing Municipal People's Government. The PPP's investment will be approximately RMB 4.6 billion (HK$4.4 billion), contributing to 30% 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 1.4 billion (HK$1.3 billion), about RMB 676 million (HK$650 million) of which will be contributed and owned by the Company. The remaining 70% of the PPP's investment is expected to be funded by non-recourse bank loans. No significant construction contracts have been awarded as to-date.

48 Post balance sheet event

A In January 2006, the Group entered into a long-term lease up to 47 years for the operation and management of a shopping centre in Dong Cheng district, Beijing. The shopping centre has a gross floor area of about 31,000 square metres. Annual lease payments are approximately RMB50 million for the first five years of the lease during which the Group has the right to acquire the shopping centre at a pre-determined price.

B On 1 February 2006, the Company entered into a development agreement with Rich Asia Investments Limited, a subsidiary of Cheung Kong (Holdings) Limited to develop Tseung Kwan O Town Lot No. 70 Site AB in respect of which the Company has accepted Government's assessed land premium of approximately HK$8 billion, and the Company is to provide an interest-free loan of HK$4 billion to assist the developer in financing the project. The development site involves accommodation and facilities with a total gross floor area of 309,696 square metres and is expected to be completed by 2010.

49 Comparative figures

Certain comparative figures have been adjusted or reclassified as a result of the changes in accounting policies. Details are disclosed in note 3.

50 Accounting estimates and judgements

A Key sources of accounting estimates and estimation uncertainty include the following:

(i) Estimated useful life and depreciation of property, plant and equipment
The Group estimates the useful lives of the various categories of property, plant and equipment on the basis of their design lives, planned asset maintenance programme and actual usage experience. Depreciation is calculated using the straight-line method at rates sufficient to write off their cost or valuation over their estimated useful lives (note 2H).

(ii) Impairment of long-lived assets
The Group reviews its long-lived assets for indications of impairment at each balance sheet date according to accounting polices set out in note 2G(ii). In analysing potential impairments identified, the Group uses projections of future cash flows from the assets based on management's assignment of a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

(iii) Pension costs
The Group employed independent valuation professionals to conduct annual assessment of the actuarial position of the Group's retirement plans. The determination of the Group's obligation and expense for the defined benefit element of these plans is dependent on certain assumptions and factors provided by the Company, which are disclosed in note 43A(iii).

(iv) Revenue recognition on property development
Recognition of property development profits requires management's estimation of the final project costs upon completion and, in the case of property distributions-in-kind, the properties' fair value upon recognition. The Company takes into account independent qualified surveyors report, past experience on sales and marketing costs, as well as the prevailing market conditions when estimating final project costs on completion, and bases on professionally qualified valuers' reports in determining the estimated fair value of property distribution-in-kinds.

(v) Valuation of investment properties
The valuation of investment properties requires management's input of various assumptions and factors relevant to the valuation. The Group conducts annual revaluation of its investment properties by independent professionally qualified valuers based on these assumptions agreed with the valuers prior to adoption.

(vi) Franchise
The current franchise under which the Group is operating allows it to run the mass transit railway system until 30 June 2050. Pursuant to the terms stipulated in the Operating Agreement with the Government, the Company considers that it has the legal right to extend the franchise for further periods of 50 years upon expiry of each franchise term (note 46C). The Group's depreciation policies (note 2H) in respect of certain assets' lives which extend beyond 2050 are relied on this basis.

50 Accounting estimates and judgements (continued)

(vii) Income tax

Certain treatments adopted by the Company in its tax returns in the past years are yet to be finalised with the Hong Kong Inland Revenue Department. In assessing the Company's income tax and deferred taxation in the 2005 accounts, the Company has followed the tax treatments it has adopted in those tax returns, which may be different from the final outcome in due course.

(viii) Project provisions

The Group establishes project provisions for the settlement of estimated claims that may arise due to time delays, additional costs or other unforeseen circumstances common to major construction contracts. The claims provisions are estimated based on an assessment of the Group's liabilities under each contract by professionally qualified personnel, which may differ from the actual claims settlement.

B Critical accounting judgements in applying the Group's accounting policies

(i) Properties held for sale

The Group has temporarily let out certain retail and carpark spaces at Olympian City but has decided to treat these as properties held for sale as it is not the Group's intention to hold them in the long-term for capital appreciation or rental income.

(ii) Provisions and contingent liabilities

The Group recognises provisions for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. 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 contingent liability. As at 31 December 2005, the Group considered that it had no disclosable contingent liabilities as there were neither pending litigations nor events with potential obligation which were probable to result in material outflow of economic benefits to the Group.

51 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2005

Up to the date of issue of these accounts, the HKICPA has issued several amendments, new standards and interpretations which are not yet effective for the accounting period ended 31 December 2005 and which have not been adopted in these accounts. The Group has carried out an assessment on those accounting pronouncements and considered that the following new standards will apply to the Group's accounts in future:

	Effective for accounting periods beginning on or after
Amendment to HKAS 19 "Employee Benefits" – Actuarial Gains and Losses, Group Plans and Disclosures	1 January 2006
Amendment to HKAS 39 "Financial Instruments: Recognition and Measurement" – Financial Guarantee Contracts	1 January 2006
HKFRS 7 "Financial Instruments: Disclosures"	1 January 2007
Amendment to HKAS 1 "Presentation of Financial Statements" – Capital Disclosures	1 January 2007

So far it has concluded that except for the Amendment to HKAS 39, which requires the recognition of financial guarantee contracts at their fair value in the balance sheet, the other matters are unlikely to have a significant impact on the Group's results of operations and financial position apart from certain additional disclosure and changes in presentation in the accounts.

52 Approval of accounts

The accounts were approved by the Board on 7 March 2006.