



KOWLOON-CANTON RAILWAY CORPORATION
ANNUAL REPORT 2010



100 YEARS OF SERVING HONG KONG



CONTENTS

- 2 MANAGING BOARD & KEY MANAGEMENT
- 4 CHAIRMAN'S STATEMENT
- 6 CHIEF OFFICER'S STATEMENT AND
FINANCIAL REVIEW
- 10 100 YEARS OF
RAILWAY OPERATIONS IN HONG KONG
- 18 CORPORATE GOVERNANCE REPORT
- 22 REPORT OF THE MEMBERS OF THE
MANAGING BOARD
- 26 INDEPENDENT AUDITOR'S REPORT
- 28 FINANCIAL STATEMENTS AND NOTES
- 96 FIVE-YEAR STATISTICS

MANAGING BOARD & KEY MANAGEMENT

Managing Board



Prof K C Chan SBS, JP (Left)

PhD

Chairman

Secretary for Financial Services and the Treasury of the Hong Kong Special Administrative Region Government



Eva Cheng JP (Right)

B Soc Sc

Secretary for Transport and Housing of the Hong Kong Special Administrative Region Government



Stanley Y H Ying JP (Left)

Member of Audit Committee

Permanent Secretary for Financial Services and the Treasury (Treasury) of the Hong Kong Special Administrative Region Government



Francis Ho Suen-wai JP (Right)

Permanent Secretary for Transport and Housing (Transport) of the Hong Kong Special Administrative Region Government



Clement Leung Cheuk-man JP (Left)

Member of Audit Committee

Deputy Secretary for Financial Services and the Treasury (Treasury) of the Hong Kong Special Administrative Region Government (until 24 October 2010)



Cathy Chu JP (Right)

Member of Audit Committee

Deputy Secretary for Financial Services and the Treasury (Treasury) of the Hong Kong Special Administrative Region Government (with effect from 25 October 2010)



K T Li JP (Left)

FCCA, CPA

Chairman of Audit Committee

Director of Accounting Services of the Hong Kong Special Administrative Region Government (until 19 January 2011)



Lesley Y C Wong JP (Right)

CPA, FCCA, ACA, ACIS

Chairperson of Audit Committee

Director of Accounting Services of the Hong Kong Special Administrative Region Government (with effect from 20 January 2011)

Key Management



Ir James Blake OBE, JP
FHKIE, FHKEng, FICE, FIStructE, FCIHT
Chief Officer



Michael J Arnold
BSc, CEng, MICE, MCIHT
Senior Manager-Administration
Company Secretary



Julian P Walsh
MA, ACA, CPA
Senior Manager-Finance

CHAIRMAN'S STATEMENT

“Against strong demand for rail travel, the Corporation’s revenue stream was strengthened by the first variable annual payment in addition to the fixed annual payment.”



Apart from marking the centenary year for Kowloon-Canton Railway, I am pleased to record 2010 as another successful year for the Corporation. Taking advantage of favourable borrowing opportunities, the cost of our debt portfolio has significantly further reduced. Against strong demand for rail travel, the Corporation's revenue stream was strengthened by the first variable annual payment in addition to the fixed annual payment from MTR Corporation Limited.

Due to general market sentiment, our 51% owned subsidiary, West Rail Property Development Limited, was not able to progress developments as we had hoped for. The reasons behind this lay outside the Corporation's control. Actions are being actively pursued by MTR Corporation Limited, as the agent of West Rail Property Development Limited, with the Government. The results thus far are encouraging. With concerted efforts from

relevant parties, we look forward with anticipation that the development of the West Rail property development sites can be expedited.

As Chairman, I would like to express my gratitude to all Members of the Managing Board for their contributions during the past year. I would like to express special thanks to Mr K T Li, who retired from the Board on 19 January 2011, for his additional contribution as the Chairman of the Audit Committee for the past two years, and to welcome as his replacement Mrs Lesley Wong, the Hong Kong SAR Government's new Director of Accounting Services. Last but not the least, on behalf of the Board, I take this opportunity to thank members of the direct management team for their dedication, hard work and commitment. They are invaluable assets of the Corporation.

Prof K C Chan SBS, JP

Chairman

20 April 2011

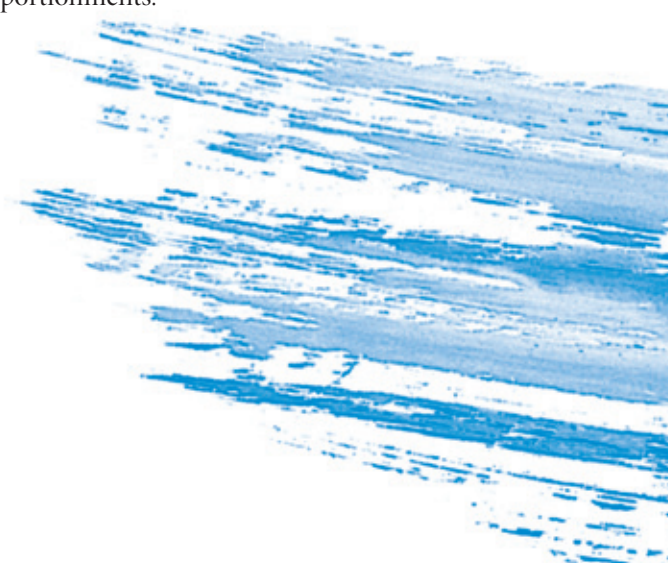
CHIEF OFFICER'S STATEMENT AND FINANCIAL REVIEW

During the 2010 Christmas and New Year holiday period Hong Kong's rail network for the first time carried over 5 million travellers over a 24-hour period. The MTR Corporation Limited as the railway operator is to be congratulated. KCRC's earlier ten year expansion of its rail network is now achieving the intended results, and through the operating Service Concession providing the Corporation with an increasing share of the fare revenue.

Last year I reported that the Corporation had secured new financing of some HK\$10 billion in notes, and HK\$4.5 billion in bank loans and facilities, to refinance maturing debts and to meet any remaining capital expenditure. Major capital expenditure is now effectively at an end following settlement of the financial accounts for the Kowloon Southern Link. The Corporation's residual business activities involve only relatively small operating costs. This enables the increasing annual payments received from the MTR Corporation Limited under the Service Concession to be directed almost entirely to servicing the debt portfolio.

Whereas the Corporation has received until now fixed annual payments of HK\$750 million, from 2 December 2010 onwards the MTR Corporation Limited, in addition, will also make variable annual payments calculated as a percentage of the gross annual revenue generated from KCRC's railway assets. For the 2010 financial year this variable payment is calculated against the gross annual revenue earned from the KCRC railway assets only in respect of the month of December, and amounted to HK\$45 million.

The Corporation's reliance on the fixed and variable annual payments requires that the formulaic methodology, used to apportion the Corporation's share of gross revenues from the rail network, must be clearly understood and accepted by Government, the Corporation and the MTR Corporation Limited. I am grateful to the relevant MTR and Government staff, who have thus far cooperated in a transparent and meaningful manner, for ensuring confidence on the part of all three parties in the outcome for 2010 as the basis for future annual apportionments.



“KCRC’s earlier ten year expansion of its rail network is now achieving the intended results, providing the Corporation with an increasing share of the fare revenue.”



Anticipating that low interest rates during 2010 will prevail into the future, the Corporation again entered the fixed rate market with the issue of a further HK\$1.8 billion in fixed rate notes. This enabled repayment of older loans carrying higher rates of interest. The Corporation adheres to a policy of maintaining a prudent balance between floating and fixed rate debt, and currently fixed-rate, longer-term debt accounts for 54% of the total debt portfolio. During the past two years, the Corporation's average cost of borrowing has been reduced from somewhat in excess of 7% to around 3% at the end of 2010.

Operating profit for 2010 before depreciation, amortisation and impairment amounted to HK\$979 million, an increase of HK\$151 million from 2009. Depreciation and amortisation charges were HK\$2,974 million and net loss for the year was HK\$2,034 million, a better than budget result.

1 October 2010 marked the 100-year anniversary of KCR train services, the Kowloon-Canton Railway (British Section), which was a single track line running from a temporary terminus in Tsim Sha Tsui to another temporary terminus at Lo Wu, having been opened on that same date in 1910 by the then Acting Governor of Hong Kong. In the early days this single track served about 1,000 passengers per day, contrasting today with the merged MTR and KCR networks, including Light Rail, which serve well in excess of 4 million passengers per day and have become the backbone of Hong Kong's public transport system.

The Corporation was notified by the MTR Corporation Limited that railway freight services were no longer a financially viable operation, and accordingly operations ceased during the year. This decision has little material impact on the payments that the Corporation expects to receive from the MTR Corporation Limited under the Service Concession Agreement, but has raised issues

“Operating profit for 2010 before depreciation, amortisation and impairment amounted to HK\$979 million, an increase of HK\$151 million from 2009.”

“1 October 2010 marked the 100-year anniversary of KCR.”

in regard to land used for freight facilities that remains vested in or leased to the Corporation. For now, both railway corporations have advised the Government that the land must be retained to enable use under the Sha Tin to Central Link (SCL) project, which MTR Corporation Limited is implementing for the Government.

Also in regard to the SCL, the Corporation has brought to the attention of both the Government and the MTR Corporation Limited certain legal and commercial issues that could arise during the project's construction and future operation. These include implications arising from possible impact on the Corporation assets, from which it derives most of its annual revenue.

Given its 51% interest in West Rail Property Development Limited (WRPDL), the Corporation was disappointed that market sentiment turned against a joint venture award for the Nam Cheong residential site during 2010.

Efforts are being made by the MTR Corporation Limited as property development agent to revitalise the situation, as well as expedite the development of five other sites along West Rail. The decision has been taken that in doing so WRPDL will adopt the latest Quality and Sustainable Built Environment requirements issued by the Government and, so far as possible, provide more small and medium-sized “no frills” flats. This work is now in hand.

On behalf of the direct management team, I would like to express my thanks to the Members of the Managing Board for the support and confidence they have shown in us, without which our work would have been far more difficult. Taken overall I can report that 2010 has been another good year of progress for the Corporation in consolidating its post rail-merger development into a major holder of railway assets.

Ir James Blake OBE, JP
FHKIE, FHKEng, FICE, FIStructE, FCIHT
Chief Officer
20 April 2011

100 YEARS OF RAILWAY OPERATIONS IN HONG KONG



The Centenary Exhibition

2010 was a significant year for the Corporation in that one hundred years earlier KCR trains first began operating regular services from Tsim Sha Tsui to Lo Wu along a single-track railway that is now known as East Rail Line. To celebrate the centenary the Corporation enlisted the support of former KCRC staff, the MTR Corporation Limited, holders of private collections of historical railway items, and various bureaus and departments of the Government in organising two events. It also gave its support to the Hongkong Post's issue in September 2010 of a special set of stamps to commemorate the 100 years of railway operations in Hong Kong.



Ir James Blake, the Chief Officer, stamping a commemorative postcard at the opening of the centenary exhibition.



The bilingual commemorative booklet for the exhibition

The Corporation initiated action to donate back to the people of Hong Kong the large bronze bell, weighing one ton, that had first been installed in the clock tower of the former KCR terminus in Tsim Sha Tsui in 1921. An exhibition was also organised at the Hong Kong Heritage Museum in Sha Tin from 9 October until 8 November, showcasing photographs and exhibits illustrating the development of railways in Hong Kong over the past 100 years.

Supporting the exhibition was the production of a bi-lingual booklet, providing a summary of the development of railways in Hong Kong, a copy of which



was given to all visitors. Copies of the booklet were also sent to every primary and secondary school in Hong Kong, the media and Members of the Legislative Council.

Special mention should be made of the contribution from former staff of KCRC, now mostly retired, in organising the collection of some exhibits held by former staff and in volunteering to man the exhibition at the Heritage Museum. Their previous service with the KCRC enabled them to bring an invaluable living history element to the exhibition for visitors in being able to explain from personal experience the background to many of the exhibits.

Mention should also be made of two private collectors of railway memorabilia, Mr Peter Crush and Mr Grimble Chu, both of whom lent a number of rare and valuable items from their personal collections for inclusion in the display.

The Under Secretary for Transport and Housing, Mr Yau Shing-mu, officially opened the exhibition on 9 October. Some 18,000 people, both local and from overseas, were recorded as visiting the exhibition over the following month. From the many comments received both in writing and orally, the exhibition appeared to have been well received by all who visited.



Officiating guests in front of photo backdrop of high speed train control room



Private collections

A Short History of the Kowloon-Canton Railway (KCR) Network



Beacon Hill Tunnel under construction 1909

100 years ago, on 1 October 1910, regular commercial services began operating on the Kowloon-Canton Railway (British Section). The railway, which had been constructed by the Hong Kong Government, comprised a single track line running from its southerly terminus in Tsim Sha Tsui, Kowloon, northwards to Lo Wu at the boundary with Mainland China. One year later, on 5



The first train leaving Tsim Sha Tsui on 1 October 1910



British construction staff 1907





At the Opening ceremony of KCR (British section), the Acting Governor of Hong Kong, Sir Henry May, standing next to Mr Wei Han, the Managing Director of the Chinese Section, at Lo Wu.



Passengers crossing the old Lo Wu bridge to the Mainland

October 1911, the Canton-Kowloon Railway (Chinese Section) was opened by the Mainland authorities, extending the line from Lo Wu to Canton.

The next 60 years saw only incremental changes to the single-track railway, with diesel electric locomotives gradually replacing steam locomotives starting in the mid 1950's. The 1970s, however, brought major changes with the line being double tracked and electrified to provide

the necessary capacity to meet the increasing travel needs of the rapidly growing populations of the Sha Tin, Tai Po, Fan Ling and Sheung Shui new towns.

The late 1970s also saw the beginnings of what would prove to be massive growth in cross boundary passengers arising from the opening up of the Mainland and the development of the Shenzhen Special Economic Zone.

This required a series of several major improvements having to be made to the Lo Wu Station starting in the 1980s.



100 YEARS OF RAILWAY OPERATION IN HONG KONG



Double-tracking the KCR

Until 1982 KCR had remained a government department. On 24 December 1982 the Government enacted legislation to change the status of the KCR into a public corporation (KCRC). Although remaining wholly owned by the Government, the legislation required the Corporation to operate the railway on a prudent commercial basis.

In 1984 the KCRC agreed to take on the design and construction of a new light rail system to serve the internal public transport needs of the new towns of Tuen Mun and Yuen Long. The initial phase was completed in 1988, and over the following years the network was extended in stages, the most significant expansion being in the early 1990s to serve the latest rapidly developing Tin Shui Wai new town.

In October 1998 KCRC began work on the construction of West Rail, Phase 1, which was 30.5 kilometres long with nine stations, starting from Nam Cheong Station in urban Kowloon and ending at Tuen Mun Station in the centre of the new town. After five years of major engineering work, the railway was opened for regular passenger services in December 2003.

In parallel with the construction of West Rail, work also began on the planning and construction of three extensions to the original KCR line to Lo Wu, which was renamed as East Rail. These comprised –

- (a) an extension of East Rail from Hung Hom Station to East Tsim Sha Tsui, opened in October 2004;
- (b) a new line from East Rail's Tai Wai Station to Ma On Shan, opened in December 2004; and
- (c) a spur line from East Rail's Sheung Shui Station to a new station to be located at Lok Ma Chau, opened in August 2007.



Light Rail serving North West New Territories

In August 2006 KCRC also commenced construction of the Kowloon Southern Link (KSL). The new line, which opened in August 2009, links East Rail and West Rail



West Rail linking Nam Cheong and Tuen Mun, seen running on viaduct

by way of a 3.8 kilometre extension of West Rail from Nam Cheong Station to East Tsim Sha Tsui Station, with an intermediate station located in West Kowloon (Austin Station). Also forming part of the project was the construction of an extension of the Middle Road Subway to connect KCRC's East Tsim Sha Tsui Station network of subways with the existing public subways in Peking Road and Kowloon Park Drive, the purpose being to better serve the pedestrian needs of the busy commercial and tourist area as a whole.

On 2 December 2007, the daily operations of the rail networks of the MTR Corporation Limited (MTR) and KCRC were merged, but not the two corporations, which remain separate entities. MTR was granted a Service Concession to operate KCRC's railway assets for 50 years (which may be extended) in exchange for annual payments being made to KCRC, comprising a



Lok Mau Chau Station



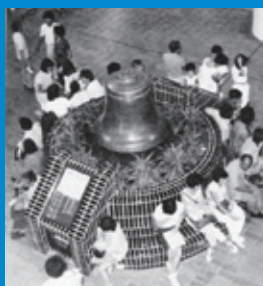
Austin Station

fixed annual payment and (starting from 2 December 2010) an additional variable annual payment calculated as percentage of the gross annual revenue generated by MTR from the KCRC railway assets. KCRC remained responsible for bearing the full cost of any capital projects begun before the merger, such as the KSL.

KCRC as the holder of major railway assets expects to play an ongoing role in the growth of the railway network in Hong Kong. The Government also proposes to vest new railway assets in KCRC, with MTR assuming responsibility for the day-to-day railway operations under an extension of the current Service Concession arrangement.

The KCR Bell

The bell, which was manufactured by the John Taylor bellfoundry of Loughborough, UK, weighs one ton. It was originally hung in the clock tower of the former Kowloon Station in Tsim Sha Tsui. Although construction of the clock tower was completed in 1915, the electric turret clock and its one-ton bell were only delivered in the autumn of 1920 due to the time taken by the Hong Kong Government in finally approving funds for their purchase, the initial request for funds being turned down by the Public Works Subcommittee in 1915. Installation was further delayed because of the non arrival of necessary drawings and instructions from the manufacturers. The clock finally began operating on 22 March 1921, with the bell ringing on every hour, half-hour and quarter-hour.



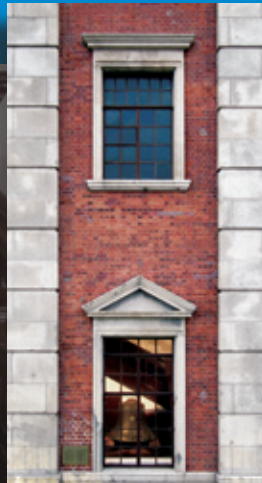
The bell on display at Shatin

During the Japanese occupation of Hong Kong from December 1941 to August 1945, the bell stopped ringing. Only with the liberation of Hong Kong in 1945 did the bell once again ring.

Following the relocation of Kowloon Station from Tsim Sha Tsui to Hung Hom, the bell was removed and re-sited in the Kowloon Station concourse on 30 January 1976. On 17 April 1984, it was moved to the public area of Shatin Station. On 3 April 1995, the bell was moved to the podium at



The bell on railway sleepers at current location



The bell within the Clock Tower

the rear of KCRC House at Fo Tan. KCRC House was renamed Fo Tan Railway House following the MTR Corporation Limited being granted a service concession to operate the KCRC railway assets for 50 years from 2 December 2007.

In 2010, as part of the activities to celebrate the centenary of railway operations in Hong Kong, arrangements were made with the Antiquities and Monuments Office for the bell to be donated back to the community. On 18 August 2010, the bell was moved from Fo Tan Railway House to

The Donation Ceremony of the Kowloon-Canton Railway Bell

the ground floor of the clock tower of the former KCR Kowloon Station, where it is now on view to the public. A formal ceremony to mark the donation of the bell was held on 17 September 2010, with the Secretary for Development, Mrs Carrie Lam, officiating, with the Chief Officer of KCRC, Ir James Blake, representing the Corporation.



Corporate Governance

The Corporation maintains high standards of corporate governance. Being a statutory Corporation established in Hong Kong by the Kowloon-Canton Railway Corporation Ordinance (Chapter 372 of the Laws of Hong Kong) (the KCRC Ordinance), it is not bound by The Stock Exchange of Hong Kong Limited Listing Rules. Nonetheless, it supports the principles of good corporate governance contained in the Cadbury Committee's Code of Best Practice to the extent that they are applicable to the Corporation. As a matter of policy, the Corporation complies with The Stock Exchange of Hong Kong Limited Code of Corporate Governance Practices (the Code) as set out in Appendix 14 to the Listing Rules to the extent that they are applicable to the Corporation, International Financial Reporting Standards issued by the International Accounting Standards Board and all applicable Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance.

The Managing Board

The Corporation and its wholly or majority owned subsidiary companies are controlled through its Managing Board (the Board). The Board's main roles are to ensure that the Corporation complies in every respect with the provisions of the Ordinance to create value for its sole shareholder, to provide leadership to the Corporation, to approve the Corporation's strategic objectives and to ensure that the necessary financial and other resources are made available to Management to enable them to meet those objectives. The Board has a schedule of matters reserved for its approval. The specific responsibilities reserved for the Board include but are not limited to:

- (a) rules for conduct of the Corporation's business;
- (b) Three Year Business Plans, including revenue, expenses and capital budgets for the ensuing year, annual manpower plan and pay review;

- (c) annual budget;
- (d) annual report and audited financial statements;
- (e) recommendations with respect to dividend payments;
- (f) major business strategies; and
- (g) award of major contracts and significant variations to those contracts.

In addition to the above, Management must report to the Board monthly on significant developments, together with the operating and financial results, information on use of the Corporate Seal, letting of major contracts, and any other matters which may be required by the Board from time to time. The Board has delegated all other authorities to carry out the Corporation's activities to the Chief Officer.

The Roles of the Chairman and the Chief Officer

The division of responsibilities between the Chairman of the Board and the Chief Officer is clearly defined and has been approved by the Board. The non-executive Chairman leads the Board in the determination of its strategy and in the achievement of its objectives. The Chairman is responsible for the conduct of the business of the Board, ensuring its effectiveness and setting its agenda. The Chairman is not involved in the day-to-day business of the Corporation. The Chairman facilitates the effective contribution of non-executive Members of the Board and constructive relations between executive management and Members, ensuring that Members receive accurate, timely and clear information, as well as ensuring effective communication with the Corporation's sole shareholder. The Chief Officer has direct charge of the Corporation on a day-to-day basis and is accountable to the Board for the Corporation's financial and operational performance.

Members and Members' Independence

The Board currently comprises the Chairman and five other non-executive Members, all of whom are senior public office holders in the Government of the Hong Kong Special Administrative Region. All are appointed to the Board on an ex-officio basis by the Chief Executive of the Hong Kong Special Administrative Region. Members have, if required, access to independent professional advice at the Corporation's expense, in order for them to carry out their responsibilities. Notwithstanding that they are public office holders, Members are expected to be independent in their judgement. The names of Members together with their biographical details are set out on page 2.

Professionalism

On appointment, each Member receives information about the Corporation, the role of the Board and the matters reserved for its decision, the terms of reference and membership of the Board and its committees, and the powers delegated to those committees, the Corporation's corporate governance practices and procedures, including the powers reserved for the Corporation's senior executives, and the latest financial information about the Corporation. This is supplemented by visits to key locations and meetings with key senior executives. Throughout their period in office Members are continually updated on the Corporation's business, the competitive and regulatory environments in which it operates, corporate social responsibility matters and other changes affecting the Corporation, and the industry it operates in as a whole, by written briefing papers and meetings with senior executives. Members are also advised, on appointment, of their legal and other duties and obligations as a Member of the Board, by the Company Secretary. They are regularly reminded of these duties and updated on changes to the legal and governance requirements which impact on the Corporation and themselves as Members of the Board.

Regular reports and papers are circulated to Members in a timely manner in preparation for Board and Committee meetings. These papers are supplemented

by information specifically requested by Members from time to time. All Members receive monthly management accounts and regular management reports, which enable them to scrutinise the Corporation's and management's performance against agreed objectives.

The Company Secretary

The Company Secretary is responsible for advising the Board, through the Chairman, on all governance matters. Members have access to the advice and services of the Company Secretary.

Relations with the Sole Shareholder

To fulfil the Chairman's obligations under the Ordinance and the Code, the Chairman gives feedback to the Board on issues raised with him by the Corporation's sole shareholder. The Corporation maintains a corporate website, www.kcrc.com, containing a wide range of information of interest to all stakeholders.

Internal Control

The Board is ultimately responsible for the Corporation's system of internal control. It ensures through the Audit Committee that appropriate policies on internal control are in place, and through this Committee seeks assurance that enables it to satisfy itself that the system is functioning effectively and is effective in managing risks in the manner which they are approved. Members have continued to review the effectiveness of the Corporation's system of internal control through the Audit Committee, including operational and compliance controls, risk management and the Corporation's internal control arrangements. These reviews have included an assessment of internal control and, in particular, internal financial control, by the internal audit function; management assurance of the maintenance of control; and reports from the external auditor on matters identified during the course of statutory audit work.

The Corporation views the careful management of risk as a key management activity. Managing business risk to deliver opportunities is a key element of all activities. This is done using a simple and flexible framework that

provides a consistent and sustained way of implementing the Corporation's values. These business risks, which may be strategic, operational or reputation-related, are made known to Members. The business context determines in each situation the level of acceptable risk and controls.

Board and Audit Committee Meetings

The Board usually meets quarterly, and on an ad hoc basis when appropriate. It is responsible, inter alia, for overall corporate strategy, approval of the Corporation's annual budget, major financing arrangements, and ensuring that sound administrative systems and procedures are in place. It reviews monthly the Corporation's operating results, and the progress made towards annual targets. In 2010, a total of 49 decision and information papers were considered by Board Members. With the position of Chief Executive Officer being left vacant from December 2007, the Board has delegated to the Chief Officer the authority for the management of day-to-day operations.

There were three Board and four Audit Committee meetings held during the year up to 31 December 2010 and attended by Members as listed in the following table.

Audit Committee

During the year, the Audit Committee comprised Mr Li Kwok-tso (Chairman), Mr Stanley Ying Yiu-hong, Mr Clement Leung Cheuk-man (up to 24 October 2010), and Miss Cathy Chu (from 25 October 2010). All members of the Committee are non-executive Members. The Committee has at least one member possessing "recent and relevant experience", namely, Mr Li Kwok-tso, who is a chartered certified accountant and is also the Director of Accounting Services of the Government of the Hong Kong SAR.

Under its terms of reference, the Audit Committee monitors the integrity of the financial statements and any formal announcements relating to the Corporation's performance. The Committee is responsible for monitoring the effectiveness of the external audit process and making recommendations to the Board in relation to the appointment, reappointment and remuneration of the external auditor. It is responsible for ensuring that an appropriate relationship between the Corporation and the external auditor is maintained, including reviewing non-audit services and fees. It also monitors the effectiveness of the Corporation's systems of internal control and the processes for monitoring and evaluating the risks facing the Corporation. The Committee reviews

	Board Meetings	Audit Committee Meetings
Professor K C Chan (Note 1)	3	N.A.
Ms Eva Cheng	3	N.A.
Mr Stanley Ying	2	3
Mr Francis Ho	3	N.A.
Mr Clement Leung (Note 2)	2	3
Miss Cathy Chu	1	1
Mr K T Li (Note 3)	3	4

Note 1. Chairman of the Board

Note 2. Replaced by Miss Cathy Chu on 25 October 2010

Note 3. Chairman of the Audit Committee

the effectiveness of the internal audit function, which is currently provided by the internal audit department of the MTR Corporation Limited under an outsourcing arrangement, and is responsible for recommending to the Managing Board the renewal and termination of that outsourced service function. The Committee has undertaken to review its terms of reference at least once every three years and its effectiveness and, if appropriate, will recommend to the Board any changes required as a result of the review.

The Committee meets with Management, as well as privately with both the external and internal auditors. The Committee's terms of reference are available from the Company Secretary and are displayed on the Corporation's website, www.kcrc.com. In 2010 the Audit Committee discharged its responsibilities by:

- (a) reviewing the Corporation's draft financial statements prior to Board approval;
- (b) reviewing the external auditor's reports thereon;
- (c) reviewing the appropriateness of the Corporation's accounting policies;
- (d) reviewing at various times the potential impact of the generally accepted accounting principles in Hong Kong on the Corporation's financial statements;
- (e) reviewing, recommending or pre-approving audit fees or non-audit fees;
- (f) reviewing the external auditor's plan for the audit of the Corporation's financial statements, which includes key areas of focus; and
- (g) approving the annual internal audit plan and reviewing reports on the adequacy and effectiveness of systems of internal control, financial reporting and risk management.

The Audit Committee has taken on responsibility for monitoring the Corporation's whistle blowing procedures, which ensure that appropriate arrangements are in place for employees to be able to raise matters of possible impropriety in confidence, with suitable subsequent follow-up action.

Auditors' Independence and Objectivity

The Audit Committee monitors regularly and closely the non-audit services being provided to the Corporation and its subsidiary companies by its external auditor, who is appointed by the Chief Executive of the Hong Kong Special Administrative Region, to ensure that the provision of such services does not impair the external auditor's independence or objectivity. If and when appropriate the Committee will engage the services of alternative, appropriately qualified accounting firms to undertake non-audit services. When considering any non-audit work to be undertaken by the external auditor, the Committee is mindful of the need to be satisfied that the external auditor should not audit its own work, make management decisions for the Corporation or its subsidiaries, have a mutuality of financial interest with the Corporation or its subsidiaries, or be put in the role of advocate for the Corporation or its subsidiaries. The Committee also takes into consideration relevant professional and regulatory requirements so that these are not impaired by the provision of permissible non-audit services by the external auditor. Prior approval by the Audit Committee is required for any services provided by the external auditor. Any activities that may be perceived to be in conflict with the role of the external auditor must be submitted to the Committee for its consideration and approval prior to engagement. Details of the amounts paid to the external auditor during the year for audit services are set out in Note 7 (a) to the Financial Statements.

REPORT OF THE MEMBERS OF THE MANAGING BOARD

The Members of the Managing Board have pleasure in submitting herewith their report and audited financial statements for the financial year ended 31 December 2010.

Kowloon-Canton Railway Corporation Ordinance

The Kowloon-Canton Railway Corporation Ordinance (the KCRC Ordinance), enacted in 1982, established the Corporation and empowered it to operate the Kowloon-Canton Railway. Amendments in 1986 and 1998 empowered the Corporation to construct and operate Light Rail and new railways, and enabled the Government to inject equity into the Corporation to fund the construction of such new railways. Inter alia, the KCRC Ordinance contains provisions covering the appointments and roles of the Members of the Managing Board.

An amendment of the KCRC Ordinance in December 2001 provided for the separation of the functions and duties of the Chairman from those of the Chief Executive by creating the office of Chief Executive Officer of the Corporation. The Chief Executive Officer was also appointed as a Member of the Managing Board.

On 2 December 2007, following the enactment of the Rail Merger Ordinance, the MTR Corporation Limited commenced operating KCRC's railway assets by way of a service concession for an initial period of 50 years, which is extendable. KCRC retains ownership of the railway assets covered in the service concession agreement and should the MTR Corporation Limited fail to observe the terms of the agreement, there is provision for KCRC to take back and operate its assets. The Rail Merger Ordinance also made provision for the position of Chief Executive Officer to be left vacant, which the Managing Board agreed should be the case from 2 December 2007.

Instead the Corporation appointed a Chief Officer, who is not a Member of the Managing Board, to head the executive management team.

Principal Activities of the Corporation

The principal activities of the Corporation are –

- railway asset holder, with responsibility for monitoring that the MTR Corporation Limited complies with the terms of the service concession agreement
- investing the annual payments from the MTR Corporation Limited
- servicing the Corporation's outstanding debts
- managing its subsidiaries

The principal activities of the subsidiary companies incorporated to facilitate the undertaking of the above activities are set out in Note 19 to the Financial Statements.

The Managing Board

The Board is the governing body of the Corporation with authority to exercise the duties conferred upon it by the KCRC Ordinance.

Members of the Board are all public officers (appointed ex-officio), being Prof K C Chan (Chairman) (the Secretary for Financial Services and the Treasury), Ms Eva Cheng (the Secretary for Transport and Housing), Mr Stanley Ying Yiu-hong (the Permanent Secretary for Financial Services and the Treasury (Treasury)), Mr Francis Ho Suen-wai (the Permanent Secretary for Transport and Housing (Transport)), Mr Clement Leung Cheuk-man (the Deputy Secretary for Financial Services and the Treasury (Treasury)) up to 24 October 2010, Miss Cathy Chu (the Deputy Secretary

for Financial Services and the Treasury (Treasury)) from 25 October 2010, Mr Li Kwok-tso (the Director of Accounting Services) up to 19 January 2011, and Mrs Lesley Y C Wong (the Director of Accounting Services) from 20 January 2011.

Brief biographical details of Board Members are set out on page 2.

Long-Term Planning, Business Planning and Financial Management Framework

Business plans, incorporating triennial forecasts of income and expenditure, are prepared each year for submission to the Managing Board. The first year of the Business Plan forms the basis for formulating the Budget for that year.

There are defined procedures and regular quality reviews of the operation of the Corporation's computerised systems to ensure the accuracy and completeness of financial records and the efficiency of data processing. There are defined procedures for the appraisal, review and approval of all major capital projects, and all major expenditure and revenue contracts. All contracts over HK\$50 million and all consultancy services over HK\$10 million require the approval of the Managing Board. Operating and financial reports, comparing results against their respective budgets and providing updates on significant events, are put to and considered by the Managing Board on a monthly basis.

Corporate Governance

As set out in the Corporate Governance Report, the Managing Board maintains high standards of corporate governance.

Interests in Contracts of Members of the Managing Board and Senior Executive Staff

No contracts of significance to which the Corporation or any of its subsidiaries was a party and in which a Member

of the Managing Board, or Senior Executive Staff, had a material interest subsisted at the end of the year or at any time during the year.

At no time during the year was the Corporation or any of its subsidiaries a party to any arrangements to enable Members of the Managing Board, or Senior Executive Staff, to acquire benefits by means of the acquisition of shares in or debt securities of the Corporation or subsidiaries of the Corporation.

Financial Statements

The results of the Group for the year ended 31 December 2010 and the state of the Corporation's and the Group's affairs at that date are set out in the Financial Statements on pages 28 to 95.

Fixed Assets

Movements in fixed assets during the year are set out in Note 16 to the Financial Statements.

Share Capital

Details of the Corporation's share capital are set out in Note 29 to the Financial Statements. Any further contributions of capital will be determined by the Government in consultation with the Corporation.

Dividend

No dividend to the Government is proposed.

Capitalised Interest and Finance Income/Expenses

Details of the Corporation's capitalised interest and finance income/expenses are set out in Note 10 to the Financial Statements.

Interest-Bearing Borrowings

Details of the Corporation's interest-bearing borrowings are set out in Note 27 to the Financial Statements.

Turnover, Financial Results and Financial Position

Details of the Corporation's turnover, financial results and financial position are set out in the Financial Statements, the Chief Officer's Statement and Financial Review, and the Five-Year Statistics of the Annual Report.

Going Concern

The Financial Statements on pages 28 to 95 have been prepared on a going concern basis. The Managing Board has approved the Corporation's budget for 2011 and is satisfied that the Corporation can operate in a viable manner for the foreseeable future.

Responsibility for the Financial Statements

The Kowloon-Canton Railway Corporation Ordinance requires the Corporation to produce financial statements. In doing so, the Corporation complies with all applicable International Financial Reporting Standards issued by the International Accounting Standards Board, Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong, the disclosure requirements of the Hong Kong Companies Ordinance, and produces financial statements that give a true and fair view of the Corporation's financial results and position for the financial year to which they relate.

Auditor

In accordance with section 14B (4) of the Kowloon-Canton Railway Corporation Ordinance, KPMG were appointed as the auditor by the Chief Executive of the Hong Kong Special Administrative Region.

By order of the Managing Board

Michael Arnold
Company Secretary
20 April 2011

26	Independent Auditor's Report	65	17	Construction in progress
	Financial Statements	66	18	Deferred expenditure
28	Consolidated statement of comprehensive income	67	19	Investments in subsidiaries
29	Consolidated balance sheet	69	20	Interest in associate
30	Corporation balance sheet	70	21	Loan to non-controlled subsidiary
31	Consolidated statement of changes in equity	71	22	Investments
32	Consolidated cash flow statement	71	23	Interest and other receivables
	Notes to the Financial Statements	73	24	Cash and cash equivalents
33	1 Establishment of the Corporation	73	25	Interest and other payables
33	2 Rail Merger with MTR Corporation Limited ("MTRCL")	74	26	Accrued charges and provisions for capital projects
35	3 Significant accounting policies	75	27	Interest-bearing borrowings
52	4 Changes in accounting policies	77	28	Deferred income
53	5 Turnover	79	29	Capital, reserves and dividends
53	6 Operating costs before depreciation, amortisation and impairment	80	30	Financial risk management and fair values
54	7 Operating profit before depreciation, amortisation and impairment	91	31	Notes to the consolidated cash flow statement
55	8 Depreciation and amortisation	92	32	Related parties
56	9 Impairment of and loss on disposal of fixed assets	93	33	Outstanding commitments
56	10 Interest and finance income/expenses	93	34	Retirement benefit scheme
57	11 Gains/(Losses) on changes in fair value of financial instruments	94	35	Debt facilities
58	12 Income tax	94	36	Contingent liabilities
59	13 Loss for the year wholly attributable to the sole shareholder of the Corporation	94	37	Impairment of railway assets
60	14 Other comprehensive income	95	38	Accounting estimates and judgements
60	15 Segment reporting	95	39	Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting year ended 31 December 2010
61	16 Fixed assets and interest in leasehold land held for own use under operating leases	96		Five-Year Statistics

Independent auditor's report to the members of the Managing Board of the Kowloon-Canton Railway Corporation

We have audited the consolidated financial statements of the Kowloon-Canton Railway Corporation ("the Corporation") and its subsidiaries (together "the Group") set out on pages 28 to 95, which comprise the consolidated and the Corporation balance sheets as at 31 December 2010, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information.

Board Members' responsibilities for the consolidated financial statements

The Board Members of the Corporation are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board, Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Kowloon-Canton Railway Corporation Ordinance and for such internal control as the Board Members determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 14B(3) of the Kowloon-Canton Railway Corporation Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board Members, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Corporation and of the Group as at 31 December 2010 and of the Group's loss and cash flows for the year then ended in accordance with International Financial Reporting Standards and Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the applicable disclosure requirements of the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong
20 April 2011

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2010 (Expressed in Hong Kong dollars)

	Note	2010 \$ million	2009 \$ million
Turnover	5	1,013	921
Operating costs before depreciation, amortisation and impairment	6	(34)	(93)
Operating profit before depreciation, amortisation and impairment	7	979	828
Depreciation and amortisation	8	(2,974)	(2,790)
Impairment of and loss on disposal of fixed assets	9	(132)	(95)
Operating loss after depreciation, amortisation and impairment		(2,127)	(2,057)
Interest and finance income	10(a)	210	270
Interest and finance expenses	10(b)	(770)	(1,448)
Share of profit of associate		48	57
Loss before unrealised gains/losses		(2,639)	(3,178)
Gains/(Losses) on changes in fair value of financial instruments	11	209	(168)
Loss before taxation		(2,430)	(3,346)
Income tax	12(a)	396	585
Loss for the year wholly attributable to the sole shareholder of the Corporation	13	(2,034)	(2,761)
Other comprehensive income for the year (after tax and reclassification adjustments)			
Cash flow hedge: net movement in the hedging reserve	14(a)	(13)	13
Total comprehensive income for the year wholly attributable to the sole shareholder of the Corporation		(2,047)	(2,748)

The notes on pages 33 to 95 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

at 31 December 2010 (Expressed in Hong Kong dollars)

	Note	2010 \$ million	2009 \$ million
Assets			
Fixed assets	16(a)	69,261	70,754
Interest in leasehold land held for own use under operating leases	16(a)	5,638	5,767
Construction in progress	17	525	994
Deferred expenditure	18	1,188	1,613
Interest in associate	20	208	189
Loan to non-controlled subsidiary	21	4,405	4,405
Derivative financial assets	30(e)	385	185
Investments	22	435	402
Interest and other receivables	23	684	755
Cash and cash equivalents	24	710	8,872
		83,439	93,936
Liabilities			
Interest and other payables	25	202	488
Accrued charges and provisions for capital projects	26	1,273	1,516
Derivative financial liabilities	30(e)	37	49
Interest-bearing borrowings	27	15,117	23,059
Deferred income	28	5,873	5,441
Deferred tax liabilities	12(c)	2,375	2,774
		24,877	33,327
Net Assets		58,562	60,609
Capital and Reserves			
Share capital	29(b)	39,120	39,120
Reserves		19,442	21,489
Total equity		58,562	60,609

Approved and authorised for issue by the Managing Board on 20 April 2011

Professor K C Chan**Mrs Lesley Y C Wong**

Members of the Managing Board

Mr James Blake

Chief Officer

The notes on pages 33 to 95 form part of these financial statements.

CORPORATION BALANCE SHEET

at 31 December 2010 (Expressed in Hong Kong dollars)

	Note	2010 \$ million	2009 \$ million
Assets			
Fixed assets	16(a)	69,261	70,754
Interest in leasehold land held for own use under operating leases	16(a)	5,638	5,767
Construction in progress	17	525	994
Deferred expenditure	18	1,188	1,613
Interest in associate	20	9	9
Loan to non-controlled subsidiary	21	4,405	4,405
Derivative financial assets	30(e)	385	185
Investments	22	435	402
Interest and other receivables	23	684	755
Cash and cash equivalents	24	710	8,872
		83,240	93,756
Liabilities			
Interest and other payables	25	202	488
Accrued charges and provisions for capital projects	26	1,273	1,516
Derivative financial liabilities	30(e)	37	49
Interest-bearing borrowings	27	15,117	23,059
Deferred income	28	5,873	5,441
Deferred tax liabilities	12(c)	2,375	2,774
		24,877	33,327
Net Assets		58,363	60,429
Capital and Reserves			
Share capital	29(b)	39,120	39,120
Reserves	29	19,243	21,309
Total equity		58,363	60,429

Approved and authorised for issue by the Managing Board on 20 April 2011

Professor K C Chan**Mrs Lesley Y C Wong**

Members of the Managing Board

Mr James Blake

Chief Officer

The notes on pages 33 to 95 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2010 (Expressed in Hong Kong dollars)

	Note	Share capital \$ million	Hedging reserve \$ million	Retained profits \$ million	Total equity \$ million
Balance at 1 January 2009		39,120	–	24,237	63,357
Changes in equity for 2009:					
Loss for the year		–	–	(2,761)	(2,761)
Other comprehensive income for the year	14	–	13	–	13
Total comprehensive income for the year		–	13	(2,761)	(2,748)
Balance at 31 December 2009 and 1 January 2010		39,120	13	21,476	60,609
Changes in equity for 2010:					
Loss for the year		–	–	(2,034)	(2,034)
Other comprehensive income for the year	14	–	(13)	–	(13)
Total comprehensive income for the year		–	(13)	(2,034)	(2,047)
Balance at 31 December 2010		39,120	–	19,442	58,562

The notes on pages 33 to 95 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2010 (Expressed in Hong Kong dollars)

	Note	2010 \$ million	2009 \$ million
Operating activities			
Net cash inflow from operations	31	903	658
Investing activities			
Decrease/(increase) in deposits with banks with maturity more than three months when placed		7,967	(7,967)
Payments for capital expenditure:			
– Kowloon Southern Link project		(493)	(1,068)
– Other capital projects and purchase of fixed assets		(151)	(160)
Recovery of capital expenditure of Express Rail Link from the Government		328	–
Interest received		42	137
Payment for the purchase of investments		(39)	–
Dividend received from associate		29	15
Receipts on disposal of investment securities		–	2,712
Net cash inflow/(outflow) from investing activities		7,683	(6,331)
Net cash inflow/(outflow) before financing activities		8,586	(5,673)
Financing activities			
Net cash flows on (repayment)/drawdown of loans		(7,984)	5,556
Interest paid		(888)	(1,511)
Net cash inflow relating to derivative financial instruments		146	101
Finance expenses paid		(55)	(61)
Net cash (outflow)/inflow from financing activities		(8,781)	4,085
Net decrease in cash and cash equivalents		(195)	(1,588)
Cash and cash equivalents at 1 January		905	2,493
Cash and cash equivalents at 31 December		710	905
Analysis of the balances of cash and cash equivalents			
Cash and cash equivalents in the consolidated balance sheet		710	8,872
Less: Deposits with banks with more than three months to maturity when placed		–	(7,967)
Cash and cash equivalents in the consolidated cash flow statement	24	710	905

The notes on pages 33 to 95 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

1 Establishment of the Corporation

The Kowloon-Canton Railway Corporation (“the Corporation”) was incorporated in Hong Kong under the Kowloon-Canton Railway Corporation Ordinance (“the Ordinance”) on 24 December 1982 to undertake the operation of the Hong Kong section of the Kowloon-Canton Railway. The assets, rights and liabilities of the then existing railway were vested in the Corporation on 1 February 1983 in accordance with Section 7 of the Ordinance.

On 8 June 2007, the Legislative Council passed the Rail Merger Bill. Following agreement by the respective parties to the detailed merger transaction terms, the Rail Merger took place on 2 December 2007 (the “Appointed Day”). The Chief Executive of the HKSAR appointed six public officers as members of the Managing Board with effect from the Appointed Day. As provided for under the amendments made to the Ordinance by the Rail Merger Bill, the position of Chief Executive Officer has been left vacant, with a Chief Officer, who is not a member of the Managing Board, being appointed by the Board to be responsible for managing the day-to-day business of the Corporation.

2 Rail Merger with MTR Corporation Limited (“MTRCL”)

The Rail Merger Ordinance permitted the granting of a long-term service concession (the “Service Concession”) in respect of the Corporation’s rail and bus operations and the sale of certain rail-related assets (the “Purchased Rail Assets”), certain subsidiaries and property-related rights and interests of the Corporation, to MTRCL.

Since the Appointed Day, the Corporation has been responsible for monitoring MTRCL’s compliance with its obligations under the merger transaction, including revenue sharing, annual payments and the specified day-to-day activities of the Corporation outsourced to MTRCL. The Corporation, besides meeting its obligations under the merger transaction, retains responsibility for the management and financing of its debts, for investing any available funds and for managing its remaining subsidiaries and other assets excluded from the merger transaction (the “Excluded Assets”).

Service Concession

The Service Concession grants MTRCL the right to operate the Corporation’s existing railway lines (including the Kowloon Southern Link which was completed in August 2009) and other rail-related businesses (“concession assets”) for a period of 50 years (the “Concession Period”). Under the Service Concession, MTRCL receives all revenues generated from the operation of the Corporation’s rail network and other rail-related businesses. During the Concession Period, except for projects retained by the Corporation as specified under the Merger Framework Agreement, MTRCL is responsible for the daily operations and maintenance of the transport operations and will fund all related operating capital expenditure, including the improvement and replacement of the Corporation’s railway network assets. The Corporation does not have responsibility for any railway or bus operations during the Concession Period.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

2 Rail Merger with MTR Corporation Limited (“MTRCL”) (continued)

Service Concession (continued)

In consideration for the Service Concession, MTRCL agreed to make a fixed annual payment of \$750 million and commencing after the first 36 months, an additional variable annual payment based on revenue generated above the first \$2.5 billion from the operation of the Corporation’s rail network and other rail-related businesses during each financial year of MTRCL. The variable payments are computed at 10% of such revenue between \$2.5 billion and \$5 billion; 15% of such revenue between \$5 billion and \$7.5 billion; and 35% of such revenue above \$7.5 billion.

The Corporation’s role during the Concession Period essentially comprises the following duties:

- (i) acting as the grantor of the Service Concession to MTRCL, monitoring the compliance of MTRCL with the terms of the Service Concession and receiving concession payments from MTRCL;
- (ii) holding legal and beneficial title to all assets not forming part of the sale to MTRCL, such as the initial concession assets, which are defined as the physical assets including the Corporation’s railway land required for the operation of the Corporation’s railway system which were capitalised by the Corporation immediately prior to the Appointed Day, the Corporation’s shares in Octopus Holdings Limited and the Excluded Assets;
- (iii) acting as the borrower and obligor in relation to the Corporation’s existing financial obligations and contingent liabilities; and
- (iv) holding legal and beneficial title to and funding all capital expenditure for any new railway project that was under construction as of the Appointed Day, such as the Kowloon Southern Link, and acting as the principal of the project management agreement with MTRCL under which the Corporation, among other things, employed MTRCL as its agent, and in other capacities, to complete the construction of the Kowloon Southern Link.

Should the Corporation undertake any new railway projects during the Concession Period, these would be subject to a service concession granted by the Corporation in favour of MTRCL, with the parties entering into a Supplemental Service Concession Agreement.

3 Significant accounting policies

(a) Statement of compliance

Although not required to do so under the Ordinance, the Corporation has prepared these financial statements in accordance with all applicable International Financial Reporting Standards (“IFRSs”) issued by the International Accounting Standards Board (“IASB”). These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and the Hong Kong Companies Ordinance. A summary of the significant accounting policies adopted by the Corporation and its controlled subsidiaries (the “Group”) is set out below.

These financial statements have also been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) and accounting principles generally accepted in Hong Kong.

The IASB has issued certain new and revised IFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Corporation. The equivalent new and revised HKFRSs consequently issued by HKICPA have the same effective date as those issued by the IASB and are in all material respects identical to the pronouncements issued by the IASB. Note 4 provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group and the Corporation for the current and prior accounting periods reflected in these financial statements.

(b) Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements is the historical cost basis except where stated otherwise in the accounting policies set out below.

The preparation of financial statements in conformity with IFRSs and 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 prevailing circumstances, the results of which form the basis of making the judgements 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 with significant effect on the financial statements and major sources of estimation uncertainty are discussed in note 38.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

3 Significant accounting policies (continued)

(c) Basis of consolidation

The consolidated financial statements comprise the Corporation and its controlled subsidiaries and the Group's interest in associate made up to 31 December each year.

The financial statements of certain subsidiaries held by the Corporation for the sole purpose of developing, on behalf of the Government of the HKSAR ("the Government"), commercial or residential properties along the West Rail, Phase I route are excluded from consolidation on the basis that these are not considered to be controlled subsidiaries as the Corporation has no effective control over nor beneficial interests in the net assets of these subsidiaries, other than the amount of capital provided. The Corporation is not entitled to any earnings distribution, nor is it required to ultimately fund any losses which may be sustained by these subsidiaries.

Furthermore, the financial statements of the Metropolis Management Company Limited ("MMC"), which was established for the sole purpose of rendering property management services to a commercial property, are also excluded from consolidation on the basis that, under the Equity Sub-participation Agreement which formed part of the merger transaction, the Corporation is obliged to act on MTRCL's instructions in respect of the exercise of any and all rights the Corporation has as a shareholder of MMC. All the beneficial interests to which the Corporation was previously entitled now rest with MTRCL although there has been no direct disposition of the shares of MMC to MTRCL.

(d) Investments in subsidiaries

Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a controlled subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. An investment in a non-controlled subsidiary is excluded from consolidation and is stated at cost less impairment losses, if any, in the Group's and Corporation's balance sheet.

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

In the Corporation's balance sheet, an investment in a controlled subsidiary is stated at cost less impairment losses, if any.

3 Significant accounting policies (continued)

(e) Interest in associate

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

An investment in an associate is accounted for in the Group's consolidated financial statements under the equity method and is initially recorded at cost, adjusted for any excess of the Group's share of acquisition-date fair values of the investee's identifiable net assets over the cost of the investment (if any). Thereafter, the investment is adjusted for the post acquisition change in the Group's share of the associate's net assets (see note 3(l)). The Group's share of the post-acquisition post-tax results of an associate and any impairment losses for the year are recognised in profit or loss, whereas the Group's share of the post-acquisition post-tax items of an associate's other comprehensive income is recognised in other comprehensive income.

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

The results of the associates are included in the Corporation's statement of comprehensive income to the extent of dividends received and receivable, providing the dividend in respect of a period ending on or before the Corporation's financial year and the Corporation's right to receive the dividend is established before the balance sheet date.

When the Group ceases to have significant influence over an associate, it is accounted for as a disposal of the entire interest in that investee, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former investee at the date when significant influence is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset (see note 3(f)).

In the Corporation's balance sheet, an investment in an associate is stated at cost less impairment losses, if any.

(f) Investments

Investments comprise:

- (i) dated debt securities that the Group has the positive ability and intention to hold to maturity which are classified as held-to-maturity securities and are stated in the balance sheet at amortised cost less impairment losses, if any;
- (ii) dated debt securities that include embedded derivatives with economic characteristics and risks different from that of the host contracts which are designated as at fair value through profit or loss. At the end of each reporting period the fair value is remeasured, with any resultant gain or loss being recognised in profit or loss; and

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

3 Significant accounting policies (continued)

(f) Investments (continued)

- (iii) dated debt securities which are classified as available-for-sale securities. At the end of each reporting period the fair value is remeasured, with any resultant gain or loss being recognised in other comprehensive income and accumulated separately in equity in the fair value reserve, except foreign exchange gains and losses resulting from changes in the amortised cost of monetary items such as debt securities which are recognised directly in profit or loss. When these investments are derecognised or impaired (see note 3(l)), the cumulative gain or loss is reclassified from equity to profit or loss.

Investments in debt securities are initially stated at fair value, which is their transaction price unless fair value can be more reliably estimated using valuation techniques whose variables include only data from observable markets.

Investments are recognised/derecognised on the trade date, which is the date the Group commits to purchase/sell the investments or when the investments expire.

(g) Derivative financial assets and liabilities

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its policies, the Group does not hold or issue derivative financial instruments for trading purposes.

All the Group's derivative financial instruments are recognised initially as derivative financial assets or liabilities at fair value. The fair value of each derivative financial instrument is remeasured at the end of each reporting period, with any resultant gain or loss recognised immediately in profit or loss, except where the derivatives qualify for cash flow hedge accounting, in which case recognition of any resultant gain or loss depends on the item being hedged as covered by the policy statement below.

(i) Cash flow hedges

Currency swaps are designated as hedges of the variability in cash flows attributable to the foreign exchange risk of certain of the Group's interest-bearing borrowings denominated in foreign currencies and recognised in the financial statements.

The effective portion of any gains or losses on remeasurement of such derivative financial instruments to fair value is recognised in other comprehensive income and accumulated separately in equity in the hedging reserve. The ineffective portion of any gain or loss is recognised immediately in profit or loss. The associated gain or loss is reclassified from equity to profit or loss in the same period or periods during which the hedged item affects profit or loss.

(ii) Fair value hedges

Interest rate swaps are designated as hedges of the variability in the fair value attributable to interest rate risk of certain of the Group's fixed rate interest-bearing borrowings recognised in the financial statements.

3 Significant accounting policies (continued)

(g) Derivative financial assets and liabilities (continued)

(ii) Fair value hedges (continued)

Changes in fair value of interest rate swaps designated as hedging instruments in a fair value hedge are recognised in profit or loss.

When a hedging relationship ceases to meet the requirements for hedge accounting, any adjustment to the carrying amount of the then hedged item is amortised to the profit or loss over the remaining life of the item based on a recalculated effective interest rate from the date the hedging relationship ceases.

(h) Investment properties

Investment properties comprise land and/or buildings which are owned or held under a leasehold interest to earn rental income and are held for their investment potential.

Investment properties are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated to write off the cost of investment properties, less their residual values, if any, using the straight-line method over the shorter of the unexpired term of leases and their estimated useful lives.

Gains or losses arising from the retirement or disposal of an investment property are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

(i) Property, plant and equipment

(i) Property, plant and equipment, including those assets which are the subject of the Service Concession with MTRCL, is stated in the balance sheet at cost less accumulated depreciation and impairment losses, if any.

During the Concession Period, MTRCL is responsible for the daily operations and maintenance of the railway operations and will fund all related expenditure including the improvement and replacement of the Corporation's railway network assets. Such expenditure on improvement and replacement of the Corporation's railway network assets is defined as Additional Concession Property ("ACP") pursuant to the Service Concession Agreement. According to the Service Concession Agreement, the ACP will be returned to the Corporation at no cost, together with the initial concession assets acquired by the Corporation, upon the expiry or termination of the Concession Period subject to a threshold of \$115.8 billion of cumulative expenditure funded by MTRCL which will be adjusted from time to time pursuant to the provisions of the Service Concession Agreement. As the ACP will be returned together with the initial concession assets acquired by the Corporation before the Rail Merger, the ACP, although funded by MTRCL, is treated in the same way as the initial concession assets and is capitalised in the balance sheet at cost less accumulated depreciation and impairment losses, if any. The cost of ACP that is funded by MTRCL is credited to deferred income and amortised to profit or loss over the shorter of the useful life of the ACP and the remaining Concession Period.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

3 Significant accounting policies (continued)

(i) Property, plant and equipment (continued)

Property, plant and equipment relating to rail networks and ancillary commercial activities which is the subject of the Service Concession comprises:

- buildings which are situated on leasehold land being classified as held under operating lease (see note 3(k)); and
- other items of plant and equipment including tunnels, bridges, roads, permanent way, rolling stock and other equipment.

The cost of property, plant and equipment vested by the Government has been determined as follows:

- for property, plant and equipment vested on 1 February 1983 – as determined by the Financial Secretary; and
- for property, plant and equipment vested subsequent to 1 February 1983 – based on actual cost as reflected in the Government's records.

The cost of property, plant and equipment acquired by the Group and ACP funded by MTRCL comprises:

- its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
- any costs, such as the costs of material, direct labour, an appropriate proportion of production overheads and interest and finance income/expenses directly attributable to bringing the asset to the location and condition capable of operating in the manner intended by management.

Expenditure incurred by the Group on property, plant and equipment, which is below \$20,000 per item or expected to be fully used within one year, is expensed to profit or loss when incurred.

- (ii) Subsequent expenditure on existing property, plant and equipment, for both concession assets and non-concession assets, is added to the carrying amount of the asset if either future economic benefits will flow to the Group or the condition of the asset will improve beyond its originally assessed standard of performance.

Expenditure incurred by the Group on repairs or maintenance of existing property, plant and equipment to restore or maintain the originally assessed standard of performance of the asset is recognised as an expense when incurred.

Expenditure incurred by MTRCL after the Appointed Day on repairs or maintenance of concession assets is borne by MTRCL.

3 Significant accounting policies (continued)

(i) Property, plant and equipment (continued)

- (iii) Gains or losses arising from the retirement or disposal of an item of property, plant and equipment, including concession assets, are determined as the difference between the net disposal proceeds attributable to the Group, if any, and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

(j) Depreciation and amortisation

- (i) Depreciation for property, plant and equipment is calculated to write off the cost of an item of property, plant and equipment less its estimated residual value, if any, using the straight-line basis over its estimated useful life as follows:

	No. of years
Tunnels, bridges and roads (see note 3(j)(iii))	38-64
Buildings (see note 3(j)(iii))	20-50
Rolling stock	2.5-40
Locomotives and wagons	5-35
Lifts and escalators	20-25
Permanent way comprising rails, ballast, sleepers and concrete civil works (see note 3(j)(iii))	10-50
Machinery and equipment	3-45
Telecommunication and signalling systems and air-conditioning plant	3-50
Fare collection systems	5-20
Mobile phone systems	7-15
Tools	10-40
Furniture and fixtures	3-40
Computer and office equipment (including computer software)	3-20
Buses	4-17
Other motor vehicles	4-15

- (ii) Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a measurable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually. The residual value of an asset is the estimated amount that the Group could currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life.
- (iii) Tunnels, bridges, roads, concrete civil works and buildings situated on leasehold land are depreciated over the shorter of the unexpired term of the related lease and their estimated useful lives.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

3 Significant accounting policies (continued)

(k) Leased assets

(i) Classification of leased assets

Leases of assets under which the lessee assumes substantially all the risks and rewards of ownership are classified as finance leases. Leases of assets under which the lessor has not transferred substantially all the risks and rewards of ownership are classified as operating leases, except that property held under an operating lease that would otherwise meet the definition of an investment property may be classified as an investment property on a property-by-property basis.

(ii) Operating lease charges

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset.

Land lease premiums, land resumption costs and other costs directly associated with the acquisition of leasehold land held for own use under operating leases are amortised on a straight-line basis over the period of the lease term. The cost in relation to leasehold land vested by the Government has been determined as follows:

- vested on 1 February 1983 – as determined by the Financial Secretary; and
- vested subsequent to 1 February 1983 – based on actual cost as reflected in the Government's records or the costs incurred by the Corporation directly associated with the acquisition of leasehold land.

(l) Impairment of assets

(i) Impairment of financial assets

All financial assets are reviewed at the end of each reporting period to determine whether there is objective evidence of impairment. Objective evidence of impairment includes observable data that comes to the attention of the Group about one or more of the following loss events:

- significant financial difficulties being experienced by a debtor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- it becomes probable that the debtor will enter bankruptcy or some form of financial reorganisation;

3 Significant accounting policies (continued)

(l) Impairment of assets (continued)

(i) Impairment of financial assets (continued)

- significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor; and
- a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

If any such evidence exists, an impairment loss is determined and recognised as follows:

- For interest and other receivables and loan to non-controlled subsidiary with no fixed repayment terms that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material.
- For interest and other receivables carried at amortised cost, an impairment loss is measured as the difference between the asset's carrying amount and the estimated future cash flows (taking into account bad and doubtful debts), discounted at the current market rate of return of a similar financial asset where the effect of discounting is material. This assessment is made collectively where financial assets carried at amortised cost share similar risk characteristics, such as similar past due status, and have not been individually assessed as impaired. Future cash flows for financial assets which are assessed for impairment collectively are based on historical loss experience for assets with credit risk characteristics similar to the collective group.
- For held-to-maturity securities carried at amortised cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return of a similar financial asset where the effect of discounting is material.
- Impairment losses on interest and other receivables, loan to non-controlled subsidiary and held-to-maturity securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit or loss to the extent that the cumulative impairment loss has been charged to profit or loss.
- For available-for-sale securities, the cumulative loss that has been recognised in the fair value reserve is reclassified to profit or loss. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in profit or loss.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit or loss.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

3 Significant accounting policies (continued)

(I) Impairment of assets (continued)

(ii) Impairment of other assets

Internal and external sources of information are reviewed at the end of each reporting period to identify indications that any assets, other than financial assets, may be impaired or an impairment loss previously recognised no longer exists or may have decreased.

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

– Calculation of recoverable amount

The recoverable amount of an asset is the greater of its fair value less costs to sell 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 the 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).

– Recognition of impairment losses

An impairment loss is recognised in profit or loss if the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

– Reversals of impairment losses

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

A reversal of an impairment loss 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 profit or loss in the year in which the reversals are recognised.

3 Significant accounting policies (continued)

(m) Construction in progress

Assets under construction and capital works for the operating railways are stated at cost incurred by the Corporation (or by MTRCL in the case of ACP) less impairment losses, if any. Costs comprise direct costs of construction, including materials, staff costs and overheads, interest and finance income/expenses and gains or losses arising from changes in fair value of pre-funding investments capitalised during the period of construction or installation and testing. Capitalisation of these costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are interrupted or completed. The assets concerned are transferred to fixed assets when substantially all the activities necessary to prepare the assets for their intended use are completed, at which time the assets begin to be depreciated in accordance with the relevant policies. Land lease premiums, land resumption costs and other related costs incurred by the Corporation for the purpose of acquiring the land on which the new railways or extensions to existing railways are to be operated are initially included in construction in progress. These costs are transferred to interest in leasehold land held for own use under operating leases when the related assets are completed and ready for their intended use at which time the costs begin to be amortised in accordance with the relevant policies.

Costs incurred by the Corporation (or MTRCL in the case of ACP) 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 the proposed project proceeding, the costs concerned are written off to profit or loss as incurred; and
- where the proposed projects are at a detailed study stage, having demonstrated an acceptable financial viability and having obtained the Managing Board's approval to proceed further, the costs concerned are initially dealt with as deferred expenditure and then transferred to construction in progress after the relevant project agreements are reached with the Government.

(n) Deferred expenditure

Deferred expenditure relates to costs incurred for proposed railway related construction projects which will be transferred to construction in progress after the relevant project agreements are reached with the Government. The composition of costs and their capitalisation criteria follow that of construction in progress as set out in note 3(m).

(o) Property development

When the Corporation determines or reaches agreement with property developers to develop a site for resale or for rent, the carrying amount of the leasehold land and existing buildings on the development site are transferred to properties under development. Costs related to the respective projects incurred by the Corporation are also dealt with as properties under development until such time that profit on the development is recognised by the Corporation.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

3 Significant accounting policies (continued)

(o) Property development (continued)

Profits on property development undertaken in conjunction with property developers are recognised in profit or loss as follows:

- where the Corporation receives payments from property developers as a consequence of their participation in a project to develop a property, such payments are set off against the balance in properties under development in respect of that project. Any surplus amounts of payments received from property developers in excess of the balance in properties under development are transferred to deferred income. In such circumstances, further costs subsequently incurred by the Corporation in respect of that project are charged against the related balance of deferred income and any excess is charged to properties under development to the extent it is considered to be recoverable. The balance of deferred income is credited to profit or loss when the property enabling works are completed and acceptable for development and after taking into account the outstanding risks and obligations in connection with the development, if any, retained by the Corporation. The balance of properties under development not previously offset by payments received from property developers is charged to profit or loss where the costs are considered to be irrecoverable, together with provision for losses, if any, borne by the Corporation in respect of the development;
- where the Corporation receives a share of profits from the sale of properties, profits are recognised upon the issue of occupation permits provided that the amounts of revenue and related costs can be measured reliably; and
- where the Corporation retains certain assets of the development, profits are measured based on the fair value of such assets and are recognised at the time of receipt after taking into account the costs incurred by the Corporation in respect of the development and the outstanding risks, if any, retained by the Corporation in connection with the development.

(p) Loan to non-controlled subsidiary

Loan to non-controlled subsidiary is a non-derivative financial asset without fixed or determinable repayment terms and is not quoted in an active market. It arose when the Group entered into a shareholding agreement with the Government for the formation of a sub-group of the Corporation under an intermediate holding company, West Rail Property Development Limited (“WRPDL”), to undertake all property developments along the West Rail, Phase I route. Loan to non-controlled subsidiary is initially recognised at fair value, which is equivalent to cost, and thereafter is stated at cost less impairment losses, if any.

(q) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand, demand deposits with banks and other financial institutions and short-term, highly liquid investments. Cash equivalents are readily convertible into known amounts of cash with an insignificant risk of changes in value and have a maturity of less than three months at acquisition.

For the purposes of the consolidated cash flow statement, cash equivalents exclude bank deposits with a maturity of more than three months when placed but include bank overdrafts that are repayable on demand and form an integral part of the Group’s cash management.

3 Significant accounting policies (continued)

(r) Interest and other receivables

Interest and other receivables are initially recognised at fair value and thereafter are stated at amortised cost less impairment losses, if any, except where the present value is not determinable because there is no fixed repayment term. In such cases, interest and other receivables are stated at cost less impairment losses, if any.

(s) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, the unhedged portion of interest-bearing borrowings is stated at amortised cost with any difference between the cost and redemption value being recognised in profit or loss over the period of the borrowings using the effective interest method.

Subsequent to initial recognition, the carrying amount of the portion of interest-bearing borrowings, which is the subject of a fair value hedge, is remeasured and the change in fair value attributable to the risk being hedged is recognised in profit or loss to offset the effect of the gain or loss on the related hedging instrument.

(t) Interest and other payables

Interest and other payables are initially recognised at fair value and thereafter are stated at amortised cost except where the present value is not determinable because there are no fixed payment terms. In such cases, other payables are stated at cost.

(u) Employee benefits

(i) Short term employee benefits and contributions to defined contribution retirement plans

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees.

(ii) Termination benefits

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.

(v) Income tax

(i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised in other comprehensive income or directly to equity, in which case the relevant amounts of tax are recognised in other comprehensive income or direct in equity, respectively.

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

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

3 Significant accounting policies (continued)

(v) Income tax (continued)

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

All deferred tax assets, to the extent that it is probable that future taxable profits will be available against which the assets can be utilised, are recognised. All deferred tax liabilities are recognised.

The amount of deferred tax provided is 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 end of the reporting period. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at the end of each reporting period and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

- (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 the Group or Corporation 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 Group or Corporation 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, they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities which intend to realise the current tax assets and settle the current tax liabilities on a net basis in the same period.

(w) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Corporation 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 the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

3 Significant accounting policies (continued)

(w) Provisions and contingent liabilities (continued)

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the possibility of an obligation arising as a result of a past event 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.

(x) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

(i) Concession income

Different components of concession income are recognised in profit or loss as follows:

- Fixed annual payments of \$750 million and variable annual payments based on revenue generated from the operation of the Corporation's rail network and other rail-related businesses are recognised when earned during the Concession Period;
- The upfront payment received less the cost of Purchased Rail Assets for the Service Concession and the assets and liabilities assumed by MTRCL are amortised over the Concession Period on a straight-line basis; and
- ACP funded by MTRCL is recognised as deferred income and amortised over the shorter of its useful life and the remaining Concession Period.

(ii) Interest income

Interest income is recognised as it accrues using the effective interest method.

(iii) Rental and licence income

Rental and licence income receivable under operating leases is recognised in profit or loss in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the use of the leased asset. Lease incentives granted are recognised in profit or loss as an integral part of the aggregate net lease payment receivable. Contingent rentals are recognised as income in the accounting period in which they are earned.

(iv) Other income

Other income is recognised once the related services or goods are delivered and the related risks and rewards of ownership have been transferred.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

3 Significant accounting policies (continued)

(y) Lease out and lease back transactions

A series of lease out and lease back transactions with third parties is linked and accounted for as one arrangement when the overall economic effect cannot be understood without reference to the series of transactions as a whole and when the series of transactions is closely interrelated, negotiated as a single arrangement and takes place concurrently or in a continued sequence.

The primary purpose of such arrangements is to achieve a particular tax result for the third parties in return for a fee. The arrangements do not, in substance, involve a lease under IAS 17 and HKAS 17 since the Group retains all the risks and rewards incidental to the ownership of the underlying assets and enjoys substantially the same rights to their use as before the transactions were entered into. The transactions are, therefore, not accounted for as leases.

Where commitments to make long-term lease payments have been defeased by the placement of security deposits or by the advance of loans to third parties, they are not recognised in the balance sheet. Where commitments and deposits or advances of loans to third parties meet the definition of a liability and an asset, they are recognised in the balance sheet.

The income and expenses arising from the arrangements are accounted for on a net basis in order to reflect the overall commercial effect of the transactions. The net amounts are accounted for as deferred income and are amortised over the applicable lease terms of the transactions.

(z) Translation of foreign currencies

Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the foreign exchange rates ruling at the end of the reporting period.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into Hong Kong dollars using the foreign exchange rates ruling at the dates the fair value was determined.

(aa) Interest and finance income/expenses

(i) Interest and finance income includes:

- interest income from bank deposits and investments;
- interest income arising from delayed reimbursement from MTRCL relating to property development enabling works;
- realised gains arising from derivative financial instruments designated as hedges for borrowings;
- net gains on redemption and disposal of investments; and
- net exchange gains arising from foreign currency transactions.

3 Significant accounting policies (continued)

(aa) Interest and finance income/expenses (continued)

- (ii) The Group's interest and finance income arising from non-derivative financial assets are not classified as at fair value through profit or loss, except for those financial assets that include embedded derivatives with economic characteristics and risks different from that of the host contracts.

Interest and finance income is credited to profit or loss in the period in which it is earned.

- (iii) Interest and finance expenses include:

- interest payable on borrowings;
- finance expenses including amortisation of discounts/premiums and ancillary costs incurred in connection with the arrangement of borrowings calculated using the effective interest rate;
- realised losses arising from derivative financial instruments designated as hedges for borrowings;
- net realised losses on redemption and disposal of investments; and
- net exchange losses arising from foreign currency transactions.

- (iv) The Group's interest and finance expenses arising from non-derivative financial liabilities are not classified as at fair value through profit or loss.

Interest and finance expenses are expensed in profit or loss in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

(ab) 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 and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals.

(ac) Segment reporting

Operating segments, and the amounts of each segment item reported in the financial statements, are identified from the financial information provided regularly to the Group's direct management team for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

4 Changes in accounting policies

The IASB has issued two revised IFRSs, a number of amendments to IFRSs and two new interpretations that are first effective for the current accounting period of the Group and the Corporation. The equivalent new and revised HKFRSs consequently issued by HKICPA have the same effective date as those issued by the IASB and are in all material respects identical to the pronouncements issued by IASB. Of these, the following developments are relevant to the Group's financial statements:

- IFRS 3 (revised 2008) and HKFRS 3 (revised 2008), Business combinations
- Amendments to IAS 27 and HKAS 27, Consolidated and separate financial statements
- Amendments to IAS 39 and HKAS 39, Financial instruments: Recognition and measurement – eligible hedged items
- Improvements to IFRSs (2009) and HKFRSs (2009)
- HK(Int) 5, Presentation of financial statements – classification by the borrower of a term loan that contains a repayment on demand clause

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

The amendments to IAS 39 and HKAS 39 and the issuance of HK(Int) 5 have had no material impact on the Group's financial statements as the amendments and the interpretation's conclusions were consistent with policies already adopted by the Group.

As a result of the amendments to IAS 17 and HKAS 17, Leases, arising from the "Improvements to IFRSs (2009) and HKFRSs (2009)" omnibus standard, the Group has re-evaluated the classification of its interests in leasehold land as to whether, in the Group's judgement, the lease transfers substantially all the risks and rewards of ownership of the land such that the Group is in a position economically similar to that of a purchaser. The Group has concluded that the classification of such leases as operating leases continues to be appropriate.

The other developments resulted in changes in accounting policy but none of these changes in policy have a material impact on the current or comparative periods, for the following reasons:

- The impact of the majority of the revisions to IFRS 3, HKFRS 3, IAS 27 and HKAS 27 have not yet had a material effect on the Group's financial statements as these changes will first be effective as and when the Group enters into a relevant transaction (for example, a business combination or a disposal of a subsidiary) and there is no requirement to restate the amounts recorded in respect of previous such transactions.

5 Turnover

Turnover principally represents revenue from the Service Concession after eliminating inter-company transactions. The amounts of revenue recognised in turnover during the year are as follows:

	2010 \$ million	2009 \$ million
Service Concession income	970	877
Property services	29	28
Income from lease out and lease back transactions	14	16
	1,013	921

6 Operating costs before depreciation, amortisation and impairment

	2010 \$ million	2009 \$ million
Staff costs	5	6
One-off payment for allowances for former KCRC staff	–	36
Repairs and maintenance	1	1
Government rent and rates	1	1
Cost of services acquired (including services outsourced to MTRCL of \$17 million (2009: \$19 million))	22	32
Others	5	17
	34	93

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

7 Operating profit before depreciation, amortisation and impairment

(a) Operating profit before depreciation, amortisation and impairment is arrived at after charging:

	2010 \$ million	2009 \$ million
Auditors' remuneration	2	3
Operating lease charges (minimum lease payments) for rental of property	–	1
Emoluments of the Chief Officer who is not a Member of the Managing Board	1	3
and after crediting:		
Rentals receivable from operating leases less direct outgoings of \$1 million (2009: \$1 million) (including contingent rentals of nil (2009: nil))	29	28

(b) Fees for Members of the Managing Board including the Chairman are shown below:

	2010 \$'000	2009 \$'000
Chairman		
Professor K C Chan in the capacity of Secretary for Financial Services and the Treasury	–	–
Members		
Ms Eva Cheng in the capacity of Secretary for Transport and Housing	–	–
Mr Francis Ho in the capacity of Permanent Secretary for Transport and Housing (Transport)	–	–
Mr Stanley Ying in the capacity of Permanent Secretary for Financial Services and the Treasury (Treasury)	–	–
Mr Clement Leung in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury) *	–	–
Mr K T Li in the capacity of Director of Accounting Services	–	–
Miss Cathy Chu in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury) **	–	–
	–	–

* Mr Clement Leung in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury) up to 24 October 2010.

** Miss Cathy Chu in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury) from 25 October 2010.

7 Operating profit before depreciation, amortisation and impairment (continued)

- (c) Emoluments of the Chief Officer who is not a Member of the Managing Board include fixed remuneration which comprises base pay, allowances and gratuities and benefits-in-kind. Details of emoluments are shown below:

	2010 \$ million	2009 \$ million
Mr James Blake	1.22	2.64

The ranges of remuneration set out below include the five highest paid employees of the Corporation.

	No. of employees	
	2010	2009
The remuneration of the highest five employees ranges from		
\$2,000,001 – \$3,000,000	–	2
\$1,000,001 – \$2,000,000	2	–
Nil – \$1,000,000	3	3

8 Depreciation and amortisation

	2010 \$ million	2009 \$ million
Depreciation:		
– investment properties	3	3
– other assets	2,838	2,658
– depreciation charge capitalised	–	(1)
	2,841	2,660
Amortisation:		
– amortisation of interest of leasehold land held for own use under operating leases	133	130
	2,974	2,790

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

9 Impairment of and loss on disposal of fixed assets

	2010 \$ million	2009 \$ million
Impairment of:		
– fixed assets (note 16)	–	44
– construction in progress (note 17)	–	13
– deferred expenditure (note 18)	97	–
	97	57
Fixed assets written off on disposal	35	38
	132	95

10 Interest and finance income/expenses**(a) Interest and finance income**

	2010 \$ million	2009 \$ million
Interest income from deposits	10	25
Interest income from MTRCL relating to property development enabling works	22	22
Interest income from investments	25	59
Interest income from non-derivative financial assets	57	106
Realised gains arising from derivative financial instruments	153	164
	210	270

10 Interest and finance income/expenses (continued)

(b) Interest and finance expenses

	2010 \$ million	2009 \$ million
Interest expenses on loans	729	1,339
Finance expenses	4	61
Interest and finance expenses on non-derivative financial liabilities	733	1,400
Realised losses arising from derivative financial instruments	7	72
Exchange loss (net)	30	18
	770	1,490
Less: Amount capitalised #	-	(16)
	770	1,474
Cross-currency swaps: cash flow hedges, reclassified from equity (note 14(b))	-	(26)
	770	1,448

In 2009, interest expenses capitalised were charged at average interest rates ranging between 4.63% and 7.32% per annum.

11 Gains/(Losses) on changes in fair value of financial instruments

	2010 \$ million	2009 \$ million
Net gain/(loss) on derivative financial instruments	228	(214)
Net (loss)/gain arising from hedged interest-bearing borrowings	(12)	27
Net unrealised (loss)/gain on investments designated as at fair value through profit or loss	(7)	19
	209	(168)

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

12 Income tax

(a) Income tax in the consolidated statement of comprehensive income represents:

	2010 \$ million	2009 \$ million
<i>Current tax</i>		
Provision for Hong Kong Profits Tax at 16.5% (2009: 16.5%) of the estimated assessable profits for the year	–	–
<i>Deferred tax credit</i>		
Origination and reversal of temporary differences	(396)	(585)
	(396)	(585)

The Corporation sustained a loss for tax purposes during the year and has accumulated tax losses carried forward of approximately \$21,500 million at 31 December 2010 (2009: approximately \$18,500 million) which are available to set off against future assessable profits. The tax losses do not expire under current tax legislation.

(b) Reconciliation between tax credit and accounting loss at applicable tax rates:

	2010 \$ million	2009 \$ million
Loss before taxation	(2,430)	(3,346)
Tax credit on accounting loss before taxation at 16.5% (2009: 16.5%)	(401)	(552)
Tax effect of non-deductible expenses	48	34
Tax effect of non-taxable revenue	(43)	(67)
Actual tax credit	(396)	(585)

12 Income tax (continued)

(c) Deferred tax assets and liabilities of the Group and the Corporation recognised:

The components of deferred tax (assets)/liabilities of the Group and the Corporation recognised in the Group's and the Corporation's balance sheet and the movements during the year are as follows:

The Group and the Corporation

	Future benefit of tax losses \$ million	Depreciation allowances in excess of the related depreciation \$ million	Cash flow hedges \$ million	Total \$ million
At 1 January 2009	(1,974)	5,330	–	3,356
(Credited)/charged to profit or loss	(1,087)	502	–	(585)
Charged to reserves	–	–	3	3
At 31 December 2009	(3,061)	5,832	3	2,774
At 1 January 2010	(3,061)	5,832	3	2,774
(Credited)/charged to profit or loss	(494)	98	–	(396)
Credited to reserves	–	–	(3)	(3)
At 31 December 2010	(3,555)	5,930	–	2,375

13 Loss for the year wholly attributable to the sole shareholder of the Corporation

Of the consolidated loss for the year amounting to \$2,034 million (2009: \$2,761 million), a loss of \$2,053 million (2009: \$2,803 million) has been dealt with in the financial statements of the Corporation.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

14 Other comprehensive income

(a) Tax effects relating to each component of other comprehensive income

	2010			2009		
	Before-tax amount \$ million	Tax benefit \$ million	Net-of-tax amount \$ million	Before-tax amount \$ million	Tax expense \$ million	Net-of-tax amount \$ million
Cash flow hedge: net movement in hedging reserve	(16)	3	(13)	16	(3)	13
Other comprehensive income	(16)	3	(13)	16	(3)	13

(b) Reclassification adjustments relating to components of other comprehensive income

	2010 \$ million	2009 \$ million
Cash flow hedges:		
Effective portion of changes in fair value of hedging instruments recognised during the period	–	42
Reclassification adjustments for amounts transferred to profit or loss:		
– interest and financing expenses (note 10(b))	–	(26)
– ineffectiveness	(16)	–
Net deferred tax credited/(debited) to other comprehensive income	3	(3)
Net movement in the hedging reserve during the year recognised in other comprehensive income	(13)	13

15 Segment reporting

The Group manages its businesses as a whole as the Service Concession is the only reporting segment and virtually all of the turnover and operating loss is derived from activities in Hong Kong. The financial statements are already presented in a manner consistent with the way in which information is reported internally to the Group's direct management team for the purposes of resource allocation and performance assessment. Accordingly, no business and geographical segment information is disclosed in accordance with IFRS 8 and HKFRS 8.

16 Fixed assets and interest in leasehold land held for own use under operating leases

(a) The Group and the Corporation

	Investment properties \$ million	Tunnels, bridges, roads and permanent way \$ million	Buildings \$ million	Rolling stock \$ million	Other equipment \$ million	Total fixed assets \$ million	Interest in leasehold land held for own use \$ million
Cost or valuation:							
At 1 January 2009	-	26,175	33,528	10,241	12,746	82,690	6,523
Transfer from construction in progress	-	2,747	2,383	354	1,974	7,458	74
Additions	-	2	2	-	-	4	12
Purchase of ACP by MTRCL	-	-	-	-	89	89	-
Disposals	-	(23)	-	(47)	(228)	(298)	-
Reclassifications	70	-	(4,994)	-	4,938	14	(14)
At 31 December 2009	70	28,901	30,919	10,548	19,519	89,957	6,595
At 1 January 2010	70	28,901	30,919	10,548	19,519	89,957	6,595
Transfer from construction in progress	-	66	45	564	479	1,154	1
Additions	-	53	93	64	2	212	3
Purchase of ACP by MTRCL	-	-	-	-	17	17	-
Disposals	-	(26)	(9)	(46)	(194)	(275)	-
Reclassifications	-	(4)	(4)	87	(79)	-	-
At 31 December 2010	70	28,990	31,044	11,217	19,744	91,065	6,599
Accumulated depreciation, amortisation and impairment:							
At 1 January 2009	-	2,436	3,919	3,358	7,040	16,753	703
Charge for the year	3	627	716	367	948	2,661	130
Written back on disposals	-	(8)	-	(31)	(221)	(260)	-
Impairment loss	-	32	-	-	12	44	-
Reclassifications	28	-	(448)	-	425	5	(5)
At 31 December 2009	31	3,087	4,187	3,694	8,204	19,203	828
At 1 January 2010	31	3,087	4,187	3,694	8,204	19,203	828
Charge for the year	3	691	769	382	996	2,841	133
Written back on disposals	-	(11)	(1)	(39)	(189)	(240)	-
Reclassifications	-	-	2	4	(6)	-	-
At 31 December 2010	34	3,767	4,957	4,041	9,005	21,804	961
Carrying amounts:							
At 31 December 2010	36	25,223	26,087	7,176	10,739	69,261	5,638
At 31 December 2009	39	25,814	26,732	6,854	11,315	70,754	5,767

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

16 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

- (b) Permanent way principally comprises the cost of rail tracks, sleepers, track base and ballast.
- (c) Other equipment comprises lifts and escalators, telecommunication and signalling systems, machinery, furniture and fixtures, motor vehicles and computer and office equipment.
- (d) The minimum total future amounts receivable by the Group and Corporation under non-cancellable operating leases are expected to be received as follows:

	2010 \$ million	2009 \$ million
Within one year	29	23
After one year but within five years	25	–
	54	23

- (e) The Group and Corporation have previously entered into a number of individually structured transactions or arrangements with unrelated parties to lease out and lease back assets which include rolling stock, signalling equipment, revenue collection equipment and railway infrastructure. Under each arrangement, the Group and Corporation have leased the assets to an overseas investor, who has prepaid all the rentals in relation to a lease agreement. Simultaneously, the Group and Corporation have leased the assets back from the overseas investor and will pay the rentals on a semi-annual or annual basis in accordance with a pre-determined payment schedule. The Group and Corporation have an option to purchase the overseas investor's leasehold interest in the assets at a pre-determined date for a fixed or agreed amount and it is the intention of the Group and Corporation to exercise such purchase options. As long as the Group and Corporation comply with the requirements of the lease agreements, the Group and Corporation will continue to be entitled to quiet enjoyment of and continued possession, use or operation of the assets subject to these arrangements. The arrangements have been entered into with investors in the United States.

16 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

- (e) As at 31 December 2010, a portion of the Group's and Corporation's assets (including assets replaced during the lease periods) with a total cost of \$10,655 million (2009: \$10,342 million) and net book value of \$4,694 million (2009: \$4,721 million) is covered by eight arrangements (2009: eight arrangements). Five arrangements involve rolling stock, with basic lease terms of 15 to 28 years. Two arrangements, one involving signalling equipment and the other involving the revenue collection system, have a basic lease term of 15 years. The remaining arrangement involving railway infrastructure has basic lease terms of between 24 years and 27 years. Since the Group and Corporation retain risks and rewards incidental to ownership of the underlying assets in respect of each arrangement and enjoy substantially the same rights to their use as before the arrangements were entered into, no adjustment has been made to fixed assets. As a result of the eight arrangements, the Group and Corporation have received cash of \$10,805 million (2009: \$10,805 million) and, assuming exercise of the purchase option in each arrangement, will be obligated to make long-term lease payments over the duration of the relevant leases with a total estimated net present value at the inception of the arrangements of \$10,292 million (2009: \$10,292 million), the obligations of which are expected to be funded by the proceeds to be generated from existing deposits and investments over the relevant lease periods.

The total net amounts of cash received by the Group and Corporation from the arrangements have been recorded as deferred income and are being amortised to profit or loss over the applicable lease terms of the arrangements.

- (f) Included in additions are amounts paid and payable to the Government by the Corporation in respect of the following:

Nil (2009: \$16 million) for land resumption work on the West Rail and East Rail Extensions projects undertaken by the Government on behalf of the Corporation and for lease of land required for construction sites.

- (g) In compliance with IAS 16 and HKAS 16 which require an annual review of the estimated useful lives of fixed assets, a review of the estimated useful lives of all major fixed asset categories was undertaken by in-house engineers of MTRCL during the year. Details of the assets affected and the resultant financial effect are as follows:

Asset category	Original useful life (years)	Revised useful life (years)	Decrease in depreciation charge for the year \$ million
Certain items under machinery and equipment	5-20	7-15	1.2

- (h) The carrying value of the Group's and Corporation's interest in leasehold land held in Hong Kong is \$5,618 million (2009: \$5,746 million) under medium-term leases (less than 50 years) and \$20 million (2009: \$21 million) under long-term leases (50 years or above).

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

16 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

- (i) During 2009, the Corporation reclassified certain floors of Citylink Plaza at Sha Tin Station, which are leased out under operating leases, from held for own use to investment property as a result of a change in the terms of the land grant. The revised land grant allows the Corporation to sell these floors separately from the railway network on which Citylink Plaza is situated. At 31 December 2010, the fair value of investment properties as assessed by management amounted to \$1,483 million (2009: \$1,130 million), which was estimated with reference to recent average transaction prices of properties with comparable rental value.
- (j) During the year, project management fees of \$107 million (2009: \$235 million which was included in construction in progress) were paid and payable to MTRCL by the Corporation for the management of design and construction of the Kowloon Southern Link project on its behalf pursuant to the Kowloon Southern Link Project Management Agreement.
- (k) During the year, project management fees of \$1 million (2009: \$5 million which was included in construction in progress) were paid and payable to MTRCL by the Corporation for the reimbursement of staff costs for the management of the operations of the East Rail Extensions and West Rail projects pursuant to the Service Concession Agreement.
- (l) During the year, pursuant to the Project Management Agreement between the Corporation and the MTRCL, an incentive fee of \$110 million (2009: \$55 million which was accrued under construction in progress) was paid to MTRCL for the early completion of the Kowloon Southern Link project.

17 Construction in progress

(a) Construction in progress comprises:

The Group and the Corporation

2010	Kowloon Southern Link \$ million	East Rail Extensions \$ million	Other assets \$ million	Total construction in progress \$ million
Balance as at 1 January 2010	474	1	519	994
Costs incurred during the year	–	–	59	59
Purchase of ACP by MTRCL	–	–	627	627
Transfer to fixed assets or leasehold land	(474)	(1)	(680)	(1,155)
Balance as at 31 December 2010	–	–	525	525

2009	Kowloon Southern Link \$ million	East Rail Extensions \$ million	Other assets \$ million	Total construction in progress \$ million
Balance as at 1 January 2009	6,162	15	749	6,926
Costs incurred/(adjusted) during the year	1,081	(37)	46	1,090
Purchase of ACP by MTRCL	–	–	523	523
Transfer to fixed assets or leasehold land	(6,769)	23	(786)	(7,532)
Impairment loss	–	–	(13)	(13)
Balance as at 31 December 2009	474	1	519	994

(b) As at 31 December 2010, land resumption costs and other costs totalling approximately nil (2009: \$1 million) directly associated with the acquisition of leasehold land for the construction of the Kowloon Southern Link are included in the balance of construction in progress. These costs will be transferred to interest in leasehold land when the land is vested in the Corporation by the Government, at which time the costs will begin to be amortised in accordance with relevant policies.

(c) Included in costs incurred during the year are amounts paid and payable to the Government by the Corporation in respect of the following:

- Nil (2009: \$35 million) for the lease of land required for construction sites for the East Rail Extensions and Kowloon Southern Link projects. The land does not have a measurable value as it cannot be assigned and can only be used by the Corporation and/or its contractors.
- Nil (2009: \$5 million) for land resumption work undertaken by the Government and compensation in respect of resumed land paid and payable by the Government on behalf of the Corporation in respect of the Kowloon Southern Link project. The Corporation is obligated to reimburse such sums to the Government.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

17 Construction in progress (continued)

- (d) The costs incurred during the year are arrived at after crediting nil (2009: \$21 million) on-cost recovery from the Government for certain essential public infrastructure works and other works along the railways. Such work was undertaken by the Corporation on behalf of the Government pursuant to the entrustment agreements in respect of such entrustment works and from the subsidiary, West Rail Property Development Limited, for property development along the West Rail, Phase I route as governed by the Shareholding Agreement between the Corporation and the Government (see note 21).

18 Deferred expenditure

- (a) Deferred expenditure comprises:

The Group and the Corporation

	Shatin to Central Link \$ million	Express Rail Link/ Northern Link \$ million	Total deferred expenditure \$ million
2010			
Balance as at 1 January 2010	1,188	425	1,613
Cost recovered during the year	–	(328)	(328)
Impairment loss	–	(97)	(97)
Balance as at 31 December 2010	1,188	–	1,188
2009			
Balance as at 1 January 2009	1,188	424	1,612
Expenditure incurred during the year	–	1	1
Balance as at 31 December 2009	1,188	425	1,613

18 Deferred expenditure (continued)

- (b) The Government has indicated that the Shatin to Central Link (“the SCL”), upon completion, is likely to be vested in the Corporation and operated by MTRCL through a service concession arrangement. A final decision on the detailed arrangements will be subject to Government policy approval which is expected to be available in early 2012. Although the final details of the arrangement are subject to Government policy approval as noted above, management are confident that the recovery of the costs incurred to date by the Corporation on the SCL will be achieved over the duration of the additional or supplemental service concession arrangement with MTRCL.
- (c) As at 31 December 2010, land related costs totalling approximately \$6 million (2009: \$6 million) directly associated with the acquisition of leasehold land for the purpose of the SCL are included in the balance of deferred expenditure. These costs will be transferred to interest in leasehold land when the land is vested in the Corporation by the Government, at which time the costs will begin to be amortised in accordance with the relevant policies.
- (d) During the year, funding approval was obtained from the Finance Committee of the Legislative Council on the Express Rail Link project and the Corporation received from the Government a reimbursement of the enabling work costs incurred for the project, totalling \$328 million (2009: nil). The remaining project costs of Express Rail Link and Northern Link incurred on the original project proposal, totalling \$97 million (2009: nil), have been written off to profit or loss.

19 Investments in subsidiaries

	Corporation	
	2010 \$ million	2009 \$ million
Unlisted shares, at cost	–	–

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

19 Investments in subsidiaries (continued)

Details of the subsidiaries listed by principal activities are as follows:

Name of company	Place of incorporation and operation	Number of issued and fully paid ordinary shares	Par value of shares	Percentage of shares held by the Corporation
Asset Leasing				
Buoyant Asset Limited	Hong Kong	100	\$10	100%
Advanced Asset Limited	Hong Kong	100	\$10	100%
Quality Asset Limited	Hong Kong	100	\$10	100%
Kasey Asset Limited	Hong Kong	100	\$10	100%
Circuit Asset Limited	Hong Kong	100	\$10	100%
Shining Asset Limited	Hong Kong	100	\$10	100%
Fluent Asset Limited	Hong Kong	100	\$10	100%
Bowman Asset Limited	Cayman Islands	1,000	US\$1	100%
Statesman Asset Limited	Cayman Islands	1,000	US\$1	100%
Kudos Asset Limited ^	Hong Kong	100	\$10	100%
Unique Asset Limited ^	Hong Kong	100	\$10	100%
Non-controlled subsidiaries				
Property development:				
West Rail Property				
Development Limited, and its 13 wholly owned subsidiaries *	Hong Kong	51 'A' 49 'B'	\$10 \$10	100% Nil
Property management:				
The Metropolis Management Company Limited **	Hong Kong	25,500 'A' 24,500 'B'	\$1 \$1	100% Nil

^ Kudos Asset Limited and Unique Asset Limited were deregistered on 16 April 2010 and 30 April 2010 respectively.

* These subsidiaries are held by the Corporation for the sole purpose of developing commercial or residential property along the West Rail, Phase I route on behalf of the Government. Their financial statements are excluded from consolidation as the Corporation has no effective control over nor beneficial interests in the net assets of these subsidiaries, other than the amount of capital provided.

** The subsidiary is held by the Corporation for the sole purpose of rendering property management services to a commercial property. The financial statements are excluded from consolidation on the basis that, under the Equity Sub-participation Agreement which formed part of the merger transaction, the Corporation is obliged to act on MTRCL's instructions in respect of the exercise of any and all rights the Corporation has as a shareholder of the MMC. All the beneficial interests to which the Corporation was previously entitled now rest with MTRCL although there has been no direct disposition of the shares of MMC to MTRCL.

19 Investments in subsidiaries (continued)

A summary of consolidated financial information of WRPDL and its subsidiaries based on the management accounts of these companies as of 31 December is as follows:

	2010 \$ million	2009 \$ million
Assets	2,835	2,849
Liabilities	4,485	4,491
Equity	(1,650)	(1,642)
Turnover	–	–
Loss after taxation for the year	(8)	(10)

20 Interest in associate

The interest in associate is as follows:

	Group		Corporation	
	2010 \$ million	2009 \$ million	2010 \$ million	2009 \$ million
Unlisted shares, at cost	–	–	9	9
Share of net assets	208	189	–	–
	208	189	9	9

Details of the associate, which is incorporated and operates in Hong Kong, are as follows:

Name of company	Number of issued and fully paid ordinary shares	Par value of shares	Percentage of shares held
Octopus Holdings Limited	42,000,000	\$1	22.1%

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

20 Interest in associate (continued)

A summary of financial information of the associate based on the consolidated management accounts of Octopus Holdings Limited as of 31 December is as follows:

	2010		2009	
	100%	Group's effective	100%	Group's effective
	\$ million	interest (22.1%)	\$ million	interest (22.1%)
		\$ million		\$ million
Assets	3,338	738	3,041	672
Liabilities	2,396	530	2,188	483
Equity	942	208	853	189
Turnover	597	132	629	139
Profit after tax for the year	219	48	259	57

21 Loan to non-controlled subsidiary

On 24 February 2000, the Corporation and the Government entered into a shareholding agreement (the "Shareholding Agreement") for the formation of a sub-group of the Corporation under an intermediate holding company, West Rail Property Development Limited ("WRPDL"), to undertake all property developments along the West Rail, Phase I route. The issued share capital of WRPDL comprises 51 ordinary "A" shares and 49 ordinary "B" shares, which are held by the Corporation and the Government respectively. The holders of ordinary "A" shares are not entitled to any distribution by WRPDL other than a return of capital, and the holders of ordinary "B" shares are entitled to all dividends declared by WRPDL and a return of capital. In other words, the Corporation is not entitled to any earnings distribution, nor is it required to ultimately fund any losses which may be sustained by WRPDL and its subsidiaries.

Subsidiaries of WRPDL have been formed to handle the property developments along the West Rail, Phase I route. The Government will receive the profits less losses from the developments whereas the Corporation was to recover the on-costs for the handling of the property developments along the route.

Since the Appointed Day, the Corporation, WRPDL and its subsidiaries (the "WRPDL Group") have appointed MTRCL as an agent to handle the property developments and an agency fee is payable by each subsidiary of WRPDL to MTRCL as remuneration. All costs incurred up to the Appointed Day in relation to the West Rail property developments were funded by loans from the Corporation to WRPDL bearing interest at an annual rate of 1% over the Corporation's average cost of funds in the preceding year. The Corporation agreed to stop accruing further interest on the loan with effect from 1 January 2008. To the extent that WRPDL may be unable to repay the loan, the Government shall seek the necessary authority to reimburse costs incurred by the Corporation. The Government has also undertaken to indemnify the Corporation against all liabilities properly incurred by the Corporation in relation to such property developments.

21 Loan to non-controlled subsidiary (continued)

The recoverability of the loan to WRPDL depends on the nature and extent of the development conditions which the relevant statutory authorities impose on the property developments along the West Rail, Phase I route. The timetable for the projects' tender programme may need to be extended and it is uncertain as to whether the scope and design of such projects will be changed or delayed or whether additional costs will arise. Whilst there is uncertainty as to whether the Corporation will be able to recover the loan in full, based on current projections, which involve an estimation of future development plans and economic data, management are confident that the loan to WRPDL will be recovered in full. The loan to non-controlled subsidiary is expected to be recovered after one year.

22 Investments

Investments comprise:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Available-for-sale debt securities		
– Listed outside Hong Kong	39	–
Unlisted debt securities designated as at fair value through profit or loss	396	402
Total carrying amount of investments	435	402
Total market value of listed investments	39	–

23 Interest and other receivables

(a) Interest and other receivables comprise:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Interest receivable	1	8
Amount due from the Government	9	42
Debtors, deposits, prepayments and revenue in arrears	69	67
Amount due from MTRCL relating to property under development	433	571
Amount due from MTRCL	172	67
	684	755

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

23 Interest and other receivables (continued)

- (a) Interest and other receivables comprise: (continued)

The amount due from the Government represents amounts receivable for certain essential public infrastructure works and other works along the railways undertaken on behalf of the Government pursuant to the respective entrustment agreements and project agreements with the Government.

The amount due from MTRCL relating to property under development represents property development enabling work costs incurred by the Corporation. The amount will be reimbursed from MTRCL once the joint venture for the respective property development site is formed in accordance with the Merger Framework Agreement.

- (b) Interest and other receivables are expected to be recovered as follows:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Within one year	678	184
After one year	6	571
	684	755

- (c) Included in interest and other receivables are debtors with the following ageing analysis:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Current	52	45
Deposits, prepayments and revenue in arrears	17	22
	69	67

Normally, no credit is allowed except for revenue sharing arrangements in which the normal credit period is one month. For the amount due from the Government regarding the entrustment works undertaken by the Corporation on behalf of the Government, the normal credit period is 21 days pursuant to the respective entrustment agreements.

24 Cash and cash equivalents

Cash and cash equivalents comprise:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Deposits with banks		
– Within three months to maturity when placed	697	900
– More than three months to maturity when placed	–	7,967
Cash at bank and in hand	13	5
Cash and cash equivalents in the balance sheets	710	8,872
Less: deposits with banks with more than three months to maturity when placed	–	(7,967)
Cash and cash equivalents in the consolidated cash flow statement	710	905

25 Interest and other payables

(a) Interest and other payables comprise:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Interest payable	117	284
Deposits and advances	76	149
Creditors and accrued charges	9	55
	202	488

(b) Interest and other payables are expected to be settled as follows:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Within one year	190	467
After one year	12	21
	202	488

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

25 Interest and other payables (continued)

(c) Included in interest and other payables are interest payable and creditors with the following ageing analysis:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Due within one month or on demand	28	16
Due between one month to three months	12	186
Due between three months to six months	82	88
Total interest payable and creditors	122	290
Deposits and advances	76	149
Accrued charges	4	49
	202	488

26 Accrued charges and provisions for capital projects

The balance includes accrued charges and provisions for claims related to capital projects. Accrued charges will be settled upon certification of work done. Provisions for claims relate to the West Rail, East Rail Extensions and Kowloon Southern Link projects.

The balance includes an aggregate amount of \$1,267 million (2009: \$1,297 million) payable to the Government mainly for land premium, land resumption and associated costs in relation to the West Rail, East Rail Extensions and Shatin to Central Link projects.

During the year, the Corporation did not make any additional provision for claims and land premium, land resumption and associated costs and reversed or utilised amounts totalling \$25 million. As of 31 December 2010, provisions for claims and land premium, land resumption and associated costs totalled \$1,247 million.

Accrued charges and provisions for capital projects are expected to be settled or utilised as follows:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Within one year	67	256
After one year	1,206	1,260
	1,273	1,516

27 Interest-bearing borrowings

(a) Interest-bearing borrowings comprise:

The Group and the Corporation

	2010		2009	
	Carrying amount \$ million	Fair value \$ million	Carrying amount \$ million	Fair value \$ million
Capital market instruments				
HK dollar retail notes due 2013 – see (c) below	687	758	683	755
US dollar notes due 2010 – see (d) below	–	–	7,783	7,901
HK dollar notes due 2013 – see (e) below	865	865	859	859
US dollar notes due 2014 – see (e) below	390	465	388	460
HK dollars notes due 2012 – see (f) below	299	304	299	302
HK dollars notes due 2014 – see (f) below	397	412	397	397
HK dollars notes due 2019 – see (f) below	1,283	1,277	1,282	1,224
HK dollars notes due 2024 – see (f) below	413	403	412	394
US dollars notes due 2019 – see (f) below	5,817	5,929	5,792	5,577
HK dollars notes due 2021 – see (f) below	493	513	492	498
HK dollars notes due 2021 – see (f) below	739	738	738	716
HK dollars notes due 2019 – see (f) below	434	441	434	425
HK dollars notes due 2015 – see (f) below	1,000	1,031	–	–
HK dollars notes due 2013 – see (f) below	800	806	–	–
	13,617	13,942	19,559	19,508
Bank loans – see (g) below	1,500	1,500	3,500	3,500
	15,117	15,442	23,059	23,008

(b) The fair values of capital market instruments were determined using discounted cash flow techniques.

(c) The Corporation issued 4.80% notes due 2013 with an aggregate nominal value of \$700 million at a premium on 6 June 2003. All the notes issued are unsecured and rank equally with all of the Corporation's other unsecured senior indebtedness.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

27 Interest-bearing borrowings (continued)

- (d) The Corporation issued 8.00% notes due 2010 with an aggregate nominal value of US\$1 billion at a discount on 16 March 2000. These notes are listed on The Stock Exchange of Hong Kong Limited and the London Stock Exchange plc. All the notes issued are unsecured and rank equally with all of the Corporation's other unsecured senior indebtedness. The Corporation redeemed the notes at maturity.
- (e) The Corporation issued 7.77% notes due 2014 with an aggregate nominal value of US\$50 million at a discount on 17 November 1999, and 4.65% notes due 2013 with an aggregate nominal value of \$800 million at par on 9 June 2003 under its US\$3 billion medium term note programme. All the notes issued are unsecured and rank equally with all of the Corporation's other unsecured senior indebtedness.
- (f) The Corporation issued the following notes under its 2009 US\$3 billion medium term note programme:

Date of issue	Nominal value	Interest rate	Maturity	Pricing
28 April 2009	\$300 million	2%	2012	At a discount
28 April 2009	\$400 million	2.65%	2014	At a discount
28 April 2009	\$1.3 billion	3.5%	2019	At a discount
15 May 2009	\$415 million	4.13%	2024	At a discount
18 May 2009	US\$750 million	5.125%	2019	At a discount
15 June 2009	\$500 million	3.88%	2021	At a discount
9 July 2009	\$750 million	3.82%	2021	At a discount
24 July 2009	\$435 million	3.64%	2019	At a discount
2 February 2010	\$1 billion	2.8%	2015	At par
20 May 2010	\$800 million	1.3%	2013	At par

All the notes issued are unsecured and rank equally with all of the Corporation's other unsecured senior indebtedness.

- (g) The Corporation has drawn down \$2 billion from its Syndicated Loan facility in 2009. Of which, \$1 billion was repaid on 29 March 2010 and the other \$1 billion was repaid on 29 June 2010. A \$1.5 billion bank loan due 2016 was raised during 2009. As at 31 December 2010, all bank loans are unsecured and interest-bearing at rates ranging from 0.91% (2009: 0.43%) to 1.15% (2009: 0.96%) per annum.
- (h) The covenants attached to the Corporation's interest-bearing borrowings are customary ones.

27 Interest-bearing borrowings (continued)

- (i) The interest-bearing borrowings were repayable as follows:

	2010 \$ million	2009 \$ million
Within one year	–	7,783
After one year but within two years	299	1,000
After two years but within five years	4,139	3,626
After five years	10,679	10,650
	15,117	23,059

28 Deferred income

- (a) The balance of deferred income at 31 December 2010 includes cash received from property developers for property development sites along East Rail and Ma On Shan Rail; cash receipts arising from the lease out and lease back arrangements; the upfront payment received less the cost of Purchased Rail Assets for the Service Concession; assets and liabilities assumed by MTRCL as part of the merger transaction; and the cost of Additional Concession Property (“ACP”) funded by MTRCL less related amortisation. Under the property package of the Rail Merger, the Corporation shall continue to be responsible for the funding of the property enabling works for the eight development sites sold to MTRCL. The cash received from property developers will be set off against costs to be incurred by the Corporation in respect of each property development. The unutilised balance will be credited to profit or loss when the property enabling works are completed and accepted for development and after taking into account the outstanding risks and obligations in connection with the development, if any, retained by the Corporation. The balance relating to the lease out and lease back arrangements is being amortised and credited to profit or loss over the applicable lease terms. The balance relating to the net upfront payment received for the Service Concession and assets and liabilities assumed by MTRCL is being amortised and credited to profit or loss over the Concession Period. The balance relating to ACP is being amortised to profit or loss over the shorter of the useful life of the ACP and the remaining Concession Period.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

28 Deferred income (continued)

(b) Movements in deferred income comprise:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Balance at 1 January	5,441	5,001
Net amount paid and payable	(15)	(21)
Deferred income relating to ACP funded by MTRCL	644	612
Recognised in profit or loss	(197)	(151)
Balance at 31 December	5,873	5,441

(c) Deferred income is expected to be recognised in profit or loss as follows:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Within one year	197	150
After one year	5,676	5,291
	5,873	5,441

29 Capital, reserves and dividends

(a) Movements in components of equity

The reconciliation between the opening and closing balances of each component of the group's consolidated equity is set out in the consolidated statement of changes in equity. Details of the changes in the company's individual components of equity between the beginning and the end of the year are set out below:

The Corporation

	Share capital \$ million	Hedging reserve \$ million	Retained profits \$ million	Total \$ million
Balance at 1 January 2009	39,120	–	24,099	63,219
Changes in equity for 2009:				
Total comprehensive income for the year	–	13	(2,803)	(2,790)
Balance at 31 December 2009 and 1 January 2010	39,120	13	21,296	60,429
Changes in equity for 2010:				
Total comprehensive income for the year	–	(13)	(2,053)	(2,066)
Balance at 31 December 2010	39,120	–	19,243	58,363

- (i) Included in the retained profits of the Group is an amount of \$199 million (2009: \$180 million) being the retained profits attributable to an associate.
- (ii) Pursuant to the relevant provisions of the Ordinance, the reserves available for distribution comprise an amount out of the whole or part of the profits of the Corporation in any financial year after making allowance for any accumulated loss at the end of the financial year prior to the year in which the distribution is declared. The fair value change of financial assets and liabilities, net of related deferred tax, recognised in retained profits are not available for distribution to the sole shareholder because they are not realised profits of the Corporation. As at 31 December 2010, the amount of reserves available for distribution to the sole shareholder amounted to \$19,009 million (2009: \$21,237 million).

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

29 Capital, reserves and dividends (continued)**(b) Share Capital**

	2010		2009	
	No. of shares	\$ million	No. of shares	\$ million
Authorised:				
Shares of \$100,000 each	425,000	42,500	425,000	42,500
Issued and fully paid:				
At 31 December	391,200	39,120	391,200	39,120

(c) Hedging reserve

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 3(g)(i).

(d) Capital management

The Corporation's capital includes share capital and reserves.

The entire issued share capital of the Corporation is held by the Financial Secretary Incorporated.

Pursuant to the relevant provisions of the Ordinance, the Corporation may declare dividends to the Government as its sole shareholder. The Financial Secretary may, after consultation with the Corporation and after taking into account the extent of its loans and other obligations, direct the Corporation to declare a dividend.

30 Financial risk management and fair values

In the normal course of its business, the Group is exposed to a variety of financial risks: foreign exchange risk, interest rate risk, credit risk and liquidity risk. The Group uses derivative financial instruments to hedge certain risk exposures.

The Managing Board has approved policies in respect of foreign exchange risk, interest-rate risk, credit risk, use of derivative financial instruments and investment of surplus funds. As part of its risk management, the Group identifies and evaluates the financial risks and, where appropriate, hedges those risks in accordance with the policies established by the Managing Board.

The Group documents at the inception of each hedging transaction the relationship between the hedging instrument and hedged item, as well as its risk management objective and strategy for undertaking the transaction. The Group also documents its assessment, both at inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of the hedged items.

30 Financial risk management and fair values (continued)

(a) Credit risk

The Group's credit risk is primarily attributable to its investment in debt securities, its deposits and over-the-counter derivative financial instruments entered into for hedging purposes.

The Group has no significant concentrations of credit risk. It has policies in place that limit the amount of credit exposure to any financial institution with which the Group has transactions. The Group can only invest in debt securities issued by or place deposits with financial institutions that meet the established credit rating or other criteria. Derivative counterparties are limited to high-credit-quality financial institutions. The exposures to these credit risks are monitored on an ongoing basis.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial assets and liabilities, in the balance sheet.

The Group and the Corporation

	2010 \$ million	2009 \$ million
Loan to non-controlled subsidiary	4,405	4,405
Investments	435	402
Interest rate swaps	184	120
Currency swaps	201	65
Interest and other receivables	684	755
	5,909	5,747

(b) Interest rate risk

(i) Hedging

The Group's interest rate risk arises from its long-term borrowings. Borrowings at variable rates expose the Group to cash flow interest rate risk. Borrowings at fixed rates expose the Group to fair value interest rate risk. The Group aims to maintain the proportion of its fixed rate borrowings at between 30% and 75% of total borrowings. At 31 December 2010, 54% (2009: 69%) of total borrowings were at fixed rates.

The Group enters into receive-fixed-pay-floating interest rate swaps to hedge the fair value interest rate risk arising from fixed rate borrowings as well as to achieve an appropriate mix of fixed and floating rate exposure.

At 31 December 2010, the Group had interest rate swaps with a notional contract amount of \$800 million (2009: \$800 million) which qualify as fair value hedges. These interest rate swaps are stated at fair value with changes in fair value being recognised in profit or loss to offset the effect of the gain or loss on the related hedged portion of interest-bearing borrowings.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

30 Financial risk management and fair values (continued)

(b) Interest rate risk (continued)

(i) Hedging (continued)

The net fair value of interest rate swaps which qualify as fair value hedges, entered into by the Group at 31 December 2010 was \$65 million (assets) (2009: \$59 million (assets)).

(ii) Fair value through profit or loss

For interest rate swaps where the hedging relationships do not qualify as fair value hedges or the Corporation does not opt for hedging accounting, changes in their fair values are recognised in profit or loss.

At 31 December 2010, the Group had such interest rate swaps with a notional contract amount of \$4,635 million (2009: \$2,897 million) and net fair value of \$82 million (assets) (2009: \$50 million (assets)), which comprises assets of \$119 million (2009: \$61 million) and liabilities of \$37 million (2009: \$11 million).

(iii) Sensitivity analysis

The sensitivity analysis below indicates the instantaneous change in the Group's loss after taxation (and retained profits) that would arise assuming that changes in interest rates of +/- 100 basis points (bps) had occurred at the end of the reporting period and such changes had been applied to re-measure those financial instruments held by the Group which expose the Group to fair value risk at the end of the reporting period. In respect of the exposure to cash flow interest rate risk arising from floating rate non-derivative instruments held by the Group at the end of the reporting period, the impact on the Group's loss after taxation is estimated as an annualised impact on interest expense or income of such a change in interest rates. The analysis is performed on the same basis for 2009.

Other than for currency swaps where the forward exchange rates are slightly changed by a parallel shift in the interest rates of the underlying currencies, all other variables, in particular spot foreign currency rates, remain constant.

30 Financial risk management and fair values (continued)

(b) Interest rate risk (continued)

(iii) Sensitivity analysis (continued)

The estimated impact of a general increase/decrease of 100 basis points in interest rates, with all other variables held constant, on the Group's and the Corporation's loss after taxation and equity is shown below:

The Group and the Corporation

	2010		2009	
	\$ million +100 bps	\$ million -100 bps	\$ million +100 bps	\$ million -100 bps
Effect on profit or loss:				
Interest rate swaps	(180)	196	(80)	87
Currency swaps	(5)	5	–	1
Interest-bearing borrowings	16	(16)	22	(23)
(Increase)/decrease in loss after taxation	(169)	185	(58)	65
Effect on equity:				
Currency swaps	–	–	6	(8)
(Increase)/decrease in equity	–	–	6	(8)

(c) Currency risk

The Group derives its revenues almost entirely in Hong Kong dollars and is, therefore, exposed to currency risk arising only from borrowings, purchases and capital expenditure payments in relation to the development of new railways that are denominated in foreign currencies.

The Corporation uses forward exchange contracts and currency swaps to hedge its foreign exchange risk. The Corporation's risk management policy is to hedge its foreign currency borrowings into either Hong Kong dollars or United States dollars and limit its exposure to United States dollars to no greater than 30% of its total borrowings.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

30 Financial risk management and fair values (continued)

(c) Currency risk (continued)

The Corporation may have investments in debt securities and other financial assets from time to time. Where these investments are denominated in foreign currencies other than United States dollars or Hong Kong dollars, the Corporation hedges the exposure into either United States dollars or Hong Kong dollars.

(i) Recognised assets and liabilities

Changes in the fair value of currency swaps that effectively hedge recognised monetary liabilities denominated in foreign currencies are recognised in the hedging reserve. The net fair value of currency swaps used by the Corporation as economic hedges of monetary assets and liabilities in foreign currencies at 31 December 2010 and recognised as net derivative financial assets was nil (2009: \$42 million (assets)), comprising assets of nil (2009: \$65 million) and liabilities of nil (2009: \$23 million).

Changes in the fair value of currency swaps that could not effectively hedge recognised monetary liabilities denominated in foreign currencies are recognised in profit or loss. The net fair value of currency swaps used by the Corporation as economic hedges of monetary assets and liabilities in foreign currencies at 31 December 2010 and recognised as net derivative financial assets was \$201 million (2009: \$15 million (liabilities)), comprising assets of \$201 million (2009: nil) and liabilities of nil (2009: \$15 million).

(ii) Fair value through profit or loss

Changes in the fair value of forward exchange contracts for which no hedge accounting is applied are recognised in profit or loss. At 31 December 2010, the Corporation did not hold any forward exchange contracts (2009: nil).

In respect of other receivables and other payables denominated in currencies other than the functional currency, the Corporation ensures that the net exposure is kept to an acceptable level by buying or selling foreign currencies at spot or forward rates where necessary.

All the Group's borrowings are denominated in either Hong Kong dollars or United States dollars. Given this, management does not expect that there will be any significant currency risk associated with the Group's borrowings.

30 Financial risk management and fair values (continued)

(c) Currency risk (continued)

(iii) Exposure to currency risk

Based on the notional amounts of the financial assets and liabilities, the following table shows the Group's and the Corporation's exposure at the balance sheet date to currency risk arising from recognised assets or liabilities denominated in a currency other than the functional currency of the Group.

The Group and the Corporation

	US dollars million (Expressed in foreign currency)	Japanese yen million
2010		
- Investments	56	-
- Cash and cash equivalents	-	456
- Currency swaps	800	-
- Interest and other payables	(5)	-
- Interest-bearing borrowings	(800)	-
Overall net exposure	51	456
2009		
- Investments	52	-
- Interest and other receivables	2	-
- Cash and cash equivalents	324	455
- Currency swaps	1,700	-
- Forward foreign exchange contracts	33	-
- Interest and other payables	(29)	-
- Interest-bearing borrowings	(1,800)	-
Overall net exposure	282	455

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

30 Financial risk management and fair values (continued)

(c) Currency risk (continued)

(iv) Sensitivity analysis

The following table indicates the instantaneous change in the Group's loss after taxation that would have arisen upon changes to foreign exchange rates to which the Group had exposure at the end of the reporting period, assuming all other risk variables remained constant. Such exposure relates to the portion of United States dollars borrowings which is unhedged, and other assets and liabilities, such as deposits and future contract payments, denominated in foreign currencies.

	Increase/ (decrease) in foreign exchange rate	2010 Decrease/ (increase) in loss after taxation \$ million	2009 Decrease/ (increase) in loss after taxation \$ million
US dollars	1%	11	17
	(1%)	(11)	(17)
Japanese yen	10%	4	3
	(10%)	(4)	(3)

Results of the analysis as presented in the above table represent an aggregation of the instantaneous effects on the Group's loss after taxation measured in the respective functional currencies, translated into Hong Kong dollars at exchange rates, based on direct quotes, prevailing at the end of the reporting period for presentation purposes.

The sensitivity analysis assumes that the change in foreign exchange rates had been applied to re-measure those financial instruments held by the Group which expose the Group to foreign currency risk at the end of the reporting period.

The analysis is performed on the same basis for 2009.

(d) Liquidity risk

Liquidity risk represents the Group's ability to meet its contractual obligations. The Group evaluates its liquidity requirements on an ongoing basis. It employs projected cash flow analyses to forecast its future funding requirements. The Group's approach to managing liquidity is to ensure there will be sufficient liquidity to meet its liabilities when they fall due, under both normal and stressed conditions.

The Group aims to secure committed credit facilities well ahead of funding needs. This protects the Group against adverse market conditions which may result in difficulties in raising funds to meet payment obligations. The Group has put in place committed revolving facilities and uncommitted stand-by facilities to cater for short-term liquidity requirements.

30 Financial risk management and fair values (continued)

(d) Liquidity risk (continued)

The following table shows the time periods after the end of the reporting period during which contractual payments, presented on an undiscounted basis, are due to be made. These payments include, inter alia, interest payments computed using contractual rates (for fixed rate instruments) and rates prevalent at the end of the reporting period (for floating rate instruments), in respect of the Group's and the Corporation's non-derivative and derivative financial liabilities which are due to be paid.

The Group and the Corporation

	Contractual undiscounted cash outflow					Balance sheet carrying amount \$ million
	Within 1 year or on demand \$ million	More than 1 year but less than 2 years \$ million	More than 2 years but less than 5 years \$ million	More than 5 years \$ million	Total \$ million	
2010						
Interest and other payables	(190)	(4)	(5)	(3)	(202)	202
Interest rate swap	-	-	(19)	(88)	(107)	(147)
Currency swaps						
– outflow	(269)	(270)	(1,199)	(6,753)	(8,491)	-
– inflow	300	300	1,292	6,911	8,803	(201)
Interest-bearing borrowings	(485)	(905)	(5,739)	(12,499)	(19,628)	15,117
	(644)	(879)	(5,670)	(12,432)	(19,625)	14,971
2009						
Interest and other payables	(467)	(6)	(15)	-	(488)	488
Interest rate swap	-	-	(6)	(30)	(36)	(109)
Currency swaps						
– outflow	(7,305)	(269)	(1,200)	(7,021)	(15,795)	38
– inflow	7,306	299	1,287	7,185	16,077	(65)
Forward foreign exchange contracts						
– outflow	(256)	-	-	-	(256)	-
– inflow	257	-	-	-	257	-
Interest-bearing borrowings	(8,395)	(1,617)	(5,406)	(12,967)	(28,385)	23,059
	(8,860)	(1,593)	(5,340)	(12,833)	(28,626)	23,411

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

30 Financial risk management and fair values (continued)

(e) Fair value

(i) Financial instruments carried at fair value

The following table presents the carrying value of financial instruments measured at fair value at the balance sheet date across the three levels of the fair value hierarchy defined in IFRS 7 and HKFRS 7, Financial Instruments: Disclosures, with the fair value of each financial instrument categorised in its entirety based on the lowest level of input that is significant to that fair value measurement. The levels are defined as follows:

- Level 1 (highest level): fair values measured using quoted prices (unadjusted) in active markets for identical financial instruments
- Level 2: fair values measured using quoted prices in active markets for similar financial instruments, or using valuation techniques in which all significant inputs are directly or indirectly based on observable market data
- Level 3 (lowest level): fair values measured using valuation techniques in which any significant input is not based on observable market data

The Group and the Corporation

2010	Level 1 \$ million	Level 2 \$ million	Level 3 \$ million	Total \$ million
Assets				
Derivative financial assets:				
– Interest rate swaps	–	184	–	184
– Currency swaps	–	201	–	201
Listed available-for-sale debt securities	39	–	–	39
Unlisted debt securities designated as at fair value through profit or loss	–	–	396	396
	39	385	396	820
Liabilities				
Derivative financial liabilities:				
– Interest rate swaps	–	(37)	–	(37)
	–	(37)	–	(37)

30 Financial risk management and fair values (continued)

(e) Fair value (continued)

(i) Financial instruments carried at fair value (continued)

2009	Level 1 \$ million	Level 2 \$ million	Level 3 \$ million	Total \$ million
Assets				
Derivative financial assets:				
- Interest rate swaps	-	120	-	120
- Currency swaps	-	65	-	65
Unlisted debt securities designated as at fair value through profit or loss	-	-	402	402
	-	185	402	587
Liabilities				
Derivative financial liabilities:				
- Interest rate swaps	-	(11)	-	(11)
- Currency swaps	-	(38)	-	(38)
	-	(49)	-	(49)

The movement during the period in the balance of Level 3 fair value measurements is as follows:

The Group and the Corporation

	2010 \$ million	2009 \$ million
Investments		
At 1 January	402	383
Net unrealised gains or losses recognised in profit or loss during the period	(6)	19
At 31 December	396	402

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

30 Financial risk management and fair values (continued)

(e) Fair value (continued)

(ii) Fair values of financial instruments carried at other than fair value

The carrying amounts of the Group's and the Corporation's financial instruments carried at cost or amortised cost are not materially different from their fair values as at 31 December 2010 and 2009 except as follows:

The Group and the Corporation

	2010		2009	
	Carrying amount \$ million	Fair value \$ million	Carrying amount \$ million	Fair value \$ million
Assets				
Loan to non-controlled subsidiary	4,405	#	4,405	#
	4,405	-	4,405	-
Liabilities				
Interest-bearing borrowings	(15,117)	(15,442)	(23,059)	(23,008)
	(15,117)	(15,442)	(23,059)	(23,008)

Since the Appointed Day, the Corporation, WRPDL and its subsidiaries (the "WRPDL Group") have appointed MTRCL as an agent to handle the property developments in respect of which the costs, including the agency fees as well as any disbursements paid by MTRCL, would be recovered from the WRPDL Group, at a higher priority than the Corporation. As a result, the fair value of the loan to non-controlled subsidiary cannot be measured reliably as its present value is not determinable in the absence of fixed repayment terms.

(f) Estimation of fair value

The following summarises the major methods and assumptions used in estimating the fair values of financial assets and liabilities.

(i) Investments

The fair value of financial assets traded in active markets was based on quoted market prices at the end of the reporting period.

30 Financial risk management and fair values (continued)

(f) Estimation of fair value (continued)

(ii) Interest rate swaps, currency swaps and forward exchange contracts

The fair value of interest rate swaps and currency swaps was based on the present value of the estimated amount that the Group would receive or pay to terminate the swap at the end of the reporting period, taking into account prevailing interest rates, foreign exchange rates and creditworthiness of the swap counterparties. The fair value of forward exchange contracts was based on the quoted market price at the end of the reporting period, being the present value of the quoted forward price. Discounted cash flow techniques were used in determining the fair value of swaps.

(iii) Loan to non-controlled subsidiary and interest-bearing borrowings

Where applicable, fair value was calculated based on discounted cash flows of expected future principal and interest payments.

(iv) Discount rates used for determining fair value

The Corporation used the applicable yield curve at the end of the reporting period plus an appropriate constant credit spread to discount financial assets and liabilities. The interest rates used were as follows:

	2010	2009
Interest rate swaps, currency swaps	0.11% – 3.30%	0.17% – 4.08%
Interest-bearing borrowings	0.37% – 5.21%	0.44% – 6.04%

31 Notes to the consolidated cash flow statement

Reconciliation of operating loss after depreciation, amortisation and impairment to net cash inflow from operations

	2010 \$ million	2009 \$ million
Operating loss after depreciation, amortisation and impairment	(2,127)	(2,057)
Depreciation and amortisation	2,974	2,790
Impairment of and loss on disposal of fixed assets	132	95
Decrease/(increase) in other receivables	94	(95)
Decrease in other payables and deferred income	(170)	(75)
Net cash inflow from operations	903	658

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

32 Related parties

The Corporation is wholly owned by the Government. The Corporation has entered into transactions with the Government in respect of the developments of the West Rail, Phase I route, East Rail Extensions and Kowloon Southern Link which are considered to be related party transactions under IAS 24 and HKAS 24 and these are disclosed in notes 1, 3(c) and (i), 6, 16(f), 17(b), (c) and (d), 18(b), (c) and (d), 19, 21, 23 and 26 to the financial statements. Transactions with Government departments and agencies in the course of their normal dealings with the Corporation are not considered to be related party transactions.

Members of the Managing Board, the key management who are not Members of the Managing Board and parties related to them are also related parties of the Corporation. During the year there were no significant transactions with any such parties other than their remuneration which is disclosed in note 7 to the financial statements.

MTRCL is considered to be a related party of the Corporation under IAS 24 and HKAS 24 as they share a common shareholder, the Government. The Corporation has entered into transactions with MTRCL since the Appointed Day which are considered to be related party transactions and these are disclosed in notes 2, 3(c), (i), (m) and (x), 5, 6, 10(a), 16(j), (k) and (l), 19, 21, 23 and 28 to the financial statements.

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

- (i) On 15 September 1998, the Government approved the construction of West Rail, Phase I to be undertaken by the Corporation. The West Rail Project Agreement, which set out how the project was to be undertaken and the respective obligations of the Government and the Corporation in terms of the financing, design, construction and operation of West Rail, Phase I, was signed on 23 October 1998. On 24 February 2000, the Corporation and the Government entered into a shareholding agreement for undertaking all property developments along the West Rail, Phase I route (note 21).
- (ii) The Corporation entered into a project agreement for the East Rail Extensions with the Government on 28 February 2003. The project agreement provided for the financing, design, construction and operations of the East Rail Extensions and related services and facilities.
- (iii) The Corporation entered into a project agreement for the financing, design, construction and operation of Kowloon Southern Link with the Government on 6 October 2005. Under the terms of the KSL Project Agreement, the Corporation is responsible for, and will finance the entire capital cost of constructing the Kowloon Southern Link, along with the costs of the removal, replacement, modification or improvement of existing facilities affected by or required as a consequence of the construction of the Kowloon Southern Link.
- (iv) The Corporation accepted an offer from the Government to allow the Corporation to proceed with the development of the site at Ho Tung Lau, Wu Kai Sha and Tai Wai Maintenance Centre in March 2003, October 2005 and July 2006 respectively.

33 Outstanding commitments

- (a) Commitments outstanding in respect of capital expenditure not provided for in the financial statements were as follows:

	2010 \$ million	2009 \$ million
Property, plant and equipment		
– authorised and contracted for	39	283
– authorised but not contracted for	338	342
Interest in leasehold land held for own use under operating leases		
– authorised and contracted for	–	62
– authorised but not contracted for	247	153
Balance at 31 December	624	840

- (b) The total future minimum lease payments under non-cancellable operating leases for property with varying terms and renewal rights are payable as follows:

	2010 \$ million	2009 \$ million
Within one year	–	5

The operating leases are mainly related to work areas used for construction of new railways. In 2009, amounts payable under operating leases totalling \$24 million were capitalised as part of construction in progress or deferred expenditure, as appropriate.

34 Retirement benefit scheme

The Group operates a Mandatory Provident Fund Scheme (“MPF Scheme”) under the Hong Kong Mandatory Provident Fund Schemes Ordinance. The MPF Scheme is a defined contribution retirement plan administrated by independent trustees. Under the MPF Scheme, the employer and its employees are required to make contributions to the plan at 5% of the employees’ relevant income, subject to a cap of monthly relevant income of \$20,000.

NOTES TO THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

35 Debt facilities

(a) Total unutilised debt facilities available to the Group and the Corporation comprise:

	2010 \$ million	2009 \$ million
Short-term uncommitted revolving credit facilities	500	500
Overdraft facilities	30	25
Letters of credit for leveraged leases	2,039	2,429
Revolving loan facility	1,000	1,000
	3,569	3,954

(b) The unutilised debt facilities are expected to expire as follows:

	2010 \$ million	2009 \$ million
Floating rate		
– expiring within one year	530	1,919
– expiring after one year	3,039	2,035
	3,569	3,954

36 Contingent liabilities

At 31 December 2010, the Group had contingent liabilities arising from the land resumption claims and certain contractors' claims in respect of the construction of the Kowloon Southern Link, West Rail and East Rail Extensions projects. The Group has made provision in the financial statements at 31 December 2010 for its best estimate of amounts which are likely to be payable in connection with these claims which the Group is in the process of resolving.

37 Impairment of railway assets

At 31 December 2010, the Group assessed whether there was any indication of impairment of the Group's railway assets at that date in accordance with the Group's accounting policies for the assessment of asset impairment by comparing the key determinant factors, such as inflation, cost of debt, expected return on equity, to those of 2009.

As a result of this assessment, management considers that no indication of impairment of the railway assets of the Group exists at 31 December 2010 and, accordingly, that no provision for impairment of the Group's railway assets is required at that date.

38 Accounting estimates and judgements

(a) Key sources of estimation uncertainty

Note 30 contains information about the assumptions and their risk factors relating to financial instruments. Other key sources of estimation uncertainty include the assessment of useful lives for depreciation of fixed assets (see note 3(j)), assessment of provisions and contingent liabilities (see notes 3(w), 26 and 36), determination of the recoverability of deferred tax assets (see note 12(c)), assessment of the possibility of implementation of the Shatin to Central Link project (see note 18(b)), assessment of the recoverability of the loan to non-controlled subsidiary (see note 21) and assessment of the outstanding risk and obligations in recognition of profit from property development (see note 28).

(b) Critical accounting judgements in applying the Group's accounting policies

Critical accounting judgements in applying the Group's accounting policies include the classification of revenue and expenditure as capital or revenue in nature (see note 3(i)(i)), the classification of revenue and cost-recovery, the classification of operating leases or lease-out and lease-back transactions (see note 3(k)(i) and (y)), transfers from construction in progress to fixed assets (see note 3(m)), assessment of controlled and non-controlled subsidiaries (see note 3(c)), the categorisation of financial assets and liabilities, adoption of hedge accounting (see note 30) and impairment of railway assets (see note 37).

39 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting year ended 31 December 2010

Up to the date of issue of these financial statements, the IASB and HKICPA have issued a number of amendments and Interpretations and one new standard which are not yet effective for the year ended 31 December 2010 and which have not been adopted in these financial statements.

The Group is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Group's and the Corporation's results of operations and financial position.

In addition, the following developments may result in new or amended disclosures in the financial statements:

	Effective for accounting periods beginning on or after
Revised IAS 24 and HKAS 24, Related party disclosures	1 January 2011
IFRS 9 and HKFRS 9, Financial instruments	1 January 2013
Improvements to IFRSs 2010 and HKFRSs 2010	1 July 2010 or 1 January 2011
Amendments to IAS 12 and HKAS 12, Income taxes	1 January 2012

FIVE-YEAR STATISTICS

FINANCIAL (HK\$ million)	2010	2009	2008	2007	2006
Statement of Comprehensive Income					
Turnover	1,013	921	870	5,581	5,622
Operating profit before depreciation, amortisation and impairment	979	828	819	2,793	2,624
Gain on sale of property development rights	-	-	-	4,868	-
Gain on sale of investment properties and other property, plant and equipment	-	-	-	1,318	-
Gain on sales of property management and telecommunication businesses	-	-	-	48	-
Merger-related expenses	-	-	-	(216)	(20)
Net interest and finance expenses/(income)	560	1,178	912	847	316
Profit on property development	-	-	-	-	427
(Loss)/profit before unrealised gains/losses	(2,639)	(3,178)	(2,675)	5,555	430
(Loss)/profit after unrealised gains/losses and taxation	(2,034)	(2,761)	(1,815)	5,321	278
Dividend	-	-	-	-	82
Balance Sheet					
Fixed assets (including interest in leasehold land held for own use under operating leases) Note 1	74,899	76,521	71,757	73,191	65,400
Construction in progress	525	994	6,926	5,509	13,644
Deferred expenditure	1,188	1,613	1,612	1,585	1,389
Properties under development	-	-	-	20	449
Loan to non-controlled subsidiary	4,405	4,405	4,406	4,407	4,022
Investments	435	402	3,095	2,585	-
Cash and cash equivalents	710	8,872	2,493	6,636	1,947
Other assets	1,277	1,129	1,180	951	1,124
Total assets	83,439	93,936	91,469	94,884	87,975
Interest-bearing borrowings	15,117	23,059	17,503	17,857	19,212
Deferred tax liabilities	2,375	2,774	3,356	4,033	3,250
Deferred income	5,873	5,441	5,001	4,566	527
Other liabilities	1,512	2,053	2,252	3,256	5,053
Total liabilities	24,877	33,327	28,112	29,712	28,042
Equity	58,562	60,609	63,357	65,172	59,933
Key financial data					
Return on equity (%)	(3)	(5)	(3)	8	-
Debt/equity ratio	1:3.9	1:2.6	1:3.6	1:3.7	1:3.1
Debt to total capitalisation (%)	21	28	22	22	24
Interest cover (times)	1.6	0.8	0.9	5.9	2.2

Note 1: In 2009, the Corporation reclassified certain floors of Citylink Plaza at Sha Tin Station from being held for own use to investment property as a result of a change in the terms of the land grant. The investment property is stated at cost less accumulated depreciation, which represents a change in accounting policy as prior to 2009 the investment properties had been stated in the balance sheet at fair value. Comparative figures before 2009 have not been restated as it is not meaningful to do so.

For further information, please contact:

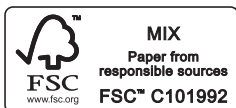
KOWLOON-CANTON RAILWAY CORPORATION

Tel : (852) 2688 1333

Fax : (852) 3124 1073

Address : 8th Floor, Fo Tan Railway House, 9 Lok King Street
Fo Tan, New Territories, Hong Kong

This Annual Report is also available via: www.kcrc.com



This Annual Report is printed on FSC[™]-certified paper using soy-based inks. Pulps used are elemental chlorine-free. This FSC[™] logo identifies products which contain wood from well-managed forests and controlled sources certified in accordance with the rules of the Forest Stewardship Council.