

1 Statement of compliance

These accounts have been prepared in compliance with the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"). These accounts have also been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKAS") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and accounting principles generally accepted in Hong Kong. A summary of the principal accounting policies adopted by the Group is set out in note 2.

The HKICPA has issued certain new and revised HKFRSs that are effective for accounting periods beginning on or after 1 January 2006. Changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these accounts are disclosed in note 2A(iii).

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 50).

2 Principal accounting policies

A Basis of preparation of the accounts

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

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

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

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

Judgements made by management in the application of HKFRSs that have significant effect on the accounts and estimates are discussed in note 49.

(iii) The HKICPA has issued certain new and revised HKFRSs that are effective for accounting periods beginning on or after 1 January 2006. Among those new and revised standards, the Amendment to HKAS 39 "Financial instruments: recognition and measurement on financial guarantee contracts" may have significant changes in the Company's relevant accounting policy for the current accounting period onwards.

In prior years, financial guarantees issued by the Group were disclosed as contingent liabilities in accordance with HKAS 37 "Provisions, contingent liabilities and contingent assets". No provisions were made in respect of these guarantees unless it was more likely than not that the guarantee would be called upon.

With effect from 1 January 2006, in order to comply with the Amendment to HKAS 39, the Group has changed its accounting policy for financial guarantees issued. Under the new policy, material financial guarantee contracts are accounted for as financial liabilities under HKAS 39 and measured initially at fair value, where the fair value can be reliably measured. Subsequently, they are measured at the higher of the amount initially recognised less accumulated amortisation, and the amount of the provision, if any, that should be recognised in accordance with HKAS 37. Further details of the new policy are set out in note 2X. The adoption of this amendment does not have a significant financial impact on the Group's results of operations and financial position for financial years 2005 and 2006.

B Basis of consolidation

The consolidated accounts include the accounts of the Company and its subsidiaries (collectively referred to as the "Group") and the Group's interest in non-controlled subsidiaries (see note 2D) and associates made up to 31 December each year. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from or to the date of their acquisition or disposal, as appropriate.

2 Principal accounting policies (continued)

C Subsidiaries

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

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

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and statement of changes in equity within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated profit and loss account as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.

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

Investments in subsidiaries are carried in the Company's balance sheet at cost less any impairment losses (see note 2G(ii)).

D Non-controlled subsidiaries

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

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

In the Company's balance sheet, its investments in non-controlled subsidiaries are stated at cost less impairment losses (see note 2G(ii)).

E Associates and jointly controlled entities

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

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

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

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

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

In the Company's balance sheet, its investments in associates and jointly controlled entities are stated at cost less impairment losses (see note 2G(ii)).

2 Principal accounting policies *(continued)*

F Fixed assets

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

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

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

(ii) Land held for own use under operating leases and buildings thereon, where the fair values of the leasehold interest in the land and buildings cannot be measured separately at the inception of the lease are accounted for as being held under a finance lease, unless the buildings are also clearly held under an operating lease. The self-occupied land and buildings are stated in the balance sheet at their fair values on the basis of their existing use at the date of revaluation less any subsequent accumulated depreciation. Revaluations are performed by independent qualified valuers every year, with changes in the value arising on revaluations treated as movements in the fixed asset revaluation reserve, except:

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

(iii) Civil works and plant and equipment are stated at cost less accumulated depreciation and impairment losses (see note 2G(ii)).

(iv) Assets under construction are stated at cost less impairment losses (see note 2G(ii)). Cost comprises direct costs of construction, such as materials, staff costs and overheads, together with interest expense capitalised during the period of construction or installation and testing. Capitalisation of these costs ceases and the asset concerned is transferred to the appropriate fixed assets category when substantially all the activities necessary to prepare the asset for its intended use are completed.

(v) Leased assets

(a) Leases of assets under which the lessee assumes substantially all the risks and rewards of ownership are classified as finance leases. Where the Group acquires the use of assets under finance leases, the amounts representing the fair value of the leased asset, or, if lower, the present value of the minimum lease payments (computed using the rate of interest implicit in the lease), of such assets are included in fixed assets and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation and impairment losses are accounted for in accordance with the accounting policy as set out in notes 2H(iv) and 2G(ii) respectively. Finance charges implicit in the lease payments are charged to the profit and loss account over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

(b) Leases of assets, other than that mentioned in note 2F(v)(c) below, under which the lessor has not transferred substantially all the risks and rewards of ownership are classified as operating leases. Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies. Impairment losses are accounted for in accordance with the accounting policies on impairment of assets (see note 2G(ii)). Revenue arising from operating leases is recognised in accordance with the Group's revenue recognition policies as set out in note 2Z(iv).

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

2 Principal accounting policies *(continued)*

F Fixed assets *(continued)*

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

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

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

G Impairment of assets

(i) Impairment of debtors and other receivables

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

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

(ii) Impairment of other assets

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

- fixed assets (other than properties carried at revalued amounts);
- railway construction in progress;
- property development in progress;
- prepaid land lease payments;
- deferred expenditure; and
- investments in subsidiaries, non-controlled subsidiaries, associates and jointly controlled entities.

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

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

An impairment loss is recognised in the profit and loss account whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount.

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

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

2 Principal accounting policies (continued)

H Depreciation

(i) Investment properties are not depreciated.

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

Land and Buildings

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

Civil Works

Excavation and boring Indefinite
 Tunnel linings, underground civil structures, overhead structures and immersed tubes 100 years
 Station building structures 100 years
 Depot structures 80 years
 Concrete kiosk structures 20 years
 Cableway station tower and theme village structures 27 years

Plant and Equipment

Rolling stock and components 4 – 40 years
 Platform screen doors 35 years
 Rail track 7 – 30 years
 Environmental control systems, lifts and escalators, fire protection and drainage system 7 – 30 years
 Power supply systems 7 – 40 years
 Aerial ropeway and cabin 5 – 27 years
 Automatic fare collection systems, metal station kiosks, and other mechanical equipment 20 years
 Train control and signalling equipment, station announcement systems, telecommunication systems and advertising panels 5 – 20 years
 Station architectural finishes 20 – 30 years
 Fixtures and fittings 10 – 15 years
 Maintenance equipment, office furniture and equipment 10 years
 Computer software licences and applications 5 – 7 years
 Cleaning equipment, computer equipment and tools 5 years
 Motor vehicles 4 years

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

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

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

I Construction costs

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

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

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

J Property development

(i) Costs incurred by the Group in respect of site preparation and land costs paid for property development are dealt with as property development in progress.

2 Principal accounting policies *(continued)*

J Property development *(continued)*

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

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

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

(v) Where an interest-free loan is provided to a developer as one of the terms of the development contract, such loan is initially stated at fair value which is its present value discounted at the prevailing market rates of interest at inception. The difference between the fair value and the face value of the loan is dealt with as property development in progress during construction and transferred to the profit and loss account upon completion of the development. Interest income is credited to the profit and loss account and debited to the loan over the period of the loan so that the fair value of the loan at maturity equates to its face value.

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

- where the Group receives payments from developers at the commencement of the project, profits arising from such payments are recognised when the foundation and site enabling works are complete and acceptable for development, and after taking into account the outstanding risks and obligations, if any, retained by the Group in connection with the development;
- where the Group receives a right to a share of the net surplus from sale of the development, income is initially recognised by the Group upon the issue of occupation permits provided the amounts of revenue and costs can be estimated reliably. The interest in any unsold properties is subsequently remeasured on a basis consistent with the policy set out in note 2J(viii); and
- where the Group receives a distribution of the assets of the development, profit is recognised based on the fair value of such assets at the time of receipt and after taking into account any outstanding risks and obligations retained by the Group in connection with the development.

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

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

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

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

K Jointly controlled operations

The arrangements entered into by the Group with developers for property developments without establishing separate entities are considered to be jointly controlled operations pursuant to HKAS 31 "Investments in joint ventures". Under the development arrangements, the Group is normally responsible for its own costs, including in-house staff costs and the costs of enabling works, and the developers normally undertake to pay for all other project costs such as land premium, construction costs, professional fees, etc. Such costs are deductible from the proceeds of sale before surplus proceeds are shared. In respect of its interests in such operations, the Group accounts for the costs of enabling works and land costs paid net of up-front payments received as property development in progress. In cases where up-front payments received from developers exceed the related expenditures incurred by the Group, such excess is recorded as deferred income. Expenses incurred by the Group on staff, overhead and consultancy fees in respect of these developments are also capitalised as property development in progress. The Group's share of income earned from such operations is recognised in the profit and loss account on the basis of note 2J(vi) after netting off any related balance in property development in progress at that time.

2 Principal accounting policies *(continued)*

L Investments in securities

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

- (i) Investments in securities are initially stated at fair value. At each balance sheet date the fair value is remeasured, with any resultant unrealised gain or loss being recognised in the profit and loss account.
- (ii) Investments are recognised/derecognised on the date the Group commits to purchase/sell the investments or they expire.
- (iii) Profit or loss on disposal of investments in securities are determined as the difference between the estimated net disposal proceeds and the carrying amount of the investments and are accounted for in the profit and loss account as they arise.

M Defeasance of long-term lease payments

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

N Stores and spares

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

O Long-term consultancy contracts

The accounting policy for contract revenue is set out in note 2Z(iii). When the outcome of a fixed-price consultancy contract can be estimated reliably, contract costs are recognised as expense by reference to the stage of completion of the contract activity at the balance sheet date. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. When the outcome of a consultancy contract cannot be estimated reliably, contract costs are recognised as an expense in the period in which they are incurred.

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

P Cash and cash equivalents

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

Q Debtors, deposits and payments in advance

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

R Interest-bearing borrowings

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

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

S Creditors, accrued charges and provisions

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

2 Principal accounting policies *(continued)*

T Derivative financial instruments and hedging activities

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

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

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

(i) Fair value hedge

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

(ii) Cash flow hedge

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

Amounts accumulated in equity are transferred to the profit and loss account in the periods when the hedged liability affects earnings. However, when the firm commitment that is hedged results in the recognition of a non-financial asset, the associated gains and losses that were recognised in equity are transferred from equity and included in the initial cost or carrying amount of the asset.

When a hedging instrument expires or is sold, terminated or exercised, or when a hedge no longer meets the criteria for hedge accounting, the cumulative gain or loss existing in equity at that time shall remain in equity and is recognised when the hedged liability affects profit or loss, or when the firm commitment is recognised as a non-financial asset, in accordance with the above policy. However, when a hedged liability or a firm commitment is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the profit and loss account.

(iii) Derivatives that do not qualify for hedge accounting

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

U Employee benefits

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

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

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

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

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

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

2 Principal accounting policies (continued)

U Employee benefits (continued)

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

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

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

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

V Retirement Schemes

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

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

Employer's contributions to the defined contribution section of the MTR Corporation Limited Retirement Scheme and the MPF Scheme are recognised in the accounts in accordance with the policy set out in note 2U(ii).

The employer's contributions paid and payable in respect of employees of the hybrid benefit section of the MTR Corporation Limited Retirement Scheme, as calculated annually by independent actuaries in accordance with the Retirement Scheme Rules and provisions of the Occupational Retirement Schemes Ordinance, are used to satisfy the pension expenses recognised in the accounts according to note 2U(iii). Any deficit or surplus thereof will be dealt with in the balance sheet as accrued or prepaid benefit expenses, as the case may be.

W Income tax

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

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

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

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

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

2 Principal accounting policies *(continued)*

W Income tax *(continued)*

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

The carrying amount of a deferred tax asset is reviewed at each balance sheet date 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. Any 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, and only if, the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

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

X Financial guarantee contracts

Financial guarantees are contracts that require the issuer to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment to the holder when due in accordance with the original or modified terms of a debt instrument.

When the Group issues a financial guarantee, where the effect is material, the fair value of the guarantee (being the transaction price, unless the fair value can otherwise be reliably estimated) after netting of any consideration received or receivable at inception is initially debited to the profit and loss account and recognised as deferred income within creditors, accrued charges and provisions.

The amount of the guarantee initially recognised as deferred income is amortised in the profit and loss account over the term of the guarantee as income from financial guarantees issued. In addition, provisions are recognised in accordance with note 2Y if and when (i) it becomes probable that the holder of the guarantee will call upon the Group under the guarantee, and (ii) the amount of that claim on the Group is expected to exceed the amount currently carried in creditors, accrued charges and provisions in respect of that guarantee, i.e. the amount initially recognised less accumulated amortisation.

Y Provisions and contingent liabilities

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

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

Z Revenue recognition

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

- (i) Fare revenue is recognised when the journey is provided.
- (ii) Advertising income and service fees from telecommunication services provided within the railway are recognised when the services are provided.
- (iii) Contract revenue is recognised when the outcome of a consultancy contract can be estimated reliably. Contract revenue is recognised using the percentage of completion method, measured by reference to the percentage of contract costs incurred to date to estimated total contract costs for the contract. When the outcome of a consultancy contract cannot be estimated reliably, revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable.
- (iv) Rental income from investment properties, station kiosks and other railway premises under operating leases is accounted for in accordance with the terms of the leases. Lease incentives granted are recognised in the profit and loss account as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognised as income in the accounting period in which they are earned. Property management income is recognised when the services are provided.

2 Principal accounting policies (continued)

AA Operating lease charges

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

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

BB Interest and finance charges

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

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

CC Foreign currency translation

Foreign currency transactions during the year are translated into Hong Kong dollars and recorded at exchange rates ruling at the transaction dates. Foreign currency monetary assets and liabilities are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in profit and loss account.

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

DD Segment reporting

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

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

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

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

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

EE Related parties

For the purposes of these accounts, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities including entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

FF Government grants

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

3 Fare revenue

<i>in HK\$ million</i>	2006	2005
Fare revenue comprises:		
MTR Lines	5,911	5,721
Airport Express	612	561
	6,523	6,282

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

4 Non-fare revenue

A Station commercial and other revenue

<i>in HK\$ million</i>	2006	2005
Station commercial and other revenue comprises:		
Advertising	534	510
Kiosk rental	391	344
Telecommunication income	259	334
Consultancy income	199	211
Ngong Ping 360 business revenue	64	–
Miscellaneous business revenue	159	156
	1,606	1,555

Ngong Ping 360 business revenue comprises revenue generated from the Tung Chung cable car operations and related businesses at the Ngong Ping Theme Village, which commenced on 18 September 2006.

B Rental and management income

<i>in HK\$ million</i>	2006	2005
Rental income was attributable to:		
Telford Plaza	492	470
Luk Yeung Galleria	122	120
Paradise Mall	112	111
Maritime Square	281	252
International Finance Centre	128	122
Other properties	128	108
	1,263	1,183
Management income	146	126
Property agency income	3	7
	1,412	1,316

Included in rental income is service income of HK\$64 million (2005: HK\$63 million) relating to the provision of air conditioning services.

5 Operating expenses before depreciation

A Staff costs comprise:

<i>in HK\$ million</i>	2006	2005
Amount charged to profit and loss account under:		
– staff costs and related expenses	1,653	1,614
– repairs and maintenance	58	50
– expenses relating to station commercial and other businesses	145	145
– property ownership and management expenses	40	40
– project study and business development expenses	115	32
– other line items	42	51
Amount capitalised in:		
– railway construction in progress	40	136
– property development in progress	79	76
– assets under construction and other projects	309	261
Amount recoverable	197	166
Total staff costs	2,678	2,571

Included in operating expenses are the following:

<i>in HK\$ million</i>	2006	2005
Share options granted to directors and employees	9	5
Contributions to defined contribution plans and Mandatory Provident Fund	17	12
Expense recognised in respect of defined benefit plans (note 43E)	123	134
	149	151

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

C Project study and business development expenses comprise:

<i>in HK\$ million</i>	2006	2005
Business development expenses	245	129
Miscellaneous project study expenses	22	13
	267	142

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

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

<i>in HK\$ million</i>	2006	2005
Auditors' remuneration		
– audit services	5	4
– tax services	1	1
– other services	–	2
Loss on disposal of fixed assets	37	40
Derivative financial instruments:		
– foreign exchange contracts – ineffective portion of cash flow hedges	(8)	6
– transfer from hedging reserve	1	3
Amortisation of land lease expenses (note 20)	14	13
Unrealised gain on revaluation of investment in securities	(2)	–

5 Operating expenses before depreciation (continued)

E Operating lease expenses charged to the profit and loss account comprise:

<i>in HK\$ million</i>	2006	2005
Shopping centre, office building and staff quarters	46	10
Amount capitalised	(1)	(2)
	45	8

6 Remuneration of Members of the Board and the Executive Directorate

A Remuneration of Members of the Board and the Executive Directorate

(i) The emoluments of the Members of the Board and the Executive Directorate of the Company were as follows:

<i>in HK\$ million</i>	Fees	Base pay, allowances, and benefits in kind	Retirement scheme contribution	Variable remuneration related to performance	Total
2006					
Members of the Board					
– Raymond Ch'ien Kuo-fung	1.0	–	–	–	1.0
– Cheung Yau-kai	0.2	–	–	–	0.2
– David Gordon Eldon	0.2	–	–	–	0.2
– Christine Fang Meng-sang	0.2	–	–	–	0.2
– Edward Ho Sing-tin	0.3	–	–	–	0.3
– Lo Chung-hing	0.2	–	–	–	0.2
– T. Brian Stevenson	0.3	–	–	–	0.3
– Sarah Liao Sau-tung	0.2	–	–	–	0.2
– Frederick Ma Si-hang	0.2	–	–	–	0.2
– Alan Wong Chi-kong	0.2	–	–	–	0.2
Members of the Executive Directorate					
– Chow Chung-kong	–	5.9	–*	4.2	10.1
– Russell John Black	–	3.7	0.3	1.0	5.0
– William Chan Fu-keung	–	3.5	0.3	1.0	4.8
– Thomas Ho Hang-kwong	–	3.6	0.3	0.9	4.8
– Lincoln Leong Kwok-kuen	–	3.5	0.5	1.0	5.0
– Francois Lung Ka-kui	–	3.4	0.4	0.9	4.7
– Andrew McCusker	–	3.5	0.3	0.9	4.7
– Leonard Bryan Turk	–	3.5	0.3	1.0	4.8
	3.0	30.6	2.4	10.9	46.9

* C K Chow is a member of the Company's Mandatory Provident Fund Scheme. The total contributions paid by the Company in each of the years 2005 and 2006 were HK\$12,000.

The above emoluments do not include the fair value of share options granted to Lincoln K K Leong and Francois K K Lung under the Company's New Joiners Share Option Scheme, as estimated at the date of grant. The fair value of share-based payments for Lincoln K K Leong for the year ended 31 December 2006 was HK\$0.3 million (2005: HK\$0.6 million). The options granted to Francois K K Lung lapsed on 17 October 2006 in accordance with the terms of the New Joiners Share Option Scheme and the fair value of his share-based payments for the year ended 31 December 2005 was HK\$0.3 million. The details of directors' interest in the Company's shares are disclosed under the paragraph "Board Members' and Executive Directorate's Interests in Shares" of the Report of the Members of the Board and note 41.

6 Remuneration of Members of the Board and the Executive Directorate (continued)**A Remuneration of Members of the Board and the Executive Directorate** (continued)

In addition, C K Chow does not participate in the Company's two share option schemes. He was entitled to receive an equivalent value in cash of 700,000 shares on completion of his initial three-year contract on 30 November 2006. Pursuant to this contract and following the completion of the contract period, HK\$13,396,600 was paid to C K Chow on 1 December 2006 (note 41B).

The aggregate emoluments of Members of the Board and the Executive Directorate for the year pursuant to section 161 of the Hong Kong Companies Ordinance was HK\$60.6 million (2005: HK\$45.4 million).

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

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

(ii) Non-executive directors of the Company are not appointed for a specific term but are subject (save for those appointed pursuant to Section 8 of the Mass Transit Railway Ordinance (Chapter 556 of the Laws of Hong Kong)) to retirement by rotation and re-election at the Company's annual general meetings in accordance with Articles 87 and 88 of the Company's Articles of Association. Dr. Raymond Ch'ien Kuo-fung, a Member of the Board, was appointed as the non-executive Chairman of the Company with effect from 21 July 2003 for a term of three years. In July 2006, he was re-appointed as the non-executive Chairman of the Company until 31 July 2007. All of the five individuals with the highest emoluments are Members of the Executive Directorate whose emoluments are disclosed above.

(iii) C K Chow has a derivative interest in respect of 418,017 shares within the meaning of Part XV of the Securities and Futures Ordinance. That derivative interest represents C K Chow's entitlement to receive an equivalent value in cash of 418,017 shares on completion of his three-year contract ending on 30 November 2009.

The arrangement was offered in order to provide a competitive level of compensation which is to be closely tied to the performance of the Company.

6 Remuneration of Members of the Board and the Executive Directorate *(continued)*

B Share options

Options exercised and outstanding in respect of each Member of the Executive Directorate as at 31 December 2006 are set out under the paragraph "Board Members' and Executive Directorate's Interests in Shares" of the Report of the Members of the Board. Details of the options granted to Members of the Executive Directorate are as follows:

(i) Pre-Global Offering Share Option Scheme

Under the Company's Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") described in note 41A(i), each Member of the Executive Directorate, except C K Chow, Lincoln K K Leong, Francois K K Lung and Andrew McCusker, was granted options on 20 September 2000 to acquire 1,066,000 shares. C K Chow, Lincoln K K Leong and Francois K K Lung joined the Company on 1 December 2003, 1 February 2002 and 26 September 2005 respectively, and are not beneficiaries of the Pre-IPO Option Scheme. Andrew McCusker was granted 266,500 options on 20 September 2000 under the Pre-IPO Option Scheme and no additional share options were granted upon his appointment as a Member of the Executive Directorate on 1 October 2005.

Under the vesting terms of the Pre-IPO Option Scheme, each eligible Member of the Executive Directorate must continue to beneficially own (i) at all times after 26 October 2001, at least 23,000 shares; and (ii) at all times after 26 October 2002, at least 46,000 shares, in each case, up to and including the date on which he has exercised his option in full or the date on which his option lapses (whichever is earlier).

(ii) New Joiners Share Option Scheme

Under the New Joiners Share Option Scheme ("New Option Scheme") as described in note 41A(ii), Lincoln K K Leong and Francois K K Lung, Members of the Executive Directorate, were granted options to acquire 1,066,000 shares on 1 August 2003 and 27 September 2005 respectively.

Under the vesting terms of the New Option Scheme, Lincoln K K Leong must continue to beneficially own (i) at all times on and after 4 August 2004, at least 23,000 shares; and (ii) at all times on and after 4 August 2005, at least 46,000 shares, up to and including the date on which he has exercised his option in full or the date on which his option lapses (whichever is earlier).

Under the vesting terms of the New Option Scheme, Francois K K Lung was required to beneficially own at all times on and after 17 October 2006, at least 23,000 shares up to and including the date on which he has exercised his option in full or the date on which his option lapses (whichever is earlier). Francois K K Lung's options lapsed on 17 October 2006 in accordance with the terms of the New Option Scheme.

7 Profit on property developments

<i>in HK\$ million</i>	2006	2005
Profit on property developments comprises:		
Transfer from deferred income on		
– up-front payments (note 18B(i))	1,213	1,794
– sharing in kind (note 18B(ii))	555	95
Share of surplus from development	3,724	3,296
Income recognised from sharing in kind	342	971
Other overhead costs	(17)	(11)
	5,817	6,145

8 Depreciation

<i>in HK\$ million</i>	2006	2005
Depreciation comprised charges on:		
Railway operations		
– on fixed assets held under finance leases	19	19
– on other railway fixed assets	2,526	2,502
Assets relating to station commercial and other businesses	82	126
Unallocated corporate assets	47	35
	2,674	2,682

9 Interest and finance charges

<i>in HK\$ million</i>	2006	2005
Interest expenses in respect of:		
Bank loans, overdrafts and capital market instruments wholly repayable within 5 years	1,143	934
Bank loans and capital market instruments not wholly repayable within 5 years	504	485
Obligations under finance leases	15	25
Finance charges	25	33
Exchange (gain)/loss	(2)	7
Derivative financial instruments:		
Fair value hedges	(19)	107
Cash flow hedges:		
– transfer from hedging reserve	(18)	29
– ineffective portion	2	1
Derivatives not qualified as hedges	8	(130)
	(27)	7
Interest expenses capitalised	(126)	(114)
	1,532	1,377
Interest income in respect of:		
Deposits with banks and other financial institutions	(9)	(15)
Staff housing loans	(2)	(1)
	(11)	(16)
Interest income from loan to a property developer	(123)	–
	1,398	1,361

Interest expenses have been capitalised at the average cost of borrowings to the Group calculated on a monthly basis. The average interest rates for each month varied from 5.4% to 5.6% per annum during the year (2005: 4.8% to 5.6% per annum).

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

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

<i>in HK\$ million</i>	2006	2005
Share of profit before taxation of non-controlled subsidiaries (note 21)	80	47
Share of loss of associates (note 23)	(23)	(31)
	57	16
Share of income tax of non-controlled subsidiaries (note 21)	(12)	(7)
	45	9

11 Income tax

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

<i>in HK\$ million</i>	2006	2005
Current tax		
– overseas tax for the year	2	1
Deferred tax		
– origination and reversal of temporary differences on:		
– change in fair value of investment properties	381	490
– others	1,028	1,058
	1,409	1,548
	1,411	1,549

No provision for current Hong Kong Profits Tax has been made in the consolidated profit and loss account in respect of the Company and its subsidiaries, as the Company and its subsidiaries either have substantial accumulated tax losses brought forward which are available for set off against current year's assessable profits or have sustained tax losses for the year ended 31 December 2006. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

Provision for deferred tax on temporary differences arising in Hong Kong is calculated at Hong Kong Profits Tax rate at 17.5% (2005: 17.5%).

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

	2006		2005	
	<i>HK\$ million</i>	%	<i>HK\$ million</i>	%
Profit before tax	9,169		10,012	
Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned	1,584	17.3	1,737	17.3
Tax effect of non-deductible expenses	27	0.3	30	0.3
Tax effect of non-taxable revenue	(230)	(2.5)	(228)	(2.3)
Tax effect of unused tax losses not recognised	30	0.3	10	0.1
Actual tax expenses	1,411	15.4	1,549	15.4

12 Profit attributable to equity shareholders

The consolidated profit attributable to equity shareholders includes a profit of HK\$7,717 million (2005: HK\$8,364 million) which has been dealt with in the accounts of the Company.

13 Dividends

During the year, dividends paid and proposed to equity shareholders of the Company comprised:

<i>in HK\$ million</i>	2006	2005
Dividends paid and payable in respect of 2006		
– Interim dividend of 14 cents (2005: 14 cents) per share	774	764
– Final dividend proposed after the balance sheet date of 28 cents (2005: 28 cents) per share	1,554	1,535
	2,328	2,299
Dividend in respect of 2005		
– Final dividend of 28 cents (2004: 28 cents) per share approved and paid in 2006	1,535	1,509

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

During the year, scrip dividend elections were offered to all shareholders except shareholders with registered addresses in the United States of America or any of its territories or possessions. The Company's majority shareholder, The Financial Secretary Incorporated ("FSI"), had elected to receive part of its entitlement to dividends in the form of scrip to the extent necessary to ensure that the amount payable in cash would not exceed 50% of the total dividend payable. Details of dividends paid to the FSI are disclosed in note 45L. On 8 November 2006, the Government agreed to extend the scrip dividend arrangement for another three financial years until the financial year ending 31 December 2009.

14 Earnings per share

A Basic earnings per share

The calculation of basic earnings per share is based on the profit for the year attributable to equity shareholders of HK\$7,759 million (2005: HK\$8,450 million) and the weighted average number of ordinary shares of 5,510,345,238 in issue during the year (2005: 5,430,594,654), calculated as follows:

Weighted average number of ordinary shares

	2006	2005
Issued ordinary shares at 1 January	5,481,856,439	5,389,999,974
Effect of scrip dividends issued	25,713,468	37,418,279
Effect of share options exercised	2,775,331	3,176,401
Weighted average number of ordinary shares at 31 December	5,510,345,238	5,430,594,654

B Diluted earnings per share

The calculation of diluted earnings per share is based on the profit for the year attributable to equity shareholders of HK\$7,759 million (2005: HK\$8,450 million) and the weighted average number of ordinary shares of 5,516,115,460 in issue during the year (2005: 5,436,752,536) after adjusting for the number of dilutive potential ordinary shares under the employee share option schemes, calculated as follows:

Weighted average number of ordinary shares (diluted)

	2006	2005
Weighted average number of ordinary shares at 31 December	5,510,345,238	5,430,594,654
Number of ordinary shares deemed to be issued for no consideration	5,770,222	6,157,882
Weighted average number of ordinary shares (diluted) at 31 December	5,516,115,460	5,436,752,536

C Both basic and diluted earnings per share would have been HK\$1.08 (2005: HK\$1.13) if the calculation is based on profit from underlying businesses attributable to equity shareholders, i.e. excluding increase in fair value of investment properties net of related deferred tax, adjusted as follows:

<i>in HK\$ million</i>	2006	2005
Profit attributable to equity shareholders	7,759	8,450
Increase in fair value of investment properties	(2,178)	(2,800)
Deferred tax on change in fair value of investment properties (note 11A)	381	490
Profit from underlying businesses attributable to equity shareholders	5,962	6,140

15 Segmental information

Segmental information is presented in accordance with the Group's business segments, which comprise the following:

Railway operations: The operation of an urban mass transit railway system within Hong Kong and an Airport Express serving the Hong Kong International Airport and the AsiaWorld-Expo both at Chek Lap Kok.

15 Segmental information *(continued)*

Station commercial and other businesses: Related commercial activities including letting of advertising and retail space, bandwidth services on the railway telecommunication system, railway consultancy services, cableway and subsidiaries' businesses.

Property ownership and management: Property management and leasing management of investment properties.

Property developments: Property development at locations relating to the railway system.

The results of major business activities are summarised below:

<i>in HK\$ million</i>	Railway operations	Station commercial and other businesses	Property ownership and management	Total railway operations and related activities	Property developments	Total
2006						
Revenue	6,523	1,606	1,412	9,541	–	9,541
Operating expenses before depreciation	(3,003)	(443)	(312)	(3,758)	–	(3,758)
	3,520	1,163	1,100	5,783	–	5,783
Profit on property developments	–	–	–	–	5,817	5,817
Operating profit before depreciation	3,520	1,163	1,100	5,783	5,817	11,600
Depreciation	(2,541)	(82)	(4)	(2,627)	–	(2,627)
	979	1,081	1,096	3,156	5,817	8,973
Unallocated corporate expenses						(629)
Operating profit before interest and finance charges						8,344
Interest and finance charges						(1,398)
Change in fair value of investment properties			2,178			2,178
Share of profits less losses of non-controlled subsidiaries and associates						45
Income tax						(1,411)
Profit for the year ended 31 December 2006						7,758
Assets						
Operational assets *	76,097	2,503	22,971	101,571	825	102,396
Assets under construction	1,037	9	63	1,109	3,796	4,905
Railway construction in progress	232	–	–	232	–	232
Property development in progress	–	–	–	–	3,297	3,297
Deferred expenditure	395	–	–	395	–	395
Prepaid land lease payments	594	–	–	594	–	594
Investments in securities	272	–	–	272	–	272
Properties held for sale	–	–	–	–	2,018	2,018
Loan to a property developer	–	–	–	–	3,355	3,355
	78,627	2,512	23,034	104,173	13,291	117,464
Interests in non-controlled subsidiaries						171
Interests in associates						100
Unallocated assets						2,686
Total assets						120,421
Liabilities						
Segmented liabilities	1,988	511	711	3,210	623	3,833
Deferred income	120	–	–	120	1,562	1,682
	2,108	511	711	3,330	2,185	5,515
Unallocated liabilities						38,120
Total liabilities						43,635
Other Information						
Capital expenditure on:						
Operational assets	64	4	470	538	–	538
Assets under construction	1,075	116	63	1,254	898	2,152
Railway construction in progress	430	–	–	430	–	430
Property development in progress	–	–	–	–	1,113	1,113
Non-cash expenses other than depreciation	37	11	–	48	–	48

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

15 Segmental information (continued)

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

As substantially all the principal operating activities of the Group were carried out in Hong Kong throughout the reporting periods, no geographical analysis is provided.

16 Fixed assets

The Group

<i>in HK\$ million</i>	Investment properties	Self-occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation						
At 1 January 2006	19,892	1,705	46,188	56,339	3,661	127,785
Additions	469	–	–	69	2,152	2,690
Disposals/Write-offs	–	–	(20)	(370)	(2)	(392)
Change in fair value	2,178	–	–	–	–	2,178
Surplus on revaluation (note 40)	–	284	–	–	–	284
Tung Chung Cable Car Project commissioned (note 17)	–	–	375	824	–	1,199
Other assets commissioned	–	–	1	905	(906)	–
At 31 December 2006	22,539	1,989	46,544	57,767	4,905	133,744
At Cost	–	–	46,544	57,767	4,905	109,216
At 31 December 2006 Valuation	22,539	1,989	–	–	–	24,528
Aggregate depreciation						
At 1 January 2006	–	–	3,492	21,018	–	24,510
Charge for the year	–	45	380	2,249	–	2,674
Written back on disposal	–	–	(8)	(330)	–	(338)
Written back on revaluation (note 40)	–	(45)	–	–	–	(45)
At 31 December 2006	–	–	3,864	22,937	–	26,801
Net book value at 31 December 2006	22,539	1,989	42,680	34,830	4,905	106,943
Cost or Valuation						
At 1 January 2005	16,687	1,246	45,704	55,081	3,051	121,769
Additions	405	–	–	44	1,727	2,176
Capitalisation adjustments *	–	–	(2)	(76)	–	(78)
Disposals/Write-offs	–	–	(2)	(275)	(3)	(280)
Change in fair value	2,800	–	–	–	–	2,800
Surplus on revaluation (note 40)	–	459	–	–	–	459
Reclassification	–	–	175	(175)	–	–
Disneyland Resort Line and AsiaWorld-Expo Station Projects commissioned (note 17)	–	–	176	763	–	939
Other assets commissioned	–	–	137	977	(1,114)	–
At 31 December 2005	19,892	1,705	46,188	56,339	3,661	127,785
At Cost	–	–	46,188	56,339	3,661	106,188
At 31 December 2005 Valuation	19,892	1,705	–	–	–	21,597
Aggregate depreciation						
At 1 January 2005	–	–	3,093	18,984	–	22,077
Charge for the year	–	33	395	2,258	–	2,686
Capitalisation adjustments *	–	–	–	(4)	–	(4)
Written back on disposal	–	–	(1)	(215)	–	(216)
Written back on revaluation (note 40)	–	(33)	–	–	–	(33)
Reclassification	–	–	5	(5)	–	–
At 31 December 2005	–	–	3,492	21,018	–	24,510
Net book value at 31 December 2005	19,892	1,705	42,696	35,321	3,661	103,275

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

16 Fixed assets (continued)**The Company**

<i>in HK\$ million</i>	Investment properties	Self-occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation						
At 1 January 2006	19,892	1,705	46,188	55,676	3,637	127,098
Additions	469	–	–	65	2,069	2,603
Disposals/Write-offs	–	–	(20)	(241)	(2)	(263)
Change in fair value	2,178	–	–	–	–	2,178
Surplus on revaluation (note 40)	–	284	–	–	–	284
Tung Chung Cable Car Project commissioned (note 17)	–	–	375	824	–	1,199
Other assets commissioned	–	–	1	871	(872)	–
At 31 December 2006	22,539	1,989	46,544	57,195	4,832	133,099
At Cost	–	–	46,544	57,195	4,832	108,571
At 31 December 2006 Valuation	22,539	1,989	–	–	–	24,528
Aggregate depreciation						
At 1 January 2006	–	–	3,492	20,428	–	23,920
Charge for the year	–	45	380	2,216	–	2,641
Written back on disposal	–	–	(8)	(204)	–	(212)
Written back on revaluation (note 40)	–	(45)	–	–	–	(45)
At 31 December 2006	–	–	3,864	22,440	–	26,304
Net book value at 31 December 2006	22,539	1,989	42,680	34,755	4,832	106,795
Cost or Valuation						
At 1 January 2005	16,687	1,246	45,704	54,414	3,045	121,096
Additions	405	–	–	30	1,709	2,144
Capitalisation adjustments *	–	–	(2)	(76)	–	(78)
Disposals/Write-offs	–	–	(2)	(257)	(3)	(262)
Change in fair value	2,800	–	–	–	–	2,800
Surplus on revaluation (note 40)	–	459	–	–	–	459
Reclassification	–	–	175	(175)	–	–
Disneyland Resort Line and AsiaWorld-Expo Station Projects commissioned (note 17)	–	–	176	763	–	939
Other assets commissioned	–	–	137	977	(1,114)	–
At 31 December 2005	19,892	1,705	46,188	55,676	3,637	127,098
At Cost	–	–	46,188	55,676	3,637	105,501
At 31 December 2005 Valuation	19,892	1,705	–	–	–	21,597
Aggregate depreciation						
At 1 January 2005	–	–	3,093	18,471	–	21,564
Charge for the year	–	33	395	2,180	–	2,608
Capitalisation adjustments *	–	–	–	(4)	–	(4)
Written back on disposal	–	–	(1)	(214)	–	(215)
Written back on revaluation (note 40)	–	(33)	–	–	–	(33)
Reclassification	–	–	5	(5)	–	–
At 31 December 2005	–	–	3,492	20,428	–	23,920
Net book value at 31 December 2005	19,892	1,705	42,696	35,248	3,637	103,178

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

16 Fixed assets (continued)

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

The Group and The Company

in HK\$ million	Investment properties		Self-occupied land and buildings	
	2006	2005	2006	2005
Long leases	1,437	1,399	–	–
Medium-term leases	21,102	18,493	1,989	1,705
	22,539	19,892	1,989	1,705

B All investment properties of the Group were revalued at open market value at 31 December 2006 by an independent firm of surveyors, DTZ Debenham Tie Leung, who have among their staff Members of the Hong Kong Institute of Surveyors. The valuations are based on a "term and reversion basis", which capitalises the existing and reversionary net rental income having regard to market valuation checks on comparable sale and yields. The net increase in fair value of HK\$2,178 million (2005: HK\$2,800 million) arising from the revaluation has been credited to the profit and loss account.

C All self-occupied land and buildings were revalued at open market value on an existing use basis at 31 December 2006 by an independent firm of surveyors, DTZ Debenham Tie Leung, who have among their staff Members of the Hong Kong Institute of Surveyors. The valuation resulted in a net revaluation surplus of HK\$329 million (2005: HK\$492 million), which net of deferred tax of HK\$58 million (2005: HK\$86 million) (note 38B), has been transferred to the fixed asset revaluation reserve account (note 40).

The carrying amount of the self-occupied land and buildings at 31 December 2006 would have been HK\$892 million (2005: HK\$914 million) had the land and buildings been stated at cost less accumulated depreciation.

D Assets under construction include a partially renovated shell of the retail shopping centre at Union Square, Kowloon Station and its car parking spaces received by the Company as a sharing in kind from the development. The properties under construction are stated at cost, which is deemed to be the fair value upon receipt (note 2J(ix)) determined by reference to an open market valuation undertaken by an independent firm of surveyors, Jones Lang LaSalle, who have among their staff Members of the Hong Kong Institute of Surveyors.

E In addition to the self-occupied land and buildings treated as being held under finance leases in note 16A above, the Group has the following assets held under agreements which are treated as finance leases:

The Group and The Company

in HK\$ million	Civil works Eastern Harbour Crossing	
	2006	2005
Cost	1,254	1,254
Less: Aggregate depreciation	307	288
Net book value	947	966

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

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

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

16 Fixed assets (continued)

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

The gross carrying amounts of investment properties of the Group and the Company held for use in operating leases were HK\$22,539 million (2005: HK\$19,892 million). The gross carrying amounts of station kiosks held for use in operating leases were HK\$439 million (2005: HK\$446 million) and the related accumulated depreciation charges were HK\$108 million (2005: HK\$95 million).

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

The Group and The Company

<i>in HK\$ million</i>	2006	2005
Within 1 year	1,350	1,295
After 1 year but within 5 years	1,875	2,025
Later than 5 years	161	214
	3,386	3,534

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

As a result of the Lease Transaction, the Group received total cash of approximately HK\$3,688 million and committed to long-term lease payments with an estimated net present value in March 2003 of approximately HK\$3,533 million, which have been defeased by purchase of debt securities to meet the payment obligations. The Group received in 2003 the cash amount of HK\$141 million net of costs from the Lease Transaction.

As the Group is not able to control the investment account in pursuit of its own objectives and its obligations to pay the lease payments are funded by the proceeds of the above investments, those liabilities and investments in debt securities are not recognised in March 2003 as obligations and assets of the Group. The net amount of cash received by the Group has been accounted for as deferred income and is being amortised to the Group's profit and loss account over the terms of the respective leases.

17 Railway construction in progress

The Group and The Company

<i>in HK\$ million</i>	Balance at 1 Jan	Expenditure	Capitalised on commissioning (note 16)	Transfer to stores and spares	Balance at 31 Dec
2006					
Tseung Kwan O South Station Project					
Construction costs	18	99	-	-	117
Consultancy fees	8	2	-	-	10
Staff costs and other expenses	16	27	-	-	43
Finance costs	1	4	-	-	5
	43	132	-	-	175
Tung Chung Cable Car Project					
Construction costs	755	193	(943)	(5)	-
Consultancy fees	51	24	(75)	-	-
Staff costs and other expenses	79	15	(94)	-	-
Finance costs	48	39	(87)	-	-
	933	271	(1,199)	(5)	-
SkyPlaza Platform Project					
Construction costs	24	16	-	-	40
Staff costs and other expenses	6	8	-	-	14
Finance costs	-	3	-	-	3
	30	27	-	-	57
Total	1,006	430	(1,199)	(5)	232
2005					
Tseung Kwan O South Station Project					
Construction costs	1	17	-	-	18
Consultancy fees	1	7	-	-	8
Staff costs and other expenses	5	11	-	-	16
Finance costs	-	1	-	-	1
	7	36	-	-	43
Disneyland Resort Line Project					
Construction costs	1,074	185	(1,259)	-	-
Consultancy fees	46	5	(51)	-	-
Staff costs and other expenses	279	74	(353)	-	-
Finance costs	10	14	(24)	-	-
	1,409	278	(1,687)	-	-
Government grant (note 45E)	(931)	-	931	-	-
	478	278	(756)	-	-
Tung Chung Cable Car Project					
Construction costs	336	419	-	-	755
Consultancy fees	37	14	-	-	51
Staff costs and other expenses	57	22	-	-	79
Finance costs	14	34	-	-	48
	444	489	-	-	933
AsiaWorld-Expo Station Project					
Construction costs	16	124	(140)	-	-
Staff costs and other expenses	16	23	(39)	-	-
Finance costs	1	3	(4)	-	-
	33	150	(183)	-	-
SkyPlaza Platform Project					
Construction costs	-	24	-	-	24
Staff costs and other expenses	-	6	-	-	6
Finance costs	-	-	-	-	-
	-	30	-	-	30
Total	962	983	(939)	-	1,006

17 Railway construction in progress *(continued)*

A Tseung Kwan O South Station Project

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

The main civil contract and associated electrical and mechanical contracts have been awarded and the construction works are in progress. The project is on programme and scheduled for completion in 2009. The capital cost for the project based on the defined scope of works and programme is estimated at approximately HK\$1 billion.

At 31 December 2006, the Company had incurred expenditure of HK\$175 million (2005: HK\$43 million) on the project and had authorised outstanding commitments on contracts totalling HK\$321 million (2005: HK\$12 million) related to the project.

B Tung Chung Cable Car Project

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

The project was completed in mid 2006 and started to serve the public on 18 September 2006. Negotiation on the final accounts with various contractors is in progress. It is estimated that the total cost of the project will be approximately HK\$1.2 billion.

C SkyPlaza Platform Project

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

The project construction work is nearly completed with target opening in the first half of 2007. The capital cost for the project based on the defined scope of works and programme is estimated at approximately HK\$0.1 billion.

At 31 December 2006, the Company had incurred expenditure of HK\$57 million (2005: HK\$30 million) on the project and had authorised outstanding commitments on contracts totalling HK\$2 million (2005: HK\$14 million) related to the project.

18 Property development in progress

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

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

Costs of foundation, site enabling works and land costs incurred by the Company are capitalised as property development in progress and payments received from developers are credited to property development in progress to offset costs incurred in respect of the same development. In cases where payments received from developers exceed the related expenditure incurred by the Company, such excess is recorded as deferred income (note 18B(i)). In these cases, any subsequent expenditure incurred by the Company in respect of that development will be charged against deferred income. Deferred income is to be recognised as profits of the Company at the appropriate time after charging any remaining costs related to foundation and site enabling works, and after taking into account the outstanding risks and obligations retained by the Company relating to each development. Until such time as deferred income is recognised as profit, it is recorded as a liability of the Company in recognition of the Company's obligations under the Land Grant.

The Tseung Kwan O Extension ("TKE") Project Agreement entered into in 1998 between the then Secretary for Transport, for and on behalf of the Government, and the Company in respect of the construction of the Tseung Kwan O Extension provides the Company with the right to undertake property developments at four station and depot sites along the Tseung Kwan O Line ("Tseung Kwan O Extension Property Projects") under separate land grant agreements. The basis of accounting for development costs incurred by the Company and payment related thereto is consistent with that for the property developments along the Airport Railway.

18 Property development in progress (continued)

A Property development in progress

The Group and The Company

<i>in HK\$ million</i>	Balance at 1 Jan	Expenditure	Offset against payments received from developers (note 18B(i))	Transfer out on project completion	Balance at 31 Dec
2006					
Airport Railway Property Projects	–	106	(106)	–	–
Tseung Kwan O Extension Projects	2,756	1,007	(452)	(14)	3,297
	2,756	1,113	(558)	(14)	3,297
2005					
Airport Railway Property Projects	–	210	(152)	(58)	–
Tseung Kwan O Extension Projects	2,043	1,241	(528)	–	2,756
Other property projects	45	4	(27)	(22)	–
	2,088	1,455	(707)	(80)	2,756

Included in the amount for Tseung Kwan O Extension Projects is HK\$768 million (2005: nil) in connection with the Company's interest-free loan of HK\$4,000 million extended to the developer of Package 2, Tseung Kwan O Area 86 property development project in 2006 (note 30).

B Deferred income on property development

The Group and The Company

<i>in HK\$ million</i>	2006	2005
Deferred income on property development comprises:		
– Up-front payments received from developers (note 18B(i))	1,120	2,461
– Sharing in kind (note 18B(ii))	442	997
	1,562	3,458

(i) Deferred income on up-front payments

The Group and The Company

<i>in HK\$ million</i>	Balance at 1 Jan	Payments received from developers	Offset against property development in progress (note 18A)	Amount recognised as profit (note 7)	Balance at 31 Dec
2006					
Airport Railway Property Projects	2,419	20	(106)	(1,213)	1,120
Tseung Kwan O Extension Property Projects	42	410	(452)	–	–
	2,461	430	(558)	(1,213)	1,120
2005					
Airport Railway Property Projects	3,409	956	(152)	(1,794)	2,419
Tseung Kwan O Extension Property Projects	5	565	(528)	–	42
Other property projects	–	27	(27)	–	–
	3,414	1,548	(707)	(1,794)	2,461

18 Property development in progress (continued)**B Deferred income on property development** (continued)*(ii) Deferred income on sharing in kind*

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

The Group and The Company

<i>in HK\$ million</i>	2006	2005
Balance as at 1 January	997	1,092
Less: Amount recognised as profit (note 7)	(555)	(95)
Balance as at 31 December	442	997

C Stakeholding funds

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

The Group and The Company

<i>in HK\$ million</i>	2006	2005
Balance as at 1 January	3,478	4,064
Stakeholding funds received and receivable	22,843	15,599
Add: Interest earned thereon	176	111
	26,497	19,774
Disbursements during the year	(19,637)	(16,296)
Balance as at 31 December	6,860	3,478
<i>Represented by:</i>		
Balances in designated bank accounts as at 31 December	6,858	3,476
Retention receivable	2	2
	6,860	3,478

19 Deferred expenditure

The Group

<i>in HK\$ million</i>	Balance at 1 Jan	Expenditure during the year	Balance at 31 Dec
2006			
Merger studies	72	98	170
Expenditure on proposed capital projects	209	186	395
	281	284	565
2005			
Merger studies	56	16	72
Expenditure on proposed capital projects	78	131	209
	134	147	281

The Company

<i>in HK\$ million</i>	Balance at 1 Jan	Expenditure during the year	Balance at 31 Dec
2006			
Merger studies	72	98	170
Expenditure on proposed capital projects	43	70	113
	115	168	283
2005			
Merger studies	56	16	72
Expenditure on proposed capital projects	27	16	43
	83	32	115

Merger studies comprise external consultancy, incremental direct staff costs and expenses in relation to the studies on the proposed merger between the Company and Kowloon-Canton Railway Corporation.

The expenditure incurred on the proposed capital projects for the year mainly relates to design works for the Shenzhen Metro Line 4 Project in China and the West Island Line Project in Hong Kong.

20 Prepaid land lease payments**The Group and The Company**

<i>in HK\$ million</i>	2006	2005
Cost		
At 1 January	732	732
Addition	–	–
At 31 December	732	732
Accumulated amortisation		
At 1 January	124	111
Charge for the year	14	13
At 31 December	138	124
Net book value at 31 December	594	608

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

The Group and The Company

<i>in HK\$ million</i>	2006	2005
At net book value		
– long leases	157	160
– medium-term leases	437	448
	594	608

B The lease of the land on which the civil works, plant and equipment are situated for the operation of the railway was granted to the Company under a running line lease for the period up to 29 June 2050 which can be extended for further periods of 50 years at nominal payment (note 45C).

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

21 Interests in non-controlled subsidiaries

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Unlisted shares, <i>at cost</i>	–	–	24	24
Share of net assets	171	103	–	–
	171	103	24	24

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

Name of company	Issued and paid up ordinary share capital	Proportion of ownership interest			Place of incorporation and operation	Principal activities
		Group's effective interest	Held by the Company	Held by subsidiary		
Octopus Holdings Limited	HK\$42,000,000	57.4%	57.4%	–	Hong Kong	Investment holding
Octopus Cards Limited	HK\$42,000,000	57.4%	–	100%	Hong Kong	Operate a contactless smartcard common payment system in Hong Kong
Octopus Connect Limited	HK\$2	57.4%	–	100%	Hong Kong	Customer relationship management service
Octopus Investments Limited	HK\$2	57.4%	–	100%	Hong Kong	Investment holding
Octopus Knowledge Limited	HK\$2	57.4%	–	100%	Hong Kong	Marketing and management of overseas automatic fare collection consultancy projects
Octopus Netherlands Limited	HK\$1	57.4%	–	100%	Hong Kong	Consultancy services on introducing a smart card system in the Netherlands
Octopus Rewards Limited	HK\$1	57.4%	–	100%	Hong Kong	Operate a common loyalty scheme
Octopus Cards Macau Limited	MOP25,000	57.4%	–	100%	Macau	Promote the contactless smartcard common payment system in Macau
Octopus Cards (NL) B.V.	EUR18,000	57.4%	–	100%	Netherlands	Project management on introducing a smart card system in the Netherlands

21 Interests in non-controlled subsidiaries *(continued)*

In June 1994, the Company entered into an agreement with four local transport companies, Kowloon-Canton Railway Corporation, The Kowloon Motor Bus Company (1933) Limited (subsequently replaced by KMB Public Bus Services Holdings Limited), Citybus Limited and The Hongkong and Yaumati Ferry Co., Limited (subsequently replaced by New World First Bus Services Limited and New World First Ferry Services Limited), to incorporate a company, Creative Star Limited, now Octopus Cards Limited ("OCL"), to undertake the development and operation of the "Octopus" contactless smart card ticketing system, which was initially used by the shareholding transport companies. Although the Company currently holds a 57.4% interest in the issued shares of OCL, its appointees to the Board of Directors of OCL are limited to 49% of the voting rights at board meetings. The shareholders have agreed to provide the necessary funding to OCL for its operations and for the development of the "Octopus" system.

On 20 April 2000, OCL received approval from The Hong Kong Monetary Authority ("HKMA") to become a deposit-taking company ("DTC") for purposes of extending the use of Octopus cards to a wider range of services, including those that are non-transport related. Prior to becoming a DTC, the Octopus card was exempted from the definition of "multi-purpose card" under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) on the basis that its use was restricted to transport related services only.

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

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

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

During the year ended 31 December 2006, a total amount of HK\$56 million (2005: HK\$54 million) was paid by the Company to OCL in respect of the central clearing services provided by OCL to the Company. During the same period, load agent fees and fees for handling Octopus card issuance and refund amounting to HK\$9 million (2005: HK\$9 million) and HK\$5 million (2005: HK\$5 million) respectively were received from OCL in respect of services and facilities provided by the Company at various MTR stations.

During the year, services fees amounting to HK\$2 million (2005: HK\$2 million) were also received from OCL in respect of rental of computer equipment and services and warehouse storage space payable to the Company under a service agreement.

21 Interests in non-controlled subsidiaries (continued)

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

Consolidated profit and loss account

Year ended 31 December in HK\$ million	2006 (Audited)	2005 (Audited)
Turnover	382	332
Other operating income	23	22
	405	354
Staff costs	(99)	(78)
Load agent fees and bank charges for add value services	(54)	(47)
Other expenses	(97)	(100)
Operating profit before depreciation	155	129
Depreciation	(70)	(89)
Operating profit before interest and finance charges	85	40
Net interest income	55	41
Profit before taxation	140	81
Income tax	(22)	(12)
Profit for the year	118	69
Group's share of profit before taxation (note 10)	80	47
Group's share of income tax (note 10)	(12)	(7)

Consolidated balance sheet

at 31 December in HK\$ million	2006 (Audited)	2005 (Audited)
Assets		
Fixed assets	156	158
Investments	1,521	1,210
Cash at banks and on hand	314	336
Other assets	190	129
	2,181	1,833
Liabilities		
Card floats and card deposits due to cardholders	(1,446)	(1,311)
Amounts due to shareholders	(65)	(41)
Other liabilities	(373)	(301)
	(1,884)	(1,653)
Net assets	297	180
Equity		
Share capital	42	42
Retained profits	255	138
	297	180
Group's share of net assets	171	103

22 Investments in subsidiaries

The Company

<i>in HK\$ million</i>	2006	2005
Unlisted shares, <i>at cost</i>	187	185
Less: Impairment losses	3	3
	184	182

Investments in subsidiaries include HK\$24 million (2005: HK\$24 million) in respect of investments in non-controlled subsidiaries, the relevant details of which are disclosed in note 21. The following list contains details of controlled subsidiaries as defined under note 2C as at 31 December 2006, which have been consolidated into the Group's financial statements.

Name of company	Issued and paid up ordinary/registered share capital	Proportion of ownership interest			Place of incorporation and operation	Principal activities
		Group's effective interest	Held by the Company	Held by subsidiary		
Glory Goal Limited	HK\$10,000	100%	100%	–	Hong Kong	Investment holding
MTR (Shanghai Project Management) Limited	HK\$1,000	100%	100%	–	Hong Kong	Railway consultancy services, property investment and development
MTR Beijing Line 4 Investment Company Limited	HK\$1	100%	100%	–	Hong Kong	Investment holding
MTR China Consultancy Company Limited	HK\$1,000	100%	100%	–	Hong Kong	Railway consultancy services
MTR China Property Limited	HK\$1,000	100%	100%	–	Hong Kong	Property management
MTR Engineering Services Limited	HK\$1,000	100%	100%	–	Hong Kong	Engineering services
MTR Property Agency Co. Limited	HK\$2	100%	100%	–	Hong Kong	Property agency
MTR Rail Transport Training (International) Company Limited	HK\$2,800,000	100%	100%	–	Hong Kong	Provide rail transport training
MTR Shenzhen Investment Holding Limited	HK\$400,000	100%	100%	–	Hong Kong	Investment holding
MTR Telecommunication Company Limited	HK\$100,000,000	100%	100%	–	Hong Kong	Radio communication services
MTR Travel Limited	HK\$2,500,000	100%	100%	–	Hong Kong	Travel services
Rail Sourcing Solutions (International) Limited	HK\$2	100%	100%	–	Hong Kong	Global railway supply and sourcing services
TraxComm Limited	HK\$15,000,000	100%	100%	–	Hong Kong	Fixed telecommunication network services
Hong Kong Cable Car Limited *	HK\$1,000	100%	100%	–	Hong Kong	Dormant
Lantau Cable Car Limited *	HK\$1,000	100%	100%	–	Hong Kong	Dormant
MTR (Estates Management) Limited *	HK\$1,000	100%	100%	–	Hong Kong	Dormant
MTR (Shanghai Metro Management) Limited *	HK\$1,000	100%	100%	–	Hong Kong	Dormant
Candiman Limited *	US\$1	100%	100%	–	British Virgin Islands	Investment holding
Fasttrack Insurance Ltd.	HK\$77,500,000	100%	100%	–	Bermuda	Insurance underwriting

22 Investments in subsidiaries (continued)

Name of company	Issued and paid up ordinary/registered share capital	Proportion of ownership interest			Place of incorporation and operation	Principal activities
		Group's effective interest	Held by the Company	Held by subsidiary		
MTR Corporation (C.I.) Limited	US\$1,000	100%	100%	–	Cayman Islands/ Hong Kong	Finance
MTR Finance Lease (001) Limited *	US\$1	100%	100%	–	Cayman Islands/ Hong Kong	Finance
Chongqing Premier Property Management Co. Ltd. * (Incorporated)	US\$150,000	70%	–	70%	The People's Republic of China	Property management
MTR (Beijing) Commercial Facilities Management Co. Ltd. (Incorporated)	HK\$93,000,000	100%	–	100%	The People's Republic of China	Property management
MTR (Beijing) Property Services Co. Limited * (Incorporated)	RMB3,000,000	100%	100%	–	The People's Republic of China	Property management
MTR Consultancy (Beijing) Co. Ltd. (Incorporated)	HK\$1,000,000	100%	100%	–	The People's Republic of China	Railway consultancy services, marketing and promotion
MTR Consulting (Shenzhen) Co. Ltd. (Incorporated)	HK\$1,000,000	100%	100%	–	The People's Republic of China	Railway consultancy services
MTR Corporation (Shenzhen) Limited (Incorporated)	HK\$250,000,000	100%	–	100%	The People's Republic of China	Conduct early-stage preparatory work for Shenzhen Metro Line 4 project
Shanghai Hong Kong Metro Construction Management Co. Ltd. (Incorporated)	HK\$15,000,000	60%	–	60%	The People's Republic of China	Railway construction management and development
MTR Corporation (IKF) Limited	GBP29	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (No.2) Limited	GBP1	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (Silverlink) Limited *	GBP1	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (SWT) Limited *	GBP1	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (UK) Limited	GBP29	100%	100%	–	United Kingdom	Investment holding
Rail Sourcing Solutions (UK) Limited *	GBP1	100%	–	100%	United Kingdom	Railway supply and sourcing services

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

During the year, Shenzhen Donghai Anbo Property Management Co. Ltd. has been disposed of at a consideration of HK\$1.5 million, which was equivalent to the company's net book value at the time of the disposal.

23 Interests in associates**The Group**

<i>in HK\$ million</i>	2006	2005
Share of net assets	100	–

The Group and the Company had interests in the following associates as at 31 December 2006:

Name of company	Issued and paid up ordinary/registered share capital	Proportion of ownership interest			Place of incorporation and operation	Principal activities
		Group's effective interest	Held by the Company	Held by subsidiary		
Beijing MTR Corporation Limited (Incorporated)	RMB1,380,000,000	49%	–	49%	The People's Republic of China	Railway construction, management and development
Great South Eastern Railway Limited *	GBP100	29%	–	29%	United Kingdom	Bidding vehicle
MTR Laing Metro Limited *	GBP2	50%	–	50%	United Kingdom	Bidding vehicle
MTR Laing Railway Company Limited *	GBP2	50%	–	50%	United Kingdom	Bidding vehicle
South Western Railway Limited *	GBP2	50%	–	50%	United Kingdom	Bidding vehicle

* Companies not audited by KPMG.

The registered share capital of Beijing MTR Corporation Limited is RMB1,380 million of which 49% (RMB 676 million) is to be contributed by the Group. As of 31 December 2006, the Group has made an equity contribution of HK\$100 million, representing about 15% of the registered capital committed by the Group.

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

<i>in HK\$ million</i>	2006	2005
Non-current assets	185	–
Current assets	6	2
Non-current liabilities	(25)	–
Current liabilities	(105)	(33)
Net assets/(liabilities)	61	(31)
Income	–	–
Expenses	(23)	(31)
Loss for the year	(23)	(31)

23 Interests in associates (continued)

The above financial information included the results of Beijing MTR Corporation Limited, whose condensed profit and loss account and the balance sheet are shown below:

Profit and loss account

For the period from 16 January 2006 (date of incorporation) to 31 December 2006 in HK\$ million	(Unaudited)
Net loss for the period	-
Group's share of loss for the period	-

Balance sheet

at 31 December 2006 in HK\$ million	(Unaudited)
Assets	
Fixed assets	6
Construction in progress	372
Other assets	10
	388
Liabilities	
Creditors, accrued charges and provisions	(48)
Loans	(135)
	(183)
Net assets	205
Equity	
Share capital	202
Exchange reserve	3
	205
Group's share of net assets	100

24 Investments in securities

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

The Group

in HK\$ million	2006	2005
Trading securities listed overseas, at fair value		
– maturing within 1 year	35	23
– maturing after 1 year	237	160
	272	183

25 Staff housing loans

The Group and The Company

<i>in HK\$ million</i>	2006	2005
Balance at 1 January	34	47
Redemption	(5)	(8)
Repayment	(4)	(5)
Balance at 31 December	25	34

The Group and The Company

<i>in HK\$ million</i>	2006	2005
Amounts receivable:		
– within 1 year	4	5
– after 1 year	21	29
	25	34

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

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

26 Properties held for sale

The Group and The Company

<i>in HK\$ million</i>	2006	2005
Properties held for sale		
– at cost	876	1,090
– at net realisable value	1,142	221
	2,018	1,311

Properties held for sale at 31 December 2006 comprised mainly residential units, retail and car parking spaces at the Olympic Station, Kowloon Station, Tiu Keng Leng Station and Tseung Kwan O Area 55b and Area 57a developments, while those held for sale at 31 December 2005 comprised mainly properties at Olympic Station, Kowloon Station and Hang Hau Station. They represent either properties received by the Company as sharing in kind or as part of the profit distribution upon completion of the development and the attributable interest in unsold units of shared surplus developments for which occupation permits have been issued. The properties are stated in the balance sheet at the lower of cost, which is deemed to be their fair value upon initial recognition as determined by reference to an independent open market valuation at the date of receipt (notes 2J(vi) and (viii)), and their net realisable value at the balance sheet date. Net realisable value represents the estimated selling price less costs to be incurred in selling the properties. The net realisable values as at 31 December 2005 and 2006 are determined by reference to an open market valuation of the properties as at those dates, undertaken by an independent firm of surveyors, DTZ Debenham Tie Leung, who have among their staff Members of the Hong Kong Institute of Surveyors.

Properties held for sale at net realisable value are stated net of provision of HK\$49 million (2005: HK\$18 million), made in order to state these properties at the lower of their cost and estimated net realisable value.

27 Derivative financial assets and liabilities

A Fair value

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

The Group and The Company

<i>in HK\$ million</i>	Notional amount	Fair values Maturing in				Total
		Less than 1 year	1 – 2 years	2 – 5 years	Over 5 years	
2006						
Derivative financial assets						
Foreign exchange forwards						
– cash flow hedges	418	1	4	–	–	5
– not qualified as hedges	650	4	–	–	–	4
Cross currency swaps						
– fair value hedges	2,032	4	4	45	–	53
Interest rate swaps						
– fair value hedges	3,373	2	11	44	71	128
– cash flow hedges	400	–	4	–	–	4
– not qualified as hedges	1,000	1	–	–	–	1
	7,873	12	23	89	71	195
Derivative financial liabilities						
Foreign exchange forwards						
– cash flow hedges	9	1	–	–	–	1
– not qualified as hedges	1	–	–	–	–	–
Cross currency swaps						
– fair value hedges	14,480	–	–	190	268	458
Interest rate swaps						
– fair value hedges	150	–	–	1	25	26
– cash flow hedges	2,242	–	–	7	17	24
– not qualified as hedges	1,908	6	–	–	–	6
	18,790	7	–	198	310	515
Total	26,663					
2005						
Derivative financial assets						
Foreign exchange forwards						
– cash flow hedges	478	1	–	–	–	1
Cross currency swaps						
– fair value hedges	2,517	1	1	68	6	76
Interest rate swaps						
– fair value hedges	4,219	5	–	84	32	121
– cash flow hedges	2,000	14	–	13	–	27
– not qualified as hedges	900	8	–	1	–	9
	10,114	29	1	166	38	234
Derivative financial liabilities						
Foreign exchange forwards						
– cash flow hedges	25	1	–	–	–	1
– not qualified as hedges	95	5	–	–	–	5
Cross currency swaps						
– fair value hedges	14,015	–	–	128	153	281
Interest rate swaps						
– fair value hedges	750	–	–	3	12	15
– cash flow hedges	100	–	1	–	–	1
– not qualified as hedges	650	–	4	–	–	4
	15,635	6	5	131	165	307
Total	25,749					

27 Derivative financial assets and liabilities *(continued)*

A Fair value *(continued)*

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

The Group's derivative financial instruments consist predominantly of interest rate and cross currency swaps, and the Group used the relevant interest rate swap curves as of 31 December 2006 and 2005 to discount financial instruments. For Hong Kong dollars, interest rates used ranged from 3.904% to 4.185% (2005: 3.925% to 4.594%), U.S dollars from 5.062% to 5.431% (2005: 4.334% to 5.106%) and Euro from 3.721% to 4.348% (2005: 2.384% to 3.853%).

B Financial risks

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

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

(i) Liquidity risk

Liquidity risk refers to the risk that funds will not be available to meet liabilities as they fall due, and it results from timing and amount mismatches of cash inflow and outflow. The Group adopts a prudent approach to managing liquidity risk by maintaining sufficient cash balances and an adequate amount of committed banking facilities at all times to provide forward coverage of all of its funding needs including working capital, debt refinancing, dividend payments, capital expenditures and new investments for a set minimum period of time of between 6 to 15 months.

(ii) Interest rate risk

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

(iii) Foreign exchange risk

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

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

(iv) Credit risk

Credit risk refers to the risk that a counterparty will be unable to pay amounts in full when due. For the Group, this arises mainly from the deposits it maintains and the derivative financial instruments that it has entered into with various banks and counterparties. To limit its exposure to credit risk, the Group places deposits and enters into derivative financial instruments only with financial institutions with acceptable credit ratings. For derivative financial instruments, the Group further quantifies and monitors its credit exposure by estimating the current fair market values and the potential change in fair market values of these instruments based on the "value-at-risk" concept.

(v) Concentration risk

The Group has no significant concentrations of credit risk with respect to the deposits it maintains and the derivative financial instruments it has entered into with various banks and counterparties. To reduce concentration risk, the Group assigns to each deposit-taking bank a credit rating based limit in accordance with credit policy approved by the Board. Pursuant to this policy, the Group also assigns mark-to-market limits to all its counterparties, and monitors the current and potential exposures due to derivative financial instruments against these limits.

28 Stores and spares

The Group and The Company

<i>in HK\$ million</i>	2006	2005
Stores and spares expected to be consumed:		
– within 1 year	156	137
– after 1 year	124	121
	280	258
Less: Specific provision for obsolete stock	8	10
	272	248

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

29 Debtors, deposits and payments in advance

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Debtors (net of specific impairment losses for bad and doubtful debts), deposits and payments in advance relate to:				
– Property development projects	825	2,042	825	2,042
– Railway operations and others	1,069	1,053	957	933
	1,894	3,095	1,782	2,975

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

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

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

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

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

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

29 Debtors, deposits and payments in advance (continued)

The ageing analysis of debtors included above is as follows:

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Amounts not yet due	1,157	2,461	1,145	2,448
Overdue by 30 days	102	107	96	61
Overdue by 60 days	18	26	17	24
Overdue by 90 days	6	35	4	6
Overdue by more than 90 days	150	17	143	12
Total debtors	1,433	2,646	1,405	2,551
Deposits and payments in advance	342	348	258	323
Prepaid pension costs	119	101	119	101
	1,894	3,095	1,782	2,975

Included in amounts not yet due are HK\$478 million (2005: HK\$46 million) receivable from certain stakeholding funds (note 18C) awaiting finalisation of the respective development accounts.

As at 31 December 2006, all debtors, deposits and payments in advance were expected to be recovered within one year except for HK\$160 million (2005: HK\$168 million) included in the amounts relating to deposits and receivables in respect of railway operations and others, which were expected to be recovered between one to three years. The nominal values less impairment losses for bad and doubtful debts are not discounted as it is considered that the effect of discounting would not be significant.

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

<i>in \$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Euro	1	2	1	2
Japanese Yen	-	1	-	1
New Taiwan dollar	37	13	37	13
Pataca	-	2	-	2
Pound sterling	1	-	-	-
United States dollar	25	22	24	22
Won	1	-	1	-

30 Loan to a property developer**The Group and The Company**

<i>in HK\$ million</i>	2006		2005	
	Nominal amount	Carrying amount	Nominal amount	Carrying amount
Interest-free loan to a property developer	4,000	3,355	-	-

The loan was provided to the developer of Package 2, Tseung Kwan O Area 86 property development project under the terms of the development agreement. The loan is interest-free and guaranteed by the developer's ultimate holding company and is repayable on completion of the respective phases of the project.

The difference between the nominal and carrying amount of the loan at inception, amounting to HK\$768 million, has been capitalised as property development in progress.

31 Amounts due from the Government and other related parties

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Amounts due from:				
– the Government	40	27	40	27
– the Housing Authority	22	22	22	22
– the Kowloon-Canton Railway Corporation (“KCRC”)	3	2	3	2
– non-controlled subsidiaries	94	88	94	88
– associates	18	–	18	–
– other subsidiaries of the Company (net of impairment losses)	–	–	523	285
Loans to associates	–	15	–	–
	177	154	700	424

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

The amount due from the Housing Authority relates to site formation works entrusted to the Company by the Housing Authority in respect of the Tseung Kwan O Extension Project.

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

All contract retentions on the above entrusted works were due for release within one year. All other amounts due from the Government and other related parties were expected to be received within 12 months.

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

32 Cash and cash equivalents

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Deposits with banks and other financial institutions	34	53	34	53
Cash at banks and on hand	276	306	93	63
Cash and cash equivalents in the balance sheet	310	359	127	116
Bank overdrafts (note 33B)	(5)	(14)	(5)	(14)
Cash and cash equivalents in the cash flow statement	305	345	122	102

During the year, the Group recognised deferred income and received properties as profit distribution in respect of property development of HK\$3,833 million (2005: HK\$3,868 million), which were transactions not involving movements of cash or cash equivalents.

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

<i>in \$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Euro	2	2	2	2
New Taiwan dollar	22	63	22	63
Swiss franc	2	2	2	2
United States dollar	8	14	–	2

33 Loans and obligations under finance leases**A By type****The Group**

<i>in HK\$ million</i>	Carrying amount 2006	Fair value 2006	Repayable amount 2006	Carrying amount 2005	Fair value 2005	Repayable amount 2005
Capital market instruments						
Listed or publicly traded:						
US dollar Global notes due 2009	5,651	6,100	5,834	5,711	6,253	5,834
US dollar Global notes due 2010	4,511	5,056	4,679	4,582	5,176	4,679
Debt issuance programme (Eurobond due 2014)	4,380	4,565	4,663	4,514	4,605	4,663
	14,542	15,721	15,176	14,807	16,034	15,176
Unlisted:						
Debt issuance programme notes due 2006 to 2020	7,046	7,383	7,075	5,976	6,226	6,021
HK dollar notes due 2006 to 2008	515	512	500	1,526	1,520	1,500
HK dollar retail bonds due 2006	–	–	–	1,002	1,003	1,000
	7,561	7,895	7,575	8,504	8,749	8,521
Total capital market instruments	22,103	23,616	22,751	23,311	24,783	23,697
Bank loans	4,789	4,706	4,757	4,282	4,315	4,306
Obligations under finance leases (note 33C)	141	141	141	272	272	272
Loans and obligations under finance leases	27,033	28,463	27,649	27,865	29,370	28,275
Bank overdrafts	5	5	5	14	14	14
Short-term loans	1,114	1,114	1,114	385	385	385
Total	28,152	29,582	28,768	28,264	29,769	28,674

The Company

<i>in HK\$ million</i>	Carrying amount 2006	Fair value 2006	Repayable amount 2006	Carrying amount 2005	Fair value 2005	Repayable amount 2005
Capital market instruments						
Listed or publicly traded:						
US dollar Global notes due 2009	5,651	6,100	5,834	5,711	6,253	5,834
US dollar Global notes due 2010	4,511	5,056	4,679	4,582	5,176	4,679
	10,162	11,156	10,513	10,293	11,429	10,513
Unlisted:						
Debt issuance programme notes due 2018	426	597	465	443	614	480
	426	597	465	443	614	480
Total capital market instruments	10,588	11,753	10,978	10,736	12,043	10,993
Bank loans	4,789	4,706	4,757	4,282	4,315	4,306
Obligations under finance leases (note 33C)	141	141	141	272	272	272
Loans and obligations under finance leases	15,518	16,600	15,876	15,290	16,630	15,571
Bank overdrafts	5	5	5	14	14	14
Short-term loans	1,114	1,114	1,114	385	385	385
Total	16,637	17,719	16,995	15,689	17,029	15,970

33 Loans and obligations under finance leases *(continued)*

A By type *(continued)*

As at 31 December 2006, the Group had available undrawn committed bank loan facilities amounting to HK\$5,700 million (2005: HK\$5,300 million). In addition, the Group had a number of uncommitted facilities with undrawn amounts totalling HK\$14,946 million (2005: HK\$8,851 million), comprising a debt issuance programme and short-term bank loan facilities.

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

The Group's derivative financial instruments consist predominantly of interest rate and cross currency swaps, and the Group used the relevant interest rate swap curves as of 31 December 2006 and 2005 to discount financial instruments. For Hong Kong dollars, interest rates used ranged from 3.904% to 4.185% (2005: 3.925% to 4.594%), U.S dollars from 5.062% to 5.431% (2005: 4.334% to 5.106%) and Euro from 3.721% to 4.348% (2005: 2.384% to 3.853%).

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

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

The Group

<i>in \$ million</i>	Before hedging activities		After hedging activities	
	2006	2005	2006	2005
Euro	10	13	–	–
United States dollar	2,118	2,120	8	10

The Company

<i>in \$ million</i>	Before hedging activities		After hedging activities	
	2006	2005	2006	2005
Euro	10	13	–	–
United States dollar	1,418	1,420	8	10

33 Loans and obligations under finance leases (continued)**B By repayment terms****The Group**

<i>in HK\$ million</i>	Capital market instruments 2006	Bank loans and overdrafts 2006	Obligations under finance leases 2006	Total 2006	Capital market instruments 2005	Bank loans and overdrafts 2005	Obligations under finance leases 2005	Total 2005
Long-term loans and obligations under finance leases								
Amounts repayable beyond 5 years	10,088	600	–	10,688	10,084	916	–	11,000
Amounts repayable within a period of between 2 and 5 years	11,663	2,092	–	13,755	11,163	2,178	–	13,341
Amounts repayable within a period of between 1 and 2 years	1,000	2,030	–	3,030	–	606	141	747
Amounts repayable within 1 year	–	35	141	176	2,450	606	131	3,187
	22,751	4,757	141	27,649	23,697	4,306	272	28,275
Bank overdrafts	–	5	–	5	–	14	–	14
Short-term loans	–	1,114	–	1,114	–	385	–	385
	22,751	5,876	141	28,768	23,697	4,705	272	28,674
Less: Unamortised discount/premium/finance charges outstanding	(103)	(3)	–	(106)	(118)	(5)	–	(123)
Adjustment due to fair value change of financial instruments	(545)	35	–	(510)	(268)	(19)	–	(287)
Total carrying amount of debt	22,103	5,908	141	28,152	23,311	4,681	272	28,264

The Company

<i>in HK\$ million</i>	Capital market instruments 2006	Bank loans and overdrafts 2006	Obligations under finance leases 2006	Total 2006	Capital market instruments 2005	Bank loans and overdrafts 2005	Obligations under finance leases 2005	Total 2005
Long-term loans and obligations under finance leases								
Amounts repayable beyond 5 years	465	600	–	1,065	480	916	–	1,396
Amounts repayable within a period of between 2 and 5 years	10,513	2,092	–	12,605	10,513	2,178	–	12,691
Amounts repayable within a period of between 1 and 2 years	–	2,030	–	2,030	–	606	141	747
Amounts repayable within 1 year	–	35	141	176	–	606	131	737
	10,978	4,757	141	15,876	10,993	4,306	272	15,571
Bank overdrafts	–	5	–	5	–	14	–	14
Short-term loans	–	1,114	–	1,114	–	385	–	385
	10,978	5,876	141	16,995	10,993	4,705	272	15,970
Less: Unamortised discount/premium/finance charges outstanding	(51)	(3)	–	(54)	(65)	(5)	–	(70)
Adjustment due to fair value change of financial instruments	(339)	35	–	(304)	(192)	(19)	–	(211)
Total carrying amount of debt	10,588	5,908	141	16,637	10,736	4,681	272	15,689

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

33 Loans and obligations under finance leases *(continued)*

C Obligations under finance leases

As at 31 December 2006, the Group and the Company had obligations under finance leases repayable as follows:

The Group and The Company

<i>in HK\$ million</i>	Present value of the minimum lease payments 2006	Interest expense relating to future periods 2006	Total minimum lease payments 2006	Present value of the minimum lease payments 2005	Interest expense relating to future periods 2005	Total minimum lease payments 2005
Amounts repayable within a period of between 1 and 2 years	–	–	–	141	9	150
Amounts repayable within 1 year	141	9	150	131	19	150
	141	9	150	272	28	300

Obligations under finance lease are the Group's and the Company's commitments to make future payments to New Hong Kong Tunnel Company Limited under the agreement for the Eastern Harbour Crossing which is treated as a finance lease (note 16E).

D Bonds and notes issued and redeemed

Bonds and notes issued during the year ended 31 December 2006 and 2005 comprise:

The Group

<i>in HK\$ million</i>	2006		2005	
	Principal amount	Net consideration received	Principal amount	Net consideration received
Debt issuance programme notes	1,500	1,499	1,500	1,491

The above notes were issued by a subsidiary, MTR Corporation (C.I.) Limited. The notes issued are unconditionally and irrevocably guaranteed by the Company; and are direct, unsecured, unconditional and unsubordinated to other unsecured and unsubordinated obligations of MTR Corporation (C.I.) Limited. The obligations of the Company under the guarantee are direct, unsecured, unconditional, and unsubordinated to other unsecured and unsubordinated obligations of the Company. The net proceeds received from the issues were on lent to the Company for general working capital, refinancing or other corporate purposes.

During the year, the Group redeemed HK\$2,450 million (2005: HK\$1,650 million) unlisted Hong Kong dollar notes upon maturity.

None of the Group's listed debt securities was redeemed during the year ended 31 December 2006 (2005: HK\$2,518 million).

E Guarantees

There were no guarantees given by the Government in respect of loan facilities as at 31 December 2006 and 2005.

33 Loans and obligations under finance leases (continued)**F Interest rates**

Outstanding amount of total borrowings, excluding obligations under finance leases, of HK\$28,011 million (2005: HK\$27,992 million) comprise:

The Group

	Fixed rate borrowings and borrowings swapped to fixed rates		Variable rate borrowings and borrowings swapped from fixed rate	
	Carrying amount HK\$ million	Interest rate % p.a.	Carrying amount HK\$ million	Interest rate % p.a.
2006				
Amounts repayable beyond 5 years	7,667	4.2 – 8.4	2,711	(Note)
Amounts repayable within a period of between 2 and 5 years	7,517	4.2 – 7.5	5,904	
Amounts repayable within a period of between 1 and 2 years	1,207	3.1 – 5.5	1,844	
Amounts repayable within 1 year	557	4.9 – 5.5	604	
	16,948		11,063	3.1 – 7.3
2005				
Amounts repayable beyond 5 years	6,635	4.3 – 8.4	4,169	(Note)
Amounts repayable within a period of between 2 and 5 years	7,528	3.1 – 7.5	5,594	
Amounts repayable within a period of between 1 and 2 years	557	4.9 – 5.5	45	
Amounts repayable within 1 year	3,409	2.2 – 5.5	55	
	18,129		9,863	3.3 – 6.2

The Company

	Fixed rate borrowings and borrowings swapped to fixed rates		Variable rate borrowings and borrowings swapped from fixed rate	
	Carrying amount HK\$ million	Interest rate % p.a.	Carrying amount HK\$ million	Interest rate % p.a.
2006				
Amounts repayable beyond 5 years	1,590	4.2 – 8.4	(562)	(Note)
Amounts repayable within a period of between 2 and 5 years	7,517	4.3 – 7.5	4,754	
Amounts repayable within a period of between 1 and 2 years	707	3.1 – 5.5	1,329	
Amounts repayable within 1 year	557	4.9 – 5.5	604	
	10,371		6,125	3.1 – 7.3
2005				
Amounts repayable beyond 5 years	447	5.5 – 8.4	911	(Note)
Amounts repayable within a period of between 2 and 5 years	7,528	3.1 – 7.5	4,928	
Amounts repayable within a period of between 1 and 2 years	557	4.9 – 5.5	45	
Amounts repayable within 1 year	2,407	2.2 – 5.5	(1,406)	
	10,939		4,478	3.3 – 6.2

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

34 Creditors, accrued charges and provisions

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Creditors, accrued charges and provisions				
– Airport Railway Project	79	87	79	87
– Tseung Kwan O Extension Project	152	155	152	155
– Property projects and management	1,263	1,112	1,263	1,112
– Railway operations and others	2,089	2,005	1,709	1,676
Gross amount due to customers for contract work	56	56	56	56
	3,639	3,415	3,259	3,086

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

The aggregate amount of costs incurred plus recognised profits less recognised losses to date, included in the gross amount due to customers for contract work at 31 December 2006, is HK\$179 million (2005: HK\$130 million).

The gross amount due to customers for contract work at 31 December 2006 that is expected to be settled after more than one year is HK\$56 million (2005: HK\$56 million).

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

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Due within 30 days or on demand	645	591	456	459
Due after 30 days but within 60 days	651	643	589	601
Due after 60 days but within 90 days	103	116	97	104
Due after 90 days	1,472	1,430	1,377	1,293
	2,871	2,780	2,519	2,457
Rental and other refundable deposits	631	498	603	492
Accrued employee benefits	137	137	137	137
Total	3,639	3,415	3,259	3,086

Creditors, accrued charges and provisions in respect of the capital projects and other construction works include provisions for claims on completed contracts, which were capitalised as part of the related assets. Most of these claims have been resolved and it is anticipated that, subject to unforeseen circumstances, the remaining amount required to be paid will be sufficiently covered by the above mentioned provisions of the respective projects. The carrying amounts of such claim provisions and their movements are not separately disclosed in view of their commercial sensitivity.

As at 31 December 2006, all creditors, accrued charges and provisions were expected to be settled within one year except for HK\$512 million (2005: HK\$463 million) included in the amounts relating to railway operations and others, which were expected to be settled after one year. The amounts due after one year are mainly rental deposits received from shop and station kiosk tenants and advance income received from telecommunication services operators, majority of which are due to be repaid within three years. The Group considers the effect of discounting these deposits would be immaterial.

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

34 Creditors, accrued charges and provisions (continued)

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

<i>in \$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Euro	3	3	3	3
Japanese Yen	5	2	5	2
New Taiwan dollar	3	–	3	–
Pound sterling	1	1	1	1
Swiss franc	1	1	1	1
United States dollar	53	51	39	37
Won	–	2	–	2

35 Contract retentions

The Group

<i>in HK\$ million</i>	Due for release after 12 months	Due for release within 12 months	Total
2006			
Railway extension projects	19	48	67
Railway operations	34	92	126
	53	140	193
2005			
Railway extension projects	7	63	70
Railway operations	9	91	100
	16	154	170

The Company

<i>in HK\$ million</i>	Due for release after 12 months	Due for release within 12 months	Total
2006			
Railway extension projects	19	46	65
Railway operations	34	92	126
	53	138	191
2005			
Railway extension projects	7	63	70
Railway operations	9	91	100
	16	154	170

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

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

<i>in \$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Swiss franc	3	3	3	3

36 Amounts due to related parties

The followings are amounts due to the subsidiaries and other related Group companies:

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Amounts due to:				
– subsidiaries	–	–	11,718	12,773
– associates	–	17	–	–
	–	17	11,718	12,773

Amounts due to the subsidiaries of HK\$11,515 million (2005: HK\$12,773 million) are expected to be settled after one year.

Amounts due to the Company's subsidiaries includes HK\$11,704 million (2005: HK\$12,773 million) due to MTR Corporation (C.I.) Limited in respect of proceeds from bonds and notes issued by the subsidiary, which were on-lent to the Company for its general corporate purposes with specified repayment dates and interest rates (note 33D), and accrued interest. These amounts are stated at their fair values. The remaining balances due to subsidiaries are non-interest bearing and have not been discounted as they do not have any fixed repayment terms and the amount is not material.

37 Deferred income

The Group and The Company

<i>in HK\$ million</i>	2006	2005
Deferred income on property development (note 18B)	1,562	3,458
Deferred income on lease out and lease back transaction (note 16G)	126	132
Less: Amount recognised as income	6	6
	120	126
	1,682	3,584

38 Income tax in the balance sheet

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

B Deferred tax assets and liabilities recognised

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

The Group

<i>in HK\$ million</i>	Depreciation allowances in excess of related depreciation	Revaluation of properties	Deferred tax arising from			Total
			Provision and other temporary differences	Cash flow hedges	Tax losses	
2006						
At 1 January 2006	8,895	2,242	228	5	(3,378)	7,992
Charged/(credited) to consolidated profit and loss account	(146)	381	(23)	–	1,197	1,409
Charged to reserves (note 40)	–	58	–	(7)	–	51
At 31 December 2006	8,749	2,681	205	(2)	(2,181)	9,452
2005						
At 1 January 2005	8,663	1,666	229	–	(4,205)	6,353
Charged/(credited) to consolidated profit and loss account	232	490	(1)	–	827	1,548
Charged to reserves (note 40)	–	86	–	5	–	91
At 31 December 2005	8,895	2,242	228	5	(3,378)	7,992

The Company

<i>in HK\$ million</i>	Depreciation allowances in excess of related depreciation	Revaluation of properties	Deferred tax arising from			Total
			Provision and other temporary differences	Cash flow hedges	Tax losses	
2006						
At 1 January 2006	8,896	2,242	228	5	(3,360)	8,011
Charged/(credited) to profit and loss account	(153)	381	(23)	–	1,186	1,391
Charged to reserves (note 40)	–	58	–	(7)	–	51
At 31 December 2006	8,743	2,681	205	(2)	(2,174)	9,453
2005						
At 1 January 2005	8,652	1,666	229	–	(4,179)	6,368
Charged/(credited) to profit and loss account	244	490	(1)	–	819	1,552
Charged to reserves (note 40)	–	86	–	5	–	91
At 31 December 2005	8,896	2,242	228	5	(3,360)	8,011

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Net deferred tax asset recognised in the balance sheet	(1)	(19)	–	–
Net deferred tax liability recognised in the balance sheet	9,453	8,011	9,453	8,011
	9,452	7,992	9,453	8,011

C The Group has not recognised deferred tax assets in respect of its subsidiaries' cumulative tax losses of HK\$155 million (2005: HK\$77 million) as it is not probable that future taxable profits against which the losses can be utilised will be available in the relevant tax jurisdictions and entities.

39 Share capital, share premium and capital reserve

<i>in HK\$ million</i>	2006	2005
Authorised: 6,500,000,000 shares of HK\$1.00 each	6,500	6,500
Issued and fully paid: 5,548,613,951 shares (2005: 5,481,856,439 shares) of HK\$1.00 each	5,549	5,482
Share premium	5,902	4,780
Capital reserve	27,188	27,188
	38,639	37,450

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

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

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

	Number of shares	Option/ scrip price HK\$	Proceeds credited to		Total HK\$ million
			Share capital account HK\$ million	Share premium account HK\$ million	
Employee share options exercised					
– Pre-Global Offering Share Option Scheme	4,094,000	8.44	4	31	35
– New Joiners Share Option Scheme	132,500	9.75	–	1	1
Issued as 2005 final scrip dividends	43,101,387	17.79	43	724	767
Issued as 2006 interim scrip dividends	19,429,625	19.87	20	366	386
	66,757,512		67	1,122	1,189

Outstanding share options under the Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme as at 31 December 2006 are disclosed in note 41.

40 Other reserves

The Group

<i>in HK\$ million</i>	Attributable to equity shareholders of the Company					Total
	Fixed asset revaluation reserve	Hedging reserve	Employee share-based capital reserve	Exchange reserve	Retained profits	
2006						
Balance as at 1 January 2006	697	24	2	4	31,698	32,425
Cash flow hedges:						
Effective portion of changes in fair value, net of deferred tax	–	(18)	–	–	–	(18)
Transfer from equity						
– to profit and loss account	–	(17)	–	–	–	(17)
– to initial carrying amount of non-financial hedged items	–	(2)	–	–	–	(2)
– to deferred tax	–	3	–	–	–	3
2005 final dividend	–	–	–	–	(1,535)	(1,535)
2006 interim dividend	–	–	–	–	(774)	(774)
Surplus on revaluation, net of deferred tax (notes 16 and 38)	271	–	–	–	–	271
Employee share-based payments	–	–	3	–	–	3
Exchange difference on translation of accounts of overseas subsidiaries	–	–	–	13	–	13
Profit for the year	–	–	–	–	7,759	7,759
Balance as at 31 December 2006	968	(10)	5	17	37,148	38,128
2005						
Balance as at 1 January 2005	291	(66)	1	–	25,521	25,747
Cash flow hedges:						
Effective portion of changes in fair value, net of deferred tax	–	69	–	–	–	69
Transfer from equity						
– to profit and loss account	–	32	–	–	–	32
– to initial carrying amount of non-financial hedged items	–	(21)	–	–	–	(21)
– to deferred tax	–	10	–	–	–	10
2004 final dividend	–	–	–	–	(1,509)	(1,509)
2005 interim dividend	–	–	–	–	(764)	(764)
Surplus on revaluation, net of deferred tax (notes 16 and 38)	406	–	–	–	–	406
Employee share-based payments	–	–	1	–	–	1
Exchange difference on translation of accounts of overseas subsidiaries	–	–	–	4	–	4
Profit for the year	–	–	–	–	8,450	8,450
Balance as at 31 December 2005	697	24	2	4	31,698	32,425

40 Other reserves (continued)

The Company

<i>in HK\$ million</i>	Fixed asset revaluation reserve	Hedging reserve	Employee share-based capital reserve	Retained profits	Total
2006					
Balance as at 1 January 2006	697	24	2	31,394	32,117
Cash flow hedges:					
Effective portion of changes in fair value, net of deferred tax	-	(18)	-	-	(18)
Transfer from equity					
– to profit and loss account	-	(17)	-	-	(17)
– to initial carrying amount of non-financial hedged items	-	(2)	-	-	(2)
– to deferred tax	-	3	-	-	3
2005 final dividend	-	-	-	(1,535)	(1,535)
2006 interim dividend	-	-	-	(774)	(774)
Surplus on revaluation, net of deferred tax (notes 16 and 38)	271	-	-	-	271
Employee share-based payments	-	-	3	-	3
Profit for the year	-	-	-	7,717	7,717
Balance as at 31 December 2006	968	(10)	5	36,802	37,765
2005					
Balance as at 1 January 2005	291	(66)	1	25,303	25,529
Cash flow hedges:					
Effective portion of changes in fair value, net of deferred tax	-	69	-	-	69
Transfer from equity					
– to profit and loss account	-	32	-	-	32
– to initial carrying amount of non-financial hedged items	-	(21)	-	-	(21)
– to deferred tax	-	10	-	-	10
2004 final dividend	-	-	-	(1,509)	(1,509)
2005 interim dividend	-	-	-	(764)	(764)
Surplus on revaluation, net of deferred tax (notes 16 and 38)	406	-	-	-	406
Employee share-based payments	-	-	1	-	1
Profit for the year	-	-	-	8,364	8,364
Balance as at 31 December 2005	697	24	2	31,394	32,117

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

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

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

The exchange reserve comprises all foreign exchange differences arising from the translation of the accounts of foreign enterprises. The reserve is dealt with in accordance with the accounting policy set out in note 2CC.

Apart from retained profits, the other reserves are not available for distribution to shareholders because they do not constitute realised profits. In addition, the Company considers the cumulative surpluses on revaluation of investment properties, net of tax of HK\$11,671 million (2005: HK\$9,874 million) included in retained profits are non-distributable as they also do not constitute realised profits. As at 31 December 2006, the Company considers that the total amount of reserves available for distribution to equity shareholders amounted to HK\$25,131 million (2005: HK\$21,520 million).

Included in the Group's retained profits as at 31 December 2006 is an amount of HK\$93 million (2005: HK\$48 million), being the retained profits attributable to the non-controlled subsidiaries and associates.

41 Share-based payments

A Equity-settled share-based payments

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

(i) Pre-Global Offering Share Option Scheme

In connection with the Initial Public Offering ("IPO") and Stock Exchange listing of the Company's shares in October 2000, a Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") was established. Under the Pre-IPO Option Scheme, a total of 769 employees including all the Members of the Executive Directorate, except C K Chow, Lincoln K K Leong and Francois K K Lung who were appointed on 1 December 2003, 1 February 2002 and 26 September 2005 respectively, were granted on 20 September 2000 options to purchase an aggregate of 48,338,000 shares, representing 0.9% of the issued share capital of the Company as at 31 December 2006. The options carry an exercise price of HK\$8.44 per share, which was equivalent to 90% of the IPO offer price of HK\$9.38 per share. The options may be exercised prior to 11 September 2010, subject to the vesting provisions under the Scheme. As of 31 December 2006, all options granted under the Pre-IPO Option Scheme have been vested.

In 2006, a total of 4,094,000 previously vested share options have been exercised. The weighted average closing price in respect of the share options exercised during the year was HK\$19.86 per share. In addition, no share options were lapsed as a result of the resignation of option holders during the year. As at 31 December 2006, total options to subscribe for 7,829,500 (2005: 11,923,500) shares remained outstanding.

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

(ii) New Joiners Share Option Scheme

In May 2002, the New Joiners Share Option Scheme (the "New Option Scheme") was adopted at the 2002 Annual General Meeting to provide share options to new members of the top and senior management of the Company who did not participate in the Pre-IPO Option Scheme. Under the Rules of the New Option Scheme, a maximum of 5,056,431 shares, which represent 0.1% of the issued share capital of the Company as at 31 December 2006, may be issued pursuant to the exercise of options granted under the New Option Scheme. Options granted will be evenly vested in respect of their underlying shares over a period of three years from the date on which the relevant option is offered. The exercise price of any option granted under the New Option Scheme is to be determined by the Company upon the offer of grant of the option and which should not be less than the greatest of (i) the average closing price of an MTR share for the five business days immediately preceding the day of offer of such option; (ii) the closing price of an MTR share on the day of offer of such option, which must be a business day; and (iii) the nominal value of an MTR share.

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

Date of grant	Number of share options	Exercise price HK\$	Exercisable period
1 August 2003	1,311,200	9.75	on or prior to 14 July 2013
13 September 2005	94,000	15.97	on or prior to 9 September 2015
23 September 2005	213,000	15.97	on or prior to 9 September 2015
12 January 2006	94,000	15.45	on or prior to 9 January 2016
31 March 2006	94,000	18.05	on or prior to 20 March 2016
12 May 2006	266,500	20.66	on or prior to 25 April 2016
12 May 2006	213,000	21.00	on or prior to 2 May 2016
15 May 2006	213,000	20.66	on or prior to 25 April 2016
4 July 2006	94,000	18.30	on or prior to 19 June 2016
5 October 2006	94,000	19.732	on or prior to 29 September 2016
17 November 2006	94,000	19.104	on or prior to 13 November 2016

41 Share-based payments (continued)

A Equity-settled share-based payments (continued)

During the year, the following share options lapsed in accordance with the terms of the New Option Scheme:

Date of grant	Number of share options	Exercise price HK\$	Exercisable period
27 September 2005	1,066,000	15.75	on or prior to 26 September 2015
17 October 2005	94,000	16.05	on or prior to 6 October 2015
27 March 2006	94,000	18.05	on or prior to 20 March 2016

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

	2006		2005	
	Number of options	Weighted average exercise price HK\$	Number of options	Weighted average exercise price HK\$
Outstanding at 1 January	2,910,700	12.81	1,561,200	9.75
Granted during the year	1,256,500	19.57	1,467,000	15.82
Exercised during the year	(132,500)	9.75	(117,500)	9.75
Lapsed during the year	(1,254,000)	15.94	–	–
Outstanding at 31 December	2,780,700	14.60	2,910,700	12.81
Exercisable at 31 December	1,413,700	10.20	924,500	9.75

The weighted average closing price in respect of the share options exercised during the year was HK\$20.43 (2005: HK\$15.21).

Share options outstanding at 31 December 2006 had the following exercise prices and remaining contractual lives:

Exercise price	2006		2005	
	Number of options	Remaining contractual life years	Number of options	Remaining contractual life years
HK\$9.75	1,311,200	6.53	1,443,700	7.53
HK\$15.97	307,000	8.69	307,000	9.69
HK\$15.75	–	–	1,066,000	9.74
HK\$16.05	–	–	94,000	9.76
HK\$15.45	94,000	9.02	–	–
HK\$18.05	94,000	9.22	–	–
HK\$20.66	479,500	9.32	–	–
HK\$21.00	213,000	9.34	–	–
HK\$18.30	94,000	9.47	–	–
HK\$19.732	94,000	9.75	–	–
HK\$19.104	94,000	9.87	–	–
	2,780,700	7.96	2,910,700	8.64

41 Share-based payments (continued)**A Equity-settled share-based payments** (continued)

According to the Black-Scholes pricing model, the fair values of options granted during the year ended 31 December 2006 were as follows:

Date of grant	Inputs into the Black-Scholes pricing model						
	Fair value of options granted HK\$	Share price immediately before grant date HK\$	Exercise price HK\$	Expected volatility	Expected life years	Risk-free interest rate %	Expected dividend per share HK\$
12 January 2006	3.17	16.05	15.45	0.20	5	4.00	0.42
31 March 2006	3.28	17.65	18.05	0.20	5	4.47	0.42
12 May 2006	4.11	20.10	20.66	0.21	5	4.62	0.42
12 May 2006	3.99	20.10	21.00	0.21	5	4.62	0.42
15 May 2006	4.13	20.10	20.66	0.21	5	4.67	0.42
4 July 2006	4.19	18.70	18.30	0.21	5	4.73	0.42
5 October 2006	3.51	19.22	19.732	0.20	5	3.83	0.42
17 November 2006	3.70	19.12	19.104	0.21	5	3.81	0.42

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

During the year ended 31 December 2006, the Group recognised total expenses of HK\$3 million (2005: HK\$1 million) related to equity-settled share-based payments.

B Cash-settled share-based payments

The CEO does not participate in the Company's two share option schemes. He was entitled to receive an equivalent value in cash of 700,000 shares on completion of his initial three-year contract on 30 November 2006. Pursuant to this contract and following the completion of the contract period, HK\$13,396,600 was paid to the CEO on 1 December 2006 (at a price of HK\$19.138 per share derived in accordance with the terms of the grant by reference to the average closing price of the Company's shares on the 20 business days immediately preceding 30 November 2006).

Following renewal of the CEO's contract for another three years expiring on 30 November 2009, he is entitled to receive an equivalent value in cash of 418,017 shares in the Company on completion of his new contract in 2009. As at 31 December 2006, an amount of HK\$6.2 million (2005: HK\$4.3 million) has been recorded as share-based payment expense for the year, including HK\$0.2 million in respect of his entitlement accrued under the new contract. Fair value of the outstanding entitlement is calculated based on the closing price of the Company's shares at year-end date. As at 31 December 2006, the fair value of these shares was HK\$19.56 per share (2005: HK\$15.25).

42 Retirement Schemes

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

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

A Retirement Scheme

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

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

(i) The hybrid benefit section

Members' contributions to the hybrid benefit section are based on a fixed percentage of basic salary. The Company's contributions are determined by the Executive Directorate with reference to an actuarial valuation. At 31 December 2006, the total membership was 5,749 (2005: 5,844). In 2006, members contributed HK\$65 million (2005: HK\$65 million) and the Company contributed HK\$166 million (2005: HK\$165 million) to the hybrid benefit section. The net asset value of the hybrid benefit section as at 31 December 2006 was HK\$6,906 million (2005: HK\$5,899 million).

(ii) The defined contribution benefit section

Both members' and the Company's contributions to the defined contribution benefit section are based on fixed percentages of members' basic salary. As at 31 December 2006, the total membership under this section was 599 (2005: 501). In 2006, total members' contributions were HK\$9.9 million (2005: HK\$5.5 million) and the total contribution from the Company was HK\$20.3 million (2005: HK\$9.6 million). The net asset value as at 31 December 2006 was HK\$141.7 million (2005: HK\$97.7 million).

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

(iii) Actuarial valuations

Actuarial valuations are carried out annually in accordance with the ORSO. A full actuarial valuation of the Retirement Scheme, comprising both the hybrid and the defined contribution benefit sections, was carried out at 31 December 2006 by Towers, Perrin, Forster & Crosby, Inc., an independent firm of consulting actuaries, using the Attained Age Method. The principal actuarial assumptions used included a long-term rate of investment return net of salary increases of 2.0% (2005: 2.0%) per annum, together with appropriate allowances for expected rates of mortality, turnover, redundancy and retirement and an adjustment for salary increases expected over the short term. The actuary confirmed that, at the valuation date:

- (a) the Scheme was solvent, with assets more than adequate to cover the aggregate value of members' vested benefits had all members left the Scheme; and
- (b) the value of the Scheme's assets was more than sufficient to cover the aggregate past service liability on the assumption that the Scheme continued in force. The corresponding funding level was 116%.

42 Retirement Schemes *(continued)*

B RBS

The RBS was established under trust as of 1 January 1995. The RBS is a defined benefit scheme and applies to all employees classified by the Company as staff working on designated projects and who are not on gratuity terms. The RBS provides for benefits to be payable only in the event of redundancy for accrued service up to 31 December 2002. The RBS was registered under the Occupational Retirement Schemes Ordinance with effect from 1 December 1995. As at 31 December 2006, there were 358 members *(2005: 366)* under the RBS.

The RBS is non-contributory for members. The Company's contributions are determined by the Executive Directorate with reference to an actuarial valuation and are charged as part of the staff costs to various projects on the basis of the amount contributed. During 2005 and 2006, the Company was not required to make any contributions to the Scheme. The net asset value of the RBS as at 31 December 2006 was HK\$12 million *(2005: HK\$13 million)*.

Actuarial valuations are carried out annually. A full actuarial valuation of the RBS was carried out at 31 December 2006 by Towers, Perrin, Forster & Crosby, Inc. using the Attained Age Method. The principal actuarial assumptions used included an expected weighted rate of investment return net of salary increases, of approximately -1.25% *(2005: -1.35%)* per annum, together with appropriate allowance for expected rates of redundancy. The actuary confirmed that, at the valuation date:

- (a) due to the nature of the RBS which provides for benefits only on redundancy, there was no aggregate vested liability, and thus the RBS was technically solvent; and
- (b) the value of the RBS assets, together with the future contributions recommended by the actuary and to be adopted by the Company, would be sufficient to meet the liabilities of the RBS on an on-going basis.

C MPF Scheme

Effective from the MPF commencement date of 1 December 2000, the Company joined The Bank Consortium MPF Plan which has been registered with the Mandatory Provident Fund Schemes Authority and authorised by the Securities and Futures Commission. As at 31 December 2006, the total number of employees of the Company participating in the MPF Scheme was 726 *(2005: 520)*. In 2006, total members' contributions were HK\$2.7 million *(2005: HK\$1.5 million)* and total contribution from the Company was HK\$3.0 million *(2005: HK\$1.9 million)*.

43 Defined benefit retirement plan obligations

The Group makes contributions to two defined benefit plans that provide benefits for employees upon retirement or termination of services for other reasons (note 42). The movements in respect of these defined benefit plans during the year are summarised as follows:

A The amounts recognised in the balance sheets are as follows:

The Group and The Company

<i>in HK\$ million</i>	Retirement Scheme 2006	RBS 2006	Total 2006	Retirement Scheme 2005	RBS 2005	Total 2005
Present value of funded obligations	7,311	3	7,314	5,974	7	5,981
Fair value of plan assets	(6,906)	(12)	(6,918)	(5,899)	(13)	(5,912)
Net unrecognised actuarial gains/(losses)	(520)	5	(515)	(172)	2	(170)
Net asset	(115)	(4)	(119)	(97)	(4)	(101)

A portion of the above asset is expected to be recovered after more than one year. However, it is not practicable to segregate this amount from the amounts receivable in the next twelve months, as future contributions will also relate to future services rendered and future changes in actuarial assumptions and market conditions. The Group expects to pay HK\$151 million in contribution to the Retirement Scheme in 2007.

B Plan assets consist of the following:

The Group and The Company

<i>in HK\$ million</i>	Retirement Scheme 2006	RBS 2006	Total 2006	Retirement Scheme 2005	RBS 2005	Total 2005
Equity securities	3,623	–	3,623	3,245	–	3,245
Bonds	3,128	–	3,128	2,531	–	2,531
Cash	198	12	210	158	13	171
	6,949	12	6,961	5,934	13	5,947
Voluntary units	(43)	–	(43)	(35)	–	(35)
	6,906	12	6,918	5,899	13	5,912

Included in the plan assets are investments in the Company's ordinary shares and debt securities of HK\$1 million (2005: HK\$1 million) and HK\$13 million (2005: HK\$10 million) respectively.

C Movements in the present value of the defined benefit obligations

The Group and The Company

<i>in HK\$ million</i>	Retirement Scheme 2006	RBS 2006	Total 2006	Retirement Scheme 2005	RBS 2005	Total 2005
At 1 January	5,974	7	5,981	5,456	7	5,463
Members' contributions paid to the Schemes	65	–	65	65	–	65
Benefits paid by the Schemes	(91)	(1)	(92)	(141)	(1)	(142)
Current service cost	253	–	253	261	–	261
Interest cost	251	–	251	230	–	230
Actuarial (gains)/losses	859	(3)	856	103	1	104
At 31 December	7,311	3	7,314	5,974	7	5,981

43 Defined benefit retirement plan obligations (continued)**D Movements in plan assets****The Group and The Company**

<i>in HK\$ million</i>	Retirement Scheme 2006	RBS 2006	Total 2006	Retirement Scheme 2005	RBS 2005	Total 2005
At 1 January	5,899	13	5,912	5,365	14	5,379
Group's contributions paid to the Schemes	166	–	166	165	–	165
Members' contributions paid to the Schemes	65	–	65	65	–	65
Benefits paid by the Schemes	(91)	(1)	(92)	(141)	(1)	(142)
Expected return on plan assets	357	–	357	326	–	326
Actuarial gains/(losses)	510	–	510	119	–	119
At 31 December	6,906	12	6,918	5,899	13	5,912

E Expense recognised in the consolidated profit and loss account is as follows:

<i>in HK\$ million</i>	Retirement Scheme 2006	RBS 2006	Total 2006	Retirement Scheme 2005	RBS 2005	Total 2005
Current service cost	253	–	253	261	–	261
Interest cost	251	–	251	230	–	230
Expected return on plan assets	(357)	–	(357)	(326)	–	(326)
Net actuarial (gain)/loss recognised	–	(1)	(1)	–	(3)	(3)
Expense recognised	147	(1)	146	165	(3)	162
Less: Amount capitalised	24	(1)	23	31	(3)	28
	123	–	123	134	–	134

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

F Actual return on plan assets

<i>in HK\$ million</i>	2006	2005
MTRCL Retirement Scheme	867	445
MTRCL Retention Bonus Scheme	–	–

43 Defined benefit retirement plan obligations *(continued)*

G The principal actuarial assumptions used as at 31 December 2006 (expressed as weighted average) are as follows:

	Retirement Scheme 2006	RBS 2006	Retirement Scheme 2005	RBS 2005
Discount rate at 31 December	3.75%	3.50%	4.25%	4.00%
Expected rate of return on plan assets	6.00%	2.75%	6.00%	2.25%
Future salary increases	4.00%	4.00%	4.00%	3.60%

The expected long-term rate of return on plan assets have been determined after taking into account actual experience, expected investment volatility and inflation in the long-term. Furthermore, it is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The amount is based exclusively on historical returns, without adjustments.

H Historical information

The Group and The Company

<i>in HK\$ million</i>	2006	Retirement Scheme			
		2005	2004	2003	2002
Present value of funded obligations	7,311	5,974	5,456	4,277	3,775
Fair value of plan assets	6,906	5,899	5,365	4,638	3,768
Surplus/(Deficits) in the Scheme	(405)	(75)	(91)	361	(7)
Experience adjustments arising on plan liabilities – gain/(loss)	(464)	(98)	(154)	(178)	(500)
Experience adjustments arising on plan assets – gain/(loss)	510	119	243	560	288

<i>in HK\$ million</i>	2006	RBS			
		2005	2004	2003	2002
Present value of funded obligations	3	7	7	14	31
Fair value of plan assets	12	13	14	14	23
Surplus/(Deficits) in the Scheme	9	6	7	–	(8)
Experience adjustments arising on plan liabilities – gain/(loss)	3	(2)	5	7	(4)
Experience adjustments arising on plan assets – gain/(loss)	–	–	–	–	–

44 Interests in jointly controlled operations

The Group has the following jointly controlled operations in respect of its awarded property development projects as at 31 December 2006.

Location/ development package	Land use	Total gross floor area (sq. m.)	Actual or expected date of completion of construction works*
Hong Kong Station	Office / Retail / Hotel	415,894	Completed by phases from 1998 – 2005
Kowloon Station			
Package One	Residential	147,547	Completed in 2000
Package Two	Residential	210,319	Completed by phases from 2002 – 2003
Package Three	Residential / Cross Border Bus Terminus	105,113	Completed in 2005
Package Four	Residential	128,845	Completed in 2003
Package Five, Six and Seven	Residential / Office / Retail / Hotel / Serviced Apartment / Kindergarten	504,350	By phases from 2006 – 2010
Olympic Station			
Package One	Residential / Office / Retail / Indoor Sports Hall	309,069	Completed in 2000
Package Two	Residential / Retail / Market	268,650	Completed in 2001
Package Three	Residential / Kindergarten	104,452	Completed in 2006
Tsing Yi Station	Residential / Retail / Kindergarten	292,795	Completed in 1999
Tung Chung Station			
Package One	Residential / Office / Retail / Hotel / Kindergarten	361,531	Completed by phases from 1999 – 2005
Package Two	Residential / Retail / Kindergarten	255,949	By phases from 2002 – 2007
Package Three	Residential / Retail / Wet Market / Kindergarten	413,154	By phases from 2002 – 2008
Hang Hau Station	Residential / Retail	142,152	Completed in 2004
Tiu Keng Leng Station	Residential / Retail	253,765	By phases from 2006 – 2007
Tseung Kwan O Station			
Area 55b	Residential / Retail	96,797	Completed in 2006
Area 57a	Residential / Retail	29,642	Completed in 2005
Tseung Kwan O South Station			
Area 86 Package One	Residential / Retail / Residential Care Home for the Elderly	139,840	2008
Area 86 Package Two	Residential / Kindergarten	310,496	By phases from 2009 – 2010
Choi Hung Park-and-Ride	Residential / Retail	21,538	Completed in 2005

* Completion based on issuance of occupation permit

The Group's assets held in relation to these joint venture operations include various site foundation works and related staff and overhead costs. The costs incurred by the Group on each development package are set off against any up-front payments received from developers in relation to that development package, and the balance is shown on the balance sheet either as property development in progress or deferred income (note 18) as the case may be.

As at 31 December 2006, total property development in progress in respect of these jointly controlled operations was HK\$2,028 million (2005: HK\$1,087 million) and total deferred income was HK\$1,562 million (2005: HK\$3,458 million).

During the year ended 31 December 2006, profits of HK\$5,817 million (2005: HK\$6,145 million) were recognised (note 7).

45 Material related party transactions

The Financial Secretary Incorporated, which holds approximately 76.6% of the Company's issued share capital on trust for the Government of the Hong Kong SAR, is the majority shareholder of the Company. Transactions between the Group and Government departments, agencies or Government controlled entities, other than those transactions such as the payment of fees, taxes, leases and rates, etc. that arise in the normal dealings between the Government and the Group, are considered to be related party transactions pursuant to HKAS 24 "Related party disclosures" and are identified separately in these accounts.

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

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

- A** The Company entered into the Airport Railway Agreement with the Government on 5 July 1995 for the construction of the Airport Railway. In addition to specifying the parameters for the design, construction and operation of the Tung Chung and Airport Express Lines, the Agreement also included provisions for the granting of land to the Company for property development (note 18).
- B** The Company entered into the TKE Project Agreement with the Government on 4 November 1998 for the design, construction, financing and operation of the Tseung Kwan O Extension and the granting of land for commercial and residential property developments along the railway extension.
- C** On 30 June 2000, the Appointed Day for the purposes of the Mass Transit Railway Ordinance, the Company was granted a franchise, for an initial period of 50 years, to operate the existing mass transit railway, and to operate and construct any extension to the railway. On the same day, the Company entered into an Operating Agreement ("OA") with the Government which detailed provisions for the design, construction, maintenance and operation of the railway under the franchise. Pursuant to the terms of the OA, the Company's franchise will be extended for further periods of 50 years upon satisfying certain capital expenditure requirements at no payment and without any change in the terms of the franchise. The OA also provides that upon extension of the franchise and subject to the Government's prevailing land policy on the date on which the franchise is extended, certain consequential amendments will be made to agreements between the Government and the Company in relation to the mass transit railway, including the renewal of various railway running line leases and land leases at nominal cost.
- D** On 14 July 2000, the Company received a comfort letter from the Government pursuant to which Government agreed to extend the period of certain of the Company's land interests so that they are coterminous with the Company's initial 50-year franchise.
- E** On 24 July 2002, the Company entered into an agreement with the Government specifying the parameters for the design, construction, financing and operation of the Disneyland Resort Line ("DRL"). In connection with the financing of the DRL Project, the Government agreed to provide financial support through the Government waivers of its entitlement to cash dividends in respect of its shareholding. Such committed financial support has been met in 2004. The DRL was completed in June 2005 and commenced operation on 1 August 2005.
- F** On 19 November 2003, the Company entered into a formal project agreement with the Government to develop, on a build, operate and transfer basis, the Tung Chung Cable Car System together with a Theme Village at Ngong Ping on the Lantau Island under a franchise granted by the Government for a period of 30 years commencing on 24 December 2003. The project was completed during the year with operation commenced on 18 September 2006. Details of the project are set out in note 17B.

45 Material related party transactions (continued)

G On 24 January 2005, the Company accepted an offer from the Government to allow the Company to proceed with the proposed development on Site F of Tseung Kwan O Town Lot No. 70, Area 86, at an assessed land premium of HK\$2,319 million together with other ancillary terms and conditions as specified in the modification letter to be entered into between the Company and the Government. Upon award of the development package on 8 February 2005, the agreed land premium, of which one-half or HK\$1,160 million was paid by the Company, was settled.

H On 18 July 2005, the Company entered into a project agreement with the Airport Authority for the procurement of MTR station extension works and related railway facilities to serve the SkyPlaza currently under construction at the Hong Kong International Airport. Details of the project are described in note 17C.

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

I In connection with the construction of various railway projects, certain essential project works are embedded within the infrastructure works to be undertaken by the Government or certain of its related parties. These works have been entrusted to the Government and its related parties and are payable on an actual cost basis according to architectural certifications. The Government and certain of its related parties, on the other hand, have entered into entrustment agreements with the Company for the construction of various other infrastructure works that are also reimbursable according to actual costs certified. Details of the amounts paid and the amounts receivable and payable as at 31 December 2006 are provided in notes 17, 31 and 36 respectively.

J The Company has business transactions with its non-controlled subsidiaries in the normal course of operations, details of which are disclosed in note 21.

K The Group has paid remuneration to the Members of the Board and Members of the Executive Directorate. Details of these transactions are described in note 6A. In addition, the Members of the Executive Directorate were granted share options under the Company's Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme. Details of the terms of these directors' options are disclosed in note 6B and under the paragraph "Board Members' and Executive Directorate's Interests in Shares" of the Report of the Members of the Board. Their gross remuneration charged to the profit and loss account is summarised as follows:

<i>in HK\$ million</i>	2006	2005
Short-term employee benefits	44.5	42.3
Post-employment benefits	2.4	2.2
Equity compensation benefits	6.5	5.2
	53.4	49.7

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

L During the year, the following dividends were paid to the Government:

<i>in HK\$ million</i>	2006	2005
Cash dividends paid	777	760
Shares allotted in respect of scrip dividends	990	978
	1,767	1,738

46 Commitments

A Capital commitments

(i) Outstanding capital commitments as at 31 December 2006 not provided for in the accounts were as follows:

The Group

<i>in HK\$ million</i>	Railway operations	Railway extension projects	Property projects and management	Overseas project	Total
2006					
Authorised but not yet contracted for	476	–	428	5	909
Authorised and contracted for	353	325	676	72	1,426
	829	325	1,104	77	2,335
2005					
Authorised but not yet contracted for	543	–	408	8	959
Authorised and contracted for	598	67	1,336	97	2,098
	1,141	67	1,744	105	3,057

The Company

<i>in HK\$ million</i>	Railway operations	Railway extension projects	Property projects and management	Total
2006				
Authorised but not yet contracted for	476	–	428	904
Authorised and contracted for	353	325	676	1,354
	829	325	1,104	2,258
2005				
Authorised but not yet contracted for	543	–	408	951
Authorised and contracted for	598	67	1,336	2,001
	1,141	67	1,744	2,952

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

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

The Group and The Company

<i>in HK\$ million</i>	Improvement and enhancement works	Acquisition of property, plant and equipment	Total
2006			
Authorised but not yet contracted for	454	22	476
Authorised and contracted for	349	4	353
	803	26	829
2005			
Authorised but not yet contracted for	479	64	543
Authorised and contracted for	259	339	598
	738	403	1,141

46 Commitments (continued)**B Operating lease commitments**

The Group had operating leases on office buildings, staff quarters and a shopping centre in Beijing as at 31 December 2006. The total future minimum lease payments under non-cancellable operating leases are payable as follows:

<i>in HK\$ million</i>	The Group		The Company	
	2006	2005	2006	2005
Payable within one year	53	8	5	8
Payable after one but within five years	250	3	5	3
	303	11	10	11

The above includes HK\$2 million (2005: HK\$1 million) in respect of the office accommodation and quarters for construction project staff, majority of which are subject to rent reviews. The Group has the right to acquire the shopping centre in Beijing at a pre-determined price during the first five years of the lease term, which commenced from April 2006, or release its obligation as a tenant by making a compensation to the landlord upon expiry of the fifth year.

C Liabilities and commitments in respect of property management contracts

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

As at 31 December 2006, the Group had total outstanding liabilities and contractual commitments of HK\$773 million (2005: HK\$619 million) in respect of these works and services. Cash funds totalling HK\$788 million (2005: HK\$695 million) obtained through monthly payments of management service charges from the managed properties are held by the Group on behalf of those properties for settlement of works and services provided.

D Material financial guarantee contracts

The Company provides guarantees to investors of debt securities issued by one of its subsidiaries, MTR Corporation (C.I.) Limited (note 33D), which amounted to approximately HK\$11,515 million as at 31 December 2006. Proceeds from such debts issued have been on lent to the Company. As such, the primary liabilities have already been recorded in the Company's balance sheet.

47 Investments in China

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

In January 2004, the Group entered into an Agreement in Principle for a Build-Operate-Transfer ("BOT") project with the Shenzhen Municipal People's Government in respect of the construction of Phase 2 of Shenzhen Line 4 of the proposed Shenzhen Metro System and the operation of the entire line for a term of 30 years. In May 2005, the Group and the Shenzhen Municipal People's Government initialed the project Concession Agreement. The project is subject to approval from the Central Government.

Shenzhen Line 4 is a 21-kilometre urban railway running from Huanggang to Longhua New Town in Shenzhen, forming the major north-south railway corridor of the Shenzhen Special Economic Zone. Upon completion of Phase 2 of Shenzhen Line 4, both Phases 1 and 2 will be operated by the Company's subsidiary established in Shenzhen. Total investment of the project is estimated at RMB 6.0 billion (HK\$6.0 billion) which will be financed by equity capital contributed by the Group of RMB 2.4 billion (HK\$2.4 billion) and the balance by non-recourse bank loans in RMB. The project will be implemented with associated property developments comprising 2.9 million square metres of commercial and residential space along the railway.

Preparatory work including design and tendering is in progress. As of 31 December 2006, costs of HK\$282 million (2005: HK\$166 million) incurred for the project have been capitalised as deferred expenditure and the Group had other contract commitments totalling HK\$77 million (2005: HK\$105 million) in relation to this project.

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

In December 2004, an Agreement in Principle was entered into between the Group, Beijing Infrastructure Investment Co. Ltd ("BIIC") and Beijing Capital Group ("BCG"), both are subsidiaries of the Beijing Municipal People's Government, to form a public-private partnership company ("PPP") for the investment in the Beijing Line 4 project, which involves the investment, construction and operation of the line for a term of 30 years. In September 2005, approval from the Central Government for the project was obtained and the PPP, Beijing MTR Corporation Limited, completed all registration requirements and obtained its business license in January 2006. In April 2006, Concession Agreement with the Beijing Municipal People's Government was signed.

Beijing Line 4 is a 29-kilometre underground metro line running from Majialou Station to Longbeicun Station, forming a main north-south traffic artery of Beijing. The total investment for the Beijing Line 4 project is estimated at RMB 15.3 billion (HK\$15.2 billion), of which 70% will be borne by the Beijing Municipal People's Government to finance mainly land acquisition and civil construction. Total investment by the PPP is RMB 4.6 billion (HK\$4.6 billion), contributing to 30% of the total investment in the project to finance mainly the electrical and mechanical systems and rolling stock. Both the Group and BCG each owns 49% interests of the PPP whilst BIIC owns the remaining 2% interest. The PPP is to operate and be responsible for maintenance of Beijing Line 4 for a term of 30 years. The PPP has a registered capital of RMB 1.4 billion (HK\$1.4 billion), of which RMB 676 million (HK\$673 million) will be contributed and owned by the Group. As of 31 December 2006, the Group has made an equity contribution of HK\$100 million, representing about 15% of the registered capital committed by the Group. Apart from equity, the PPP's investment is financed by non-recourse bank loans provided by Industrial and Commercial Bank of China and China Development Bank.

Following signing of the Concession Agreement, tenders for the provision of trains and related electrical and mechanical systems have commenced. As at 31 December 2006, a total of 41 contracts including rolling stock, signaling and automatic fare collection system have been awarded. As at the same date, the PPP has total outstanding capital commitments amounting to approximately RMB 1.9 billion (HK\$1.9 billion) (2005: nil) in respect of the contracts awarded.

48 Post balance sheet events

A On 15 February 2007, the Company has accepted a tender from Lansmart Limited, a subsidiary of Sun Hung Kai Properties Limited to carry out the development in Tseung Kwan O Area 56 ("Area 56 Development"). It is proposed that such development will be a mixed-use development comprising residential, commercial, hotel and office with maximum gross floor area of 168,537 square metres.

On 26 February 2007, the Company accepted an offer from the Government to proceed with the Area 56 Development at an assessed land premium of HK\$3,345 million, to be funded by Lansmart Limited. Details of which are set out in the section "Land Agreements" of the Report of the Members of the Board.

B On 28 February 2007, the new departure platform connecting the Airport Express with SkyPlaza, the second terminal of the Hong Kong International Airport, commenced operation upon opening of the SkyPlaza on the same day. The final cost to complete the SkyPlaza Platform Project is expected to be within the original budget of HK\$0.1 billion.

49 Accounting estimates and judgements

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

(i) Estimated useful life and depreciation of property, plant and equipment

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

(ii) Impairment of long-lived assets

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

(iii) Pension costs

The Group employs independent valuation professionals to conduct annual assessment of the actuarial position of the Group's retirement plans. The determination of the Group's obligation and expense for the defined benefit element of these plans is dependent on certain assumptions and factors provided by the Company, which are disclosed in notes 42A(iii) and 42B.

(iv) Revenue recognition on property development

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

(v) Properties held for sale

The Group values unsold properties at the lower of their costs or net realisable values (note 26) at the balance sheet date. In ascertaining the properties' net realisable values, which are represented by the estimated selling prices less costs to be incurred in relation to the sales, the Group employs independent valuation professionals to assess the properties' estimated selling prices, and makes estimations on further selling and property holding costs to be incurred based on past experience and with reference to general market practice.

(vi) Interest-free loan to a property developer

The Group estimated the fair value of the interest-free loan to a developer at its present value discounted at the prevailing market rates of interest at inception.

(vii) Valuation of investment properties

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

(viii) Franchise

The current franchise under which the Group is operating allows it to run the mass transit railway system until 30 June 2050. Pursuant to the terms stipulated in the Operating Agreement with the Government, the Company considers that it has the legal right to extend the franchise for further periods of 50 years upon expiry of each franchise term (note 45C). The Group's depreciation policies (note 2H) in respect of certain assets' lives which extend beyond 2050 are on this basis.

(ix) Income tax

Certain treatments adopted by the Company in its tax returns in the past years are yet to be finalised with the Hong Kong Inland Revenue Department. In assessing the Company's income tax and deferred taxation in the 2006 accounts, the Company has followed the tax treatments it has adopted in those tax returns, which may be different from the final outcome in due course.

(x) Project provisions

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

(xi) Deferred expenditure

As disclosed in note 21(i), the Group capitalises proposed railway project costs in deferred expenditure when the projects are at a detailed study stage and having been approved in principle by the Members of the Board. Such decision involves the Board's judgement on the outcome of the proposed project.

(xii) Fair value of derivatives and other financial instruments

In determining the fair value of financial instruments, the Group uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at each balance sheet date. For financial instruments that are not traded in active markets, the fair values were based on the discounted cash flows method which discounts the future contractual cash flows at the current market interest or foreign exchange rates, as applicable, for similar financial instruments that were available to the Group at the time.

49 Accounting estimates and judgements *(continued)*

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

(i) Provisions and contingent liabilities

The Group recognises provisions for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as contingent liability. As at 31 December 2006, the Group considered that it had no disclosable contingent liabilities as there were neither pending litigations nor events with potential obligation which were probable to result in material outflow of economic benefits to the Group.

(ii) Non-controlled subsidiaries

The Company regards Octopus Holdings Limited and its subsidiaries (the "OHL Group") as non-controlled subsidiaries. In determining whether the Group has control over these subsidiaries, the Company has taken into account its voting right conferred to it under the Shareholder's Agreement of OHL and the effective influence it may exercise over the decision of OHL's Board. Throughout the year ended 31 December 2006, the Group considered that its voting right in the OHL Group has been maintained at 49% despite an equity interest of 57.4%. As such, the OHL Group of companies were accounted for as non-controlled subsidiaries in the Group's accounts.

50 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2006

The HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2006 and which have not been adopted in these accounts. The Group considered that the following new standards will apply to its accounts in future.

	Effective for accounting periods beginning on or after
HKFRS 7 "Financial Instruments: Disclosures"	1 January 2007
Amendment to HKAS 1 "Presentation of Financial Statements" – Capital Disclosures	1 January 2007
HK(IFRIC) Interpretation 12 "Service Concession Arrangements"	1 January 2008

So far it has concluded that the adoption of HKFRS 7 and Amendment to HKAS 1 is unlikely to have a significant impact on the Group's results of operations and financial position apart from additional new or amended disclosure and changes in presentation in the accounts. The adoption of HK(IFRIC) Interpretation 12, which prescribes the accounting treatments for service concession arrangements in respect of infrastructure for public services, is currently not considered to have an effect but may have an impact to the Group's future operations. The Group is carrying out an assessment to identify the likely implications this new Interpretation may have on the its accounts should service concession arrangements be entered into in future.

51 Proposed merger with Kowloon-Canton Railway Corporation

On 11 April 2006, the Company signed a non-binding Memorandum of Understanding ("MOU") with the Government, setting out the terms for the proposed merger of the operations of the Company and the Kowloon-Canton Railway Corporation ("KCRC"), together with the acquisition of a property package.

According to the MOU, the Company will make an upfront payment of HK\$4.25 billion for the grant of a Service Concession in respect of the right to access and use the concession properties to provide the KCRC services, and as consideration for certain rail assets purchased from KCRC, HK\$7.79 billion to acquire the property package comprising development rights, investment properties and property management rights, and an annual fixed payment of HK\$0.75 billion plus annual variable payment based on revenues generated from KCRC's rail and rail-related operations over the life of the Service Concession. No variable annual payment will be payable in respect of the first 36 months. The merger proposal must go through a legislative and shareholder approval process. In July 2006, the Rail Merger Bill (the "Bill") was introduced into the Legislative Council to undergo a deliberation and debate process. As of the date of this report, such process is still in progress. If the Bill is passed by the Legislative Council, the proposed merger transaction will be presented to the Company's minority shareholders for approval.

52 Approval of accounts

The accounts were approved by the Board on 13 March 2007.