

# Corporate Governance Report

## Corporate Governance Practices

The Company is committed to ensuring high standards of corporate governance in the interests of shareholders and devotes considerable effort to identifying and formalising best practices. This Report describes how the Company has applied the principles of the Code on Corporate Governance Practices (the "Code") contained in Appendix 14 of the Listing Rules.

The Company has complied throughout the year ended 31 December 2008 with the Code Provisions except that, with respect to Code Provision A.4.1, 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 MTR Ordinance) 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. As there are currently nine Directors subject to the requirement to retire by rotation, and one-third of them shall retire at each annual general meeting of the Company (subject to re-election by the shareholders), each of these Directors is effectively appointed for a term of approximately three years.

## The Board of Directors

The overall management of the Company's business is vested in the Board. Pursuant to the Articles of Association and the Protocol adopted by the Board, the Board has delegated the day-to-day management of the Company's business to the Executive Directorate, and focuses its attention on matters affecting the Company's overall strategic policies, finances and shareholders. These include financial statements, dividend policy, significant changes in accounting policy, annual operating budget, certain material contracts, strategies for future growth, major financing arrangements and major investments, risk management strategies, treasury policies and fare structures.

The Board comprises 11 members, consisting of one executive Director (the Chief Executive Officer) and ten non-executive Directors, of whom six are independent non-executive Directors. In this regard, the Company well exceeds the requirement of the Listing Rules which requires every board of directors of a listed issuer to have at least three independent non-executive directors.

Dr. Raymond Ch'ien Kuo-fung, a Member of the Board since 1998, was appointed by the Government on 8 August 2007 as the non-executive Chairman of the Company for a term of 24 months with effect from the Rail Merger, which took effect from 2 December 2007. Dr. Ch'ien was first appointed as the

non-executive Chairman of the Company with effect from 21 July 2003 for a term of three years, which was renewed in 2006 for a further term up to 31 July 2007. In July 2007, Dr. Ch'ien was re-appointed as the non-executive Chairman of the Company with effect from 1 August 2007 for a term up to 31 December 2007 or the day to be appointed by the Secretary for Transport and Housing ("S for T&H") by notice published in the Gazette under the Rail Merger Ordinance, whichever was the earlier. The Rail Merger Ordinance relates to the Rail Merger between the Company and KCRC.

Mr. Chow Chung-kong, a Member of the Board since 2003, was selected by the Government on 8 August 2007 as the Chief Executive Officer of the Company after the Rail Merger. Mr. Chow was first appointed as the Chief Executive Officer of the Company with effect from 1 December 2003 for a term of three years. He was also appointed as a Member of the Board on the same date. His contract as the Chief Executive Officer of the Company was renewed for a further term of three years with effect from 1 December 2006.

Two of the non-executive Directors (being the S for T&H and the Commissioner for Transport) are appointed by the Chief Executive of the HKSAR. Another non-executive Director, Professor Chan Ka-keung, Ceajer, is the Secretary for Financial Services and the Treasury of the Government. The Government through FSI, holds approximately 76.7% of the issued share capital of the Company.

With effect from the conclusion of the 2008 Annual General Meeting on 29 May 2008 (the "2008 AGM"), Mr. David Gordon Eldon resigned as an independent non-executive Director, while Mr. Lo Chung-hing retired as an independent non-executive Director by rotation pursuant to Articles 87 and 88 of the Articles of Association of the Company, and did not offer himself for re-election.

Coming from diverse business and professional backgrounds, the non-executive Directors actively bring their valuable experience to the Board for promoting the best interests of the Company and its shareholders. On the other hand, the independent non-executive Directors contribute to ensuring that the interests of all shareholders of the Company are taken into account by the Board and that relevant issues are subjected to objective and dispassionate consideration by the Board. The Company has received confirmation from each independent non-executive Director about his/her independence under the Listing Rules, and continues to consider each of them to be independent.

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Each Director ensures that he/she can give sufficient time and attention to the affairs of the Company. During the year, Directors had been requested to disclose the number and nature of offices held in public companies or organisations and other significant commitments as well as their identity to the Company twice a year. At the January 2009 Board Meeting, Directors had been advised of the increased level of continuous disclosure of information about and by them, together with other matters relating to Directors, in the light of the amendments to the Listing Rules which came into effect on 1 January 2009.

Biographies of the Members of the Board are set out on pages 108 to 111. None of the Members of the Board and the Executive Directorate has any relationship (including financial, business, family or other material or relevant relationships) between each other, although the S for T&H (Ms. Eva Cheng) and Commissioner for Transport (Mr. Alan Wong Chi-kong) were appointed by the Chief Executive of the HKSAR, and Professor Chan Ka-keung, Ceajer is the Secretary for Financial Services and the Treasury of the Government, and Ms. Christine Fang Meng-sang sits on various government advisory committees.

As permitted under its Articles of Association, the Company has arranged Directors' and Officers' Liability Insurance for which Members of the Board and officers of the Company do not have to bear any excess.

### Chairman and Chief Executive Officer

The posts of Chairman and Chief Executive Officer are distinct and separate (please refer to the respective appointment of Dr. Raymond Ch'ien Kuo-fung as the non-executive Chairman of the Company, and Mr. Chow Chung-kong as the Chief Executive Officer of the Company and a Member of the Board on page 93). The non-executive Chairman is responsible for chairing and managing the operations of the Board, as well as monitoring the performance of the Chief Executive Officer and Members of the Executive Directorate. Apart from ensuring that adequate information about the Company's business is provided to the Board on a timely basis, the Chairman also ensures that the non-executive Directors make an effective contribution at Board meetings. As head of the Executive Directorate and chairman of the Executive Committee (which comprises all other Members of the Executive Directorate, General Manager – Corporate Relations, and General Manager – Marketing & Station Commercial), the Chief Executive Officer is responsible to the Board for managing the business of the Company. Biographies of the Members of the Executive Committee are set out on page 113.

The Chairman held a meeting on 15 April 2008 with the non-executive Directors without the presence of Members of the Executive Directorate. Matters discussed were Board responsibilities and effectiveness; governance and compliance infrastructure; management reporting transparency; succession plan for Members of the Executive Directorate; and general human resource issues in respect of the Company's development objectives.

Another meeting has been scheduled to be held by the Chairman in May 2009.

### Board Proceedings

The Board meets in person regularly, and all Members of the Board have full and timely access to relevant information and may take independent professional advice at the Company's expense, if necessary, in accordance with the approved procedures. The draft agenda for regular Board meetings is prepared by the Legal Director & Secretary and approved by the Chairman of the Company. Members of the Board are advised to inform the Chairman or the Legal Director & Secretary not less than one week before the relevant Board meeting if they wish to include a matter in the agenda of the meeting. The Board meeting dates for the following year are usually fixed by the Legal Director & Secretary and agreed by the Chairman some time in the third quarter of each year.

At each regular Board meeting, Members of the Executive Directorate together with senior managers report to the Board on their respective areas of business, including the operations, progress of projects, financial performance, corporate governance and outlook. The Chief Executive Officer also submits his Executive Summary, which focuses on the overall strategies and principal issues of the Company, to the Board. These reports, together with the discussions at Board meetings, provide information to enable all Members of the Board to make informed decisions for the benefit of the Company. The agenda together with board papers are sent in full at least three days before the intended date of the Board meeting.

All Members of the Board have access to the advice and services of the Legal Director & Secretary, who is responsible for ensuring that the correct Board procedures are followed and advises the Board on all corporate governance matters. The Members of the Board also have full access to all Members of the Executive Directorate as and when they consider necessary.

Unless specifically permitted by the Articles of Association, a Director cannot cast a vote on any contract, transaction, arrangement or any other kind of proposal in which he has

an interest and which he knows is material. For this purpose, interests of a person who is connected with a Director (including any of his associates) are treated as the interests of the Director himself. Interests purely as a result of an interest in the Company's shares, debentures or other securities are disregarded. A Director may not be included in the quorum for such part of a meeting that relates to a resolution he is not allowed to vote on but he shall be included in the quorum for all other parts of that meeting. This reduces potential conflicts which might otherwise arise between the Company's business and an individual Director's other interests or appointments.

In 2008, the Board held nine meetings. When matters which might result in conflicts of interest between the Company and Government were discussed at Board meetings, the Government-nominated Members of the Board, who during the course of 2008 consisted of the S for T&H, Professor Chan Ka-keung, Ceajer (the Secretary for Financial Services and the Treasury), and the Commissioner for Transport (or their respective alternates) either did not attend the relevant Board meetings, or where they did attend, they declared their interests and did not vote in any relevant motion and were not included in the calculation of the relevant quorum.

The attendance record of each Member of the Board is set out below:

Directors	Attendance of Board meetings in 2008
<b>Non-executive Directors</b>	
Dr. Raymond Ch'ien Kuo-fung (Chairman)	9/9
Commissioner for Transport (Alan Wong Chi-kong)	8/9
Secretary for Transport and Housing (Eva Cheng) 4 meetings were attended by her alternate directors	9/9
Professor Chan Ka-keung, Ceajer 2 meetings were attended by his alternate director	8/9
<b>Independent Non-executive Directors</b>	
Professor Cheung Yau-kai	4/9
David Gordon Eldon (Note)	3/3
Christine Fang Meng-sang	9/9
Edward Ho Sing-tin	7/9
Lo Chung-hing (Note)	3/3
T. Brian Stevenson	8/9
Ng Leung-sing	8/9
Abraham Shek Lai-him	8/9
<b>Executive Director</b>	
Chow Chung-kong (Chief Executive Officer)	9/9

Note

Messrs Eldon and Lo ceased to be independent non-executive Directors with effect from the conclusion of the 2008 AGM on 29 May 2008.

The minutes of Board meetings are prepared by the Secretary of the meeting with details of the matters considered by the Board and decisions reached, including any concerns raised by the Members of the Board or dissenting views expressed. The draft minutes are circulated to all Members of the Board for their comment within a reasonable time after the meeting. The approved procedure is that the Board formally adopts the draft minutes at the subsequent meeting. If Members of the Board have any comment on the draft minutes, they will discuss it at that meeting, followed by a report on what has been agreed in the minutes of that meeting. Minutes of Board Meetings are kept by the Legal Director & Secretary and open for inspection by all Members of the Board at the Company's registered office.

## Material Interests and Voting

All Directors are required to comply with their common law duty to act in the best interests of the Company and have particular regard to the interest of the shareholders as a whole. The Government is a substantial shareholder of the Company and the Chief Executive of the HKSAR, may, pursuant to Section 8 of the MTR Ordinance, appoint up to three persons as "additional directors". Each Director appointed by the Chief Executive of the HKSAR pursuant to Section 8 of the MTR Ordinance or by the Government through its shareholding must, like any other Director, act in the best interests of the Company.

Directors are required to declare their interests, if any, in any transaction, arrangement or other proposal to be considered by the Board at Board meetings and to abstain from voting on any related resolutions. As a result, if a conflict arises between the interests of the Company and those of the Government, a Director appointed by the Chief Executive of the HKSAR pursuant to Section 8 of the MTR Ordinance or by the Government, would not be included in the quorum of part of a meeting that relates to the transaction, arrangement or other proposal being considered by the Board and would not be allowed to vote on the related resolution.

There are a number of contractual arrangements that have been entered into between the Company and the Government (and its related entities), some of which are continuing in nature. As the Government is a substantial shareholder of the Company, such contractual arrangements are connected transactions (and in some cases continuing connected transactions) for the purposes of the Listing Rules. The section headed "Connected Transactions" explains how, in accordance with the Listing Rules, these transactions are treated.

### Appointment, Re-election and Removal of Members of the Board

A person may be appointed as a Member of the Board at any time either by the shareholders in general meeting or by the Board upon recommendation by the Nominations Committee of the Company. Directors who are appointed by the Board must retire at the first annual general meeting after their appointment. A Director who retires in this way is eligible for election at that annual general meeting, but is not taken into account when deciding which and how many Directors should retire by rotation. In either case, the Directors so elected and appointed are eligible for re-election and re-appointment. At each annual general meeting of the Company, one third of the Directors (or, if the number of Directors is not divisible by three, such number as is nearest to and less than one third) must retire as Directors by rotation.

The Chief Executive of the HKSAR may, pursuant to Section 8 of the MTR Ordinance, appoint up to three persons as “additional directors”. Directors appointed in this way may not be removed from office except by the Chief Executive of the HKSAR. These Directors are not subject to any requirement to retire by rotation nor will they be counted in the calculation of the number of Directors who must retire by rotation. In all other respects, the “additional directors” are treated for all purposes in the same way as other Directors and are, therefore, subject to the normal common law duties of directors, including to act in the best interests of the Company. The Chief Executive of the HKSAR has appointed the office of the S for T&H and the office of Commissioner for Transport as “additional directors”. As there are currently nine Directors subject to the requirement to retire by rotation, and one-third of them shall retire at each annual general meeting of the Company (subject to re-election by the shareholders), each of these Directors is effectively appointed for a term of approximately three years.

Each of the Directors, on appointment to the Board, is given a comprehensive induction programme on key areas of business operations and practices of the Company, as well as a Directors’ Manual. Amongst other things, the Manual not only sets out the general and specific duties of the Directors under general law (common law and legislation) and the Listing Rules, but also includes the Terms of Reference of the Board Committees. The Directors’ Manual is updated from time to time to reflect developments in those areas.

To assist their continuous professional development, the Legal Director & Secretary recommends Directors to attend relevant seminars and courses. The costs for such training are borne by the Company.

### Accountability

The Members of the Board are responsible for preparing the accounts of the Company and of the Group. The accounts are prepared on a going concern basis and give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2008, and of the Group’s profit and cash flow for the year then ended. In preparing the accounts for the year ended 31 December 2008, the Members of the Board have selected appropriate accounting policies and, apart from those new and amended accounting policies as disclosed in the notes to the accounts for the year ended 31 December 2008, have applied them consistently with previous financial periods. Judgments and estimates have been made that are prudent and reasonable. The reporting responsibilities of the External Auditor are set out on page 138.

In support of the above, the accounts presented to the Board have been reviewed by the Members of the Executive Directorate. For both the annual and interim reports and accounts, the Finance Division is responsible for clearing them with the External Auditor and then the Audit Committee. In addition, all new and amended accounting standards and requirements, as well as changes in accounting policies adopted by the Company have been discussed and approved at the Audit Committee before adoption by the Company.

### Board Committees

As an integral part of good corporate governance, the Board has established the Audit Committee, Remuneration Committee and Nominations Committee to oversee particular aspects of the Company’s affairs. These Board Committees comprise only non-executive Directors who have been invited to serve as members. Further and in December 2008, the Board set up the Corporate Responsibility Committee. Each of these Committees is governed by its respective Terms of Reference which are available on the Company’s website: [www.mtr.com.hk](http://www.mtr.com.hk).

All Committees are provided with sufficient resources to discharge their duties.

Following the completion of the Rail Merger, the Independent Committee of the Board which was established for the purpose of the Rail Merger was formally disbanded in May 2008.

### Audit Committee

The Audit Committee consists of four non-executive Directors, three of whom are independent non-executive Directors. The Members of the Committee are T. Brian Stevenson (chairman), Professor Cheung Yau-kai, the Commissioner for Transport (Alan

Wong Chi-kong), and Ng Leung-sing. None of the Committee Members is a partner or former partner of KPMG, the Company's External Auditor. The Finance & Business Development Director, the Head of Internal Audit and representatives of the External Auditor of the Company are expected to attend meetings of the Committee. At the discretion of the Committee, others may also be invited to attend meetings. The Committee meets regularly, and the External Auditor or the Finance & Business Development Director may request a meeting if they consider it necessary.

The Terms of Reference of the Audit Committee were revised in April 2008 to improve clarity. Further and in January 2009, the Terms of Reference were updated in the light of the amendments to the Listing Rules, which became effective on 1 January 2009, to reflect the new oversight role of the Audit Committee in the review of the adequacy of resources, qualifications and experience of staff of the Company's accounting and financial reporting function, and their training programmes and budget, as well as the removal of the requirement for a qualified accountant. Accordingly, the revised Terms of Reference were approved by the Board in April 2008 and January 2009 respectively. Under its Terms of Reference, the duties of the Audit Committee include financial and efficiency aspects as described below. Amongst other things, the Committee is required to oversee the relationship with the Company's External Auditor, to review the financial information of the Company, and to oversee the Company's financial reporting system and internal control procedures. The Committee discusses with the External Auditor the nature and scope of audit and reporting obligations before the audit commences. Apart from giving pre-approval of all audit services, the Committee also pre-approves any non-audit services for complying with relevant legal requirements. The Committee is primarily responsible for making recommendations to the Board on the appointment and removal of the External Auditor, and approving the remuneration and terms of such engagement. With respect to financial information of the Company, the Committee monitors the integrity of financial statements, annual and interim reports and accounts, together with the preliminary announcement of results and other announcements regarding the Company's financial information to be made public. In dealing with the financial information, the Committee liaises with the Board and the Executive Directorate (including the Finance & Business Development Director), and the chairman of the Committee further meets on an ad hoc basis with the Head of Internal Audit, representatives of the External Auditor, and Management. Apart from considering issues arising from the audit, the Committee discusses any matters that auditor(s) may wish to raise either privately or together

with executive Director(s) and any other person. The Committee is required to review, at least annually, the effectiveness of the Company's financial controls, internal control and risk management systems and to report to the Board that such a review has been carried out. These controls and systems allow the Board to monitor the Company's overall financial position and to protect its assets. Commencing from the financial year 2009 and as mentioned above, the Committee's review will also cover discussion with the Management on their review of the adequacy of resources, qualifications and experience of staff of the Company's accounting and financial reporting function, and their training programmes and budget. Regarding the Company's readiness in compliance with this new requirement, please refer to the section headed "Internal Controls" below. The Committee reviews and approves the annual Internal Audit Plan which includes audits on the efficiency of chosen activities or operations of the Company. In addition, the Committee reviews periodic reports from the Head of Internal Audit and the follow-up of major action plans recommended, and puts forward recommendations to the Board where appropriate.

The chairman of the Committee summarises activities of the Committee and highlights issues arising therefrom by a report to the Board after each Audit Committee meeting.

The minutes of the Audit Committee meetings are prepared by the secretary of the meeting with details of the matters considered by the Committee Members and decisions reached, including any concerns raised by the Committee Members and dissenting views expressed. The draft minutes are circulated to the Committee Members for comments and the final version of the minutes is sent to the Committee Members for their records within a reasonable time after the meeting and the minutes are open for inspection by the Committee Members at the Company's registered office. A framework of the agenda items for the meetings for the following year is set out for the Committee Members' reference and comment in the last quarter of each year. The chairman of the Committee makes the final determination on the agenda for the regular Committee meetings.

In 2008, the Audit Committee held three meetings where all the agenda items set out in the Agenda Framework pre-agreed with the chairman of the Committee in 2007 for 2008 had been discussed. In 2009, a total of four meetings have been scheduled. The major work performed by the Committee in 2008 included:

- Review of and recommendation for the Board's approval the draft 2007 Annual Report and Accounts and 2008 Interim Report and Accounts;

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- Approval of the 2008 Audit Plan and review of the periodic report prepared by the Internal Audit Department;
- Approval of the 2009 Audit Plan;
- Pre-approval of the audit and non-audit services provided by KPMG, the External Auditor, for 2008;
- Approval of the remuneration and terms of engagement of KPMG for the 2008 audit;
- Preview of 2008 annual accounting and compliance issues;
- Review of the effectiveness of the Company's internal control systems;
- Review of the effectiveness of the Internal Audit Department;
- Review of a report on staff complaints; and
- Review of enterprise risk management.

The attendance record of each Audit Committee Member is set out below. Representatives of the External Auditor, the Finance & Business Development Director and the Head of Internal Audit attended all those meetings for reporting and answering questions about their work. Further to that and by invitation, the Operations Director, the Property Director and the Legal Director & Secretary (or their representatives) had respectively provided an overview of the Company's railway operations, property business as well as outstanding litigation, compliance and enterprise risk management matters to the Members at the meetings. The Finance & Business Development Director also provided an overview of the business development and expansion overseas.

Directors	Attendance of Audit Committee meetings in 2008
T. Brian Stevenson (chairman)	3/3
Professor Cheung Yau-kai	2/3
Commissioner for Transport (Alan Wong Chi-kong)	3/3
Ng Leung-sing	2/3

### Remuneration Committee

The Remuneration Committee consists of three non-executive Directors, two of whom are independent non-executive Directors. The Members of the Remuneration Committee are Edward Ho Sing-tin (chairman), T. Brian Stevenson and Professor Chan Ka-keung, Ceajer. Mr. Ho and Mr. Stevenson are independent non-executive Directors.

The principal responsibilities of the Remuneration Committee include formulating a remuneration policy and practices that facilitate the employment of top quality personnel, recommending to the Board the remuneration of the Members of the Board who are non-executive Directors, determining the remuneration packages of the Members of the Board who are executive Directors and other Members of the Executive Directorate, and reviewing and approving performance-based remuneration by reference to the Company's goals and objectives.

In 2008, the Remuneration Committee held three meetings. In accordance with its Terms of Reference, the Committee performed the following work during the year:

- Approved the 2007 Remuneration Report as incorporated in the 2007 Annual Report;
- Reviewed and approved payouts under the Company's performance-based variable incentive scheme for the 2007 performance period;
- Reviewed and approved the remuneration package for the Finance & Business Development Director, following his assumption of additional responsibilities for business development in the Mainland of China and overseas in May 2008;
- Conducted an annual review of the remuneration packages for the Chief Executive Officer and other Members of the Executive Directorate, which took effect in July 2008;
- Reviewed and approved share options awards for Members of the Executive Directorate and other eligible employees; and
- Approved the framework, to be conducted by independent third parties, for auditing the payout calculation under the Variable Incentive Scheme.

The attendance record of each Committee Member is set out below:

Directors	Attendance of Remuneration Committee meetings in 2008
Edward Ho Sing-tin (chairman)	3/3
T. Brian Stevenson	2/3
Professor Chan Ka-keung, Ceajer 1 meeting was attended by his alternate director	3/3

The Remuneration Committee also met on 3 March 2009 to approve the 2008 Remuneration Report, which is set out on pages 104 to 107 and includes a description of the remuneration policy of the Company.

### Nominations Committee

The Committee consists of seven non-executive Directors, four of whom are independent non-executive Directors. Both Mr. David Gordon Eldon (chairman) and Mr. Lo Chung-hing served the Committee up to the conclusion of the 2008 AGM. Mr. Edward Ho Sing-tin succeeded Mr. Eldon as chairman and a Member of the Committee, while Mr. Ng Leung-sing was appointed as a Member of the Committee in place of Mr. Lo, both with effect from the conclusion of the 2008 AGM. The other five Members of the Nominations Committee are Dr. Raymond Ch'ien Kuo-fung, Christine Fang Meng-sang, Abraham Shek Lai-him, Professor Chan Ka-keung, Ceajer and the S for T&H (Ms. Eva Cheng). Mr. Ho, Mr. Ng, Ms. Fang and Mr. Shek are also independent non-executive Directors.

The Nominations Committee nominates and recommends to the Board candidates for filling vacancies on the Board, and the positions of Chief Executive Officer ("CEO"), Finance Director ("FD") and Chief Operating Officer ("COO") (provided that the COO position exists). For the positions of FD and COO, the Committee may consider candidates recommended by the CEO, or any other candidates (provided that the CEO shall have the right to first agree to such other candidates).

Since there was no new Board appointments in 2008, the Nominations Committee did not convene any meeting during the year.

### Corporate Responsibility Committee

In December 2008, the Board endorsed the setting up of the Corporate Responsibility Committee. Under its Terms of Reference, the Members shall consist of at least three non-executive Directors, two of whom shall be independent non-executive Directors, and two Members of the Executive Directorate. The Chairman of the Company is the chairman of the Committee. Current Members of the Committee are Dr. Raymond Ch'ien Kuo-fung (Chairman), S for T&H (Ms. Eva Cheng), Ms. Christine Fang Meng-sang, Mr. Abraham Shek Lai-him, Mr. Leonard Bryan Turk (Legal Director & Secretary) and Mr. Thomas Ho Hang-kwong (Property Director). The Committee normally meets two times a year. The Committee did not hold any meeting in 2008.

The duties of the Committee are to recommend a corporate responsibility policy to the Board for approval, monitor and oversee the implementation of the Company's corporate responsibility policy and initiatives, identify emerging corporate responsibility issues arising from external trends, review annual Sustainability Report and recommend endorsement by the Board, and provide update to the Board as required. Please also refer to the "Sustainability" section on page 92 of this Annual Report.

### Internal Controls

The Board is responsible for the system of internal controls of the Company and its subsidiaries, setting appropriate policies and reviewing the effectiveness of such controls. Internal control is defined as a process effected by the Board, Management and other personnel, designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, and not absolute assurance of the following:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with applicable laws and regulations
- effectiveness of risk management functions

Pursuant to the Protocol adopted by the Board, the Board has delegated the day-to-day management of the Company's business to the Executive Committee, and focuses its attention on matters affecting the Company's overall strategic policies, finances and shareholders.

Supported by the Members of the Executive Committee, the Chief Executive Officer who chairs the Executive Committee is responsible to the Board for the conduct of the business of the Company.

A number of committees have been established to assist the Executive Committee in the day-to-day management and control of the various core businesses and functions of the Company and its subsidiaries. Key committees include:

- Operations Executive Management Committee
- Operations Business Meeting
- Property Executive Management Committee
- Project Control Group
- Railway Extensions Steering Group

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- Consultancy Services Management Committee
- European Business Executive Committee
- China Business Executive Committee
- Information Technology Executive Management Committee
- Financial Planning Committee
- Investment Committee
- Corporate Safety Management Committee
- Enterprise Risk Committee
- Code of Conduct Steering Committee
- Tender Board
- Executive Tender Panel
- Corporate Responsibility Steering Committee

The Executive Committee is responsible for implementing the Board's policies on risk and control. In fulfilling its responsibilities, the Executive Committee identifies and evaluates the risks faced by the Company for consideration by the Board, and designs, operates and monitors a suitable system of internal controls which implements the policies adopted by the Board. The Executive Committee is accountable to the Board for monitoring the system of internal controls and providing assurance to the Board that it has done so. Additionally, all employees have responsibility for internal controls within their areas of accountability.

Various risk management strategies have been established by the Board as advised by the Executive Committee to identify, assess and reduce risks, including construction, business operations, finance, treasury, safety and enterprise risks as well as to ensure appropriate insurance coverage.

### Risk Assessment and Management

The Company has established an Enterprise Risk Management ("ERM") framework for the strategic management of business risks. The framework covers all key business areas of the Company and provides a useful forum for communicating risk issues at different levels of the organisation and thereby improves awareness and understanding of risk. The framework has been in operation since early 2006 and its application has been enhanced through annual reviews of the framework, user feedback surveys and experience sharing with leading UK ERM-practising companies. Structured cross-discipline processes and organisations are in place at corporate and divisional levels for risk identification, assessment, mitigation and monitoring. A standard rating system is employed across the Company to prioritise risks for mitigation, effective

monitoring and reporting to the Executive Committee and the Board. The ERM Manual that governs the working of the ERM framework has been enhanced, and regular briefing sessions are conducted, to promulgate the application and ensure consistent understanding of ERM.

The operation of the ERM framework, which is overseen by the Enterprise Risk Committee ("ERC"), is underpinned by line management taking direct risk management responsibilities as risk owners. Changes to existing and emerging risks are regularly reviewed by line management. The ERC reviews the operation of the ERM framework and key business risks every three months. The reviews cover the changes in business environments, the key internal and external risks facing the Company, and the risk perspectives of the Executive Committee, business managers and outside stakeholders. The ERC promotes a proactive risk culture by learning from risk events and failures.

Risks assessment is now part of the everyday management processes. Risks associated with major changes and new businesses such as Rail Merger integration, material local and overseas railway construction, investment businesses and consultancy projects are assessed at key stages and project milestones to support decision making. The Enterprise Risk Management Department plays a central role in facilitating risk assessments and reviewing existing and emerging business risks.

The Executive Committee reviews key enterprise risks half-yearly and the Board annually to ensure that such risks are under satisfactory control. The Audit Committee also reviews annually the implementation and the ERM organisation and processes that have been put in place.

### Control Activities and Processes

To ensure the efficient and effective operation of business units and functions, and safety of operating railway and construction works in railway projects, Corporate General Instructions ("CGIs"), divisional/departmental procedures and manuals, committees, working groups and quality assurance units are established to achieve, monitor and enforce internal controls and evaluate their effectiveness.

CGIs and various departmental procedures and manuals are established for preventing or detecting unauthorised expenditures/payments, safeguarding the Company's assets, ensuring the accuracy and completeness of accounting records and timely preparation of reliable financial information.



All Department Heads, including Business and Project Managers for overseas projects, are responsible for ensuring the compliance with statutes and regulations applicable to their own functional units. They are required to identify any new or updated statutes, to assess their impact on the Company's operations, and to review at least once a year that relevant statutes/regulations are complied with. Potential and actual non-compliances are also reported and followed up by Department Heads and significant ones are reported to the respective Divisional Directors and the Executive Committee. Issues relating to compliance with statutes and regulations including potential and actual non-compliances, if any, and the status of rectification and actions taken to prevent recurrence are reported annually to the Executive Committee and Audit Committee.

The Internal Audit Department plays a major role, independent of the Company's management, in assessing and monitoring the internal controls of the Company. The Head of Internal Audit reports to the Chief Executive Officer and has direct access to the Audit Committee. The Department has unrestricted access to information that allows it to review all aspects of the Company's risk management, control and governance processes. On a regular basis, it conducts audits on financial, operational and compliance controls, and effectiveness of risk management functions of all business and functional units as well as subsidiaries. Management is responsible for ensuring that control deficiencies highlighted in internal audits are rectified within a reasonable period. The Department produces an annual internal audit plan derived from risk assessment for the Audit Committee's approval. On a half-yearly basis, the Head of Internal Audit reports to the Audit Committee his audit findings and his opinion on the system of internal controls.

On behalf of the Board, the Audit Committee evaluates the effectiveness of the Company's system of internal controls, including the reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws and regulations and effectiveness of risk management functions. This is achieved primarily through approving the annual internal audit plan and reviewing the findings of internal audit work, in addition to reviewing the annual and interim financial statements, and the nature, scope of work, and report of the external auditors, and consideration of the following:

- the changes in the nature and extent of significant risks since the previous review and the Company's ability to respond to changes in its business and external environment;

- the scope and quality of management's ongoing monitoring of risks and the system of internal controls, the work of the Internal Audit Department, and the assurance provided by the Executive Committee;
- the extent and frequency with which the results of monitoring are communicated, enabling the Audit Committee to build up a cumulative assessment of the state of control in the Company and the effectiveness with which risk is being managed;
- the incidence of any significant control failings or weaknesses that have been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the Company's financial performance or condition; and
- the effectiveness of the Company's processes in relation to financial reporting and statutory and regulatory compliance.

The processes for assessing internal controls by the Audit Committee have included: regular interviews with Members of the Executive Committee in relation to key business operations, internal control and compliance issues, both financial and non-financial; review of significant issues arising from internal audit reports and external audit report, and private sessions with internal and external auditors. The Audit Committee has also reviewed the papers prepared by the Executive Committee and Internal Audit Department covering: 2007 Annual Report and Accounts, Preview of 2008 Annual Accounting and Compliance issues, 2008 Interim Accounts, 2008 and 2009 Internal Audit Plans, Internal Audit's Half-yearly Reports, Annual Report on Staff Complaints, Reporting of Internal Control Systems, Reporting of Outstanding Litigation and Compliance Issues, ERM Report 2007 and Evaluation of Effectiveness of Internal Audit Department. The chairman of the Committee meets on an ad hoc basis with the Head of Internal Audit, representatives of the External Auditor and Management of the Company as appropriate. He summarizes activities of the Committee and highlights issues arising therefrom by a report to the Board after each Audit Committee meeting.

The Board has, through the Audit Committee, conducted the review of the effectiveness of the Company's system of internal controls for the year ended 31 December 2008, covering all material financial, operational and compliance controls, and risk management function, and concluded that adequate and effective internal controls are maintained to safeguard the shareholders'

## Corporate Governance Report

investment and the Company's assets. There were no significant control failings, weaknesses or significant areas of concern identified during the year which might affect shareholders.

With regard to the new role of the Audit Committee required by the revised Listing Rules to oversee the Management's review of the adequacy of staffing of the financial and reporting function which came into effect on 1 January 2009, the Company has in place a comprehensive annual budgeting system, an effective recruitment process as well as a training and development programme for staff of the accounting and financial reporting function which will enable the Board, through the Audit Committee, to review the adequacy of resources, qualifications and experience of staff of the Company's accounting and financial reporting function, and their training programmes and budget.

### Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code")

The Company has adopted the Model Code. After having made specific enquiry, the Company confirms that Members of the Board and the Executive Directorate complied throughout the year with the Model Code set out in Appendix 10 to the Listing Rules. Senior managers, other nominated managers and staff who, because of their office in the Company, are likely to be in possession of unpublished price sensitive information, have been requested to comply with the provisions of the Model Code. In addition, every employee is bound by the Code of Conduct issued by the Company, amongst other things, to keep unpublished price sensitive information in strict confidence.

An alternate director has reported in writing to the Company and the Stock Exchange that in January 2009, due to an oversight, he and his spouse disposed of an aggregate of 2,084 shares in the Company without having first notified in writing the Chairman of the Company and received a dated written acknowledgement from the Chairman in accordance with the Model Code. The report was made shortly after the dealings. He has also given the Company and the Stock Exchange a written confirmation that he did not possess any unpublished price sensitive information of the Company at the time of the dealings. With a view to ensuring compliance with the Model Code, the Company has reminded him in writing of his obligations under the Model Code.

### Business Ethics

The Company is committed to a high standard of business ethics and integrity. The contents of the Company's Code of Conduct and the Corporate Guidebook for All Staff are reviewed every two years by Human Resources to ensure appropriateness and compliance with legislation. Commitment to our Code of Conduct and Guidebook is reinforced by a biennial certification programme, which requires all staff to acknowledge their understanding of and agreement to abide by the Code. The Code of Conduct and Guidebooks, which had been reviewed in the fourth quarter of 2008, were issued to all staff in January 2009. Certification will be completed in the first quarter of 2009. The Code of Conduct is available on the Company's website: [www.mtr.com.hk](http://www.mtr.com.hk).

To uphold the ethical culture of our subsidiaries in the Mainland of China, and internationally, similar biennial certification programme has been arranged. Briefing on the Company's Code of Conduct and Guidebook is also included in the local Induction Programme. For other joint venture companies, guidelines on business ethics have also been published for staff's observation and compliance.

### External Auditor

The Company engages KPMG as its External Auditor. In order to maintain KPMG's independence and objectivity and the effectiveness of the audit process in accordance with applicable standards, the Audit Committee, under its Terms of Reference, pre-approves all audit services to be provided by KPMG and discusses with KPMG the nature and scope of their audit and reporting obligations before the audit commences.

The Audit Committee also reviews and pre-approves the engagement of KPMG to provide any non-audit services for complying with relevant legal requirements and seeks to balance the maintenance of objectivity with value for money.

The nature of audit and non-audit services provided by KPMG and fees paid to KPMG (including any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party

having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally) are set out in note 6D to the accounts on page 159.

On the part of KPMG, for maintaining integrity and objectivity, it also requires its audit partner serving the Group to rotate off the audit engagement with the Company at least once every seven years.

## Communication with Shareholders

### Annual General Meeting (“AGM”)

The Company’s AGM is one of the principal channels of communication with its shareholders. It provides an opportunity for shareholders to communicate face to face with the Directors about the Company’s performance and operations. The Chairman of the Company and the chairmen of the Board Committees were present at the 2008 AGM to answer shareholders’ questions.

At the 2008 AGM, the Chairman gave a verbal account of the business operation and development of the Company to shareholders. He started the formal business by highlighting the positive impact of the Rail Merger on the Company in terms of the economies of scale of the rail and related businesses, and the property development land bank and rental property portfolio. Apart from an immediate fare reduction to 2.8 million rail users everyday, the Rail Merger had also provided a better integrated network in Hong Kong and linkages to the Mainland of China. The Chairman then summarised the Company’s finance performance during 2007. On business operations, he highlighted the patronage, overall market share, customer service, station commercial and rail related businesses, property development, rental and management businesses. Looking ahead, the Chairman gave a succinct account of the Company’s new rail developments in Hong Kong, as well as its continued expansion into the Mainland of China and Europe.

Separate resolutions were proposed for each substantially separate issue at that AGM. Before the resolutions were

considered, the Chairman exercised his right as the Chairman of the Meeting under Article 67 of the Company’s Articles of Association to call a poll on all resolutions. Being the first listed company in Hong Kong to conduct electronic poll voting, the Company conducted electronic poll voting for a second time at the 2008 AGM. The poll results were posted on the websites of the Company and HKSE on the same day after the AGM. The webcast of the AGM was also posted on the Company’s website in the same evening after the AGM.

### Extraordinary General Meeting (“EGM”)

The Company may also communicate with its shareholders through EGMs if and when appropriate.

If shareholders want to convene an EGM of the Company, those shareholders may requisition the Directors of the Company to do so, provided that at the date of requisition they hold, in aggregate, not less than one-twentieth of the paid-up capital of the Company. The shareholders’ requisition must state the objects of the meeting requested and must be deposited at the registered office of the Company. The requisition may consist of several documents in like form, each signed by one or more of the shareholders concerned.

If, within 21 days from the date of the deposit of the requisition, the Directors of the Company do not proceed duly to convene an EGM for a day not more than 28 days after the date on which the notice convening the EGM is given, the relevant shareholders, or any of them representing more than one-half of the total voting rights of all of them, may themselves convene an EGM, provided that any EGM so convened is held within three months from the date of the original requisition.

### Enquiries from Shareholders

Details of other means of communication with shareholders are set out in the section of Investor Relations on pages 90 and 91.