Notes to the Accounts

1 Statement of Compliance

These accounts have been prepared in compliance with the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "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 ("HKASs") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and accounting principles generally accepted in Hong Kong. The HKFRSs have been fully converged with International Financial Reporting Standards in all material respects. 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 2008. 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).

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 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 other than those intended to be held to maturity (see note 2M); and
- derivative financial instruments (see note 2U).

(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 53.

(iii) The HKICPA has issued the following interpretations and amendments to HKFRSs that are first effective for the current accounting period of the Group and the Company:

- HK(IFRIC) 11, HKFRS 2 – Group and treasury share transactions
- HK(IFRIC) 12, Service concession arrangements
- HK(IFRIC) 14, HKAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction
- Amendments to HKAS 39, Financial instruments: Recognition and measurement, and HKFRS 7, Financial instruments: Disclosures – Reclassification of financial assets

The Company early adopted HK(IFRIC) 12 in the 2007 accounts. As a result, the merger of the Company's operations with Kowloon-Canton Railway Corporation ("KCRC") on 2 December 2007 was considered as a service concession arrangement under this interpretation. Except for HK(IFRIC) 12, the other HKFRS developments listed above have no material impact on the Group's and the Company's financial statements.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 54).

B Basis of Consolidation

The consolidated accounts include the accounts of the Company and its subsidiaries (together referred to as the "Group") and the Group's interest in non-controlled subsidiaries (see note 2D) and associates (see note 2E) 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 2H(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 2H(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 2H(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 semi-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 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 semi-annually, with changes in the value arising on revaluations treated as movements in the fixed asset revaluation reserve, except:

(a) 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

(b) 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 2H(ii)).

(iv) Assets under construction are stated at cost less impairment losses (see note 2H(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 2I(iv) and 2H(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 2H(ii)). Revenue arising from operating leases is recognised in accordance with the Group's revenue recognition policies as set out in note 2AA(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 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, 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.

(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.

Gains or losses arising from the retirement or disposal of a fixed asset or an investment property are determined as the difference between the net disposal proceeds and the carrying amount of the asset. Such gains or losses 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.

2 Principal Accounting Policies *(continued)*

F Fixed Assets *(continued)*

(vii) Service concession assets

Where the Group enters into service concession arrangements under which the Group acquires the right to access, use and operate certain assets for the provision of public services:

- Upfront payments at inception of the service concession are capitalised and amortised on a straight-line basis over the period of the service concession;
- Annual payments over the period of the service concession with the amounts fixed at inception are capitalised at the present value of the total fixed annual payments discounted at the incremental long-term borrowing rate determined at inception, and amortised on a straight-line basis over the period of the service concession with a corresponding liability recognised as obligations under service concession;
- Annual payments for the service concession which are not fixed or determinable at inception and which are contingent on future revenues generated from the service concession over certain thresholds are charged to the profit and loss account in the period when incurred;
- Expenditure directly attributable to the acquisition of the service concession up to inception, including the assumption of certain obligations of the grantor of the service concession, are capitalised and amortised on a straight-line basis over the period of the service concession; and
- Payments for the replacement and/or upgrade of assets subject to the service concession arrangement are capitalised and amortised on a straight-line basis over the shorter of the assets' useful lives and the remaining period of the service concession.

The service concession asset is carried on the balance sheet, as an intangible asset, at cost less accumulated amortisation and impairment losses, if any (see note 2H(ii)).

Income and expenditure and assets and liabilities in relation to the operation of the service concession are accounted for in the respective line items of the Group's and the Company's profit and loss accounts and balance sheets.

G Property Management Rights

Where the Group makes payments for acquisition of property management rights, the amounts paid are capitalised as intangible assets and stated in the balance sheet at cost less accumulated amortisation and impairment losses (see note 2H(ii)). The intangible asset is amortised to the profit and loss account on a straight-line basis over the terms of the management rights.

H 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);
- service concession assets;
- property management rights;
- railway construction in progress;
- property development in progress;
- prepaid land lease payments;
- deferred expenditure;
- investments in held-to-maturity securities; 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).

2 Principal Accounting Policies *(continued)*

H Impairment of Assets *(continued)*

(ii) Impairment of Other Assets *(continued)*

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.

I 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 – 50 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	4 – 10 years
Office furniture and equipment	5 – 15 years
Computer software licences and applications	5 – 7 years
Computer equipment	4 – 5 years
Cleaning 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.

2 Principal Accounting Policies *(continued)*

J 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.

K Property Development

(i) Costs incurred by the Group in respect of site preparation, land costs and acquisition of development rights for as well as interest in connection with loans to property developers are dealt with as property development in progress.

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

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

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

(v) 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. Notional 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 2K(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.

2 Principal Accounting Policies *(continued)*

L 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 2K(vi) after netting off any related balance in property development in progress at that time.

M 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) are as follows:

(i) Investments in securities held for trading purpose 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 in debt securities on which the Company has the ability and intention to hold to maturity are classified as held-to-maturity securities, which are stated at amortised cost less impairment losses (see note 2(H)(ii)).

(iii) Investments are recognised/derecognised on the date the Group commits to purchase / sell the investments.

(iv) 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.

N Defeasance of Long-term Lease Payments

Where obligations to make long-term lease payments have been defeased by the placement of securities, those obligations 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 liabilities and assets.

O 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.

P Long-term Consultancy Contracts

The accounting policy for contract revenue is set out in note 2AA(iii). When the outcome of a fixed-price consultancy contract can be estimated reliably, contract costs are recognised as expenses 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 expenses 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 profits 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".

Q 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.

R 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 2H(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.

2 Principal Accounting Policies *(continued)*

S 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.

T 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.

U 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 earning. 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 is no longer expected to take place 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.

V 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.

2 Principal Accounting Policies *(continued)*

V Employee Benefits *(continued)*

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

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

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

(iv) Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is recognised as a staff cost, unless the relevant 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 are granted. The expected life used in the model is 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.

W Retirement Schemes

The Group operates both defined contribution and defined benefit retirement schemes.

Employer's contributions to defined contribution retirement schemes including MPF Schemes are recognised in the accounts in accordance with the policy set out in note 2V(ii).

Employer's contributions paid and payable in respect of employees of defined benefit retirement schemes 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 2V(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.

X 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.

2 Principal Accounting Policies *(continued)*

X Income Tax *(continued)*

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

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

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.

Y 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 off 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 2Z 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.

Z 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.

2 Principal Accounting Policies *(continued)*

AA 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 or service 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.

BB 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.

CC 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.

DD 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 the profit and loss account.

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

EE 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.

2 Principal Accounting Policies *(continued)*

FF 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.

GG 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 Rail Merger with Kowloon-Canton Railway Corporation

A On 2 December 2007 (the "Appointed Day"), the Company's operations merged with those of KCRC ("Rail Merger"). The structure and key terms of the Rail Merger were set out in a series of transaction agreements entered into between, inter alia, the Government of the Hong Kong Special Administrative Region, KCRC and the Company including the Service Concession Agreement, Property Package Agreements and Merger Framework Agreement. Key elements of the Rail Merger include the following:

- The expansion of the Company's existing franchise under the Mass Transit Railway Ordinance ("MTR Ordinance") to cover the construction, operation and regulation of railways in addition to the MTRC railway for an initial period of 50 years from the Appointed Day ("Franchise Period"), which may be extended pursuant to the provisions of the MTR Ordinance (note 51I);
- The Service Concession Agreement ("SCA") pursuant to which KCRC granted the Company the right to access, use and operate the KCRC system for an initial term of 50 years (the "Concession Period"), which will be extended if the Franchise Period (as it relates to the KCRC railway) is extended. The SCA also sets out the basis on which the KCRC system will be returned at the end of the Concession Period. In accordance with the terms of the SCA, the Company paid an upfront lump sum to KCRC on the Appointed Day and is obliged to pay an annual fixed payment to KCRC for the duration of the Concession Period. Additionally, commencing after three years from the Appointed Day, the Company is obliged to pay an annual variable fee to KCRC based on the revenue generated from the KCRC system above certain thresholds;
- Under the SCA, the Company is responsible for the expenditure incurred in relation to the maintenance, repair, replacement and upgrade of the KCRC system (with any new assets acquired being classified as "additional concession property"). To the extent that such expenditure exceeds an agreed threshold ("Capex Threshold"), the Company will be reimbursed for any above threshold expenditure at the end of the Concession Period with such reimbursement to be on the basis of depreciated book value;
- In the event that the Concession Period is extended, the fixed annual payment and the variable annual payment will continue to be payable by the Company. On such extension, the Capex Threshold may also be adjusted;
- With effect from the Appointed Day, staff of the Company and KCRC have been employed by the Company on their prevailing terms and conditions of employment. In connection with the Rail Merger, a Staff Voluntary Separation Scheme has been offered to eligible staff (note 10);
- Property Package Agreements whereby property assets comprising certain investment and own-used properties, property management rights and property development rights were acquired by the Company;
- Merger Framework Agreement setting out the framework for the Rail Merger including the implementation of the Fare Adjustment Mechanism whereby the extent to which fares may be adjusted is linked to certain public indices, the provision of a fare reduction starting from the Appointed Day and the guarantee of job security for front line staff employed at the time of the Rail Merger;
- Pursuant to the above and the vesting and novation of certain contracts, the Company assumed certain assets and liabilities of KCRC on the Appointed Day. The assumption of the liabilities of deposits refundable to third parties was subject to compensation by KCRC on the Appointed Day; and
- Other post-Appointed Day arrangements between the Company and KCRC such as the arrangements documented by the Kowloon Southern Link ("KSL") Project Management Agreement, the West Rail Agency Agreement and the Outsourcing Agreement.

3 Rail Merger with Kowloon-Canton Railway Corporation *(continued)*

B The principal financial terms of the Rail Merger and their financial impact on the accounts are described in the following paragraphs.

For the acquisition of the service concession, the Company has settled or is liable to settle the following payments to KCRC in respect of the service concession:

- Upfront payment of HK$4,250 million was paid on the Appointed Day, of which HK$326 million was in respect of stores and spares, with the balance of HK$3,924 million for the right to access, use and operate the KCRC system ("initial concession property"), which is capitalised as a service concession asset on the balance sheet and amortised on a straight-line basis over the Concession Period;
- Fixed annual payments of HK$750 million are payable by the Company to KCRC throughout the Concession Period. The present value of the total fixed annual payments discounted at the Company's estimated long-term incremental borrowing rate at inception of 6.75% amounting to HK$10,687 million was capitalised as a service concession asset on the balance sheet and amortised on a straight-line basis over the Concession Period with a corresponding liability for obligations under the service concession recognised on the balance sheet; and
- Variable annual payments are payable by the Company to KCRC commencing after the third year from the Appointed Day to the end of the Concession Period. The payments are calculated on a tiered basis by reference to the revenues generated from the operation of the service concession over certain thresholds.

The assumption of the liability of deposits refundable to third parties and other liabilities subject to cash compensation by KCRC on the Appointed Day amounted to HK$663 million. The assumption of other assets and liabilities not subject to compensation by KCRC on the Appointed Day amounted to a net liability amount of HK$226 million (note 20), formed part of the cost of acquiring the service concession and was capitalised accordingly.

On the Appointed Day, the Company paid a total consideration of HK$7,790 million for the transfer of the economic benefits of the property package from KCRC as follows:

- Acquisition of certain properties or property holding subsidiaries from KCRC at a consideration of HK$2,840 million;
- Acquisition of property development rights for eight development sites for a consideration of HK$4,910 million, which was recognised at cost as property development in progress on the balance sheet. Pursuant to the transaction agreements, when the development sites which have not been awarded as at the Appointed Day are subsequently awarded, the Company is obliged to pay KCRC an agreed amount of HK$875 million in respect of enabling works carried out by KCRC for such sites, which are to be settled by the receipt of mandatory payments from property developers when the sites are awarded;
- Acquisition of certain property management rights from KCRC in respect of existing and future managed properties at a consideration of HK$40 million. The amount was capitalised and subject to amortisation on a straight-line basis over the period of the management rights;
- Assumption of certain assets and liabilities with a net liability amount of HK$123 million relating to the property package with corresponding cash settlement from KCRC; and
- Acquisition of certain other subsidiaries of KCRC.

The Rail Merger also gave rise to the following:

- The Company obtained a new loan financing facility of HK$10 billion in 2007 as part of the financing for the above arrangements; and
- Deferred expenditure of HK$492 million incurred in connection with the acquisition of the respective assets was capitalised on the Appointed Day.

Income and expenditure and assets and liabilities in relation to the operation of the service concession are accounted for in the respective line items of the Group's and the Company's profit and loss accounts and balance sheets. Accordingly, the profit and loss accounts for the year ended 31 December 2008 reflect a full year of the Rail Merger whereas the comparatives reflect one month.

4 Fare Revenue

Fare revenue comprises:

in HK$ million	2008	2007
Domestic Service	**7,930**	6,213
Cross-boundary Service	**2,283**	201
Airport Express	**673**	655
Light Rail, Bus and Intercity	**581**	46
	11,467	7,115

The Domestic Service comprises the Kwun Tong, Tsuen Wan, Island, Tung Chung, Tseung Kwan O and Disneyland Resort lines, and additional services of the East Rail excluding Cross-boundary Service, West Rail and Ma On Shan lines after the Rail Merger. The Cross-boundary Service, Light Rail, Bus and Intercity are also KCRC transport services provided by the Company after the Rail Merger.

5 Non-fare Revenue

A Station Commercial and Rail Related Revenue

Station commercial and rail related revenue comprises:

in HK$ million	2008	2007
Advertising	**741**	593
Duty free shops and kiosk rental	**1,546**	499
Telecommunication income	**356**	239
Consultancy income	**158**	193
Miscellaneous business revenue	**648**	217
	3,449	1,741

B Rental, Management and Other Revenue

in HK$ million	2008	2007
Property rental income:		
– Telford Plaza	**571**	524
– Luk Yeung Galleria	**146**	118
– Paradise Mall	**115**	111
– Maritime Square	**330**	300
– International Finance Centre	**211**	147
– Ginza Mall – Beijing	**109**	90
– Elements	**395**	93
– Citylink Plaza	**112**	8
– Other properties	**357**	190
	2,346	1,581
Property management income	**210**	168
	2,556	1,749
Ngong Ping 360 business revenue	**156**	85
	2,712	1,834

5 Non-fare Revenue *(continued)*

B Rental, Management and Other Revenue *(continued)*

Included in rental income is HK$107 million (2007: HK$72 million) in respect of the provision of air conditioning services. Phase 1 and Phase 2A of Elements commenced operations in October 2007 and November 2008 respectively. Rental income from other properties includes income in respect of investment properties, other than Citylink Plaza, that were acquired from KCRC upon the Rail Merger of HK$163 million (2007: HK$13 million).

Ngong Ping 360 business revenue comprises revenue generated from the Tung Chung cable car operations and related businesses at the Ngong Ping Theme Village.

6 Operating Expenses

A Staff costs comprise:

in HK$ million	**2008**	2007
Amount charged to profit and loss account under:		
– staff costs and related expenses	**3,358**	1,802
– repairs and maintenance	**45**	59
– expenses relating to station commercial and rail related businesses	**454**	162
– expenses relating to property ownership, management and other businesses	**141**	55
– project study and business development expenses	**83**	136
– staff voluntary separation payments	**–**	175
– other line items	**47**	21
Amount capitalised in:		
– railway construction in progress	**46**	49
– property development in progress	**102**	83
– assets under construction and other projects	**482**	318
– service concession assets	**24**	23
Amount recoverable	**418**	233
Total staff costs	**5,200**	3,116

Amount recoverable relates to property management, entrustment works and other agreements.

The following expenditures are included in staff costs:

in HK$ million	**2008**	2007
Share-based payments	**22**	7
Contributions to defined contribution plans and Mandatory Provident Fund	**156**	38
Expense recognised in respect of defined benefit plans (note 49E)	**80**	98
	258	143

6 Operating Expenses *(continued)*

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

C Project study and business development expenses comprise:

in HK$ million	2008	2007
Business development expenses	**182**	239
Miscellaneous project study expenses	**16**	29
	198	268

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

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

in HK$ million	2008	2007
Auditors' remuneration		
– audit services	**7**	5
– tax services	**1**	1
– other services	**1**	–
	9	6
Loss on disposal of fixed assets	**30**	36
Derivative financial instruments:		
– foreign exchange contracts – ineffective portion of cash flow hedges	**8**	(1)
– transfer from hedging reserve	**3**	2
Amortisation of land lease expenses (note 25)	**14**	13
Unrealised (gain)/loss on revaluation of investment in securities	**(2)**	4

In 2007, in addition to the amounts of auditors remuneration charged to general and administration expense, HK$5 million was incurred on audit and tax related services in respect of the Rail Merger.

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

in HK$ million	2008	2007
Shopping centre, office building, staff quarters and bus depot	**79**	59
Amount capitalised	**(13)**	(1)
	66	58

7 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:

in HK$ million	Fees	Base pay, allowances and benefits in kind	Retirement scheme contribution	Variable remuneration related to performance	Total
2008					
Members of the Board					
– Raymond Ch'ien Kuo-fung	1.2	–	–	–	1.2
– Cheung Yau-kai	0.3	–	–	–	0.3
– David Gordon Eldon (retired on 29 May 2008)	0.1	–	–	–	0.1
– Christine Fang Meng-sang	0.3	–	–	–	0.3
– Edward Ho Sing-tin	0.4	–	–	–	0.4
– Lo Chung-hing (retired on 29 May 2008)	0.2	–	–	–	0.2
– Ng Leung-sing	0.3	–	–	–	0.3
– Abraham Shek Lai–him	0.3	–	–	–	0.3
– T. Brian Stevenson	0.4	–	–	–	0.4
– Ceajer Chan Ka–keung	0.3	–	–	–	0.3
– Eva Cheng	0.3	–	–	–	0.3
– Alan Wong Chi-kong	0.3	–	–	–	0.3
Members of the Executive Directorate					
– Chow Chung-kong	–	6.7	–*	8.6	15.3
– Russell John Black	–	4.3	0.2	2.7	7.2
– William Chan Fu-keung	–	4.4	0.2	2.6	7.2
– Thomas Ho Hang-kwong	–	4.4	0.2	2.6	7.2
– Lincoln Leong Kwok-kuen	–	4.8	0.7	2.7	8.2
– Francois Lung Ka-kui (left service on 31 December 2008)	–	3.6	0.5	1.7	5.8
– Andrew McCusker	–	4.4	0.2	2.3	6.9
– Leonard Bryan Turk	–	4.2	0.2	2.6	7.0
	4.4	36.8	2.2	25.8	69.2

* C K Chow participates in the Company's Mandatory Provident Fund Scheme. The total contributions paid by the Company in each of the years 2007 and 2008 were HK$12,000.

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

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

in HK$ million	Fees	Base pay, allowances and benefits in kind	Retirement scheme contribution	Variable remuneration related to performance	Total
2007					
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
– Ng Leung-sing (appointed on 18 December 2007)	–	–	–	–	–
– Abraham Shek Lai-him (appointed on 18 December 2007)	–	–	–	–	–
– T. Brian Stevenson	0.3	–	–	–	0.3
– Ceajer Chan Ka-keung (appointed on 10 July 2007)	0.1	–	–	–	0.1
– Eva Cheng (appointed on 1 July 2007)	0.1	–	–	–	0.1
– Sarah Liao Sau-tung (retired on 1 July 2007)	0.1	–	–	–	0.1
– Frederick Ma Si-hang (retired on 10 July 2007)	0.1	–	–	–	0.1
– Alan Wong Chi-kong	0.2	–	–	–	0.2
Members of the Executive Directorate					
– Chow Chung-kong	–	5.9	–*	5.1	11.0
– Russell John Black	–	3.8	0.1	1.7	5.6
– William Chan Fu-keung	–	3.7	0.1	1.7	5.5
– Thomas Ho Hang-kwong	–	3.8	0.1	1.6	5.5
– Lincoln Leong Kwok-kuen	–	3.8	0.5	1.7	6.0
– Francois Lung Ka-kui	–	3.5	0.5	0.8	4.8
– Andrew McCusker	–	3.7	0.1	1.4	5.2
– Leonard Bryan Turk	–	3.7	0.1	1.7	5.5
	3.0	31.9	1.5	15.7	52.1

The above emoluments do not include the fair value of share options, as estimated at the date of grant which is defined as the date of acceptance of the offer to grant the option. The fair values of the share options awarded to Members of the Executive Directorate are as follows:

(a) Options vested under the New Joiners Share Option Scheme (the "New Option Scheme") in 2007 and 2008

Francois K K Lung was granted options in respect of 1,066,000 shares under the New Option Scheme on 22 March 2007, of which 711,000 options were vested in 2008 (2007: nil), and the respective fair value of the share-based payments recognised for the year ended 31 December 2008 was HK$1.6 million (2007: HK$1.1 million).

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

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

(b) Options vested under the 2007 Share Option Scheme (the "2007 Option Scheme") in 2007 and 2008

Share options were granted to Members of the Executive Directorate under the Company's 2007 Option Scheme, which were offered to them on 10 December 2007 and 8 December 2008. The entitlements of each of the Members are as follows:

- C K Chow was granted options in respect of 720,000 shares on 13 December 2007 and 470,000 shares on 9 December 2008, of which 240,000 options were vested in 2008 (2007: nil), and the respective fair value of the share-based payments recognised for the year ended 31 December 2008 was HK$1.2 million (2007: HK$0.071 million);
- Russell J Black, Lincoln K K Leong and Leonard B Turk were each granted options in respect of 170,000 shares on both 12 December 2007 and 9 December 2008, of which 57,000 options were vested in 2008 (2007: nil), and the respective fair value of the share-based payments recognised for the year ended 31 December 2008 was HK$0.3 million (2007: HK$0.017 million) for each of them;
- Thomas H K Ho was granted options in respect of 170,000 shares on both 12 December 2007 and 11 December 2008, of which 57,000 were vested in 2008 (2007: nil), and the respective fair value of the share-based payments recognised for the year ended 31 December 2008 was HK$0.3 million (2007: HK$0.017 million);
- Andrew McCusker was granted options in respect of 170,000 shares on both 12 December 2007 and 12 December 2008, of which 57,000 options were vested in 2008 (2007: nil), and the respective fair value of the share-based payments recognised for the year ended 31 December 2008 was HK$0.3 million (2007: HK$0.017 million);
- William F K Chan was granted options in respect of 170,000 shares on both 13 December 2007 and 9 December 2008, of which 57,000 options were vested in 2008 (2007: nil), and the respective fair value of the share-based payments recognised for the year ended 31 December 2008 was HK$0.3 million (2007: HK$0.017 million); and
- Francois K K Lung was granted options in respect of 130,000 shares on 12 December 2007, of which 87,000 options were vested in 2008 (2007: nil), and the respective fair value of the share-based payments recognised for the year ended 31 December 2008 was HK$0.4 million (2007: HK$0.013 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 47.

(ii) 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 ("SFO"). The 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.

On 12 April 2007, Lincoln K K Leong was granted a derivative interest in respect of 160,000 shares in the Company within the meaning of Part XV of the SFO. The derivative interest represents Lincoln K K Leong's entitlement to receive an equivalent value in cash of 160,000 shares on 9 April 2010.

The arrangements were offered to C K Chow and Lincoln K K Leong in order to provide a competitive level of compensation which is also closely tied to the performance of the Company.

(iii) 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$74.2 million (2007: HK$53.4 million).

(iv) 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. 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 by notice published in the Gazette under the Rail Merger Ordinance, whichever was the earlier. On 8 August 2007, he was appointed as the non-executive Chairman of the Company after the Rail Merger for a term of two years commencing from 2 December 2007. All of the five individuals with the highest emoluments are Members of the Executive Directorate whose emoluments are disclosed above.

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

B Share Options

Options exercised and outstanding in respect of each Member of the Executive Directorate as at 31 December 2008 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 (the "Pre-IPO Option Scheme") described in note 47A(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 (the "New Option Scheme") as described in note 47A(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.

On 22 March 2007, Francois K K Lung was granted options to acquire 1,066,000 shares under the New Option Scheme. Under the vesting terms of the New Option Scheme, Francois K K Lung was required to beneficially own at all times on and after 9 April 2008, at least 23,000 shares up to and including the date on which he has exercised his options in full or the date on which his options lapse (whichever is earlier). In connection with the termination of his employment with the Company on 31 December 2008 and in accordance with the terms of the New Option Scheme, 711,000 options granted to Francois K K Lung under the New Option Scheme were vested and 355,000 options lapsed as at 31 December 2008.

(iii) 2007 Share Option Scheme

Under the 2007 Share Option Scheme (the "2007 Option Scheme") as described in note 47A(iii), all Members of the Executive Directorate were granted options to acquire shares in December 2007 and December 2008. C K Chow was granted options to acquire 720,000 shares in 2007 and 470,000 shares in 2008; Russell J Black, William F K Chan, Thomas H K Ho, Lincoln K K Leong, Andrew McCusker and Leonard B Turk were each granted options to acquire 170,000 shares in both 2007 and 2008; and Francois K K Lung was granted options to acquire 130,000 shares in 2007.

Under the vesting terms of the options granted in December 2007 and December 2008, options granted will be evenly vested in respect of their underlying shares over a period of three years from 10 December 2007 and 8 December 2008 respectively. However, in connection with the termination of his employment with the Company on 31 December 2008 and in accordance with the terms of the 2007 Option Scheme, 87,000 options granted to Francois K K Lung under the 2007 Option Scheme were vested and 43,000 options lapsed as at 31 December 2008.

8 Profit on Property Developments

Profit on property developments comprises:

in HK$ million	2008	2007
Transfer from deferred income on		
– up-front payments (note 23B(i))	**139**	861
– sharing in kind (note 23B(ii))	**61**	363
Share of surplus from development	**4,505**	7,077
Income recognised from sharing in kind	**–**	21
Other overhead costs	**(35)**	(18)
	4,670	8,304

9 Depreciation and Amortisation

Depreciation and amortisation comprise:

in HK$ million	2008	2007
Depreciation charge on:		
Railway operations		
– on fixed assets held under finance leases	**19**	19
– on other railway fixed assets	**2,388**	2,501
Assets relating to station commercial and rail related businesses	**76**	73
Assets relating to property ownership, management and other businesses	**71**	68
Unallocated corporate assets	**61**	53
	2,615	2,714
Amortisation charge on:		
Service concession assets	**310**	25
Property management rights	**5**	–
	315	25
	2,930	2,739

10 Merger Related Expenses

Merger related expenses comprise:

in HK$ million	2008	2007
Staff Voluntary Separation Scheme payments (i)	**–**	175
Merger expenses (ii)	**53**	18
	53	193

(i) In 2007, a Staff Voluntary Separation Scheme ("VSS") was offered to eligible staff affected by the Rail Merger with compensation determined according to individual staff's year of services. 384 staff terminated their employment under the VSS and the resulting compensation was charged to the profit and loss account of 2007.

(ii) After the Rail Merger, other merger related expenses not eligible for capitalisation are charged to the profit and loss account.

11 Interest and Finance Charges

in HK$ million	2008		2007	
Interest expenses in respect of:				
Bank loans, overdrafts and capital market instruments wholly repayable within 5 years	**1,046**		1,004	
Bank loans and capital market instruments not wholly repayable within 5 years	**396**		498	
Obligations under finance leases	**–**		4	
Obligations under service concession	**721**		60	
Other obligations (note 19E)	**100**		–	
Finance charges	**31**		19	
Exchange gain	**(8)**		(5)	
		2,286		1,580
Derivative financial instruments:				
Fair value hedges	**34**		62	
Cash flow hedges:				
– transfer to/(from) hedging reserve	**39**		(2)	
– ineffective portion	**(1)**		–	
Derivatives not qualified for hedge accounting	**(2)**		(3)	
		70		57
Interest expenses capitalised		**(149)**		(93)
		2,207		1,544
Interest income in respect of:				
Deposits with banks and other financial institutions	**(8)**		(43)	
Investments in debt securities	**(7)**		–	
Loan to non-controlled subsidiary and associate	**(5)**		(7)	
Staff housing loans	**(1)**		(1)	
		(21)		(51)
Accreted interest on loan to a property developer		**(188)**		(177)
		1,998		1,316

Interest expenses capitalised were calculated at the average cost of borrowings to the Group on a monthly basis. The average interest rates for each month varied from 4.5% to 5.1% per annum during the year (2007: 5.3% to 5.8% per annum).

During the year, fair value gain on fair value hedges comprising interest rate and cross currency swaps was HK$368 million (gain in 2007: HK$414 million) whereas the fair value loss on the underlying financial assets and liabilities being hedged was HK$402 million (loss in 2007: HK$476 million), resulting in a net loss of HK$34 million (loss in 2007: HK$62 million).

12 Share of Profits of Non-controlled Subsidiaries and Associates

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

in HK$ million	2008	2007
Share of profit before taxation of non-controlled subsidiaries (note 26)	**152**	125
Share of profit before taxation of associates (note 28)	**32**	3
	184	128
Share of income tax of non-controlled subsidiaries (note 26)	**(16)**	(28)
Share of income tax of associates (note 28)	**(9)**	(1)
	159	99

13 Income Tax

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

in HK$ million	2008	2007
Current tax		
– Provision for Hong Kong Profits Tax at 16.5% (2007: 17.5%) for the year	**1,021**	1
– Overseas tax for the year	**3**	2
	1,024	3
Deferred tax		
– Origination and reversal of temporary differences on:		
– change in fair value of investment properties	**(24)**	1,402
– utilisation of tax losses	**532**	1,608
– others	**(81)**	70
	427	3,080
– Effect on deferred tax balances resulting from a change in tax rate	**(704)**	–
	(277)	3,080
	747	3,083

In February 2008, the Hong Kong Government announced a decrease in the Hong Kong Profits Tax rate from 17.5% to 16.5% applicable to the Group's operations in Hong Kong as from the year ended 31 December 2008. This decrease has been taken into account in the preparation of the Group's and the Company's 2008 accounts. Accordingly, the provision for Hong Kong Profits Tax for 2008 is calculated at 16.5% (2007: 17.5%) of the estimated assessable profits for the year after deducting accumulated tax losses brought forward and the deferred tax has been re-estimated accordingly.

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

For the year ended 31 December 2007, no provision for current Hong Kong Profits Tax was made in the consolidated profit and loss account in respect of the Company and most of its subsidiaries, as the Company and these subsidiaries either had accumulated tax losses brought forward which were available for setting off against the assessable profits for the year or had sustained tax losses.

Provision for deferred tax on temporary differences arising in Hong Kong is calculated at Hong Kong Profits Tax rate at 16.5% (2007: 17.5%).

13 Income Tax *(continued)*

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

	2008		2007	
	HK$ million	%	HK$ million	%
Profit before taxation	**9,027**		18,265	
Notional tax on profit before taxation, calculated at the rates applicable to profits in the tax jurisdictions concerned	**1,472**	**16.3**	3,186	17.4
Tax effect of non-deductible expenses	**95**	**1.1**	53	0.3
Tax effect of non-taxable revenue	**(121)**	**(1.3)**	(162)	(0.9)
Tax effect of unused tax losses not recognised	**5**	**0.1**	6	0.0
Effect on deferred tax balances resulting from a change in tax rate	**(704)**	**(7.8)**	–	0.0
Actual tax expenses	**747**	**8.4**	3,083	16.8

14 Profit Attributable to Equity Shareholders

The consolidated profit attributable to equity shareholders includes a profit of HK$8,118 million (2007: HK$14,883 million) which has been dealt with in the accounts of the Company.

15 Dividends

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

in HK$ million	2008	2007
Dividends paid and payable attributable to the year		
– Interim dividend of 14 cents (2007: 14 cents) per share	**790**	782
– Final dividend proposed after the balance sheet date of 34 cents (2007: 31 cents) per share	**1,925**	1,740
	2,715	2,522
Dividends payable attributable to the previous year		
– Final dividend of 31 cents (2006: 28 cents) per share approved and paid during the year	**1,740**	1,554

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 51V. On 8 November 2006, the FSI agreed to extend the scrip dividend arrangement for another three financial years until the financial year ending 31 December 2009.

16 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$8,284 million (2007: HK$15,180 million) and the weighted average number of ordinary shares of 5,632,895,671 in issue during the year (2007: 5,573,736,592), calculated as follows:

	2008	2007
Issued ordinary shares at 1 January	**5,611,057,035**	5,548,613,951
Effect of scrip dividends issued	**20,529,968**	24,065,067
Effect of share options exercised	**1,308,668**	1,057,574
Weighted average number of ordinary shares at 31 December	**5,632,895,671**	5,573,736,592

16 Earnings Per Share *(continued)*

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$8,284 million (2007: HK$15,180 million) and the weighted average number of ordinary shares of 5,636,941,336 in issue during the year (2007: 5,578,838,104) after adjusting for the number of dilutive potential ordinary shares under the employee share option schemes, calculated as follows:

	2008	2007
Weighted average number of ordinary shares at 31 December	**5,632,895,671**	5,573,736,592
Number of ordinary shares deemed to be issued for no consideration	**4,045,665**	5,101,512
Weighted average number of ordinary shares (diluted) at 31 December	**5,636,941,336**	5,578,838,104

C Both basic and diluted earnings per share would have been HK$1.45 (2007: HK$1.54) if the calculation is based on profit from underlying businesses attributable to equity shareholders, i.e. excluding change in fair value of investment properties net of related deferred tax, adjusted as follows:

in HK$ million	**2008**	2007
Profit attributable to equity shareholders	**8,284**	15,180
Change in fair value of investment properties	**146**	(8,011)
Deferred tax on change in fair value of investment properties		
– Effect of the change during the year (note 13A)	**(24)**	1,402
– Effect on deferred tax balances resulting from a change in tax rate	**(221)**	–
Profit from underlying businesses attributable to equity shareholders	**8,185**	8,571

17 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 both the Hong Kong International Airport and the AsiaWorld-Expo at Chek Lap Kok and following the Rail Merger, with effect from 2 December 2007, the KCR System consisting of KCR Lines (comprising the East Rail excluding Cross-boundary Service, West Rail and Ma On Shan lines), Cross-boundary Service, Light Rail, Bus and Intercity passenger services.

Station commercial and rail related businesses: Commercial activities including letting of advertising and retail space, bandwidth services on the railway telecommunication system, railway consultancy services, freight and rail related subsidiaries' businesses.

Property ownership, management and other businesses: Property rental, property management and operations relating to Ngong Ping 360.

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

17 Segmental Information *(continued)*

The results of major business activities are summarised below:

in HK$ million	Railway operations	Station commercial and rail related businesses	Property ownership, management and other businesses	**Total railway operations and related activities**	Property developments	**Total**
2008						
Revenue	**11,467**	**3,449**	**2,712**	**17,628**	**–**	**17,628**
Operating expenses before depreciation and amortisation	**(5,969)**	**(822)**	**(785)**	**(7,576)**	**–**	**(7,576)**
	5,498	**2,627**	**1,927**	**10,052**	**–**	**10,052**
Profit on property developments	**–**	**–**	**–**	**–**	**4,670**	**4,670**
Operating profit before depreciation and amortisation	**5,498**	**2,627**	**1,927**	**10,052**	**4,670**	**14,722**
Depreciation and amortisation	**(2,722)**	**(76)**	**(71)**	**(2,869)**	**–**	**(2,869)**
	2,776	**2,551**	**1,856**	**7,183**	**4,670**	**11,853**
Unallocated corporate expenses						**(788)**
Merger related expenses						**(53)**
Operating profit before interest and finance charges						**11,012**
Interest and finance charges						**(1,998)**
Change in fair value of investment properties			**(146)**			**(146)**
Share of profits of non-controlled subsidiaries and associates						**159**
Income tax						**(747)**
Profit for the year ended 31 December 2008						**8,280**
Assets						
Operational assets *	**74,025**	**1,281**	**39,589**	**114,895**	**5,899**	**120,794**
Assets under construction	**1,038**	**10**	**–**	**1,048**	**352**	**1,400**
Service concession assets	**15,463**	**–**	**–**	**15,463**	**–**	**15,463**
Property management rights	**–**	**–**	**35**	**35**	**–**	**35**
Railway construction in progress	**658**	**–**	**–**	**658**	**–**	**658**
Property development in progress	**–**	**–**	**–**	**–**	**7,895**	**7,895**
Deferred expenditure	**1,975**	**–**	**–**	**1,975**	**13**	**1,988**
Prepaid land lease payments	**567**	**–**	**–**	**567**	**–**	**567**
Deferred tax assets	**–**	**3**	**8**	**11**	**–**	**11**
Investments in securities	**471**	**–**	**–**	**471**	**–**	**471**
Properties held for sale	**–**	**–**	**–**	**–**	**2,228**	**2,228**
Loan to a property developer	**–**	**–**	**–**	**–**	**3,720**	**3,720**
	94,197	**1,294**	**39,632**	**135,123**	**20,107**	**155,230**
Interests in non-controlled subsidiaries						**381**
Interests in associates						**743**
Unallocated assets						**2,984**
Total assets						**159,338**

17 Segmental Information *(continued)*

in HK$ million	Railway operations	Station commercial and rail related businesses	Property ownership, management and other businesses	**Total railway operations and related activities**	Property developments	**Total**
2008						
Liabilities						
Segment liabilities	**2,832**	**964**	**1,119**	**4,915**	**1,470**	**6,385**
Obligations under service concession	**10,656**	**–**	**–**	**10,656**	**–**	**10,656**
Deferred income	**–**	**–**	**–**	**–**	**156**	**156**
	13,488	**964**	**1,119**	**15,571**	**1,626**	**17,197**
Unallocated liabilities						**44,319**
Total liabilities						**61,516**
Other Information						
Capital expenditure on:						
Operational assets	**59**	**2**	**14**	**75**	**–**	**75**
Assets under construction	**1,153**	**137**	**–**	**1,290**	**61**	**1,351**
Investment properties	**–**	**–**	**108**	**108**	**–**	**108**
Service concession assets	**523**	**–**	**–**	**523**	**–**	**523**
Railway construction in progress	**234**	**–**	**–**	**234**	**–**	**234**
Property development in progress	**–**	**–**	**–**	**–**	**2,331**	**2,331**
Non-cash expenses other than depreciation and amortisation	**19**	**11**	**–**	**30**	**–**	**30**

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

17 Segmental Information *(continued)*

in HK$ million	Railway operations	Station commercial and rail related businesses	Property ownership, management and other businesses	**Total railway operations and related activities**	Property developments	**Total**
2007						
Revenue	7,115	1,741	1,834	10,690	–	10,690
Operating expenses before depreciation and amortisation	(3,215)	(410)	(540)	(4,165)	–	(4,165)
	3,900	1,331	1,294	6,525	–	6,525
Profit on property developments	–	–	–	–	8,304	8,304
Operating profit before depreciation and amortisation	3,900	1,331	1,294	6,525	8,304	14,829
Depreciation and amortisation	(2,545)	(73)	(68)	(2,686)	–	(2,686)
	1,355	1,258	1,226	3,839	8,304	12,143
Unallocated corporate expenses						(666)
Merger related expenses						(193)
Operating profit before interest and finance charges						11,284
Interest and finance charges						(1,316)
Change in fair value of investment properties			8,011			8,011
Net gain on acquisition of subsidiaries						187
Share of profits of non-controlled subsidiaries and associates						99
Income tax						(3,083)
Profit for the year ended 31 December 2007						15,182
Assets						
Operational assets *	75,304	1,528	39,628	116,460	3,774	120,234
Assets under construction	640	8	–	648	389	1,037
Service concession assets	15,250	–	–	15,250	–	15,250
Property management rights	–	–	40	40	–	40
Railway construction in progress	424	–	–	424	–	424
Property development in progress	–	–	–	–	9,066	9,066
Deferred expenditure	825	–	–	825	–	825
Prepaid land lease payments	581	–	–	581	–	581
Deferred tax assets	–	4	–	4	–	4
Investments in securities	333	–	–	333	–	333
Properties held for sale	–	–	–	–	756	756
Loan to a property developer	–	–	–	–	3,532	3,532
	93,357	1,540	39,668	134,565	17,517	152,082
Interests in non-controlled subsidiaries						268
Interests in associates						205
Unallocated assets						3,113
Total assets						155,668
Liabilities						
Segment liabilities	2,764	1,034	1,128	4,926	1,614	6,540
Obligations under service concession	10,685	–	–	10,685	–	10,685
Deferred income	115	–	–	115	400	515
	13,564	1,034	1,128	15,726	2,014	17,740
Unallocated liabilities						46,891
Total liabilities						64,631

17 Segmental Information *(continued)*

in HK$ million	Railway operations	Station commercial and rail related businesses	Property ownership, management and other businesses	**Total railway operations and related activities**	Property developments	**Total**
2007						
Other Information						
Capital expenditure on:						
Operational assets	31	2	11	44	–	44
Assets under construction	625	123	19	767	620	1,387
Investment properties	–	–	3,204	3,204	–	3,204
Service concession assets	14,886	–	–	14,886	–	14,886
Property management rights	–	–	40	40	–	40
Railway construction in progress	263	–	–	263	–	263
Property development in progress	–	–	–	–	6,239	6,239
Non-cash expenses other than depreciation and amortisation	36	3	1	40	–	40

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

18 Investment Properties

Movements and analysis of the Group's and the Company's investment properties, all of which are held in Hong Kong and carried at fair value, are as follows:

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Valuation				
At 1 January	**37,723**	22,539	**36,562**	22,539
Additions through Rail Merger	**–**	2,840	**–**	1,874
Other additions	**108**	364	**104**	169
Change in fair value	**(146)**	8,011	**(100)**	8,011
Transfer from assets under construction (note 19)	**98**	4,027	**98**	4,027
Transfer to self-occupied land and buildings (note 19)	**(46)**	(58)	**(46)**	(58)
At 31 December	**37,737**	37,723	**36,618**	36,562
Long leases	**1,575**	1,609	**1,575**	1,609
Medium-term leases	**36,162**	36,114	**35,043**	34,953
	37,737	37,723	**36,618**	36,562

Phase 1 and Phase 2A of Elements were completed in October 2007 and November 2008 respectively. Upon completion, the respective values of the shell and costs of fitting-out works, which were carried as assets under construction in other property, plant and equipment, were transferred to investment properties.

All investment properties of the Group were revalued at open market value at 31 December 2008 by an independent firm of surveyors, Jones Lang LaSalle Limited, 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 decrease in fair value of HK$146 million (2007: increase of HK$8,011 million) arising from the revaluation has been charged to the profit and loss account.

The Group's future minimum lease receipts in respect of investment properties under non-cancellable operating leases are disclosed together with those in respect of other properties under note 19D.

19 Other Property, Plant and Equipment

The Group

in HK$ million	Self–occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation					
At 1 January 2008	**2,240**	**46,471**	**58,820**	**1,037**	**108,568**
Additions	**–**	**–**	**75**	**1,351**	**1,426**
Capitalisation adjustments *	**–**	**(96)**	**5**	**–**	**(91)**
Disposals/Write-offs	**(36)**	**(15)**	**(316)**	**(2)**	**(369)**
Deficit on revaluation (note 46)	**(285)**	**–**	**–**	**–**	**(285)**
Reclassification	**–**	**(4)**	**4**	**–**	**–**
Transfer from / (to) investment properties (note 18)	**46**	**–**	**–**	**(98)**	**(52)**
Other assets commissioned	**–**	**3**	**885**	**(888)**	**–**
At 31 December 2008	**1,965**	**46,359**	**59,473**	**1,400**	**109,197**
At Cost	**–**	**46,359**	**59,473**	**1,400**	**107,232**
At 31 December 2008 Valuation	**1,965**	**–**	**–**	**–**	**1,965**
Aggregate depreciation					
At 1 January 2008	**–**	**4,236**	**24,888**	**–**	**29,124**
Charge for the year	**58**	**389**	**2,174**	**–**	**2,621**
Capitalisation adjustments *	**–**	**(6)**	**–**	**–**	**(6)**
Written back on disposal	**–**	**(7)**	**(281)**	**–**	**(288)**
Written back on revaluation (note 46)	**(58)**	**–**	**–**	**–**	**(58)**
At 31 December 2008	**–**	**4,612**	**26,781**	**–**	**31,393**
Net book value at 31 December 2008	**1,965**	**41,747**	**32,692**	**1,400**	**77,804**
Cost or Valuation					
At 1 January 2007	1,989	46,544	57,767	4,905	111,205
Additions	–	–	44	1,387	1,431
Capitalisation adjustments *	–	(42)	(49)	–	(91)
Disposals / Write-offs	–	(4)	(371)	–	(375)
Surplus on revaluation (note 46)	193	–	–	–	193
Reclassification	–	(61)	61	–	–
Transfer from deferred expenditure (note 24)	–	–	59	44	103
Transfer from / (to) investment properties (note 18)	58	–	–	(4,027)	(3,969)
SkyPlaza Platform Project commissioned (note 22)	–	–	71	–	71
Other assets commissioned	–	34	1,238	(1,272)	–
At 31 December 2007	2,240	46,471	58,820	1,037	108,568
At Cost	–	46,471	58,820	1,037	106,328
At 31 December 2007 Valuation	2,240	–	–	–	2,240
Aggregate depreciation					
At 1 January 2007	–	3,864	22,937	–	26,801
Charge for the year	52	387	2,279	–	2,718
Capitalisation adjustments *	–	(1)	(3)	–	(4)
Written back on disposal	–	(2)	(337)	–	(339)
Written back on revaluation (note 46)	(52)	–	–	–	(52)
Reclassification	–	(12)	12	–	–
At 31 December 2007	–	4,236	24,888	–	29,124
Net book value at 31 December 2007	2,240	42,235	33,932	1,037	79,444

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

Depreciation charge for the year was HK$2,615 million (2007: HK$2,714 million), comprising depreciation for the year of HK$2,621 million (2007: HK$2,718 million) less capitalisation adjustments of HK$6 million (2007: HK$4 million).

19 Other Property, Plant and Equipment *(continued)*

The Company

in HK$ million	Self–occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation					
At 1 January 2008	**2,240**	**46,471**	**58,143**	**1,029**	**107,883**
Additions	**–**	**–**	**66**	**1,324**	**1,390**
Capitalisation adjustments *	**–**	**(96)**	**5**	**–**	**(91)**
Disposals / Write-offs	**(36)**	**(15)**	**(315)**	**(2)**	**(368)**
Deficit on revaluation (note 46)	**(285)**	**–**	**–**	**–**	**(285)**
Reclassification	**–**	**(4)**	**4**	**–**	**–**
Transfer from / (to) investment properties (note 18)	**46**	**–**	**–**	**(98)**	**(52)**
Other assets commissioned	**–**	**3**	**860**	**(863)**	**–**
At 31 December 2008	**1,965**	**46,359**	**58,763**	**1,390**	**108,477**
At Cost	**–**	**46,359**	**58,763**	**1,390**	**106,512**
At 31 December 2008 Valuation	**1,965**	**–**	**–**	**–**	**1,965**
Aggregate depreciation					
At 1 January 2008	**–**	**4,236**	**24,377**	**–**	**28,613**
Charge for the year	**58**	**389**	**2,155**	**–**	**2,602**
Capitalisation adjustments *	**–**	**(6)**	**–**	**–**	**(6)**
Written back on disposal	**–**	**(7)**	**(280)**	**–**	**(287)**
Written back on revaluation (note 46)	**(58)**	**–**	**–**	**–**	**(58)**
At 31 December 2008	**–**	**4,612**	**26,252**	**–**	**30,864**
Net book value at 31 December 2008	**1,965**	**41,747**	**32,511**	**1,390**	**77,613**
Cost or Valuation					
At 1 January 2007	1,989	46,544	57,195	4,832	110,560
Additions	–	–	39	1,346	1,385
Capitalisation adjustments *	–	(42)	(43)	–	(85)
Disposals / Write-offs	–	(4)	(371)	–	(375)
Surplus on revaluation (note 46)	193	–	–	–	193
Reclassification	–	(61)	61	–	–
Transfer from deferred expenditure (note 24)	–	–	59	44	103
Transfer from / (to) investment properties (note 18)	58	–	–	(4,027)	(3,969)
SkyPlaza Platform Project commissioned (note 22)	–	–	71	–	71
Other assets commissioned	–	34	1,132	(1,166)	–
At 31 December 2007	2,240	46,471	58,143	1,029	107,883
At Cost	–	46,471	58,143	1,029	105,643
At 31 December 2007 Valuation	2,240	–	–	–	2,240
Aggregate depreciation					
At 1 January 2007	–	3,864	22,440	–	26,304
Charge for the year	52	387	2,262	–	2,701
Capitalisation adjustments *	–	(1)	(3)	–	(4)
Written back on disposal	–	(2)	(334)	–	(336)
Written back on revaluation (note 46)	(52)	–	–	–	(52)
Reclassification	–	(12)	12	–	–
At 31 December 2007	–	4,236	24,377	–	28,613
Net book value at 31 December 2007	2,240	42,235	33,766	1,029	79,270

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

Depreciation charge for the year was HK$2,596 million (2007: HK$2,697 million), comprising depreciation for the year of HK$2,602 million (2007: HK$2,701 million) less capitalisation adjustments of HK$6 million (2007: HK$4 million).

19 Other Property, Plant and Equipment *(continued)*

All of the Group's self-occupied land and buildings are held in Hong Kong under medium-term leases and carried at fair value.

A All self-occupied land and buildings were revalued at open market value on an existing use basis at 31 December 2008 by an independent firm of surveyors, Jones Lang LaSalle Limited, who have among their staff Members of the Hong Kong Institute of Surveyors. The valuation resulted in a revaluation loss of HK$227 million (2007: surplus of HK$245 million), which net of deferred tax credit of HK$38 million (2007: provision of HK$43 million) (note 44B), has been transferred to the fixed asset revaluation reserve account (note 46).

The carrying amount of the self-occupied land and buildings at 31 December 2008 would have been HK$949 million (2007: HK$928 million) had the land and buildings been stated at cost less accumulated depreciation.

B Assets under construction include capital works on operating railways and further renovation on a partially renovated shell of the retail shopping centre at Union Square, Kowloon Station.

C In 1986, the Company entered into a Management Agreement (the "1986 Agreement") with New Hong Kong Tunnel Company Limited ("NHKTC") to operate the Eastern Harbour Crossing ("EHC") until February 2008. Included in the assets held under the 1986 Agreement are railway and ancillary works relating to the rail tunnel.

At the expiry of the 1986 Agreement, title to the assets would, pursuant to the Eastern Harbour Crossing Ordinance, be vested in the Government which in turn entered into a Memorandum of Understanding dated 17 October 1986 with the Company to the effect that the assets would 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 would 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 were expected to be nominal. On this basis, the semi-annual payments made by the Company to NHKTC in respect of the EHC were dealt with in these accounts as payments under a finance lease.

In 2007, the Group made its final lease payment under the 1986 Agreement to NHKTC. On 5 February 2008, the Company entered into a new Operating Agreement with NHKTC whereby both companies agreed to share the future costs of maintenance, care, upkeep and repair of certain common facilities and utilities of the EHC assets; and the Company to carry out repair, maintenance and upkeep of the railway and assets solely for purpose of rail use in respect of the EHC following expiry of the 1986 Agreement.

The carrying amount of the assets in relation to the above arrangement is as follows:

The Group and The Company

	Civil works Eastern Harbour Crossing	
in HK$ million	**2008**	2007
Cost	**1,254**	1,254
Less: Aggregate depreciation	**(345)**	(326)
Net book value	**909**	928

D The Group leases out investment properties and station kiosks, including duty free shops, 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 above carry additional rental based on turnover, some of which are with reference to thresholds. 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$37,737 million (2007: HK$37,723 million) and HK$36,618 million (2007: HK$36,562 million) respectively. The gross carrying amounts of station kiosks of the Group and the Company held for use in operating leases were HK$489 million (2007: HK$482 million) and the related accumulated depreciation charges were HK$143 million (2007: HK$127 million).

Total future minimum lease receipts under non-cancellable operating leases are receivable as follows:

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Within 1 year	**3,300**	3,024	**3,265**	2,960
After 1 year but within 5 years	**5,188**	6,355	**5,152**	6,338
Later than 5 years	**123**	181	**123**	181
	8,611	9,560	**8,540**	9,479

19 Other Property, Plant and Equipment *(continued)*

E 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 based on terms ranging from 21 to 29 years 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 the expiry of the lease term 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. The Group has an obligation to replace these debt securities with other debt securities in the event those securities do not meet certain credit ratings requirements. In addition, the Group has provided standby letters of credit to the Investors to cover additional amounts payable by the Group in the event the transactions are terminated prior to the expiry of the lease terms.

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, an amount of approximately HK$3,688 million was received in an investment account and was used to purchase debt securities ("Defeasance Securities") to be used to settle the long-term lease payments with an estimated net present value in March 2003 of approximately HK$3,533 million. This resulted in the Group having received in 2003 an amount of HK$141 million net of costs. 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 obligations and investments in the Defeasance Securities were not recognised in March 2003 as liabilities and assets of the Group. The net amount of cash received was accounted for as deferred income by the Group.

A small portion of these Defeasance Securities was subject to replacement on credit rating downgrades. During 2008, credit ratings of some of these securities were downgraded and subsequently these securities were replaced by standby letters of credit issued to the relevant Investors to support the corresponding payment obligations. As a result, a total charge of HK$100 million was recorded as interest and finance charges for the year. There are other Defeasance Securities issued by the same issuer as the above mentioned Defeasance Securities, with accreted value of US$46.5 million as at 31 December 2008, which are not subject to replacement obligation on rating downgrades.

20 Service Concession Assets

Service concession assets are in respect of the Company's right to access, use and operate the KCRC system pursuant to the Rail Merger.

The Group and The Company

in HK$ million	Initial concession property	Additional concession property	Total
2008			
Cost			
At 1 January 2008	15,226	49	15,275
Net additions during the year	–	523	523
At 31 December 2008	15,226	572	15,798
Accumulated amortisation			
At 1 January 2008	25	–	25
Charge for the year	304	6	310
At 31 December 2008	329	6	335
Net book value at 31 December 2008	14,897	566	15,463

20 Service Concession Assets *(continued)*

The Group and The Company *(continued)*

in HK$ million	Initial concession property	Additional concession property	Total
2007			
Cost			
At 1 January 2007	–	–	–
Additions through the Rail Merger			
– Upfront payment (note 3B)	3,924	–	3,924
– Principal element of fixed annual payments (note 42)	10,687	–	10,687
– Others (note 3B)	226	31	257
Net additions during the year	–	18	18
Transfer from deferred expenditure (note 24)	389	–	389
At 31 December 2007	15,226	49	15,275
Accumulated amortisation			
At 1 January 2007	–	–	–
Charge for the year	25	–	25
At 31 December 2007	25	–	25
Net book value at 31 December 2007	15,201	49	15,250

Additional concession property represents expenditure incurred in relation to the maintenance, repair, replacement and upgrade of the KCRC system.

21 Property Management Rights

The Group and The Company

in HK$ million	**2008**	2007
Cost		
At 1 January	**40**	–
Addition through the Rail Merger	**–**	40
At 31 December	**40**	40
Accumulated amortisation		
At 1 January	**–**	–
Charge for the year	**5**	–
At 31 December	**5**	–
Net book value at 31 December	**35**	40

22 Railway Construction in Progress

The Group and The Company

in HK$ million	Balance at 1 Jan	Expenditure	Capitalised on commissioning (note 19)	Balance at 31 Dec
2008				
LOHAS Park Station Project				
Construction costs	**314**	**176**	–	**490**
Consultancy fees	**11**	**2**	–	**13**
Staff costs and other expenses	**81**	**33**	–	**114**
Finance costs	**18**	**23**	–	**41**
	424	**234**	–	**658**
Total	**424**	**234**	–	**658**
2007				
LOHAS Park Station Project				
Construction costs	117	197	–	314
Consultancy fees	10	1	–	11
Staff costs and other expenses	43	38	–	81
Finance costs	5	13	–	18
	175	249	–	424
SkyPlaza Platform Project				
Construction costs	40	10	(50)	–
Staff costs and other expenses	14	4	(18)	–
Finance costs	3	–	(3)	–
	57	14	(71)	–
Total	232	263	(71)	424

A LOHAS Park Station Project

The construction of the LOHAS Park Station is covered by the TKE Project Agreement with the Government signed on 4 November 1998.

The project's target completion is 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 2008, the Company has incurred expenditure of HK$658 million on the project (2007: HK$424 million) and has authorised outstanding commitments on contracts totalling HK$15 million (2007: HK$147 million) related to the project.

B SkyPlaza Platform Project

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

The project was completed and started to serve the public on 28 February 2007. Negotiation on the final accounts with various contractors is being performed.

22 Railway Construction in Progress *(continued)*

C Kowloon Southern Link ("KSL") Project

After the Rail Merger, the construction of KSL remains a responsibility of KCRC who continues to fund the relating construction costs. Pursuant to the KSL Project Management Agreement, the Company acts as a project management agent to KCRC in connection with the KSL under certain circumstances in return for a project management fee plus incentive payment if the construction of KSL is completed ahead of time and under budget. Expenditure incurred by the Company for the project management is charged to the profit and loss account while the project management fee is recognised as revenue in accordance with the Company's accounting policy on revenue recognition of contracts. During 2008, HK$310 million (2007: HK$24 million) of project management fee was recognised as income in the profit and loss account. KSL will form part of the service concession on opening for service which is scheduled in 2009.

D Shatin to Central Link ("SCL") Project

On 11 March 2008, the Executive Council has approved further planning and design of the SCL. On 24 November 2008, the Government and the Company entered into an Entrustment Agreement for the design of and site investigation and procurement activities in relation to the SCL. Pursuant to the Entrustment Agreement, the Company shall carry out or procure the carrying out of, and the Government shall fund, the design, site investigation and procurement activities.

E Guangzhou-Shenzhen-Hong Kong Express Rail Link ("XRL") Project

On 22 April 2008, the Executive Council decided that the Company should be asked to proceed with further planning and design of the Hong Kong section of the XRL with a view to implementing the Hong Kong section of the XRL under concession approach. On 24 November 2008, the Government and the Company entered into an Entrustment Agreement for the design of and site investigation and procurement activities in relation to the XRL. Pursuant to the Entrustment Agreement, the Company shall carry out or procure the carrying out of, and the Government shall fund, the design, site investigation and procurement activities.

23 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 23B(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.

On the Appointed Day, the Company acquired property development rights on eight development sites, comprising three awarded and five not yet awarded sites, along the East Rail Line, Kowloon Southern Link and Light Rail ("ERL/KSL/LR Property Projects"), from KCRC pursuant to the Rail Merger (note 3A). During 2008, the development site at Che Kung Temple Station of the East Rail Line was awarded.

23 Property Development in Progress *(continued)*

A Property Development in Progress

The Group and The Company

in HK$ million	Balance at 1 Jan	Expenditure	Offset against payments received from developers (note 23B(i))	Transfer out on project completion	Balance at 31 Dec
2008					
Airport Railway Property Projects	**–**	**31**	**(31)**	**–**	**–**
Tseung Kwan O Extension Property Projects	**3,307**	**382**	**(53)**	**(1,555)**	**2,081**
East Rail Line/Light Rail/Kowloon Southern Link Property Projects	**5,759**	**1,918**	**(42)**	**(1,821)**	**5,814**
	9,066	**2,331**	**(126)**	**(3,376)**	**7,895**
2007					
Airport Railway Property Projects	-	139	(139)	-	-
Tseung Kwan O Extension Property Projects	3,297	288	(278)	-	3,307
East Rail Line/Light Rail/Kowloon Southern Link Property Projects	-	5,812	(53)	-	5,759
	3,297	6,239	(470)	-	9,066

Tseung Kwan O Extension Property Projects includes capitalised interest of HK$768 million (2007: HK$768 million) 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 35).

East Rail Line/Light Rail/Kowloon Southern Link Property Projects include the acquisition cost for the property development rights on the development sites from KCRC and mandatory payments in respect of enabling works carried out by KCRC for such sites. As at 31 December 2008, outstanding mandatory payments including interest accrued amounted to HK$818 million (2007: HK$901 million including HK$26 million of interest accrued). Expenditure during the year ended 31 December 2008 included HK$1,831 million of land premium in respect of the Che Kung Temple property development.

B Deferred Income on Property Development

The Group and The Company

in HK$ million	**2008**	2007
Deferred income on property development comprises:		
– Upfront payments received from developers (note 23B(i))	**138**	321
– Sharing in kind (note 23B(ii))	**18**	79
	156	400

23 Property Development in Progress *(continued)*

B Deferred Income on Property Development *(continued)*

(i) Deferred Income on Upfront Payments

The Group and The Company

in HK$ million	Balance at 1 Jan	Payments received from developers	Offset against development in progress (note 23A)	Amount recognised as profit (note 8)	Balance at 31 Dec
2008					
Airport Railway Property Projects	**240**	**–**	**(31)**	**(139)**	**70**
Tseung Kwan O Extension Property Projects	**81**	**40**	**(53)**	**–**	**68**
East Rail Line/Light Rail/Kowloon Southern Link Property Projects	**–**	**42**	**(42)**	**–**	**–**
	321	**82**	**(126)**	**(139)**	**138**
2007					
Airport Railway Property Projects	1,120	120	(139)	(861)	240
Tseung Kwan O Extension Property Projects	–	359	(278)	-	81
East Rail Line/Light Rail/Kowloon Southern Link Property Projects	-	53	(53)	-	–
	1,120	532	(470)	(861)	321

(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

in HK$ million	2008	2007
Balance as at 1 January	**79**	442
Less: Amount recognised as profit (note 8)	**(61)**	(363)
Balance as at 31 December	**18**	79

23 Property Development in Progress *(continued)*

C Stakeholding Funds

As stakeholder under certain Airport Railway, Tseung Kwan O Extension and East Rail Line 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

in HK$ million	2008	2007
Balance as at 1 January	**5,264**	6,860
Stakeholding funds received	**15,518**	19,439
Add: Interest earned thereon	**100**	260
	20,882	26,559
Disbursements during the year	**(16,307)**	(21,295)
Balance as at 31 December	**4,575**	5,264
Represented by:		
Balances in designated bank accounts as at 31 December	**4,573**	5,262
Retention receivable	**2**	2
	4,575	5,264

In addition to the above, there are certain deposit monies and sales proceeds in respect of a East Rail Line property development site, amounting to HK$1,221 million (2007: nil) at 31 December 2008, that are under the custody of the solicitors and managed by the Company on behalf of KCRC as KCRC's agent.

D West Rail Property Developments

As part of the Rail Merger, the Company was appointed to act as the agent of KCRC and certain KCRC subsidiary companies ("West Rail Subsidiaries") in the development of specified development sites along the West Rail. The Company will receive an agency fee of 0.75% of the gross sale proceeds in respect of the developments except for the Tuen Mun development on which the Company will receive 10% of the net profits accrued under the development agreement. The Company will also recover from the West Rail Subsidiaries all the costs incurred in respect of the West Rail development sites plus 16.5% on-cost, together with interest accrued thereon. During 2008, the reimbursable costs incurred by the Company including on-cost and interest accrued were HK$66 million (2007: HK$1 million).

24 Deferred Expenditure

The Group

in HK$ million	Balance at 1 Jan	Expenditure during the year	Transfer to other property, plant and equipment (note 19)	Transfer to service concession assets (note 20)	Balance at 31 Dec
2008					
Expenditure on proposed capital projects	**825**	**1,163**	**–**	**–**	**1,988**
	825	**1,163**	**–**	**–**	**1,988**
2007					
Merger expenditure	170	322	(103)	(389)	–
Expenditure on proposed capital projects	395	430	–	–	825
	565	752	(103)	(389)	825

24 Deferred Expenditure *(continued)*

The Company

in HK$ million	Balance at 1 Jan	Expenditure during the year	Transfer to other property, plant and equipment (note 19)	Transfer to service concession assets (note 20)	Balance at 31 Dec
2008					
Expenditure on proposed capital projects	**155**	**183**	**–**	**–**	**338**
	155	**183**	**–**	**–**	**338**
2007					
Merger expenditure	170	322	(103)	(389)	–
Expenditure on proposed capital projects	113	42	–	–	155
	283	364	(103)	(389)	155

The expenditure incurred on the proposed capital projects for the year mainly relates to design works for the Shenzhen Metro Line 4 Project in Mainland of China, the West Island Line, Kwun Tong Line Extension and South Island Line (East) Projects in Hong Kong.

During 2008, the Company received the first part of the Government's capital grant for the West Island Line Project of HK$400 million, of which HK$355 million has been used to offset the detailed design cost incurred up to 31 December 2008.

As at 31 December 2008, the majority of the deferred expenditure was related to the Shenzhen Metro Line 4 Project (note 52G(i)).

25 Prepaid Land Lease Payments

The Group and The Company

in HK$ million	2008	2007
Cost		
At 1 January	**732**	732
Addition	**–**	–
At 31 December	**732**	732
Accumulated amortisation		
At 1 January	**151**	138
Charge for the year	**14**	13
At 31 December	**165**	151
Net book value at 31 December	**567**	581

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

The Group and The Company

in HK$ million	2008	2007
At net book value		
– long leases	**151**	154
– medium-term leases	**416**	427
	567	581

25 Prepaid Land Lease Payments *(continued)*

B The lease of the land on which the civil works, plant and equipment are situated for the operation of the railway was granted to the Company under a running line lease for the period up to 29 June 2050 which can be extended for further periods of 50 years at nominal payment (note 51C).

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.

26 Interests in Non-controlled Subsidiaries

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Unlisted shares, at cost	**–**	–	**24**	24
Share of net assets	**381**	268	**–**	–
	381	268	**24**	24

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

		Proportion of ownership interest				
Name of company	Issued and paid up ordinary share capital	Group's effective interest	Held by the Company	Held by subsidiary	Place of incorporation and operation	Principal activities
Octopus Holdings Limited	HK$42,000,000	57.4%	57.4%	-	Hong Kong	Investment holding
Octopus Cards Limited	HK$42,000,000	57.4%	–	100%	Hong Kong	Operate a contactless smartcard common payment system in Hong Kong
Octopus China Investments Limited	HK$1	57.4%	–	100%	Hong Kong	Investment holding
Octopus Connect Limited	HK$2	57.4%	–	100%	Hong Kong	Customer relationship management service
Octopus International Projects Limited	HK$1	57.4%	–	100%	Hong Kong	Marketing and management of overseas automatic fare collection consultancy projects
Octopus Investments Limited	HK$2	57.4%	–	100%	Hong Kong	Investment holding
Octopus Knowledge Limited	HK$2	57.4%	–	100%	Hong Kong	Consultancy services on introducing a smartcard system in Dubai
Octopus Netherlands Limited	HK$1	57.4%	–	100%	Hong Kong	Consultancy services on introducing a smartcard system in the Netherlands
Octopus Rewards Limited	HK$1	57.4%	–	100%	Hong Kong	Develop and operate a common loyalty scheme
Octopus Solutions Limited	HK$2	57.4%	–	100%	Hong Kong	Project management
Octopus Systems Limited	HK$2	57.4%	–	100%	Hong Kong	Project management
Octopus Cards Macau Limited	MOP10,000	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 smartcard system in the Netherlands

26 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 2008, a total amount of HK$99 million (2007: HK$62 million) was paid by the Company to OCL in respect of the central clearing services provided by OCL to the Company. Load agent fees and fees for handling Octopus card issuance and refund amounting to HK$13 million (2007: HK$9 million) and HK$9 million (2007: HK$6 million) respectively were received from OCL in respect of services and facilities provided by the Company at various MTR stations. Service fees amounting to HK$3 million (2007: HK$2 million) were also received from OCL in respect of rental of computer equipment and services and warehouse storage space provided by the Company under a service agreement.

During the same period, OHL repaid the subordinated loan provided by the Company in 2005, including principal amount of HK$86 million (2007: nil) and interest of HK$1 million (2007: HK$5 million), as well as distributed dividends of HK$23 million (2007: nil) to the Company.

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	**2008 (Audited)**	2007 (Audited)
Turnover	**527**	465
Other operating income	**61**	53
	588	518
Staff costs	**(133)**	(101)
Load agent fees and bank charges for add value services	**(66)**	(60)
Other expenses	**(149)**	(152)
Operating profit before depreciation	**240**	205
Depreciation	**(54)**	(63)
Operating profit before interest and finance charges	**186**	142
Net interest income	**80**	76
Profit before taxation	**266**	218
Income tax	**(28)**	(49)
Profit for the year	**238**	169
Group's share of profit before taxation (note 12)	**152**	125
Group's share of income tax (note 12)	**(16)**	(28)

26 Interests in Non-controlled Subsidiaries *(continued)*

Consolidated Balance Sheet

at 31 December in HK$ million	2008 (Audited)	2007 (Audited)
Assets		
Fixed assets	**164**	126
Investments	**2,142**	1,746
Other assets	**181**	170
Cash at banks and on hand	**227**	424
	2,714	2,466
Liabilities		
Card floats and card deposits due to cardholders	**(1,711)**	(1,574)
Amounts due to related parties	**(23)**	(21)
Other liabilities	**(316)**	(405)
	(2,050)	(2,000)
Net assets	**664**	466
Equity		
Share capital	**42**	42
Retained profits	**622**	424
	664	466
Group's share of net assets	**381**	268

27 Investments in Subsidiaries

The Company

in HK$ million	2008	2007
Unlisted shares, at cost	**1,153**	1,153
Less: Impairment losses	**(3)**	(3)
	1,150	1,150

Investments in subsidiaries include HK$24 million (2007: HK$24 million) in respect of investments in non-controlled subsidiaries, the relevant details of which are disclosed in note 26. The following list contains details of controlled subsidiaries as defined under note 2C as at 31 December 2008, which have been consolidated into the Group's accounts.

27 Investments in Subsidiaries *(continued)*

Name of company	Issued and paid up ordinary/ registered share capital	Proportion of ownership interest: Group's effective interest	Held by the Company	Held by subsidiary	Place of incorporation and operation	Principal activities
Subsidiaries held throughout 2008						
Glory Goal Limited	HK$10,000	100%	100%	–	Hong Kong	Investment holding
Hanford Garden Property Management Company Limited	HK$10,000	100%	100%	–	Hong Kong	Property management
MTR (Estates Management) Limited	HK$1,000	100%	100%	–	Hong Kong	Investment holding and property management
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 Hangzhou Line 1 Investment Company Limited (previously known as Hong Kong Cable Car Limited)	HK$1,000	100%	100%	–	Hong Kong	Investment holding of the proposed joint venture company for the Hangzhou Metro Line 1 project
MTR Information Solutions Company Limited (previously known as Lantau Cable Car Limited)	HK$1,000	100%	100%	–	Hong Kong	License MTR software to MTR's subsidiaries and associates
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 in Mainland China
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
Ngong Ping 360 Limited	HK$2	100%	100%	–	Hong Kong	Operate the Tung Chung to Ngong Ping cable car system and Theme Village in Ngong Ping
Pierhead Garden Management Company Limited	HK$50,000	100%	100%	–	Hong Kong	Property management
Rail Sourcing Solutions (International) Limited	HK$2	100%	100%	–	Hong Kong	Global railway supply and sourcing services
Royal Ascot Management Company Limited	HK$50,000	100%	100%	–	Hong Kong	Property management
Sun Tuen Mun Centre Management Company Limited	HK$50,000	100%	100%	–	Hong Kong	Property management
TraxComm Limited	HK$15,000,000	100%	100%	–	Hong Kong	Fixed telecommunication network services
V-Connect Limited	HK$1,000	100%	100%	–	Hong Kong	Telecommunication
MTR (Shanghai Metro Management) Limited *	HK$1,000	100%	100%	–	Hong Kong	Dormant
Fasttrack Insurance Ltd.	HK$77,500,000	100%	100%	–	Bermuda	Insurance underwriting
Candiman Limited *	US$1	100%	100%	–	British Virgin Islands	Investment holding
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

27 Investments in Subsidiaries *(continued)*

Name of company	Issued and paid up ordinary/ registered share capital	Proportion of ownership interest: Group's effective interest	Held by the Company	Held by subsidiary	Place of incorporation and operation	Principal activities
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
MTR Corporation (Shenzhen) Training Centre * (Incorporated)	RMB2,000,000	100%	–	100%	The People's Republic of China	Provide rail transport training
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
<u>Subsidiaries established during 2008</u>						
MTR Shenyang Holdings Limited *	HK$1,000	100%	100%	–	Hong Kong	Investment holding of the proposed joint venture company for the operation and maintenance of Shenyang Metro Line 1 and Line 2
MTR (Macau) Property Management Company Limited *	MOP25,000	100%	–	100%	Macau	Property management, consultancy and other property management related businesses

* 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.

28 Interests in Associates

The Group

in HK$ million	2008	2007
Share of net assets	**743**	205

The Group and the Company had interests in the following associates as at 31 December 2008:

		Proportion of ownership interest				
Name of company	Issued and paid up ordinary / registered share capital	Group's effective interest	Held by the Company	Held by subsidiary	Place of incorporation and operation	Principal activities
Beijing MTR Corporation Limited (Incorporated)	RMB1,380,000,000	49%	–	49%	The People's Republic of China	Railway construction, management and development
London Overground Rail Operations Ltd ("LOROL") *	GBP2	50%	–	50%	United Kingdom	Railway management

* Company not audited by KPMG

During the year, South Western Railway Limited, the joint venture company established for bidding of the South West Train Operation Franchise in United Kingdom in which the Group held 50% interest, was dissolved following unsuccessful bidding of the franchise.

The registered share capital of Beijing MTR Corporation Limited is RMB1,380 million of which 49% is contributed by the Group. During the year ended 31 December 2008, the Group injected its last tranche of equity of RMB471 million (HK$515 million), making the cumulative equity contribution to RMB676 million (HK$718 million) as at 31 December 2008. During the same period, the Company provided staff secondment, information technology and other support services to Beijing MTR Corporation Limited at a total amount of HK$38 million (2007: HK$32 million).

During the year ended 31 December 2008, the Company provided staff secondment and consultancy service to LOROL of HK$4 million (2007: HK$2 million). Also, the Company received HK$3 million (2007: HK$1 million) interest income in respect of the loan provided to LOROL (note 52H(i)).

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

in HK$ million	2008	2007
Non-current assets	**1,405**	692
Current assets	**208**	147
Non-current liabilities	**(36)**	(40)
Current liabilities	**(834)**	(594)
Net assets	**743**	205
Income	**1,313**	754
Expenses	**(1,281)**	(751)
Profit before taxation	**32**	3
Income tax	**(9)**	(1)
Net profit for the year	**23**	2

29 Investments in Securities

Investments in securities represent debt securities held by the overseas insurance underwriting subsidiary and the Company comprising:

The Group

in HK$ million	2008	2007
Held-to-maturity securities, at amortised cost		
– maturing within 1 year	–	–
– maturing after 1 year	90	–
	90	–
Trading securities listed overseas, at fair value		
– maturing within 1 year	100	50
– maturing after 1 year	281	283
	381	333
	471	333

The Company

in HK$ million	2008	2007
Held-to-maturity securities, at amortised cost		
– maturing within 1 year	–	–
– maturing after 1 year	90	–
	90	–

30 Staff Housing Loans

The Group and The Company

in HK$ million	2008	2007
Balance at 1 January	15	25
Redemption	(3)	(7)
Repayment	(2)	(3)
Balance at 31 December	10	15

The Group and The Company

in HK$ million	2008	2007
Amounts receivable:		
– within 1 year	2	3
– after 1 year	8	12
	10	15

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 is not significantly different from their fair values.

31 Properties Held for Sale

The Group and The Company

in HK$ million	**2008**	2007
Properties held for sale		
– at cost	**2,092**	649
– at net realisable value	**136**	107
	2,228	756

Properties held for sale at 31 December 2008 comprised mainly residential units, retail and car parking spaces at the Olympic Station, Kowloon Station and Tung Chung Station along the Airport Railway, Hang Hau Station, Tseung Kwan O Area 55b, 57a and 86 developments along the Tseung Kwan O Line as well as Fo Tan Station along the East Rail Line. 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 2K(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 2008 and 2007 are determined by reference to an open market valuation of the properties as at those dates, undertaken by an independent firm of surveyors, Jones Lang LaSalle Limited, 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$13 million (2007: HK$12 million), made in order to state these properties at the lower of their cost and estimated net realisable value.

32 Derivative Financial Assets and Liabilities

A Fair Value

The contracted notional amounts, fair values and maturities based on contractual undiscounted cash flows of derivative financial instruments outstanding are as follows:

The Group and The Company

in HK$ million	Notional amount	Fair value	Contractual undiscounted cash flow maturing in: Less than 1 year	1-2 years	2-5 years	Over 5 years	Total
2008							
Derivative Financial Assets							
Gross settled:							
Foreign exchange forwards							
– fair value hedges:	387	–					
– inflow			387	–	–	–	387
– outflow			(387)	–	–	–	(387)
– cash flow hedges:	961	14					
– inflow			441	535	–	–	976
– outflow			(432)	(528)	–	–	(960)
– not qualified for hedge accounting:	3	–					
– inflow			3	–	–	–	3
– outflow			(3)	–	–	–	(3)
Cross currency swaps							
– fair value hedges:	2,537	83					
– inflow			1,810	60	886	–	2,756
– outflow			(1,757)	(34)	(848)	–	(2,639)
Net settled:							
Interest rate swaps							
– fair value hedges	4,854	427	88	112	195	90	485
Others	300	4	–	–	–	–	–
	9,042	528	150	145	233	90	618
Derivative Financial Liabilities							
Gross settled:							
Foreign exchange forwards							
– cash flow hedges:	396	13					
– inflow			339	37	7	–	383
– outflow			(348)	(40)	(8)	–	(396)
– not qualified for hedge accounting:	131	4					
– inflow			127	–	–	–	127
– outflow			(131)	–	–	–	(131)
Cross currency swaps							
– fair value hedges:	13,547	100					
– inflow			3,798	4,666	47	5,038	13,549
– outflow			(3,787)	(4,700)	(48)	(5,133)	(13,668)
Net settled:							
Interest rate swaps							
– cash flow hedges	2,592	187	(48)	(62)	(67)	(16)	(193)
Others	300	1	–	–	–	–	–
	16,966	305	(50)	(99)	(69)	(111)	(329)
Total	26,008						

32 Derivative Financial Assets and Liabilities *(continued)*

A Fair Value *(continued)*

The Group and The Company *(continued)*

in HK$ million	Notional amount	Fair value	Contractual undiscounted cash flow maturing in: Less than 1 year	1-2 years	2-5 years	Over 5 years	Total
2007							
Derivative Financial Assets							
Gross settled:							
Foreign exchange forwards							
– fair value hedges:	7	–					
– inflow			7	–	–	–	7
– outflow			(7)	–	–	–	(7)
– cash flow hedges:	777	15					
– inflow			684	7	103	–	794
– outflow			(669)	(6)	(102)	–	(777)
– not qualified for hedge accounting:	265	3					
– inflow			266	3	–	–	269
– outflow			(262)	(3)	–	–	(265)
Cross currency swaps							
– fair value hedges:	2,012	70					
– inflow			175	2,034	40	–	2,249
– outflow			(120)	(1,985)	(31)	–	(2,136)
Net settled:							
Interest rate swaps							
– fair value hedges	4,698	184	34	59	93	43	229
– cash flow hedges	300	1	1	–	–	–	1
	8,059	273	109	109	103	43	364
Derivative Financial Liabilities							
Gross settled:							
Foreign exchange forwards							
– cash flow hedges:	593	1					
– inflow			–	591	–	–	591
– outflow			–	(593)	–	–	(593)
Cross currency swaps							
– fair value hedges:	14,480	142					
– inflow			182	3,982	4,822	5,789	14,775
– outflow			(145)	(3,983)	(4,884)	(5,969)	(14,981)
Net settled:							
Interest rate swaps							
– cash flow hedges	2,242	49	(15)	(18)	(16)	(2)	(51)
– not qualified for hedge accounting	100	–	–	–	–	–	–
	17,415	192	22	(21)	(78)	(182)	(259)
Total	25,474						

32 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 relevant interest rate swap curves as of 31 December 2008 and 2007 were used to discount the cash flows of financial instruments. For Hong Kong dollars, interest rates used ranged from 0.299% to 2.042% (2007: 2.945% to 4.122%), U.S dollars from 0.263% to 2.875% (2007: 3.832% to 5.161%) and Euro from 2.271% to 3.982% (2007: 4.097% to 4.982%).

The table above details the remaining contractual maturities at the balance sheet date of the Group's and the Company's derivative financial liabilities and assets, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the balance sheet date) and the earliest date the Group and the Company can be required to pay.

B Financial Risks

The Group's operating activities and financing activities expose it to four main types of financial risks, namely liquidity risk, interest rate risk, foreign exchange risk and credit risk. The Group's overall risk management policy focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects of these financial risks on the Group's financial performance.

The Board of Directors provides principles for overall risk management and approves 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 Group's Preferred Financing Model (the "Model") is an integral part of its risk management policies. The Model specifies amongst other things, the preferred mix of fixed and floating rate debts, the permitted level of foreign currency debts and an adequate length of financing horizon for coverage of forward funding requirements, against which the Group's financing related liquidity, interest rate and currency risk exposures are measured, monitored and controlled. The Board regularly reviews its risk management polices and authorises changes if necessary based on operating and market conditions and other relevant factors. The Board also reviews on an annual basis as part of the budgeting process and authorises changes if necessary to the Model in accordance with changes in market conditions and practical requirements.

The use of derivative financial instruments to control and hedge against interest rate and foreign exchange risk exposures is an integral part of the Group's risk management strategy. In accordance with Board policy, these instruments shall only be used for controlling or hedging risk exposures, and cannot be used for speculation purposes. All of the derivative instruments used by the Group are over-the-counter derivatives comprising principally interest rate swaps, cross currency swaps and foreign exchange forward contracts.

(i) Liquidity Risk

Liquidity risk refers to the risk that funds are not be available to meet liabilities as they fall due, and it may result from timing and amount mismatches of cash inflow and outflow. As a net borrower of funds, the Group does not maintain any sizeable cash surplus or short-term investment portfolio as it will usually use excess cash to pay down debt outstanding to reduce borrowing costs.

The Group employs projected cash flow analysis to manage liquidity risk by forecasting the amount of cash required, including working capital, debt repayments, dividend payments, capital expenditures and new investments, and by maintaining sufficient undrawn committed banking facilities to ensure these requirements are met. It adopts a prudent approach and will maintain sufficient committed banking facilities to provide forward coverage of at least 6 to 15 months of projected cash requirements as specified in the Model. The Group also conducts stress testing of its projected cash flow to analyse liquidity risk, and would arrange additional banking facilities or debt issuance or otherwise take appropriate actions if necessary should such stress test reveal significant risk of material cash flow shortfall.

The following table details the remaining contractual maturities at the balance sheet date of the Group's and the Company's non-derivative financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the balance sheet date) and the earliest date the Group and the Company can be required to pay:

The Group

	2008				2007			
in HK$ million	Capital market instruments	Bank loans and overdrafts	Others	Total	Capital market instruments	Bank loans and overdrafts	Others	Total
Loans and other obligations								
Amounts repayable beyond 5 years	**8,705**	**–**	**536**	**9,241**	11,221	–	–	11,221
Amounts repayable within a period of between 2 and 5 years	**4,199**	**2,519**	**–**	**6,718**	6,676	11,563	–	18,239
Amounts repayable within a period of between 1 and 2 years	**6,919**	**3,126**	**–**	**10,045**	7,903	542	–	8,445
Amounts repayable within 1 year	**7,960**	**1,840**	**–**	**9,800**	2,339	1,042	–	3,381
	27,783	**7,485**	**536**	**35,804**	28,139	13,147	–	41,286

32 Derivative Financial Assets and Liabilities *(continued)*

B Financial Risks *(continued)*

The Company

in HK$ million	2008 Capital market instruments	2008 Bank loans and overdrafts	2008 Others	2008 Total	2007 Capital market instruments	2007 Bank loans and overdrafts	2007 Others	2007 Total
Loans and other obligations								
Amounts repayable beyond 5 years	**604**	**–**	**536**	**1,140**	657	–	–	657
Amounts repayable within a period of between 2 and 5 years	**116**	**2,519**	**–**	**2,635**	5,071	11,563	–	16,634
Amounts repayable within a period of between 1 and 2 years	**5,035**	**3,126**	**–**	**8,161**	6,404	542	–	6,946
Amounts repayable within 1 year	**6,418**	**812**	**–**	**7,230**	825	721	–	1,546
	12,173	**6,457**	**536**	**19,166**	12,957	12,826	–	25,783

Others represent obligations under lease out/lease back transaction (note 19E).

(ii) Interest Rate Risk

The Group's interest rate risk arises principally from its borrowing activities. 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 both because of changes in market interest rates. The Group manages and controls its interest rate risk exposure by maintaining a minimum level of fixed rate debt of 40% to 60% of total debt outstanding as specified by the Model. Should the actual fixed rate debt level deviate substantially from the Model, derivative financial instruments in the form of interest rate swaps would be procured to change the fixed and floating mix to align with the Model. As at 31 December 2008, 62% of the Group's total debt outstanding was denominated either in or converted to fixed interest rate after taking into account outstanding cross currency and interest rate swaps.

As at 31 December 2008, it is estimated that a 200 basis points increase / 50 basis points decrease in interest rates, with all other variables held constant, would decrease/increase the Group's profit after tax and retained profits by approximately HK$142/37 million. Other components of consolidated equity would increase/decrease by approximately HK$173/47 million.

The sensitivity analysis above has been determined assuming that the change in interest rates had occurred at the balance sheet date and had been applied to the exposure to interest rate risk for both derivative and non-derivative financial instruments in existence at that date. The interest rate assumptions represent management's assessment of a reasonable possible change in interest rates over the period until the next annual balance sheet date in the light of the current low absolute levels of interest rates and the greater scope for rate increase than decrease in the future.

In 2007, a similar analysis was performed based on the assumption of a general increase/decrease of 200 basis points in interest rates, which would decrease/increase the Group's profit after tax and retained profits by approximately HK$232/233 million. Other components of consolidated equity would increase/decrease by approximately HK$133/147 million.

(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. For the Group, it arises principally from its borrowing and overseas procurement activities.

The Group manages and controls its exposure to the foreign exchange risk exposure by maintaining a modest level of unhedged non-Hong Kong dollar debt as specified by the Model, and minimal foreign exchange open positions created by its procurements overseas. This is usually achieved by converting non-Hong Kong dollar debt upon its inception to Hong Kong dollar through cross currency swaps and by entering into foreign exchange forward contracts to provide the necessary foreign currencies for settlement soon after the commitment to procure overseas.

As most of the company's receivables and payables are denominated in local currencies (Hong Kong dollars or Renminbi) or United States dollars (with which Hong Kong dollars are pegged) and most of its payment commitments denominated in foreign currencies are covered by foreign exchange forward contracts, management does not expect that there will be any significant currency risk associated with them.

(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 as well as from the Defeasance Securities it procured under the lease out/lease back transaction (note 19E). The Group limits its exposure to credit risk by placing deposits and transacting derivative financial instruments only with financial institutions with acceptable investment grade credit ratings, and diversifying its exposure to various counterparties.

32 Derivative Financial Assets and Liabilities *(continued)*

B Financial Risks *(continued)*

(iv) Credit Risk *(continued)*

All derivative financial instruments are subject to a maximum counterparty limit based on the respective counterparty's credit ratings in accordance with policy approved by the Board. Credit exposure in terms of estimated fair market value of and largest potential loss arising from these instruments based on the "value-at-risk" concept is measured, monitored and controlled against their respective counterparty limits. To further reduce counterparty risk exposure, the Group also applies set-off and netting arrangements across all derivative financial instruments and other financial transactions with the same counterparty.

All deposits are similarly subject to a separate maximum counterparty limit based on the respective counterparty's credit ratings and/or status as Hong Kong's note-issuing banks. There is also a limit on the length of time that the Group can maintain a deposit with a counterparty based upon the latter's credit ratings. Deposit outstanding and maturity profile are monitored on a frequent basis to ensure they are within the limits established for the counterparties. In addition, the Group actively monitors the credit default swap levels of counterparties and their daily change levels, and may on the basis of the observed levels and other considerations adjust its exposure and/or maximum counterparty limit to the relevant counterparty.

As at balance sheet date, the maximum exposure to credit risk of the Group with respect to derivative financial assets and bank deposits is represented respectively by carrying amount of the derivative financial assets and aggregate amount of deposit on its balance sheet. As at balance sheet date, there was no significant concentration risk to a single counterparty.

In addition, the Company also manages and controls its exposure to credit risks in respect of receivables and loan to a property developer as stated in notes 34 and 35 respectively.

33 Stores and Spares

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Stores and spares expected to be consumed:				
– within 1 year	**490**	347	**477**	345
– after 1 year	**206**	315	**196**	315
	696	662	**673**	660
Less: Provision for obsolete stock	**(6)**	(20)	**(6)**	(20)
	690	642	**667**	640

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

34 Debtors, Deposits and Payments in Advance

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Debtors, deposits and payments in advance relate to:				
– Property development projects	**5,818**	3,774	**5,818**	3,774
– Railway operations and others	**1,372**	1,393	**1,182**	1,283
	7,190	5,167	**7,000**	5,057

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

(i) The majority of fare revenue is collected either through Octopus Cards with daily settlement or in cash for other ticket types. A small portion of fare revenue collected through pre-sale agents is due within 21 days.

(ii) Rentals, advertising and telecommunications service fees are billed monthly with due dates ranging from immediately due 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.

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

(iv) Consultancy service incomes are billed monthly and are due within 30 days.

(v) 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.

34 Debtors, Deposits and Payments in Advance *(continued)*

The ageing analysis of debtors included above is as follows:

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Amounts not yet due	**6,219**	4,201	**6,188**	4,211
Overdue by 30 days	**148**	172	**139**	145
Overdue by 60 days	**30**	19	**26**	13
Overdue by 90 days	**3**	14	**3**	9
Overdue by more than 90 days	**16**	55	**14**	48
Total debtors	**6,416**	4,461	**6,370**	4,426
Deposits and payments in advance	**558**	552	**414**	477
Prepaid pension costs	**216**	154	**216**	154
	7,190	5,167	**7,000**	5,057

Amounts not yet due includes HK$5,801 million (2007: HK$3,731 million) in respect of property development which are due according to the terms of relevant development agreements or sale and purchase agreements as well as receivable from certain stakeholding funds (note 23C) awaiting finalisation of the respective development accounts.

As at 31 December 2008, all debtors, deposits and payments in advance were expected to be recovered within one year except for HK$161 million (2007: HK$139 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:

	The Group		The Company	
	2008	2007	**2008**	2007
Dirhams (in million)	**6**	–	**6**	–
Euros (in thousand)	**206**	579	**206**	579
New Taiwan dollars (in million)	**8**	20	**8**	20
Pound sterling (in million)	**1**	1	**1**	1
Renminbi (in million)	**79**	41	**–**	–
United States dollars (in million)	**21**	24	**21**	24

35 Loan to a Property Developer

The Group and The Company

	2008		2007	
in HK$ million	Nominal amount	Carrying amount	Nominal amount	Carrying amount
Interest-free loan to a property developer	**4,000**	**3,720**	4,000	3,532

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 (the "Guarantor") and is repayable on completion of the respective phases of the project. The Company monitors the exposure to credit risk in respect of the loan by regularly assessing the credit quality of the Guarantor, taking into account the Guarantor's current financial position, the Company's past experience on transactions with the Guarantor and other relevant factors.

36 Amounts Due from the Government and Other Related Parties

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Amounts due from:				
– the Government	**187**	34	**187**	34
– the Housing Authority	**24**	22	**24**	22
– KCRC	**127**	261	**127**	261
– non-controlled subsidiaries	**16**	96	**16**	96
– associates	**72**	131	**82**	138
– other subsidiaries of the Company (net of impairment losses)	**–**	–	**1,692**	764
	426	544	**2,128**	1,315

The amount due from the Government is related 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, reimbursable costs incurred by the Company for West Rail property developments (note 23D) and outstanding receivables in respect of the costs recoverable from the Government for the Shatin to Central Link and Express Rail Link Projects (notes 22D and 22E).

The amount due from the Housing Authority is related to infrastructure works entrusted to the Company in respect of the Tseung Kwan O Extension Project.

The amount due from KCRC is related to KCRC's cost sharing of the Rail Merger integration works, payments to the Company in respect of the Outsourcing Agreement and KSL Project Management Agreement, costs on certain capital works recoverable from KCRC in accordance with the Merger Framework Agreement as well as certain reimbursable expenditures of KCRC settled by the Company on KCRC's behalf.

The amount due from non-controlled subsidiaries is related to receivables from Octopus Holdings Limited, including the outstanding balance of a loan and the related interest which were fully settled in 2008 (note 26).

The amount due from associates as at 31 December 2008 includes the outstanding balance of loans, amounting to HK$28 million (GBP2.5 million) (2007: HK$62 million or GBP 4 million), to London Overground Rail Operations Ltd (note 52H(i)).

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.

37 Cash and Cash Equivalents

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Deposits with banks and other financial institutions	**104**	46	**104**	42
Cash at banks and on hand	**689**	530	**158**	142
Cash and cash equivalents in the balance sheet	**793**	576	**262**	184
Bank overdrafts (note 38A)	**(59)**	(2)	**(59)**	(2)
Cash and cash equivalents in the cash flow statement	**734**	574	**203**	182

During the year, the Group recognised deferred income and received properties in kind in respect of property development of HK$200 million (2007: HK$1,245 million), which did not involve movements of cash or cash equivalents.

37 Cash and Cash Equivalents *(continued)*

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

	The Group		The Company	
	2008	2007	**2008**	2007
Australian dollars (in thousand)	**974**	–	**501**	–
Euros (in million)	**4**	3	**4**	3
Japanese Yen (in million)	**221**	–	**221**	–
Pound sterling (in million)	**3**	1	**3**	1
New Taiwan dollars (in million)	**31**	38	**31**	38
Renminbi (in million)	**95**	197	**–**	–
United States dollars (in million)	**9**	7	**–**	–

38 Loans and Other Obligations

A By Type

The Group

	2008			2007		
in HK$ million	Carrying amount	Fair value	Repayable amount	Carrying amount	Fair value	Repayable amount
Capital market instruments						
Listed or publicly traded:						
US dollar Global notes due 2009	**5,730**	**5,851**	**5,834**	5,746	6,060	5,834
US dollar Global notes due 2010	**4,670**	**5,165**	**4,679**	4,649	5,126	4,679
Debt issuance programme (Eurobond due 2014)	**4,744**	**5,232**	**4,663**	4,580	4,790	4,663
	15,144	**16,248**	**15,176**	14,975	15,976	15,176
Unlisted:						
Debt issuance programme notes due 2008 to 2020	**8,647**	**9,563**	**8,347**	7,121	7,493	7,097
HK dollar notes due 2008	**–**	**–**	**–**	506	502	500
	8,647	**9,563**	**8,347**	7,627	7,995	7,597
Total capital market instruments	**23,791**	**25,811**	**23,523**	22,602	23,971	22,773
Bank loans	**5,496**	**5,500**	**5,487**	10,939	10,944	10,921
Others	**297**	**337**	**297**	–	–	–
Loans and others	**29,584**	**31,648**	**29,307**	33,541	34,915	33,694
Bank overdrafts	**59**	**59**	**59**	2	2	2
Short-term loans	**1,646**	**1,646**	**1,646**	507	507	507
Total	**31,289**	**33,353**	**31,012**	34,050	35,424	34,203

38 Loans and Other Obligations *(continued)*

A By Type *(continued)*

The Company

in HK$ million	2008 Carrying amount	2008 Fair value	2008 Repayable amount	2007 Carrying amount	2007 Fair value	2007 Repayable amount
Capital market instruments						
Listed or publicly traded:						
US dollar Global notes due 2009	**5,730**	**5,851**	**5,834**	5,746	6,060	5,834
US dollar Global notes due 2010	**4,670**	**5,165**	**4,679**	4,649	5,126	4,679
	10,400	**11,016**	**10,513**	10,395	11,186	10,513
Unlisted:						
Debt issuance programme notes due 2018	**435**	**703**	**482**	437	615	448
	435	**703**	**482**	437	615	448
Total capital market instruments	**10,835**	**11,719**	**10,995**	10,832	11,801	10,961
Bank loans	**5,496**	**5,500**	**5,487**	10,939	10,944	10,921
Others	**297**	**337**	**297**	–	–	–
Loans and others	**16,628**	**17,556**	**16,779**	21,771	22,745	21,882
Bank overdrafts	**59**	**59**	**59**	2	2	2
Short-term loans	**624**	**624**	**624**	186	186	186
Total	**17,311**	**18,239**	**17,462**	21,959	22,933	22,070

Others represent non-defeased obligations under lease out/lease back transaction (note 19E).

As at 31 December 2008, the Group had available undrawn committed bank loan facilities amounting to HK$10,400 million (2007: HK$6,300 million). In addition, the Group had a number of uncommitted facilities with undrawn amounts totalling HK$12,463 million (2007: HK$15,464 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 carrying amounts of short-term loans and overdrafts approximated their fair values.

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

The Group

	Before hedging activities 2008	Before hedging activities 2007	After hedging activities 2008	After hedging activities 2007
Euros (in million)	**6**	8	**–**	–
Pound sterling (in million)	**3**	4	**3**	4
Renminbi (in million)	**900**	300	**900**	300
United States dollars (in million)	**2,115**	2,117	**5**	6

The Company

	Before hedging activities 2008	Before hedging activities 2007	After hedging activities 2008	After hedging activities 2007
Euros (in million)	**6**	8	**6**	–
Pound sterling (in million)	**3**	4	**3**	4
United States dollars (in million)	**2,115**	1,417	**5**	6

38 Loans and Other Obligations *(continued)*

B. By Repayment Terms

The Group

in HK$ million	2008 Capital market instruments	2008 Bank loans and overdrafts	2008 Others	2008 Total	2007 Capital market instruments	2007 Bank loans and overdrafts	2007 Others	2007 Total
Long-term loans and others								
Amounts repayable beyond 5 years	7,878	–	297	8,175	10,008	–	–	10,008
Amounts repayable within a period of between 2 and 5 years	2,732	2,417	–	5,149	4,931	10,611	–	15,542
Amounts repayable within a period of between 1 and 2 years	6,079	3,035	–	9,114	6,834	155	–	6,989
Amounts repayable within 1 year	6,834	35	–	6,869	1,000	155	–	1,155
	23,523	5,487	297	29,307	22,773	10,921	–	33,694
Bank overdrafts	–	59	–	59	–	2	–	2
Short-term loans	–	1,646	–	1,646	–	507	–	507
	23,523	7,192	297	31,012	22,773	11,430	–	34,203
Less: Unamortised discount / premium / finance charges outstanding	(38)	(14)	–	(52)	(101)	(19)	–	(120)
Adjustment due to fair value change of financial instruments	306	23	–	329	(70)	37	–	(33)
Total carrying amount of debt	23,791	7,201	297	31,289	22,602	11,448	–	34,050

The Company

in HK$ million	2008 Capital market instruments	2008 Bank loans and overdrafts	2008 Others	2008 Total	2007 Capital market instruments	2007 Bank loans and overdrafts	2007 Others	2007 Total
Long-term loans and others								
Amounts repayable beyond 5 years	477	–	297	774	448	–	–	448
Amounts repayable within a period of between 2 and 5 years	5	2,417	–	2,422	4,679	10,611	–	15,290
Amounts repayable within a period of between 1 and 2 years	4,679	3,035	–	7,714	5,834	155	–	5,989
Amounts repayable within 1 year	5,834	35	–	5,869	–	155	–	155
	10,995	5,487	297	16,779	10,961	10,921	–	21,882
Bank overdrafts	–	59	–	59	–	2	–	2
Short-term loans	–	624	–	624	–	186	–	186
	10,995	6,170	297	17,462	10,961	11,109	–	22,070
Less: Unamortised discount / premium / finance charges outstanding	(19)	(14)	–	(33)	(37)	(19)	–	(56)
Adjustment due to fair value change of financial instruments	(141)	23	–	(118)	(92)	37	–	(55)
Total carrying amount of debt	10,835	6,179	297	17,311	10,832	11,127	–	21,959

The amounts repayable within 1 year in respect of capital market instruments and bank loans are included in long-term loans as these amounts are intended to be refinanced on a long-term basis.

38 Loans and Other Obligations *(continued)*

C Bonds and Notes Issued and Redeemed

Bonds and notes issued during the year ended 31 December 2008 and 2007 comprise:

The Group

in HK$ million	2008 Principal amount	2008 Net consideration received	2007 Principal amount	2007 Net consideration received
Debt issuance programme notes	**1,750**	**1,750**	–	–

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 ended 31 December 2008, the Group redeemed HK$1,000 million (2007: nil) of its unlisted debt securities.

None of the Group's listed debt securities was redeemed during the years ended 31 December 2008 and 2007.

D Guarantees and Pledges

(i) There were no guarantees given by the Government in respect of loan facilities as at 31 December 2008 and 2007.

(ii) As at 31 December 2008, certain assets held by MTR Corporation (Shenzhen) Limited, an indirect wholly owned subsidiary of the Company in the Mainland of China, were pledged as security for a RMB900 million short-term bank loan facility granted to it.

Apart from the above, none of the other Group's assets was charged or subject to any encumbrance as at 31 December 2008.

39 Creditors, Accrued Charges and Provisions

in HK$ million	The Group 2008	The Group 2007	The Company 2008	The Company 2007
Creditors, accrued charges and provisions				
– Airport Railway Project	**68**	70	**68**	70
– Tseung Kwan O Extension Project	**16**	120	**16**	120
– LOHAS Park Station Project	**31**	58	**31**	58
– West Island Line Project	**89**	2	**89**	2
– Property projects and management	**1,728**	1,776	**1,631**	1,675
– Railway operations and others	**3,346**	3,330	**2,775**	2,875
Gross amount due to customers for contract work	**56**	56	**56**	56
	5,334	5,412	**4,666**	4,856

The above amounts are mainly related to capital projects to be 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.

At 31 December 2008, the aggregate amount of costs incurred plus recognised profits less recognised losses included in the gross amount due to customers for contract works was HK$273 million (2007: HK$244 million).

The gross amount due to customers for contract work at 31 December 2008 that is expected to be settled after more than one year is HK$56 million (2007: HK$56 million).

39 Creditors, Accrued Charges and Provisions *(continued)*

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

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Due within 30 days or on demand	**1,188**	1,354	**800**	1,128
Due after 30 days but within 60 days	**927**	652	**864**	573
Due after 60 days but within 90 days	**234**	218	**224**	204
Due after 90 days	**1,392**	1,563	**1,249**	1,359
	3,741	3,787	**3,137**	3,264
Rental and other refundable deposits	**1,353**	1,462	**1,291**	1,429
Accrued employee benefits	**240**	163	**238**	163
Total	**5,334**	5,412	**4,666**	4,856

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 2008, all creditors, accrued charges and provisions were expected to be settled within one year except for HK$852 million (2007: HK$920 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.

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

	The Group		The Company	
	2008	2007	**2008**	2007
Australian dollars (in thousand)	**1,660**	429	**1,660**	429
Euros (in million)	**5**	4	**5**	4
Japanese Yen (in million)	**100**	39	**100**	39
Pound sterling (in million)	**2**	1	**2**	1
Renminbi (in million)	**305**	202	**–**	–
Swedish krona (in thousand)	**933**	421	**933**	421
Swiss franc (in thousand)	**368**	216	**368**	216
United States dollars (in million)	**65**	53	**51**	38

40 Contract Retentions

The Group

in HK$ million	Due for release within 12 months	Due for release after 12 months	Total
2008			
Railway extension projects	**29**	**80**	**109**
Railway operations	**100**	**15**	**115**
	129	**95**	**224**
2007			
Railway extension projects	52	34	86
Railway operations	98	41	139
	150	75	225

The Company

in HK$ million	Due for release within 12 months	Due for release after 12 months	Total
2008			
Railway extension projects	**24**	**27**	**51**
Railway operations	**100**	**15**	**115**
	124	**42**	**166**
2007			
Railway extension projects	24	34	58
Railway operations	98	41	139
	122	75	197

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

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

	The Group		The Company	
	2008	2007	**2008**	2007
Euros (in thousand)	**484**	337	**484**	337
Pound sterling (in thousand)	**39**	37	**39**	37
Renminbi (in million)	**52**	26	**–**	–
United States dollars (in million)	**2**	–	**2**	–

41 Amounts Due to Related Parties

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Amounts due to:				
– KCRC	**882**	975	**882**	975
– subsidiaries	**–**	–	**13,239**	11,987
	882	975	**14,121**	12,962

The amounts due to KCRC are related to mandatory payments and interest payable to KCRC in respect of the East Rail Line / Light Rail / Kowloon Southern Link property development sites as well as the accrued portion of the fixed annual payment for the service concession.

The amounts due to the subsidiaries as at 31 December 2008 of HK$11,956 million (2007: HK$10,763 million) are expected to be settled after one year.

The amounts due to the Company's subsidiaries include HK$13,156 million (2007: HK$11,960 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 38C), 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.

42 Obligations under Service Concession

As at 31 December 2008 and 2007, the Group and the Company had the following obligations under service concession in respect of the fixed annual payments for the Rail Merger (note 3):

in HK$ million	**2008**	2007
Balance as at 1 January	**10,685**	–
Total fixed annual payments capitalised at inception	**–**	10,687
Less: Amount repaid/payable during the year	**(29)**	(2)
Balance as at 31 December	**10,656**	10,685

The outstanding balances as at 31 December 2008 and 2007 are repayable as follows:

	2008			2007		
in HK$ million	Present value of fixed annual payments	Interest expense relating to future periods	Total fixed annual payments	Present value of fixed annual payments	Interest expense relating to future periods	Total fixed annual payments
Amounts repayable beyond 5 years	**10,480**	**22,457**	**32,937**	10,520	23,168	33,688
Amounts repayable within a period of between 2 and 5 years	**112**	**2,138**	**2,250**	105	2,145	2,250
Amounts repayable within a period of between 1 and 2 years	**33**	**717**	**750**	31	719	750
Amounts repayable within 1 year	**31**	**719**	**750**	29	721	750
	10,656	**26,031**	**36,687**	10,685	26,753	37,438

43 Deferred Income

The Group and The Company

in HK$ million	2008	2007
Deferred income on property development (note 23B)	**156**	400
Other deferred income (note 19E)	**–**	115
	156	515

44 Income Tax in the Balance Sheet

A Current taxation in the consolidated balance sheet comprised provision for Hong Kong Profits Tax for the Company and certain subsidiaries for the year ended 31 December 2008, chargeable at Hong Kong Profits Tax Rate at 16.5% (2007: 17.5%) and after netting off provisional tax paid, and overseas tax chargeable at the appropriate current tax rates of taxation ruling in the relevant countries.

	The Group		The Company	
in HK$ million	2008	2007	2008	2007
Provision for Hong Kong Profits Tax for the year (note 13)	**1,021**	1	**1,014**	–
Overseas tax for the year (note 13)	**3**	2	**1**	1
Hong Kong Provisional Profits Tax paid	**(575)**	–	**(574)**	–
	449	3	**441**	1
Balance of Profits Tax provision relating to prior years	**1**	–	**–**	–
	450	3	**441**	1

B Deferred tax assets and liabilities recognised

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

The Group

	Deferred tax arising from					
in HK$ million	Depreciation allowances in excess of related depreciation	Revaluation of properties	Provision and other temporary differences	Cash flow hedges	Tax losses	Total
2008						
At 1 January 2008	**8,809**	**4,126**	**215**	**(5)**	**(575)**	**12,570**
Effect on deferred tax balances resulting from a change in tax rate	**(503)**	**(235)**	**(12)**	**–**	**32**	**(718)**
Charged/(credited) to consolidated profit and loss account	**17**	**(24)**	**(98)**	**–**	**532**	**427**
Credited to reserves (note 46)	**–**	**(45)**	**–**	**(25)**	**–**	**(70)**
At 31 December 2008	**8,323**	**3,822**	**105**	**(30)**	**(11)**	**12,209**
2007						
At 1 January 2007	8,749	2,681	205	(2)	(2,181)	9,452
Addition through subsidiary acquisition	–	–	–	–	(2)	(2)
Charged to consolidated profit and loss account	60	1,402	10	–	1,608	3,080
Charged/(credited) to reserves (note 46)	–	43	–	(3)	–	40
At 31 December 2007	8,809	4,126	215	(5)	(575)	12,570

44 Income Tax in the Balance Sheet *(continued)*

The Company

in HK$ million	Deferred tax arising from: Depreciation allowances in excess of related depreciation	Revaluation of properties	Provision and other temporary differences	Cash flow hedges	Tax losses	Total
2008						
At 1 January 2008	**8,802**	**4,126**	**215**	**(5)**	**(564)**	**12,574**
Effect on deferred tax balances resulting from a change in tax rate	**(503)**	**(235)**	**(12)**	**–**	**32**	**(718)**
Charged/(credited) to profit and loss account	**16**	**(17)**	**(98)**	**–**	**532**	**433**
Credited to reserves (note 46)	**–**	**(45)**	**–**	**(25)**	**–**	**(70)**
At 31 December 2008	**8,315**	**3,829**	**105**	**(30)**	**–**	**12,219**
2007						
At 1 January 2007	8,743	2,681	205	(2)	(2,174)	9,453
Charged to profit and loss account	59	1,402	10	–	1,610	3,081
Charged/(credited) to reserves (note 46)	–	43	–	(3)	–	40
At 31 December 2007	8,802	4,126	215	(5)	(564)	12,574

in HK$ million	The Group 2008	The Group 2007	The Company 2008	The Company 2007
Net deferred tax asset recognised in the balance sheet	**(11)**	(4)	**–**	–
Net deferred tax liability recognised in the balance sheet	**12,220**	12,574	**12,219**	12,574
	12,209	12,570	**12,219**	12,574

C The Group has not recognised deferred tax assets in respect of some of its subsidiaries' cumulative tax losses of HK$227 million (2007: HK$217 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.

45 Share Capital and Capital Management

A Share Capital, Share Premium and Capital Reserve

in HK$ million	2008	2007
Authorised:		
6,500,000,000 shares of HK$1.00 each	**6,500**	6,500
Issued and fully paid:		
5,661,143,113 shares (2007: 5,611,057,035 shares) of HK$1.00 each	**5,661**	5,611
Share premium	**8,270**	7,029
Capital reserve	**27,188**	27,188
	41,119	39,828

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.

45 Share Capital and Capital Management *(continued)*

A Share Capital, Share Premium and Capital Reserve *(continued)*

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

	Number of shares	Option/ scrip price	Proceeds received / Transfer from employee share-based capital reserve: Share capital account	Share premium account	Total
		HK$	HK$ million	HK$ million	HK$ million
Employee share options exercised					
– Pre-Global Offering Share Option Scheme	**1,644,500**	**8.440**	**2**	**12**	**14**
– New Joiners Share Option Scheme	**31,500**	**15.450**	**–**	**1**	**1**
	45,000	**15.970**	**–**	**1**	**1**
	31,500	**18.300**	**–**	**1**	**1**
	355,500	**19.404**	**–**	**8**	**8**
	30,000	**20.660**	**–**	**1**	**1**
	142,000	**21.000**	**–**	**3**	**3**
Issued as 2007 final scrip dividends	**32,071,954**	**27.070**	**32**	**836**	**868**
Issued as 2008 interim scrip dividends	**15,734,124**	**25.020**	**16**	**378**	**394**
	50,086,078		**50**	**1,241**	**1,291**

An analysis of the Company's outstanding share options as at 31 December 2008 are disclosed in note 47.

B Capital Management

The Group's primary objectives in managing capital are to safeguard its ability to continue as a going concern, and to generate sufficient profit to maintain growth and provide an adequate return to its shareholders.

The Group manages the amount of capital in proportion to risk, and makes adjustments to its capital structure through the amount of dividend payment to shareholders, issuance of scrip and new shares, and managing its debt portfolio in conjunction with projected financing requirement. The Financial Secretary Incorporated of the Government of the Hong Kong SAR is the majority shareholder of the Company holding 4,344,710,490 shares as of 31 December 2008, representing 76.7% of total equity interest in the Company.

The Group monitors capital on the basis of the net debt-to-equity ratio, which is calculated on net borrowings as a percentage of the total equity attributable to shareholders of the Company where net borrowings are represented by the aggregate of loans, obligations under finance leases, bank overdrafts and obligations under service concession net of cash and cash equivalents. The Group's net debt-to-equity ratios over the past years have been trending downward in general, from approximately 60% at 31 December 2002 to 36% at 31 December 2006. Owing to the increase in borrowings to finance payments for the Rail Merger and the incorporation of the obligations under service concession as a component of debt, the ratio rose to 49% at 31 December 2007 and reverted to a downward trend to 42% at 31 December 2008.

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

46 Other Reserves

The Group

in HK$ million	Fixed asset revaluation reserve	Hedging reserve	Employee share-based capital reserve	Exchange reserve	Retained profits	Total
	Attributable to equity shareholders of the Company					
2008						
Balance as at 1 January 2008	**1,170**	**(25)**	**7**	**42**	**49,992**	**51,186**
Cash flow hedges:						
Effective portion of changes in fair value, net of deferred tax	**–**	**(151)**	**–**	**–**	**–**	**(151)**
Transfer from equity						
– to consolidated profit and loss account	**–**	**41**	**–**	**–**	**–**	**41**
– to initial carrying amount of non-financial hedged items	**–**	**(14)**	**–**	**–**	**–**	**(14)**
– to deferred tax	**–**	**(5)**	**–**	**–**	**–**	**(5)**
2007 final dividend	**–**	**–**	**–**	**–**	**(1,740)**	**(1,740)**
2008 interim dividend	**–**	**–**	**–**	**–**	**(790)**	**(790)**
Deficit on revaluation, net of deferred tax (notes 19 and 44)	**(189)**	**–**	**–**	**–**	**–**	**(189)**
Release of revaluation reserve on disposal, net of deferred tax (note 44)	**(35)**	**–**	**–**	**–**	**42**	**7**
Effect on deferred tax balances resulting from a change in tax rate	**14**	**–**	**–**	**–**	**–**	**14**
Employee share-based payments	**–**	**–**	**20**	**–**	**–**	**20**
Release to share premium upon share options exercised	**–**	**–**	**(2)**	**–**	**–**	**(2)**
Exchange difference on translation of accounts of overseas subsidiaries	**–**	**–**	**–**	**21**	**–**	**21**
Profit for the year	**–**	**–**	**–**	**–**	**8,284**	**8,284**
Balance as at 31 December 2008	**960**	**(154)**	**25**	**63**	**55,788**	**56,682**
2007						
Balance as at 1 January 2007	968	(10)	5	17	37,148	38,128
Cash flow hedges:						
Effective portion of changes in fair value, net of deferred tax	–	(13)	–	–	–	(13)
Transfer from equity						
– to consolidated profit and loss account	–	–	–	–	–	–
– to initial carrying amount of non-financial hedged items	–	(2)	–	–	–	(2)
– to deferred tax	–	–	–	–	–	–
2006 final dividend	–	–	–	–	(1,554)	(1,554)
2007 interim dividend	–	–	–	–	(782)	(782)
Surplus on revaluation, net of deferred tax (notes 19 and 44)	202	–	–	–	–	202
Employee share-based payments	–	–	2	–	–	2
Exchange difference on translation of accounts of overseas subsidiaries	–	–	–	25	–	25
Profit for the year	–	–	–	–	15,180	15,180
Balance as at 31 December 2007	1,170	(25)	7	42	49,992	51,186

46 Other Reserves *(continued)*

The Company

in HK$ million	Fixed asset revaluation reserve	Hedging reserve	Employee share-based capital reserve	Retained profits	Total
2008					
Balance as at 1 January 2008	**1,170**	**(25)**	**7**	**49,349**	**50,501**
Cash flow hedges:					
Effective portion of changes in fair value, net of deferred tax	**–**	**(151)**	**–**	**–**	**(151)**
Transfer from equity					
– to profit and loss account	**–**	**41**	**–**	**–**	**41**
– to initial carrying amount of non-financial hedged items	**–**	**(14)**	**–**	**–**	**(14)**
– to deferred tax	**–**	**(5)**	**–**	**–**	**(5)**
2007 final dividend	**–**	**–**	**–**	**(1,740)**	**(1,740)**
2008 interim dividend	**–**	**–**	**–**	**(790)**	**(790)**
Deficit on revaluation, net of deferred tax (notes 19 and 44)	**(189)**	**–**	**–**	**–**	**(189)**
Release of revaluation reserve on disposal, net of deferred tax (note 44)	**(35)**	**–**	**–**	**42**	**7**
Effect on deferred tax balances resulting from a change in tax rate	**14**	**–**	**–**	**–**	**14**
Employee share-based payments	**–**	**–**	**20**	**–**	**20**
Release to share premium upon share options exercised	**–**	**–**	**(2)**	**–**	**(2)**
Profit for the year	**–**	**–**	**–**	**8,118**	**8,118**
Balance as at 31 December 2008	**960**	**(154)**	**25**	**54,979**	**55,810**
2007					
Balance as at 1 January 2007	968	(10)	5	36,802	37,765
Cash flow hedges:					
Effective portion of changes in fair value, net of deferred tax	–	(13)	–	–	(13)
Transfer from equity					
– to profit and loss account	–	–	–	–	–
– to initial carrying amount of non-financial hedged items	–	(2)	–	–	(2)
– to deferred tax	–	–	–	–	–
2006 final dividend	–	–	–	(1,554)	(1,554)
2007 interim dividend	–	–	–	(782)	(782)
Surplus on revaluation, net of deferred tax (notes 19 and 44)	202	–	–	–	202
Employee share-based payments	–	–	2	–	2
Profit for the year	–	–	–	14,883	14,883
Balance as at 31 December 2007	1,170	(25)	7	49,349	50,501

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 as explained in note 2U(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 2V(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.

46 Other Reserves *(continued)*

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 2DD.

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$18,417 million (2007: HK$18,280 million) included in retained profits are non-distributable as they also do not constitute realised profits. As at 31 December 2008, the Company considers that the total amount of reserves available for distribution to equity shareholders amounted to HK$36,562 million (2007: HK$31,069 million).

Included in the Group's retained profits as at 31 December 2008 is an amount of HK$328 million (2007: HK$192 million), being the retained profits attributable to the non-controlled subsidiaries and associates.

47 Share-based Payments

A Equity-settled Share-based Payments

The Group granted equity-settled share options to its Members of the Executive Directorate and certain employees under three share option schemes namely, the Pre-Global Offering Share Option Scheme, the New Joiners Share Option Scheme and the 2007 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 2008. 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 2008, all options granted under the Pre-IPO Option Scheme have vested.

In 2008, a total of 1,644,500 previously vested share options have been exercised. The weighted average closing price in respect of the share options exercised during the year was HK$25.159 per share. In addition, 17,000 share options lapsed as a result of resignation of option holders during the year. As at 31 December 2008, total options to subscribe for 3,605,500 (2007: 5,267,000) shares remained outstanding.

(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 2008, 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 New Option Scheme expired on 16 May 2007 and no options can be granted under this Scheme on or after that date.

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	1,245,200	9.75	on or prior to 14 July 2013
13 September 2005	49,000	15.97	on or prior to 9 September 2015
23 September 2005	213,000	15.97	on or prior to 9 September 2015
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
15 May 2006	183,000	20.66	on or prior to 25 April 2016
5 October 2006	94,000	19.732	on or prior to 29 September 2016
22 March 2007	355,500	19.404	on or prior to 19 March 2017

47 Share-based Payments *(continued)*

A Equity-settled Share-based Payments *(continued)*

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

	2008		2007	
	Number of options	Weighted average exercise price HK$	Number of options	Weighted average exercise price HK$
Outstanding at 1 January	**3,717,700**	**16.017**	2,780,700	14.598
Granted during the year	**–**	**–**	1,066,000	19.404
Exercised during the year	**(635,500)**	**19.326**	(129,000)	13.426
Lapsed during the year	**(582,000)**	**19.237**	–	–
Outstanding at 31 December	**2,500,200**	**14.426**	3,717,700	16.017
Exercisable at 31 December	**2,278,700**	**13.865**	1,775,700	12.377

The weighted average closing price in respect of the share options exercised during the year was HK$27.985 (2007: HK$22.80).

Share options outstanding at 31 December 2008 had the following exercise prices and remaining contractual lives:

	2008		2007	
Exercise price	Number of options	Remaining contractual life years	Number of options	Remaining contractual life years
HK$9.75	**1,245,200**	**4.54**	1,245,200	5.54
HK$15.97	**262,000**	**6.69**	307,000	7.69
HK$15.45	**–**	**–**	62,500	8.02
HK$18.05	**94,000**	**7.22**	94,000	8.22
HK$20.66	**449,500**	**7.32**	479,500	8.32
HK$21.00	**–**	**–**	213,000	8.34
HK$18.30	**–**	**–**	94,000	8.47
HK$19.732	**94,000**	**7.75**	94,000	8.75
HK$19.104	**–**	**–**	62,500	8.87
HK$19.404	**355,500**	**8.22**	1,066,000	9.22
	2,500,200		3,717,700	

(iii) 2007 Share Option Scheme

Following the expiry of the New Option Scheme in May 2007, the 2007 Share Option Scheme (the "2007 Option Scheme") was submitted and approved at the 2007 Annual General Meeting to enhance the Company's ability to attract the best available personnel, to retain and motivate critical and key employees, to align their interest to the long-term success of the Company and to provide them with fair and market competitive remuneration. Under the Rules of the 2007 Option Scheme, a maximum of 277,461,072 shares, which represent 4.9% of the issued share capital of the Company as at 31 December 2008, may be issued pursuant to the exercise of options granted after 7 June 2007 under all share option schemes of the Company including the 2007 Option Scheme. Options granted will be vested in respect of their underlying shares not less than 1 year from the date on which the relevant option is offered. The exercise price of any option granted under the 2007 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.

Subject to the rules of the 2007 Option Scheme, the Company may from time to time during the scheme period, at its absolute discretion, offer to grant share options to any eligible employees. Under the 2007 Option Scheme, the date of grant is defined as the date of acceptance of the offer to grant the option. On 10 December 2007, share options in respect of 8,273,000 shares were offered to Members of the Executive Directorate and selected employees of the Company as the first tranche of the share option awards for 2008 (the "First 2008 Award"). For the First 2008 Award, share options in respect of 7,968,000 shares were accepted by the grantees during the period from 11 December 2007 to 31 December 2007 and share options in respect of 305,000 shares were accepted by the grantees during the period from 2 January 2008 to 7 January 2008. On 26 March 2008, share options in respect of 2,749,000 shares were offered to selected employees of the Company and were accepted by the grantees during the period from 28 March 2008 to 23 April 2008, as the second tranche of the share option awards for 2008. This award, together with the First 2008 Award, forms the "2008 Award". On 8 December 2008, share options in respect of 12,712,000 shares were offered to Members of the Executive Directorate and other selected employees of the Company and were accepted by the grantees during the period from 8 December 2008 to 30 December 2008, as share option awards for 2009 (the "2009 Award").

47 Share-based Payments *(continued)*

A Equity-settled Share-based Payments *(continued)*

The following table summarises the outstanding share options granted under the 2007 Option Scheme since inception.

Date of grant	Number of share options	Exercise price HK$	Exercisable period
2008 Award			
11 December 2007	45,000	27.60	on or prior to 10 December 2014
12 December 2007	2,642,000	27.60	on or prior to 10 December 2014
13 December 2007	1,805,000	27.60	on or prior to 10 December 2014
14 December 2007	1,005,000	27.60	on or prior to 10 December 2014
15 December 2007	370,000	27.60	on or prior to 10 December 2014
17 December 2007	835,000	27.60	on or prior to 10 December 2014
18 December 2007	380,000	27.60	on or prior to 10 December 2014
19 December 2007	115,000	27.60	on or prior to 10 December 2014
20 December 2007	190,000	27.60	on or prior to 10 December 2014
21 December 2007	45,000	27.60	on or prior to 10 December 2014
22 December 2007	35,000	27.60	on or prior to 10 December 2014
24 December 2007	118,000	27.60	on or prior to 10 December 2014
28 December 2007	35,000	27.60	on or prior to 10 December 2014
31 December 2007	130,000	27.60	on or prior to 10 December 2014
2 January 2008	75,000	27.60	on or prior to 10 December 2014
3 January 2008	40,000	27.60	on or prior to 10 December 2014
4 January 2008	65,000	27.60	on or prior to 10 December 2014
7 January 2008	125,000	27.60	on or prior to 10 December 2014
28 March 2008	255,000	26.52	on or prior to 26 March 2015
31 March 2008	379,000	26.52	on or prior to 26 March 2015
1 April 2008	261,000	26.52	on or prior to 26 March 2015
2 April 2008	296,000	26.52	on or prior to 26 March 2015
3 April 2008	171,000	26.52	on or prior to 26 March 2015
4 April 2008	23,000	26.52	on or prior to 26 March 2015
5 April 2008	17,000	26.52	on or prior to 26 March 2015
7 April 2008	358,000	26.52	on or prior to 26 March 2015
8 April 2008	155,000	26.52	on or prior to 26 March 2015
9 April 2008	85,000	26.52	on or prior to 26 March 2015
10 April 2008	58,000	26.52	on or prior to 26 March 2015
11 April 2008	117,000	26.52	on or prior to 26 March 2015
12 April 2008	48,000	26.52	on or prior to 26 March 2015
14 April 2008	40,000	26.52	on or prior to 26 March 2015
15 April 2008	34,000	26.52	on or prior to 26 March 2015
16 April 2008	40,000	26.52	on or prior to 26 March 2015
17 April 2008	124,000	26.52	on or prior to 26 March 2015
18 April 2008	32,000	26.52	on or prior to 26 March 2015
19 April 2008	25,000	26.52	on or prior to 26 March 2015
20 April 2008	23,000	26.52	on or prior to 26 March 2015
21 April 2008	66,000	26.52	on or prior to 26 March 2015
23 April 2008	19,000	26.52	on or prior to 26 March 2015
2009 Award			
8 December 2008	155,000	18.30	on or prior to 8 December 2015
9 December 2008	1,463,000	18.30	on or prior to 8 December 2015
10 December 2008	2,176,400	18.30	on or prior to 8 December 2015
11 December 2008	2,464,200	18.30	on or prior to 8 December 2015
12 December 2008	1,481,500	18.30	on or prior to 8 December 2015
13 December 2008	84,500	18.30	on or prior to 8 December 2015
14 December 2008	88,200	18.30	on or prior to 8 December 2015
15 December 2008	1,084,700	18.30	on or prior to 8 December 2015
16 December 2008	581,500	18.30	on or prior to 8 December 2015
17 December 2008	513,500	18.30	on or prior to 8 December 2015
18 December 2008	611,500	18.30	on or prior to 8 December 2015
19 December 2008	198,000	18.30	on or prior to 8 December 2015
20 December 2008	19,000	18.30	on or prior to 8 December 2015
22 December 2008	772,500	18.30	on or prior to 8 December 2015
23 December 2008	306,000	18.30	on or prior to 8 December 2015
24 December 2008	500,500	18.30	on or prior to 8 December 2015
25 December 2008	45,000	18.30	on or prior to 8 December 2015
29 December 2008	148,000	18.30	on or prior to 8 December 2015
30 December 2008	19,000	18.30	on or prior to 8 December 2015

47 Share-based Payments *(continued)*

A Equity-settled Share-based Payments *(continued)*

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

	2008		2007	
	Number of options	Weighted average exercise price HK$	Number of options	Weighted average exercise price HK$
Outstanding at 1 January	**7,968,000**	**27.600**	–	–
Granted during the year	**15,766,000**	**19.913**	7,968,000	27.600
Exercised during the year	**–**	**–**	–	–
Lapsed during the year	**(341,000)**	**27.210**	–	–
Outstanding at 31 December	**23,393,000**	**22.425**	7,968,000	27.600
Exercisable at 31 December	**2,811,000**	**27.600**	–	–

Share options outstanding at 31 December 2008 had the following exercise prices and remaining contractual lives:

	2008		2007	
Exercise price	Number of options	Remaining contractual life years	Number of options	Remaining contractual life years
HK$27.60	**8,055,000**	**6**	7,968,000	7
HK$26.52	**2,626,000**	**6**	–	–
HK$18.30	**12,712,000**	**7**	–	–
	23,393,000		7,968,000	

47 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 2008 were as follows:

		Inputs into the Black-Scholes pricing model					
Date of grant	Fair value of options granted	Share price immediately before grant date	Exercise price	Expected volatility	Expected life	Risk-free interest rate	Expected dividend per share
	HK$	HK$	HK$		years	%	HK$
2 January 2008	**5.49**	28.70	27.60	0.22	3.5	2.82	0.45
3 January 2008	**6.88**	30.80	27.60	0.22	3.5	2.71	0.45
4 January 2008	**7.65**	31.80	27.60	0.22	3.5	2.77	0.45
7 January 2008	**7.79**	32.00	27.60	0.22	3.5	2.77	0.45
28 March 2008	**3.80**	25.90	26.52	0.22	3.5	1.69	0.45
31 March 2008	**3.90**	26.10	26.52	0.22	3.5	1.68	0.45
1 April 2008	**4.39**	26.70	26.52	0.23	3.5	1.66	0.45
2 April 2008	**4.42**	26.70	26.52	0.23	3.5	1.75	0.45
3 April 2008	**4.84**	27.35	26.52	0.23	3.5	1.83	0.45
4 April 2008	**4.78**	27.25	26.52	0.23	3.5	1.83	0.45
5 April 2008	**4.78**	27.25	26.52	0.23	3.5	1.83	0.45
7 April 2008	**4.76**	27.25	26.52	0.23	3.5	1.79	0.45
8 April 2008	**4.69**	27.10	26.52	0.23	3.5	1.84	0.45
9 April 2008	**4.72**	27.20	26.52	0.23	3.5	1.76	0.45
10 April 2008	**4.49**	26.90	26.52	0.23	3.5	1.65	0.45
11 April 2008	**4.52**	26.90	26.52	0.23	3.5	1.72	0.45
12 April 2008	**4.63**	27.10	26.52	0.23	3.5	1.72	0.45
14 April 2008	**4.60**	27.10	26.52	0.23	3.5	1.65	0.45
15 April 2008	**4.37**	26.65	26.52	0.23	3.5	1.74	0.45
16 April 2008	**4.63**	27.05	26.52	0.23	3.5	1.81	0.45
17 April 2008	**4.42**	26.65	26.52	0.23	3.5	1.88	0.45
18 April 2008	**4.52**	26.80	26.52	0.23	3.5	1.91	0.45
19 April 2008	**4.54**	26.85	26.52	0.23	3.5	1.91	0.45
20 April 2008	**4.54**	26.85	26.52	0.23	3.5	1.91	0.45
21 April 2008	**4.54**	26.85	26.52	0.23	3.5	1.91	0.45
23 April 2008	**4.88**	27.35	26.52	0.23	3.5	1.99	0.45
8 December 2008	**2.31**	16.90	18.30	0.27	3.5	1.35	0.45
9 December 2008	**3.03**	18.30	18.30	0.27	3.5	1.28	0.45
10 December 2008	**2.87**	18.02	18.30	0.27	3.5	1.26	0.45
11 December 2008	**3.41**	18.98	18.30	0.27	3.5	1.22	0.45
12 December 2008	**3.22**	18.68	18.30	0.27	3.5	1.17	0.45
13 December 2008	**2.84**	18.00	18.30	0.27	3.5	1.17	0.45
14 December 2008	**2.84**	18.00	18.30	0.27	3.5	1.17	0.45
15 December 2008	**2.84**	18.00	18.30	0.27	3.5	1.20	0.45
16 December 2008	**3.12**	18.50	18.30	0.27	3.5	1.21	0.45
17 December 2008	**3.07**	18.48	18.30	0.27	3.5	1.04	0.45
18 December 2008	**3.32**	18.90	18.30	0.27	3.5	1.05	0.45
19 December 2008	**3.40**	19.06	18.30	0.27	3.5	1.01	0.45
20 December 2008	**3.00**	18.36	18.30	0.27	3.5	1.01	0.45
22 December 2008	**2.99**	18.36	18.30	0.27	3.5	0.99	0.45
23 December 2008	**2.72**	17.86	18.30	0.27	3.5	1.01	0.45
24 December 2008	**2.60**	17.64	18.30	0.27	3.5	0.98	0.45
25 December 2008	**2.77**	17.96	18.30	0.27	3.5	0.98	0.45
29 December 2008	**2.76**	17.96	18.30	0.27	3.5	0.97	0.45
30 December 2008	**2.86**	18.16	18.30	0.27	3.5	0.92	0.45

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 3.5 years and the expected life adopted was assumed to be 3.5 years 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.

47 Share-based Payments *(continued)*

A Equity-settled Share-based Payments *(continued)*

(iv) During the year, the equity-settled share-based payments recognised in respect of the above share option schemes were as follows:

in HK$ million	**2008**	2007
Equity-settled share-based payments in respect of:		
– New Option Scheme	**3**	1
– 2007 Option Scheme	**17**	1
	20	2

B Cash-settled Share-based Payments

(i) C K Chow did not participate in the Company's Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme. Pursuant to his three-year contract 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 this contract. As at 31 December 2008, an amount of HK$0.9 million (2007: HK$4.1 million) has been recorded as share-based payment expense for the year. 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 2008, the fair value of these shares was HK$17.96 per share (2007: HK$28.70).

(ii) Lincoln K K Leong has a derivative interest in the Company's shares, which entitled him to receive an equivalent value in cash of 160,000 shares in the Company on 9 April 2010. As at 31 December 2008, an amount of HK$0.5 million (2007: HK$1.1 million) has been recorded as share-based payment expense for the year, measured at the same basis as described in note 47B(i) above.

48 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 (the "MTR MPF Scheme") on 1 December 2000 by participating in a master trust scheme provided by an independent MPF service provider. Eligible employees could choose between the Retirement Scheme and the MTR MPF Scheme while temporary employees are required to join the MTR MPF Scheme.

Following the Rail Merger on 2 December 2007, the Company has assumed the operations of KCRC's two retirement schemes. One was a defined contribution scheme namely the Kowloon-Canton Railway Corporation Retirement Benefit Scheme (the "KCR Scheme"), which was renamed as the MTR Corporation Limited Provident Fund Scheme (the "Provident Fund Scheme") on 1 March 2008. The other was a MPF scheme ("KCR MPF Scheme") for employees who did not opt for or who were not eligible for the KCR Scheme.

Currently, new eligible employees can choose between the Provident Fund Scheme and the MTR MPF Scheme while temporary employees are required to join the MTR 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 The Retirement Scheme

The Retirement Scheme was established under trust at the beginning of 1977 containing 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 offers benefits on retirement, permanent disability, death and leaving service to its members. The hybrid benefit section of the Retirement Scheme provides benefits based on the greater of a multiple of final salary and accumulated contributions with investment returns. This section has been closed to new entrants since 31 March 1999. Before 1 March 2008, the Retirement Scheme used to contain a defined contribution section, a member choice plan provided to non-temporary employees who were hired on or after 1 April 1999 with benefits based on accumulated contributions and investment returns only. On 1 March 2008, the members and assets of the defined contribution section were transferred to the Provident Fund Scheme and the defined contribution section ceased to exist.

Given that the defined contribution benefit section was transferred to the Provident Fund Scheme, commencing 1 March 2008 (note 48E), promotees and new entrants can choose to join either the Provident Fund Scheme or the MTR MPF Scheme.

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. As at 31 December 2008, the total membership was 5,406 (2007: 5,655). In 2008, members contributed HK$68 million (2007: HK$66 million) and the Company contributed HK$152 million (2007: HK$152 million) to the hybrid benefit section. The net asset value of the hybrid benefit section as at 31 December 2008 was HK$6,162 million (2007: HK$7,929 million).

48 Retirement Schemes *(continued)*

A The Retirement Scheme *(continued)*

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

Actuarial valuations are carried out annually in accordance with the ORSO. A full actuarial valuation of the Retirement Scheme was carried out as at 31 December 2008 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 2.5% (2007: 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, as at the valuation date:

(a) the Retirement Scheme was solvent, with assets more than adequate to cover the aggregate value of members' vested benefits had all members left the Retirement Scheme; and

(b) on the assumption that the Retirement Scheme continued in force, the aggregate past service liability was almost fully funded at 99.9% by the value of the assets.

B RBS

The RBS was established under trust as of 1 January 1995. It 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 accrued up to 31 December 2002. The RBS was registered under the ORSO with effect from 1 December 1995. As at 31 December 2008, there were 327 members (2007: 346).

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 2007 and 2008, the Company was not required to make any contribution to the RBS. The net asset value of the RBS as at 31 December 2008 was HK$12 million (2007: HK$12 million).

Actuarial valuations are carried out annually. A full actuarial valuation of the RBS was carried out as at 31 December 2008 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 -1.7% (2007: -2.0%) per annum, together with appropriate allowance for expected rates of redundancy. The actuary confirmed that, as 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) on the assumption that the RBS continued in force, the value of assets was more than sufficient to cover the aggregate past service liability.

C MTR 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 2008, the total number of employees of the Company participating in the MTR MPF Scheme was 1,337 (2007: 885). In 2008, total members' contributions were HK$5.3 million (2007: HK$3.9 million) and total contribution from the Company was HK$6.3 million (2007: HK$4.5 million).

D KCR MPF Scheme

The KCR MPF Scheme is operated under the Hong Kong Mandatory Provident Fund Schemes Ordinance. It is a defined contribution retirement plan administered by independent trustees. The KCR MPF Scheme was introduced on 1 April 2000 to employees who did not opt for or who were not eligible for the KCR Scheme. On the Appointed Day, the KCR MPF Scheme was closed to new entrants.

As at 31 December 2008, the total number of employees of the Company participating in the KCR MPF Scheme was 1,029 (2007: 2,578). In 2008, total members' contributions were HK$10 million (2007: HK$1.9 million since the Appointed Day) and total contribution from the Company was HK$10.7 million (2007: HK$1.9 million since the Appointed Day).

E The Provident Fund Scheme

The Provident Fund Scheme (previously the KCR Scheme) is a defined contribution scheme which was established on 1 February 1983 under trust. The Provident Fund Scheme was registered under the ORSO with effect from 16 November 1994.

All benefits payable under the Provident Fund Scheme are calculated by reference to the employer's contributions and members' own contributions, based on fixed percentages of members' basic salaries, together with investment returns on these contributions.

On 1 March 2008, the defined contribution section of the Retirement Scheme was transferred to the KCR Scheme, which was subsequently renamed as the MTR Corporation Limited Provident Fund Scheme. As at 31 December 2008, the total number of employees participating in the Provident Fund Scheme was 5,575 (2007: 4,540). In 2008, total members' contribution was HK$42.4 million (2007: HK$10.8 million for the defined contribution section of the Retirement Scheme and HK$4.5 million for the KCR Scheme since the Appointed Day) and total contribution from the Company was HK$139.4 million (2007: HK$22 million for the defined contribution section of the Retirement Scheme and HK$9.5 million for the KCR Scheme since the Appointed Day). The net asset value as at 31 December 2008 was HK$2,522 million (2007: HK$3,577 million).

49 Defined Benefit Retirement Plan Obligations

The Company makes contributions to two defined benefit plans that provide benefits for employees upon retirement or termination of services for other reasons (note 48). 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

in HK$ million	2008 Retirement Scheme	2008 RBS	2008 Total	2007 Retirement Scheme	2007 RBS	2007 Total
Present value of funded obligations	**(9,064)**	**(1)**	**(9,065)**	(8,577)	(1)	(8,578)
Fair value of plan assets	**6,162**	**12**	**6,174**	7,929	12	7,941
Net unrecognised actuarial (gains)/losses	**3,112**	**(4)**	**3,108**	796	(5)	791
Net asset	**210**	**7**	**217**	148	6	154

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 Company expects to pay HK$199 million in contribution to the Retirement Scheme in 2009.

B Plan assets consist of the following:

The Group and The Company

in HK$ million	2008 Retirement Scheme	2008 RBS	2008 Total	2007 Retirement Scheme	2007 RBS	2007 Total
Equity securities	**2,675**	**–**	**2,675**	3,696	–	3,696
Bonds	**3,364**	**–**	**3,364**	3,976	–	3,976
Cash	**168**	**12**	**180**	311	12	323
	6,207	**12**	**6,219**	7,983	12	7,995
Voluntary units	**(45)**	**–**	**(45)**	(54)	–	(54)
	6,162	**12**	**6,174**	7,929	12	7,941

Included in the plan assets are investments in the Company's ordinary shares and debt securities of nil (2007: nil) and HK$16 million (2007: HK$13 million) respectively.

C Movements in the present value of the defined benefit obligations

The Group and The Company

in HK$ million	2008 Retirement Scheme	2008 RBS	2008 Total	2007 Retirement Scheme	2007 RBS	2007 Total
At 1 January	**8,577**	**1**	**8,578**	7,311	3	7,314
Members' contributions paid to the Schemes	**68**	**–**	**68**	66	–	66
Benefits paid by the Schemes	**(468)**	**–**	**(468)**	(125)	–	(125)
Current service cost	**273**	**–**	**273**	264	–	264
Interest cost	**297**	**–**	**297**	271	–	271
Actuarial losses/(gains)	**317**	**–**	**317**	790	(2)	788
At 31 December	**9,064**	**1**	**9,065**	8,577	1	8,578

49 Defined Benefit Retirement Plan Obligations *(continued)*

D Movements in plan assets

The Group and The Company

in HK$ million	2008 Retirement Scheme	2008 RBS	2008 Total	2007 Retirement Scheme	2007 RBS	2007 Total
At 1 January	**7,929**	**12**	**7,941**	6,906	12	6,918
Group's contributions paid to the Schemes	**152**	**–**	**152**	152	–	152
Members' contributions paid to the Schemes	**68**	**–**	**68**	66	–	66
Benefits paid by the Schemes	**(468)**	**–**	**(468)**	(125)	–	(125)
Expected return on plan assets	**477**	**–**	**477**	416	–	416
Actuarial (losses)/gains	**(1,996)**	**–**	**(1,996)**	514	–	514
At 31 December	**6,162**	**12**	**6,174**	7,929	12	7,941

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

in HK$ million	2008 Retirement Scheme	2008 RBS	2008 Total	2007 Retirement Scheme	2007 RBS	2007 Total
Current service cost	**273**	**–**	**273**	264	–	264
Interest cost	**297**	**–**	**297**	271	–	271
Expected return on plan assets	**(477)**	**–**	**(477)**	(416)	–	(416)
Net actuarial gains recognised	**–**	**(1)**	**(1)**	–	(1)	(1)
Expense recognised	**93**	**(1)**	**92**	119	(1)	118
Less: Amount capitalised	**(12)**	**–**	**(12)**	(20)	–	(20)
	81	**(1)**	**80**	99	(1)	98

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

F Actual return on plan assets

in HK$ million	**2008**	2007
MTR Corporation Limited Retirement Scheme	**(1,519)**	930
MTR Corporation Limited Retention Bonus Scheme	**–**	–

G The principal actuarial assumptions used as at 31 December 2008 (expressed as weighted average) are as follows:

	2008 Retirement Scheme	2008 RBS	2007 Retirement Scheme	2007 RBS
Discount rate at 31 December	**1.2%**	**0.8%**	3.5%	3.0%
Expected rate of return on plan assets	**6.0%**	**1.5%**	6.0%	2.5%
Future salary increases	**3.5%**	**3.2%**	4.0%	4.5%

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.

49 Defined Benefit Retirement Plan Obligations *(continued)*

H Historical information

The Group and The Company

	Retirement Scheme				
in HK$ million	**2008**	2007	2006	2005	2004
Present value of funded obligations	**(9,064)**	(8,577)	(7,311)	(5,974)	(5,456)
Fair value of plan assets	**6,162**	7,929	6,906	5,899	5,365
Deficit in the Scheme	**(2,902)**	(648)	(405)	(75)	(91)
Experience adjustments arising on plan liabilities – gain/(loss)	**1,391**	(556)	(464)	(98)	(154)
Experience adjustments arising on plan assets – gain/(loss)	**(1,997)**	514	510	119	243

	RBS				
in HK$ million	**2008**	2007	2006	2005	2004
Present value of funded obligations	**(1)**	(1)	(3)	(7)	(7)
Fair value of plan assets	**12**	12	12	13	14
Surplus in the Scheme	**11**	11	9	6	7
Experience adjustments arising on plan liabilities – gain / (loss)	**–**	1	3	(2)	5
Experience adjustments arising on plan assets – gain / (loss)	**–**	–	–	–	–

50 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 2008:

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	Completed by phases from 2002–2008
Package Three	Residential/Retail/Wet Market/ Kindergarten	413,154	Completed by phases from 2002–2008
Hang Hau Station	Residential/Retail	142,152	Completed in 2004
Tiu Keng Leng Station	Residential/Retail	253,765	Completed 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
Area 56	Residential/Hotel/Retail/Office	163,130	2011
Tseung Kwan O Area 86			
Package One	Residential/Retail/Residential Care Home for the Elderly	139,840	Completed in 2008
Package Two	Residential/Kindergarten	310,496	By phases from 2009–2010
Package Three	Residential/Kindergarten	129,544	2012
Choi Hung Park-and-Ride	Residential/Retail	21,538	Completed in 2005
Che Kung Temple Station	Residential/Retail/Kindergarten	90,655	2012

* 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, land costs, acquisition cost of development rights and interest expense. These 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 23) as the case may be. As at 31 December 2008, total property development in progress in respect of these jointly controlled operations was HK$3,036 million (2007: HK$1,961 million) and total deferred income was HK$156 million (2007: HK$400 million).

During the year ended 31 December 2008, profits of HK$4,670 million (2007: HK$8,304 million) were recognised (note 8).

50 Interests in Jointly Controlled Operations *(continued)*

In connection with the Rail Merger, the Company entered into agreements with KCRC relating to the property development projects on the following three awarded sites:

Location / Development Package	Land Use	Total Gross Floor Area (sq.m.)	Actual or Expected Date of Completion of Construction Works *
Fo Tan Station Ho Tung Lau	Residential/Retail	122,900	Completed in 2008
Wu Kai Sha Station	Residential/Retail/Kindergarten	172,650	2009
Tai Wai Maintenance Centre	Residential	313,955	By phases from 2009–2011

Under these agreements, the Company was appointed as KCRC's agent to exercise the rights and to perform the obligations of KCRC as stipulated in the agreements. The Company received a right to share the net surplus from the sale of these property development projects.

51 Material Related Party Transactions

The Financial Secretary Incorporated, which holds approximately 77% 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 23).

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. With effect from 2 December 2007, the OA was replaced by a new operating agreement, details of which are set out in note 51I below.

D On 14 July 2000, the Company received a comfort letter from the Government pursuant to which the Government agreed to extend the period of certain of the Company's land interests so that they are coterminous with the Company's franchise period. In addition, on 3 August 2007, the Government wrote to KCRC confirming that, subject to all necessary approvals being obtained, the period of certain of KCRC's land interests (which are the subject of the service concession) will be extended so that they are coterminous with the Concession Period.

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 with operation commenced on 18 September 2006.

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.

51 Material Related Party Transactions *(continued)*

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 at the Hong Kong International Airport. The project was completed with the facilities opened on 28 February 2007.

I On 8 June 2007, the Legislative Council approved the Rail Merger Ordinance which came into effect on the Appointed Day. Amongst other things, the Rail Merger Ordinance amends the KCRC Ordinance and the MTR Ordinance to provide the necessary legislative framework for the Rail Merger and the operation by the Company of the MTRC railway, KCRC railway and certain other railways under one franchise, and enables KCRC to enter into the Service Concession Agreement referred to in note 51K(ii) below with the Company.

J In connection with the Rail Merger, on 9 August 2007, the Company entered into a new operating agreement with the Government ("new OA"), which is based on the existing OA referred to in note 51C above. On the Appointed Day, the Company's existing franchise under the Mass Transit Railway Ordinance was expanded to cover railways other than the existing MTR railway for an initial period of 50 years from the Appointed Day ("expanded franchise"). The new OA detailed the design, construction, maintenance and operation of the railways under the expanded franchise. Pursuant to the terms of the new OA (and the MTR Ordinance), the Company's franchise may be extended for further periods of 50 years (from the date of the extension) upon satisfying certain capital expenditure requirements at no payment and without any change in the terms of the franchise. The new OA includes terms relating to the Company's obligations in relation to electrical power supply, control centres, the monitoring of environmental conditions, the provision of accommodation for the Hong Kong Police Force, the notification of certain events to the Commissioner for Transport, hours of operation and service capacity, performance requirements, customer service pledges and safety management. The new OA also sets out a framework for the award of new railway projects in Hong Kong and introduces a fare adjustment mechanism. A detailed description of the new OA is contained in the circular to shareholders in respect of the Extraordinary General Meeting convened to approve the Rail Merger.

K Other than the new OA described in note 51J above, the Company also entered into the following principal agreements with KCRC and the Government in connection with the Rail Merger on 9 August 2007:

(i) Merger Framework Agreement, which contains provisions for the overall structure and certain specific aspects of the rail merger, including the seamless interchange programme, corporate governance, certain employee arrangements, implementation of certain fare reductions, the payments for property package, arrangements relating to flat production and land premium, the treatment of KCRC's cross border leases, Shatin to Central Link arrangements and the allocation of liabilities for certain pre and post merger claims by third parties;

(ii) Service Concession Agreement, which contains provisions in relation to the grant of the right to access, use and operate the concession property and a licence to access and use certain KCRC land; the term of the service concession; the arrangements for the redelivery of the KCRC system upon concession expiry; the provision of ex-KCRC services by the Company to specified standards; the obligation to pay upfront and annual payments; the legal and beneficial ownership of future concession property (Additional Concession Property); and the regime for compensation payable by KCRC upon return of the Additional Concession Property;

(iii) Sale and Purchase Agreement, which sets out the terms pursuant to which the Company acquired certain assets and contracts from KCRC;

(iv) Kowloon Southern Link ("KSL") Project Management Agreement, which sets out the terms on which the Company was appointed by KCRC to project manage the design and construction of the KSL in return for a management fee of approximately HK$710.8 million and an incentive payment of up to HK$110 million if the construction of the KSL is completed ahead of time and under budget. The Company itself will not construct, nor be responsible for the costs of the KSL works. On opening of service, the KSL will form part of the service concession;

(v) West Rail Agency Agreement, which sets out the terms on which the Company was appointed to act as KCRC's agent and to exercise certain rights and perform certain obligations relating to specified development sites along the West Rail;

(vi) Outsourcing Agreement, which sets out the terms on which the Company is to provide certain financial and administrative services to KCRC after the Rail Merger, in return for an annual fee of HK$19.8 million; and

(vii) Property Package Agreements, which set out the arrangements in respect of the acquisition of the property package. These arrangements include the assignment of certain properties by KCRC to the Company, the acquisition of certain properties by the Company through its acquisition of certain KCRC subsidiaries under the Sale and Purchase Agreement, the granting of leases on certain properties by the Government to the Company and the relating interim arrangements before such granting is effective, the management of certain development sites by the Company in return for a fee substantially equal to the profits from the developments, and the granting of certain potential development sites to the Company.

A detailed description of each of these documents is contained under the paragraph "Connected Transactions" of the Report of the Members of the Board.

L Also in connection with the Rail Merger, the Company entered into US Cross Border Lease ("CBL") Assumption Agreements with KCRC on 30 November 2007 and US CBL Allocation Agreement with KCRC and KCRC's subsidiaries on 2 December 2007. The agreements set out the terms on which the Company has undertaken to perform, on a joint and several basis with KCRC, the obligations of KCRC under the respective CBLs, and delineate and allocate the obligations and responsibility for risks relating to the CBLs. Details of the commitment of the Company in connection with these agreements are specified in note 52E and a detailed description of these agreements are contained under the paragraph "Connected Transactions" of the Report of the Members of the Board.

51 Material Related Party Transactions *(continued)*

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

M On 6 February 2008, the Company entered into a preliminary project agreement with the Government for the undertaking of the pre-authorisation activities of the West Island Line. Pursuant to the agreement, the Company has received HK$400 million from the Government to undertake the detailed design of the railway works, carry out all necessary ground investigations, invite and assess tenders for the railway works construction contracts, and carry out ancillary and other support services.

N On 22 July 2008, the Government granted Sha Tin Town Lot No. 519 to the Company for the development at Che Kung Temple Station with a total consideration of HK$3,662 million.

O On 21 August 2008, the Company entered into a maintenance agreement with the Hong Kong Airport Authority for the renewal of an expired maintenance agreement for the automatic people mover system serving the Hong Kong International Airport including the SkyPlaza and SkyPier terminal buildings. The renewed agreement has a duration of five years effective from 6 July 2008 and widens the scope to cover the operation and maintenance of eight new vehicles and one new line, both of which will be ready for passenger service starting from the fourth quarter of 2009. During 2008, HK$32 million (2007: HK$23 million) was recognised as consultancy income in respect of the maintenance agreements.

P On 30 September 2008, the Company entered into a management agency agreement with KCRC in relation to 7th, 8th, 9th and 10th floors of Citylink Plaza, No. 1 Sha Tin Station Circuit, Shatin, New Territories. Pursuant to the agreement, the Company acts as KCRC's agent in the management and lease administration of the relating premises with effect from the Appointed Day to the end of the Concession Period. During 2008, HK$1 million (2007: nil) was recognised as property management income in respect of the property agency agreement.

Q On 24 November 2008, the Company entered into an entrustment agreement with the Government to provide for the design of and site investigation and procurement activities in relation to the Shatin to Central Link.

R On 24 November 2008, the Company entered into an entrustment agreement with the Government to provide for the design of and site investigation and procurement activities in relation to the Express Rail Link.

S 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 2008 are provided in notes 22, 36 and 41 respectively.

T The Company has business transactions with its non-controlled subsidiaries in the normal course of operations, details of which are disclosed in note 26.

U The Group has paid remuneration to the Members of the Board and Members of the Executive Directorate. Details of these transactions are described in note 7A. In addition, the Members of the Executive Directorate were granted share options under the Company's Pre-Global Offering Share Option Scheme, New Joiners Share Option Scheme and 2007 Share Option Scheme. Details of the terms of these directors' options are disclosed in note 7B 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:

in HK$ million	**2008**	2007
Short-term employee benefits	**67.0**	50.6
Post-employment benefits	**2.2**	1.5
Equity compensation benefits	**6.4**	6.5
	75.6	58.6

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

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

in HK$ million	**2008**	2007
Cash dividends paid	**806**	765
Shares allotted in respect of scrip dividends	**1,134**	1,025
	1,940	1,790

52 Commitments

A Capital Commitments

(i) Outstanding capital commitments as at 31 December 2008 not provided for in the accounts were as follows:

The Group

in HK$ million	Railway operations	Railway extension projects	Property projects and management	Mainland of China and Overseas projects	Total
2008					
Authorised but not yet contracted for	**846**	**–**	**57**	**–**	**903**
Authorised and contracted for	**1,832**	**180**	**264**	**859**	**3,135**
	2,678	**180**	**321**	**859**	**4,038**
2007					
Authorised but not yet contracted for	916	–	68	–	984
Authorised and contracted for	547	152	377	633	1,709
	1,463	152	445	633	2,693

The Company

in HK$ million	Railway operations	Railway extension projects	Property projects and management	Total
2008				
Authorised but not yet contracted for	**841**	**–**	**57**	**898**
Authorised and contracted for	**1,832**	**180**	**260**	**2,272**
	2,673	**180**	**317**	**3,170**
2007				
Authorised but not yet contracted for	889	–	68	957
Authorised and contracted for	547	152	377	1,076
	1,436	152	445	2,033

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

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

The Group and The Company

in HK$ million	Improvement and enhancement works	Acquisition of property, plant and equipment	Additional concession property	Total
2008				
Authorised but not yet contracted for	**661**	**12**	**173**	**846**
Authorised and contracted for	**491**	**1,105**	**236**	**1,832**
	1,152	**1,117**	**409**	**2,678**
2007				
Authorised but not yet contracted for	854	11	51	916
Authorised and contracted for	342	9	196	547
	1,196	20	247	1,463

52 Commitments *(continued)*

B Operating Lease Commitments

The Group had operating leases on office buildings, staff quarters, bus depot and a shopping centre in Beijing as at 31 December 2008. The total future minimum lease payments under non-cancellable operating leases are payable as follows:

	The Group		The Company	
in HK$ million	**2008**	2007	**2008**	2007
Payable within one year	**73**	67	**21**	17
Payable after one but within five years	**187**	228	**9**	13
	260	295	**30**	30

The above includes HK$21 million (2007: HK$24 million) in respect of the office accommodation and quarters for construction project staff, majority of which are subject to rent reviews.

In respect of the operating lease on the shopping centre in Beijing, 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. The Group obtained a bank guarantee of RMB12.5 million in respect of the quarterly rental payment arrangement with the landlord. In addition, the Company provides guarantees amounting to RMB102.5 million to the landlord for the rental payments for the first five years of the lease, which was entered into by the Company's subsidiary, MTR (Beijing) Commercial Facilities Management Co. Ltd..

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 2008, the Group had total outstanding liabilities and contractual commitments of HK$875 million (2007: HK$969 million) in respect of these works and services. Cash funds totalling HK$1,072 million (2007: HK$989 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 38C), which amounted to approximately HK$12,528 million (in notional amount) as at 31 December 2008. 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.

The Group provides standby letters of credit ("standby LC's") to the Investors to the lease out/lease back transaction ("Lease Transaction") (note 19E) to cover additional amounts payable by the Group in the event the transactions are terminated prior to the expiry of the lease terms, and such standby LC's amounted to US$113 million (HK$872 million) as at 31 December 2008. The Group also provides standby LC's to certain of the Investors under the Lease Transaction (note 19E) to replace some of the Defeasance Securities previously used to support the corresponding long-term lease payments as a result of credit rating downgrades of these securities, and such standby LC's amounted to US$33 million (HK$255 million) as at 31 December 2008.

E US Cross Border Lease ("CBL") Agreements

In connection with the Rail Merger in December 2007, the Company entered into a number of agreements ("US CBL Assumption Agreements") with respect to the CBLs that KCRC had entered into with its CBL counterparties in relation to certain of its property and equipment ("CBL Property") between 1998 and 2003. Pursuant to the US CBL Assumption Agreements, the Company has undertaken to perform, on a joint and several basis with KCRC, the obligations of KCRC under the respective CBLs.

In addition, the Company has entered into a US CBL Allocation Agreement with KCRC, whereby the rights, obligations and responsibility for risks relating to the CBLs are delineated and allocated between the Company and KCRC. Generally, the Company is responsible for operational matters, such as repair, maintenance and insurance of the CBL Property, and KCRC is responsible for all other obligations, including payment of periodic rents and collateral related obligations. Despite this allocation of obligations, the Company is prima facie jointly and severally liable to the CBL counterparties for any failure of KCRC to perform its obligations under the CBLs.

KCRC and the Government of Hong Kong have agreed to indemnify the Company for its reasonable costs incurred as a result of the due and proper performance by the Company of its obligations under the CBLs (unless such costs would have been incurred in any event). In addition, KCRC has agreed to indemnify the Company for losses and reasonable costs incurred arising from KCRC not complying with its obligations under the CBLs or from any breach of KCRC's representations, covenants and agreements provided for in relation to the CBLs.

The Company has agreed to indemnify each of the Government of Hong Kong and KCRC for losses and reasonable costs incurred arising from any breach of the Company's representations, covenants and agreements provided for in relation to the CBLs.

52 Commitments *(continued)*

F Service Concession

Pursuant to the Rail Merger, the Company is obliged under the Service Concession Agreement ("SCA") to pay an annual fixed payment of HK$750 million to KCRC over the period of the service concession. Additionally, commencing after three years from the Appointed Day, the Company is obliged to pay an annual variable fee to KCRC based on the revenue generated from the KCRC system above certain thresholds. Furthermore, under the SCA, the Company is obliged to maintain, repair, replace and/or upgrade the KCRC system over the period of the service concession which is to be returned at the expiry of the service concession.

G Investments in Mainland of China

(i) 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 ("Shenzhen 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 Government initialled the project Concession Agreement. Approval of the project has been obtained from the National Development and Reform Commission in Beijing in January 2009.

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 RMB6 billion (HK$6.8 billion), which will be financed by equity capital contributed by the Group of RMB2.4 billion (HK$2.7 billion) and the balance by bank loans in Renminbi.

Preparatory work including design and tendering and expanded trial section is in progress. As of 31 December 2008, costs of HK$1,650 million (2007: HK$670 million) incurred for the project have been included in deferred expenditure and the Group had other contract commitments totalling HK$859 million (2007: HK$633 million) in relation to this project.

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

In December 2004, an Agreement in Principle was entered into between the 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. 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 RMB15.3 billion (HK$17.4 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 RMB4.6 billion (HK$5.2 billion), contributing to 30% of the total investment in the project to finance mainly the electrical and mechanical systems and rolling stock. 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 the maintenance of Beijing Line 4 for a term of 30 years. The PPP has a registered capital of approximately RMB1.4 billion (HK$1.6 billion) with the Company's contribution amounting to RMB676 million. During 2008, the Group injected its last tranche of equity of RMB471 million (HK$515 million), making the total equity contribution as at 31 December 2008 at HK$718 million (2007: HK$203 million), which represents 100% of the Group's committed share. 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.

Equipment production and site installation were in progress as scheduled. As of 31 December 2008, the PPP has outstanding contract commitments totalling at approximately RMB1.3 billion (HK$1.4 billion) (2007: HK$2.5 billion).

(iii) Investment in Shenyang Metro Lines Project

On 26 November 2008, the Company entered into an Agreement in Principle with Shenyang Municipal Government and its wholly-owned subsidiary, Shenyang Metro Group Limited, for the operation and maintenance of Shenyang Metro Lines 1 and 2 for a term of 30 years, with the Company owning 49% of the joint venture company to be set up for the operation and maintenance franchise. Shenyang Metro Lines 1 and 2, with a total route length of 50 kilometres, are the first two metro lines among the eleven planned lines of Shenyang city. Civil construction works for the two lines commenced in 2005 and the two lines are expected to commence service by 2010 and 2012 respectively. Under a separate Principle Agreement, the Company and Shenyang Municipal Government will form Joint Working Groups to conduct planning studies for future Shenyang Metro Lines 4, 9 and 10 as well as the extension of Shenyang Metro Lines 1 and 2. Under another Principle Agreement, the Company will join the Shenyang Municipal Government for a study on town planning and to explore property development opportunities along Shenyang Metro Lines 1 and 2 corridors.

(iv) Investment in Beijing Daxing Line Project

On 27 November 2008, the Company, together with its joint venture partners of Beijing MTR Corporation Limited, Beijing Infrastructure Investment Company Limited ("BIIC") and Beijing Capital Group Company Limited ("BCG"), signed a Memorandum of Understanding (MOU) with Beijing Metro Daxing Line Investment Company Limited, the wholly owned subsidiary of Beijing Municipal Government for the operations and maintenance of Daxing Line of the Beijing Metro Network. Daxing Line is a 22-kilometre extension of the Beijing Metro Line 4 from Gongyixiqiao Station extending southward to Nanzhaolu Station and is expected to commence service in 2010.

52 Commitments *(continued)*

G Investments in Mainland of China *(continued)*

(v) Investment in Hangzhou Metro Line 1 Project

On 16 January 2009, the Company entered into a Principle Agreement for a public-private partnership project with Hangzhou Municipal Government and Hangzhou Metro Group Company Limited for the investment, construction and operation of Hangzhou Metro Line 1.

The Principle Agreement sets out the framework for the Company to further discuss with Hangzhou Municipal Government for the concession agreement for the investment in Hangzhou Metro Line 1 and for the operational right of Hangzhou Metro Line 1 Phase 1 for a period of 25 years. The 48-kilometre Hangzhou Metro Line 1 consists of 41 kilometres of underground section and 7 kilometres of at-grade and elevated sections. Hangzhou Metro Line 1 has a total of 30 stations running from south to north of Hangzhou city to other cities, namely Xiasha, Linping and Jiangnan. This line is expected to commence service in 2012.

The project will be divided into Part A and Part B, representing approximately 63% and 37% respectively of the total investment of RMB22 billion. Part A, which covers civil construction of the metro system, is being undertaken by Hangzhou Metro Group Company Limited. Part B, which mainly covers the electrical and mechanical system and operation of the metro system, will be undertaken by a cooperative joint venture owned by the Company and Hangzhou Metro Group Company Limited with equity interest of 49% and 51% respectively.

At the same time, the Company also entered into a Strategic Agreement with the same parties to explore property development opportunities along the Hangzhou Metro lines.

H Investments in Europe

(i) Investment in London Overground Franchise

On 2 July 2007, London Overground Rail Operations Ltd ("LOROL"), the 50/50 partnership between the Group and DB Reggio (UK) Limited (formerly Laing Rail Limited), was awarded the concession to operate the new London Overground service in Greater London for seven years from 11 November 2007 with an option for a two year extension. London Overground is a semi-orbital route of five rail lines serving West, North and East London and will act as a crucial link for the 2012 Olympic Games. The total London Overground route network measures 107.2 kilometres.

Under the terms of the concession agreement between LOROL and Transport for London ("TfL"), LOROL has provided a performance bond of GBP15 million to TfL, which is jointly and severally indemnified by the parent companies, that is the Company and DB Reggio (UK) Limited, through parent company guarantees. The bond may be called by TfL if the concession is terminated early as a result of default.

As at 31 December 2008, an unsecured debt of GBP5 million with interest rate at 2.5% per annum above the published Bank of England base rate from time to time was provided by the Group and DB Reggio (UK) Limited to LOROL. The final repayment date of this debt is on the date of expiry or the earlier termination of the term of the London Rail Concession under the concession agreement. Each lender shares 50% of the debt.

(ii) Investment in Stockholm Metro Franchise

On 20 January 2009, the board of the Stockholm transport authority ("SL") announced the Company as the winner of the tender for the Stockholm Metro operations concession in Sweden for a period of eight years, starting from 2 November 2009, with a possible extension for an additional period of six years.

The concession includes train and station operations as well as rolling stock maintenance. For servicing, maintenance and cleaning of trains, the Company will team up with Mantena AS, a leading maintainer of rolling stock in Norway.

The Stockholm Metro consists of three dedicated lines with 108 kilometres in total track length and 100 surface and underground stations.

The Company is in the process of mobilising resources for the contract and will invest a total of SEK175 million (approximately HK$175 million) in a mixture of equity and shareholder loans or deeply discounted securities.

Under the agreement, the Company will provide to SL a guarantee of SEK1,000 million (approximately HK$1,000 million), which can be called if the concession is early terminated as a result of default.

53 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 2I).

(ii) Impairment of Long-lived Assets

The Group reviews its long-lived assets for indications of impairment at each balance sheet date according to accounting polices set out in note 2H(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 48A and 48B.

(iv) Revenue Recognition on Property Development

Recognition of property development profits requires management's estimation of the final project costs upon completion, assessment of outstanding transactions and market values of unsold units 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 when estimating final project costs on completion; and makes reference to 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 31) 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 1 December 2057. Pursuant to the terms stipulated in the new 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 51J). The Group's depreciation policies (note 2I) in respect of certain assets' lives which extend beyond 2057 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 2008 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 2J(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.

53 Accounting Estimates and Judgements *(continued)*

A Key sources of accounting estimates and estimation uncertainty include the following: *(continued)*

(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.

(xiii) Obligations under Service Concession

In determining the present value of the obligations under service concession, the discount rate adopted was the Company's estimated long-term incremental cost of borrowing at inception after due consideration of the Company's existing fixed rate borrowing cost, future interest rate and inflation trends.

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 2008, 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 2008, 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.

54 Possible Impact of Amendments, New Standards and Interpretations Issued but Not Yet Effective for the Annual Accounting Period ended 31 December 2008

Up to the date of issue of these accounts, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2008 and which have not been adopted in these accounts.

The Company is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far, it has concluded that the following developments are relevant to the Group's accounts:

	Effective for accounting periods beginning on or after
HK(IFRIC) Interpretation 13, *Customer Loyalty Programme*	1 July 2008
Amendment to HKAS 40, *Investment Property*, under Improvements to HKFRs 2008	1 January 2009

However, the adoption of the above developments is unlikely to result in a significant restatement of the Group's results of operations and financial position.

In addition, the following developments are expected to result in amended disclosures in the financial statements, including restatement of comparative amounts in the first period of adoption:

	Effective for accounting periods beginning on or after
HKFRS 8, *Operating segments*	1 January 2009
HKAS 1 (revised 2007), *Presentation of financial statements*	1 January 2009

55 Approval of Accounts

The accounts were approved by the Board on 10 March 2009.