

AUDIT COMMITTEE REPORT

As at the date of this Report, the Audit Committee of the Company (referred to as the “Committee” in this Report) consists of six Non-executive Directors, five of whom are Independent Non-executive Directors of the Company. Details of the Committee’s membership and members’ attendance records during 2018 are set out on pages 120 to 121 of this Annual Report. None of the Committee members is a partner or former partner of KPMG, the Company’s external auditor.

The Finance Director (the “FD”), the Head of Internal Audit (the “Head of IA”) and representatives of the external auditor attend all meetings of the Committee. At the discretion of the Committee, others may also be invited to attend meetings. The Committee meets four times a year, and the Chairman of the Committee, the external auditor or the FD may request an additional meeting if they consider it necessary. The Committee, upon request, also considers and, if thinks fit, approves the appointment of the Company’s external auditor for undertaking non-audit work.

TERMS OF REFERENCE OF THE COMMITTEE

The Terms of Reference of the Committee (the “ToR”) has been updated following an amendment to the Corporate Governance Code which came into effect on 1 January 2019, which extends the cooling off period for a former partner, principal, shareholder, or professional employee of the Company’s existing external auditor from acting as a Committee member from one year to two years. The updated ToR is available on the respective websites of the Company (www.mtr.com.hk) and the Stock Exchange.

DUTIES OF THE COMMITTEE

Under the ToR, the duties of the Committee primarily comprise the following:

Oversight of the relationship with the Company’s external auditor

- Making recommendations to the Board on the appointment, re-appointment and removal of the Company’s external auditor, and approving the remuneration and terms of such engagement;
- Reviewing and monitoring the external auditor’s independence and objectivity and the effectiveness of the audit process in accordance with applicable standards;

- Discussing with the external auditor the nature and scope of its audit and reporting obligations before the audit commences; and
- Pre-approving non-audit services and ensuring that the external auditor’s provision of non-audit services does not impair its independence or objectivity.

Review of the financial information of the Company

- Monitoring the integrity of financial statements, interim and annual reports and accounts, together with the preliminary announcement of results and other announcements regarding the Company’s financial information to be made public;
- Liaising with the Board and the Executive Directorate in dealing with the Company’s financial information. The Chairman of the Committee further meets on an ad hoc basis with the Head of IA, representatives of the external auditor, and Management, as and when required; and
- Discussing any matters that the Head of IA or external auditor may wish to raise, either privately or together with Members of the Executive Directorate and any other person.

Oversight of the Company’s financial reporting system and internal control procedures

- Assisting the Board in overseeing the Company’s financial controls and internal control systems on an ongoing basis through reviewing, at least annually, the effectiveness of the Company’s financial controls and internal control systems; with a report to the Board that such a review has been carried out. These controls and systems allow the Board to monitor the Company’s overall financial position and to protect its assets;
- Overseeing Management’s review of the adequacy of the resources, qualifications and experience of staff of the Company’s accounting and financial reporting function, and their training programmes and budget;
- Reviewing and approving the annual Internal Audit Plan which includes audits on the efficiency of chosen activities or operations of the Company;



AUDIT COMMITTEE REPORT

- Reviewing periodic reports from the Head of IA and the follow-up of major action plans recommended, and putting forward recommendations to the Board, where appropriate; and
- Reviewing the annual assessment conducted by the Head of IA on the adequacy of the resources, qualifications and experience of staff of the Company's internal audit function, and its training programmes and budget.

Further details of the above are set out in the "Risk Management and Internal Control Systems" section of the Corporate Governance Report on pages 131 to 135 of this Annual Report.

Reporting to the Board

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

The minutes of Committee meetings are prepared by the secretary of the meetings with details of the matters considered by the Committee members and decisions reached, including any concerns raised by the Committee members, dissenting views expressed and suggestions for enhancing the governance and internal control systems of the Company. The draft minutes are circulated to Committee members for comment within a reasonable time after each meeting. The Committee formally adopts the draft minutes at the next subsequent meeting, after taking into account any comments that the Committee members may have on the draft minutes. Minutes of the Committee meetings are open for inspection by Committee members at the Company's registered office.

In advance of the first regular Committee meeting each year, the secretary of the meetings pre-agrees key agenda items for the year with the Chairman of the Committee who makes a final determination on the agenda for the regular Committee meetings.

WORK PERFORMED BY THE COMMITTEE IN 2018

In 2018, the Committee held four meetings. Representatives of the external auditor, the FD and the Head of IA attended all four meetings to report and answer questions about their work. The Committee devoted its attention to the review of the Company's annual and interim results announcement/

accounts at the February and August meetings respectively, allowing more time to review and discuss the Company's internal controls, internal audit and other activities at the May and November meetings.

The Committee from time to time invited relevant Members of the Executive Directorate to join the financial presentation by the FD and the presentation on the latest cost positions of the Company's railway projects under construction by General Manager – Procurement and Contracts (Projects).

As mentioned in the Corporate Governance Report, in light of the incidents relating to the Shatin to Central Link project in 2018, an analysis has been undertaken to identify areas for continuous enhancement of the Company's risk management and internal control systems. A summary of the key actions identified are set out on pages 117 to 118 of this Annual Report. The coverage of future audits will cover specifically implementation of improvement actions that have been identified within the checks and balances processes surrounding the construction quality management.

The Committee has also mandated management to carry out a review of the Company's internal control and risk management systems for Hong Kong operations, with the support of an external consultant, for continuous improvement. Processes and procedures of the Company's Projects Division are excluded under this review in light of the various investigations, validation and enhancement efforts that are going on separately. The review has adopted a phased approach and the first phase of work has started in February 2019.

Other major works performed by the Committee in 2018 included:

Financial

- Review of the draft 2017 Annual Report and Accounts and 2018 Interim Report and Accounts, including the financial impact of the Company's new railway projects in progress, and the relevant disclosure notes in the said Accounts and recommendation of the same for the Board's approval;
- Received updates on the carrying value of the Group's fixed assets;
- Received updates on the latest cost positions of the Company's railway projects under construction;

- Review of and recommendation for presentation to the Remuneration Committee of the paper headed “2017 payout under ‘2008 Variable Incentive Scheme’ - confirmation of the financial figures”; and
- Preview of 2018 interim and annual accounting and financial reporting issues.

Internal Audit

- Review of Internal Audit Department’s Reports;
- Review and endorsement of an evaluation paper on Risk Management and Internal Control Systems Effectiveness for 2017 for submission to the Board (focused on the internal control system, as the risk management system effectiveness was separately reviewed and endorsed by the Risk Committee of the Company);
- Review and endorsement of a paper on Continuing Connected Transactions for 2017 for submission to the Board;
- Review of Whistle-blowing Progress Reports;
- Review of the Report on Evaluation of Effectiveness of Internal Audit Department for 2017;
- Received an update on the Hong Kong Railway Projects Assurance Framework and the Audit Process;
- Approval of the 2019 Internal Audit Plan;
- Received the result of the Quality Assurance Review of Internal Audit Department; and
- Holding of private sessions with the Head of IA without the presence of Management.

External Auditor

- Review of KPMG’s Audit Plan and strategy for the year ended 31 December 2018;
- Received a summary of KPMG services provided to the Company and fees received by them;
- Pre-approval of audit and non-audit services provided by KPMG;
- Received KPMG’s reports on the salient features of the 2017 Annual Accounts and 2018 Interim Accounts respectively;
- Review of the 2017 Auditor’s Report;

- Review and approval of KPMG’s fee proposal for the 2018 audit, other audit related and tax services;
- Considered KPMG’s independence and other relevant factors when approving the appointment of KPMG in providing non-audit services; and receiving/noting KPMG’s confirmation of independence in its audit report in respect of the 2017 Annual Accounts and 2018 Interim Accounts respectively; and
- Holding of private sessions with representatives of KPMG without the presence of management.

Others

- Received the 2017 report on outstanding litigation/potential litigation, compliance with statutes and regulations, Operating Agreement and Rail Merger Related Agreements; and
- Received the Audit/Risk/Governance Committee Minutes of various subsidiaries of the Company.

RE-APPOINTMENT OF EXTERNAL AUDITOR

The Committee was satisfied with KPMG’s work, its independence and objectivity, and therefore recommended the re-appointment of KPMG (which has indicated its willingness to continue in office) as the Group’s external auditor for 2019 for approval by the Company’s Shareholders at the 2019 Annual General Meeting.

Dr Eddy Fong Ching
Audit Committee Chairman
 Hong Kong, 7 March 2019

The Audit Committee Report has been reviewed and endorsed by the Committee.