



INDEPENDENT AUDITOR'S REPORT

Independent auditor's report to the Members of MTR Corporation Limited

(incorporated in Hong Kong with limited liability)

Opinion

We have audited the consolidated accounts of MTR Corporation Limited ("the Company") and its subsidiaries ("the Group") set out on pages 211 to 306, which comprise the consolidated statement of financial position as at 31 December 2018, the consolidated profit and loss account, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended and notes to the consolidated accounts, including a summary of significant accounting policies.

In our opinion, the consolidated accounts give a true and fair view of the consolidated financial position of the Group as at 31 December 2018 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated accounts* section of our report. We are independent of the Group in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code") and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated accounts of the current period. These matters were addressed in the context of our audit of the consolidated accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Railway construction in progress under entrustment by the HKSAR Government

Refer to note 23 to the consolidated accounts and the accounting policies in note 22

The Key Audit Matter

The Group and the Government of the Hong Kong Special Administrative Region ("HKSAR Government") have entered into certain entrustment arrangements whereby the Group has been entrusted by the HKSAR Government to proceed with the planning, design, construction, testing and commissioning of the Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link ("the HSR") and the Shatin to Central Link ("the SCL"). As the HKSAR Government is the owner of both the HSR and the SCL, the financing of the development of these two railway lines is borne by the HKSAR Government, with the Group receiving project management fees.

HSR

Pursuant to an agreement entered into with the HKSAR Government on 30 November 2015, the Group will bear and finance project costs for the HSR (including the Group's project management fees) which exceed HK\$84.42 billion and the HKSAR Government reserves the right to refer to arbitration the question of the Group's liability, if any, in respect of the project costs borne and financed by the HKSAR Government which exceed HK\$65 billion up to HK\$84.42 billion. In the event that the Group is found to be liable under the relevant HSR entrustment agreements, the Group's liability for such costs is currently limited to the amount of the project management fees and certain other additional fees received by the Group under the agreements.

In September 2018, construction of the HSR was completed following which commercial operations commenced. However, the total project costs can only be ascertained upon finalisation of all construction contracts which may take several years to reach agreement and settlement.

Management has engaged an independent expert to provide an independent assessment of management's estimate of cost to complete the HSR project.

As at 31 December 2018, the Group has made a provision for project management costs as it estimated that the total costs to complete its performance obligations under the HSR entrustments are likely to exceed the project management fees from the HKSAR Government.

SCL

In December 2017, the Group completed a detailed review of the estimated costs to complete for the SCL under the entrustment agreement for the construction and commissioning of the SCL dated 29 May 2012 ("SCL Entrustment Agreement"). Following the review, the latest cost estimate has been increased from HK\$70.83 billion to HK\$87.33 billion and was submitted to the HKSAR Government for review.

In mid-2018, allegations concerning workmanship and timely reporting of certain construction matters were made in relation to the SCL. A Commission of Inquiry ("COI") was set up by the HKSAR Government to investigate, inter-alia, certain constructions works at the Hung Hom Station extension.

At the same time, the Group is in the process of carrying out verification works and assessing the overall structure integrity and safety of the Hung Hom Station extension.

The above matters are ongoing and the timing of their ultimate resolution and the financial impact to the Group are highly uncertain at this stage.

In the event that the Group is found to be liable under the SCL Entrustment Agreement, the Group's liability is currently limited to a cap equal to the aggregate fees received by the Group under the relevant SCL agreements. However, such cap could not be relied upon if the Group were, in accordance with general principles of law, found to be liable for any loss that had been caused by the fraudulent or other dishonest conduct of its employees or agents.

We identified railway construction in progress under entrustment by the HKSAR Government as a key audit matter because the arrangements in respect of these railway projects are highly complex and convey rights and obligations on the Group which could potentially have significant financial implications for the Group.

How the matter was addressed in our audit

Our audit procedures in relation to railway construction in progress under entrustment by the HKSAR Government included the following:

- inspecting the minutes of the relevant committees of the Group and discussing with management the current status of the HSR and SCL projects, including:
 - (a) For the HSR, the forecast total project costs, assessment of contract claims, estimate of further internal costs to be incurred and assessment of the financial implications of the project for the Group;
 - (b) For the SCL, the costs incurred to date, remaining critical milestones and estimated costs to complete including contract claims, latest status of the COI and its findings to date and the assessment of the financial implications of the project for the Group;
- assessing the design and implementation of management's key internal controls over the determination of the project costs for the HSR and SCL and the allocation of costs to each of these projects;
- evaluating the qualifications, experience, expertise, independence and objectivity of the independent expert engaged by management for the HSR;
- discussing with the independent expert the forecast total project costs for the HSR project and the risk of these exceeding HK\$84.42 billion;
- comparing, on a sample basis, the project costs for the HSR/SCL as assessed by management and, for the HSR, as assessed by the independent expert, with relevant underlying documentation;
- comparing costs, on a sample basis, incurred during the current year in respect of the HSR and SCL with underlying contracts and interim or final payment certificates;
- holding discussions with management and the Group's external legal advisors to assess the Company's legal obligations and financial exposure in connection with the HSR and SCL projects;
- inspecting the relevant entrustment agreements to ascertain project management fees receivable and comparing the receipt of such project management fees for the year with bank statements and other relevant documentation; and
- assessing the disclosures in the consolidated accounts in relation to the HSR and SCL projects with reference to the requirements of the prevailing accounting standards.

INDEPENDENT AUDITOR'S REPORT

Valuation of completed investment properties ("IP")	
Refer to note 19 to the consolidated accounts and the accounting policies in note 2F(i)	
The Key Audit Matter	How the matter was addressed in our audit
<p>The fair value of the Group's IP as at 31 December 2018 was HK\$82,676 million, with a revaluation gain for the year ended 31 December 2018 recorded in the consolidated profit and loss account of HK\$4,745 million.</p> <p>The Group's IP, which are mainly located in Hong Kong, principally comprise shopping malls and office premises.</p> <p>The fair values of the Group's IP were assessed by an external property valuer based on independent valuations.</p> <p>We identified valuation of the Group's IP as a key audit matter because of the significance of IP to the consolidated accounts and because the determination of the fair values involves significant judgement and estimation, particularly in selecting the appropriate valuation methodology, market yields and market rents.</p>	<p>Our audit procedures to assess the valuation of the Group's IP included the following:</p> <ul style="list-style-type: none"> obtaining and inspecting the IP valuation report prepared by the external property valuer; evaluating the independence, qualifications, expertise and objectivity of the external property valuer; evaluating the valuation methodologies adopted with reference to those applied by other external property valuers for similar property types; holding discussions with management and the external property valuer and challenging the key assumptions and estimates adopted in the valuations, including prevailing market rents and market yields applied by comparing, on a sample basis, the key estimates adopted with comparable available market data and government produced market statistics; and comparing the tenancy information, including occupancy rates and market rents, provided by the Group to the external property valuer with underlying contracts and documentation, on a sample basis.
Assessing potential impairment of fixed assets other than assets carried at revalued amounts	
Refer to notes 20-21 to the consolidated accounts and the accounting policies in note 2H(ii)	
The Key Audit Matter	How the matter was addressed in our audit
<p>The carrying value of the Group's fixed assets other than assets carried at revalued amounts as at 31 December 2018 totalled HK\$129,015 million and the related depreciation and amortisation charge for the year ended 31 December 2018 amounted to HK\$5,282 million.</p> <p>The carrying values of these assets are reviewed annually by management for potential indicators of impairment. For assets where such indicators exist, management performs detailed impairment reviews, taking into account, inter alia, the impact of revenue assumptions and technical factors which may affect the expected remaining useful lives and carrying value of the assets.</p> <p>We identified the potential impairment of fixed assets other than assets carried at revalued amounts as a key audit matter because the assessment can involve a significant degree of management judgement in determining the key assumptions such as expected revenue levels.</p>	<p>Our audit procedures to assess the potential impairment of fixed assets other than assets carried at revalued amounts included the following:</p> <ul style="list-style-type: none"> obtaining, discussing with management and evaluating the key assumptions underlying management's assessment of potential impairment of these assets; where potential indicators of impairment were identified, evaluating management's impairment assessments and the assumptions adopted therein, including revenue assumptions, with reference to the actual revenue levels achieved in the current year, future operating plans and broader city specific developments; assessing the discount rates adopted by management in the impairment assessments by comparison with available financial information of other similar companies taking into account regional and industry specific risk premiums; comparing the assumptions adopted in the prior year's impairment assessments with actual results for the current year, investigating significant variances identified and considering the impact on the current year's impairment assessments; and performing sensitivity analyses for the discount rates applied and the assumptions for revenue levels adopted and considering the information used to derive the most sensitive assumptions and whether there were any indicators of management bias in their selection.

Information other than the consolidated accounts and auditor's report thereon

The directors are responsible for the other information. The other information comprises all the information included in the annual report, other than the consolidated accounts and our auditor's report thereon.

Our opinion on the consolidated accounts does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated accounts, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated accounts or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors for the consolidated accounts

The directors are responsible for the preparation of the consolidated accounts that give a true and fair view in accordance with HKFRSs issued by the HKICPA and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated accounts that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated accounts, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The directors are assisted by the Audit Committee in discharging their responsibilities for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated accounts

Our objectives are to obtain reasonable assurance about whether the consolidated accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. This report is made solely to you, as a body, in accordance with section 405 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA's will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated accounts.



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As part of an audit in accordance with HKSAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated accounts, including the disclosures, and whether the consolidated accounts represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated accounts. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated accounts of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Melissa M C Wu.

KPMG

Certified Public Accountants

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