

NOTES TO THE UNAUDITED INTERIM FINANCIAL REPORT

1 Basis of Preparation

This interim financial report is unaudited but has been reviewed by KPMG in accordance with Hong Kong Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). KPMG's independent review report to the Board of Directors is set out on page 32. In addition, this interim financial report has been reviewed by the Company's Audit Committee.

This interim financial report has been prepared in accordance with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, including compliance with Hong Kong Accounting Standard ("HKAS") 34, *Interim Financial Reporting*, issued by the HKICPA.

The preparation of an interim financial report in conformity with HKAS 34 requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses on a year-to-date basis. Actual results may differ from these estimates.

This interim financial report contains the condensed consolidated accounts and selected explanatory notes, which include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Company and its subsidiaries (collectively referred to as the "Group") and the Group's interest in associates and joint venture since the issuance of the 2019 annual accounts. The condensed consolidated interim accounts and notes thereon do not include all of the information required for a complete set of accounts prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs").

The financial information relating to the financial year ended 31 December 2019 included in this interim financial report as comparative information does not constitute the Company's statutory annual consolidated accounts for that financial year but is derived from those accounts. Further information relating to these statutory accounts required to be disclosed in accordance with section 436 of the Hong Kong Companies Ordinance (Cap. 622) is as follows:

- The Company has delivered the accounts for the year ended 31 December 2019 to the Registrar of Companies in accordance with section 662(3) of, and Part 3 of Schedule 6 to, the Companies Ordinance.
- The Company's auditor has reported on those accounts. The auditor's report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report; and did not contain a statement under section 406(2), 407(2) or (3) of the Companies Ordinance.

The HKICPA has issued a number of amendments to HKFRSs that are first effective for the current accounting period of the Group. None of these developments have had a material effect on how the Group's results and financial position for the current or prior periods have been prepared or presented in this interim financial report. The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

The accounting policies adopted for the preparation of this interim financial report are the same as those adopted in the preparation of the 2019 annual accounts.

2 Revenue and Expenses relating to Mainland of China and International Subsidiaries

Revenue and expenses relating to Mainland of China and international subsidiaries comprise:

in HK\$ million	Six months ended 30 June 2020		Six months ended 30 June 2019	
	Revenue	Expenses	Revenue	Expenses
Melbourne Train	5,055	4,959	5,526	5,194
Sydney Metro Northwest	298	354	711	689
Sydney Metro City & Southwest	979	979	–	–
MTR Nordic	2,257	2,245	2,408	2,466
TfL Rail/Elizabeth Line	1,123	985	1,040	953
Shenzhen Metro Longhua Line	220	224	368	277
Others	533	410	505	307
	10,465	10,156	10,558	9,886
Property development in Mainland of China	–	4	–	10
Total Mainland of China and international subsidiaries	10,465	10,160	10,558	9,896

3 Segmental Information

The Group's businesses consist of (i) recurrent businesses (comprising Hong Kong transport operations, Hong Kong station commercial businesses, Hong Kong property rental and management businesses, Mainland of China and international railway, property rental and management businesses and other businesses) and (ii) property development businesses (together with recurrent businesses referred to as underlying businesses).

The Group manages its businesses by the various business executive committees. In a manner consistent with the way in which information is reported internally to the Group's most senior executive management for the purposes of resource allocation and performance assessment, the Group has identified the following reportable segments:

- (i) Hong Kong transport operations: The provision of passenger operation and related services on the domestic mass transit railway system in Hong Kong, the Airport Express serving both the Hong Kong International Airport and the AsiaWorld-Expo at Chek Lap Kok, cross-boundary railway connection with the border of Mainland of China at Lo Wu and Lok Ma Chau, the Guangzhou-Shenzhen-Hong Kong Express Rail Link (Hong Kong Section) ("High Speed Rail"), light rail and bus feeder with railway system in the north-west New Territories and intercity railway transport with certain cities in the Mainland of China.
- (ii) Hong Kong station commercial businesses: Commercial activities including the letting of advertising, retail and car parking spaces at railway stations, the provision of telecommunication and bandwidth services in railway premises and other commercial activities within the Hong Kong transport operations network.
- (iii) Hong Kong property rental and management businesses: The letting of retail, office and car parking spaces and the provision of estate management services in Hong Kong.
- (iv) Hong Kong property development: Property development activities at locations near the railway systems in Hong Kong.
- (v) Mainland of China and international railway, property rental and management businesses: The construction, operation and maintenance of mass transit railway systems including station commercial activities outside of Hong Kong and the letting of retail spaces and provision of estate management services in the Mainland of China.
- (vi) Mainland of China property development: Property development activities in the Mainland of China.
- (vii) Other businesses: Businesses not directly relating to transport operations or properties such as Ngong Ping 360, which comprises cable car operation in Tung Chung and related businesses at the Ngong Ping Theme Village, railway consultancy business and the provision of project management services to the Government of the Hong Kong Special Administrative Region (the "HKSAR Government").

The results of the reportable segments and reconciliation to the corresponding consolidated totals in the accounts are shown below:

in HK\$ million	Hong Kong transport operations	Hong Kong station commercial businesses	Hong Kong property rental and management businesses	Hong Kong property development	Mainland of China and international affiliates			Other businesses	Un-allocated amount	Total
					Mainland of China and international railway, property rental and management businesses	Mainland of China property development				
Six months ended 30 June 2020										
Revenue from contracts with customers within the scope of HKFRS 15	6,234	634	151	–	10,403	–	502	–	17,924	
– Recognised at a point in time	5,738	17	–	–	385	–	34	–	6,174	
– Recognised over time	496	617	151	–	10,018	–	468	–	11,750	
Revenue from other sources	–	1,175	2,431	–	62	–	–	–	3,668	
Total revenue	6,234	1,809	2,582	–	10,465	–	502	–	21,592	
Operating expenses	(6,128)	(260)	(379)	–	(10,156)	(4)	(564)	–	(17,491)	
Project study and business development expenses	–	–	–	–	(53)	–	–	(51)	(104)	
Operating profit/(loss) before Hong Kong property development, depreciation, amortisation and variable annual payment	106	1,549	2,203	–	256	(4)	(62)	(51)	3,997	
Profit on Hong Kong property development	–	–	–	6,168	–	–	–	–	6,168	
Operating profit/(loss) before depreciation, amortisation and variable annual payment	106	1,549	2,203	6,168	256	(4)	(62)	(51)	10,165	
Depreciation and amortisation	(2,344)	(101)	(8)	–	(127)	–	(33)	–	(2,613)	
Variable annual payment	(341)	(114)	(2)	–	–	–	–	–	(457)	
Share of profit of associates and joint venture	–	–	–	–	115	–	102	–	217	
(Loss)/profit before interest, finance charges and taxation	(2,579)	1,334	2,193	6,168	244	(4)	7	(51)	7,312	
Interest and finance charges	–	–	–	–	(42)	38	–	(495)	(499)	
Investment property revaluation loss	–	–	(5,900)	–	(67)	–	–	–	(5,967)	
Income tax	–	–	–	(997)	(37)	(5)	–	(118)	(1,157)	
(Loss)/profit for the six months ended 30 June 2020	(2,579)	1,334	(3,707)	5,171	98	29	7	(664)	(311)	

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3 Segmental Information (continued)

in HK\$ million	Hong Kong transport operations	Hong Kong station commercial businesses	Hong Kong property rental and management businesses	Hong Kong property development	Mainland of China and international affiliates			Un-allocated amount	Total
					Mainland of China and international railway, property rental and management businesses	Mainland of China property development	Other businesses		
Six months ended 30 June 2019									
Revenue from contracts with customers within the scope of HKFRS 15	10,690	1,059	143	-	10,388	-	825	-	23,105
- Recognised at a point in time	10,308	23	-	-	591	-	231	-	11,153
- Recognised over time	382	1,036	143	-	9,797	-	594	-	11,952
Revenue from other sources	-	2,496	2,492	-	170	-	9	-	5,167
Total Revenue	10,690	3,555	2,635	-	10,558	-	834	-	28,272
Operating expenses	(6,344)	(328)	(395)	-	(9,886)	(10)	(2,737)	-	(19,700)
Project study and business development expenses	-	-	-	-	(142)	-	-	(29)	(171)
Operating profit/(loss) before Hong Kong property development, depreciation, amortisation and variable annual payment	4,346	3,227	2,240	-	530	(10)	(1,903)	(29)	8,401
Profit on Hong Kong property development	-	-	-	898	-	-	-	-	898
Operating profit/(loss) before depreciation, amortisation and variable annual payment	4,346	3,227	2,240	898	530	(10)	(1,903)	(29)	9,299
Depreciation and amortisation	(2,346)	(93)	(8)	-	(112)	-	(33)	-	(2,592)
Variable annual payment	(1,048)	(455)	(3)	-	-	-	-	-	(1,506)
Share of (loss)/profit of associates and joint venture	-	-	-	-	(194)	-	120	-	(74)
Profit/(loss) before interest, finance charges and taxation	952	2,679	2,229	898	224	(10)	(1,816)	(29)	5,127
Interest and finance charges	-	-	-	-	(24)	38	-	(456)	(442)
Investment property revaluation gain/(loss)	-	-	2,110	-	(44)	-	-	-	2,066
Income tax	-	-	-	(148)	(98)	(3)	-	(898)	(1,147)
Profit/(loss) for the six months ended 30 June 2019	952	2,679	4,339	750	58	25	(1,816)	(1,383)	5,604

The following table sets out information about the geographical location of the Group's revenue from external customers. The geographical location of customers is based on the location at which the services were provided or goods were delivered.

in HK\$ million	Six months ended 30 June 2020	Six months ended 30 June 2019
Hong Kong SAR (place of domicile)	11,100	17,689
Australia	6,332	6,237
Mainland of China and Macao SAR	775	895
Sweden	2,257	2,408
United Kingdom	1,128	1,043
	10,492	10,583
	21,592	28,272

4 Profit on Hong Kong Property Development

Profit on Hong Kong property development comprises:

in HK\$ million	Six months ended 30 June 2020	Six months ended 30 June 2019
Share of surplus, income and interest in unsold properties from property development	6,171	849
Agency fee and other income from West Rail property development	14	83
Overheads and miscellaneous studies	(17)	(34)
	6,168	898

5 Interest and Finance Charges

Interest and finance charges comprise:

in HK\$ million	Six months ended 30 June 2020	Six months ended 30 June 2019
Interest expenses in respect of:		
– Bank loans, overdrafts and capital market instruments	530	523
– Obligations under service concession	348	350
– Lease liabilities	27	32
– Others	12	11
Finance charges	32	23
Exchange gain	(95)	(15)
	854	924
Utilisation of government subsidy for Shenzhen Metro Longhua Line operation	(30)	(38)
Derivative financial instruments:		
– Fair value hedges	4	–
– Cash flow hedges:		
– transferred from hedging reserve to interest expenses	(14)	(14)
– transferred from hedging reserve to offset exchange gain	93	23
– Hedge of net investments:		
– ineffective portion	(1)	(1)
– Derivatives not adopted hedge accounting	8	(1)
	90	7
Interest expenses capitalised	(189)	(213)
	725	680
Interest income in respect of:		
– Deposits with banks	(132)	(231)
– Others	(94)	(7)
	(226)	(238)
	499	442

6 Share of Profit/(Loss) of Associates and Joint Venture

Share of profit/(loss) of associates and joint venture comprises:

in HK\$ million	Six months ended 30 June 2020	Six months ended 30 June 2019
Share of profit before taxation	311	84
Share of income tax expenses	(94)	(158)
	217	(74)

In March 2017, the Department for Transport of the United Kingdom (“DfT”) awarded the South Western Railway franchise (“Franchise”) to First MTR South Western Trains Limited (“SWR”), an associate of the Company which the Company holds a 30% shareholding and FirstGroup plc in the United Kingdom holds a 70% shareholding. Pursuant to a franchise agreement (“Franchise Agreement”) with DfT, the period of the Franchise runs from 20 August 2017 for seven years, with an option for an eleven month extension at the discretion of the DfT.

As noted in the Company’s previous annual accounts, the financial performance of SWR has been impacted by a number of adverse factors (and this has continued since March 2019). SWR continues to be engaged in discussions with the DfT and relevant third parties to agree potential commercial and contractual remedies and there is a range of potential outcomes. Given the level of uncertainty in these outcomes and the potential financial impact of some of the possible scenarios, the Franchise Agreement has been considered as an onerous contract since 2019.

As such, a provision of GBP43 million (HK\$436 million) had been made under “share of profit/(loss) of associates and joint venture” in the consolidated profit and loss account for the six months ended 30 June 2019 which represented the Company’s 30% share of the maximum potential loss under the Franchise Agreement.

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7 Income Tax

Income tax in the consolidated profit and loss account represents:

in HK\$ million	Six months ended 30 June 2020	Six months ended 30 June 2019
Current tax		
– Hong Kong Profits Tax	1,200	1,055
– Tax outside Hong Kong	94	162
	1,294	1,217
Less: Utilisation of government subsidy for Shenzhen Metro Longhua Line operation	–	(31)
	1,294	1,186
Deferred tax		
– Origination and reversal of temporary differences on:		
– tax losses	(32)	(32)
– depreciation allowances in excess of related depreciation	(35)	(32)
– revaluation of properties	–	(3)
– provisions and others	(70)	28
	(137)	(39)
	1,157	1,147

Current tax provision for Hong Kong Profits Tax for the six months ended 30 June 2020 is calculated at 16.5% (2019: 16.5%) on the estimated assessable profits for the period after deducting accumulated tax losses brought forward, if any. Current taxes for subsidiaries outside Hong Kong are charged at the appropriate current rates of taxation ruling in the relevant tax jurisdictions.

The Company is a qualifying corporation under the two-tiered Profits Tax rate regime in Hong Kong. Under the two-tiered Profits Tax rate regime, the first HK\$2 million of assessable profits are taxed at 8.25% and the remaining assessable profits are taxed at 16.5%. The provision for Hong Kong Profits Tax for the Company was calculated on the same basis as 2019.

Provision for deferred tax on temporary differences arising in Hong Kong is calculated at the Hong Kong Profits Tax rate at 16.5% (2019: 16.5%), while that arising outside Hong Kong is calculated at the appropriate current rates of taxation ruling in the relevant tax jurisdictions.

Details of the tax reserve certificates in respect of Hong Kong Profits Tax purchased by the Company are set out in note 17 to this interim financial report.

8 Dividends

Ordinary dividends paid and proposed to shareholders of the Company comprise:

in HK\$ million	Six months ended 30 June 2020	Six months ended 30 June 2019
Ordinary dividends attributable to the period		
– Interim ordinary dividend declared after the reporting period of HK\$0.25 (2019: HK\$0.25) per share	1,540	1,539
Ordinary dividends attributable to the previous year		
– Final ordinary dividend of HK\$0.98 (2019: HK\$0.95 per share attributable to year 2018) per share approved and payable/paid during the period	6,036	5,835

The Company has recognised 2019 final ordinary dividend payable of HK\$4,541 million to the Financial Secretary Incorporated (the "FSI") of the HKSAR Government and HK\$1,495 million to other shareholders in the amounts due to related parties (note 18) and creditors, other payables and provisions (note 19) respectively in the consolidated statement of financial position as at 30 June 2020.

9 (Loss)/Earnings Per Share

A Basic (Loss)/Earnings Per Share

The calculation of basic (loss)/earnings per share is based on the loss attributable to shareholders for the six months ended 30 June 2020 of HK\$334 million (2019: profit of HK\$5,506 million) and the weighted average number of ordinary shares in issue less shares held for Executive Share Incentive Scheme, which is calculated as follows:

	Six months ended 30 June 2020	Six months ended 30 June 2019
Issued ordinary shares at 1 January	6,157,948,911	6,139,485,589
Effect of share options exercised	821,528	1,305,985
Less: Shares held for Executive Share Incentive Scheme	(5,541,611)	(5,623,421)
Weighted average number of ordinary shares less shares held for Executive Share Incentive Scheme at 30 June	6,153,228,828	6,135,168,153

9 (Loss)/Earnings Per Share *(continued)*

B Diluted (Loss)/Earnings Per Share

The calculation of diluted (loss)/earnings per share is based on the loss attributable to shareholders for the six months ended 30 June 2020 of HK\$334 million (2019: profit of HK\$5,506 million) and the weighted average number of ordinary shares in issue less shares held for Executive Share Incentive Scheme after adjusting for the dilutive effect of the Company's share option scheme and Executive Share Incentive Scheme, which is calculated as follows:

	Six months ended 30 June 2020	Six months ended 30 June 2019
	6,153,228,828	6,135,168,153
Effect of dilutive potential shares under the share option scheme	–	2,494,987
Effect of shares awarded under Executive Share Incentive Scheme	–	5,780,265
Weighted average number of shares (diluted) at 30 June	6,153,228,828	6,143,443,405

The effect of the Group's share option scheme (1,275,714 shares) and Executive Share Incentive Scheme (5,790,973 shares) are anti-dilutive for the six months ended 30 June 2020 since they would result in a decrease in the loss per share.

C Both basic and diluted earnings per share would have been HK\$0.92 (2019: HK\$0.56) if the calculation is based on profit attributable to shareholders of the Company arising from underlying businesses of HK\$5,633 million (2019: HK\$3,440 million).

10 Other Comprehensive (Loss)/Income

A Tax effects relating to each component of other comprehensive (loss)/income of the Group are shown below:

in HK\$ million	Six months ended 30 June 2020			Six months ended 30 June 2019		
	Before-tax amount	Tax credit	Net-of-tax amount	Before-tax amount	Tax expense	Net-of-tax amount
Exchange differences on translation of:						
– Financial statements of overseas subsidiaries, associates and joint venture	(268)	–	(268)	(59)	–	(59)
– Non-controlling interests	(20)	–	(20)	(6)	–	(6)
	(288)	–	(288)	(65)	–	(65)
(Loss)/surplus on revaluation of self-occupied land and buildings (note 11B)	(197)	33	(164)	75	(12)	63
Cash flow hedges: net movement in hedging reserve (note 10B)	(9)	1	(8)	154	(26)	128
Other comprehensive (loss)/income	(494)	34	(460)	164	(38)	126

B The components of other comprehensive (loss)/income of the Group relating to cash flow hedges are as follows:

in HK\$ million	Six months ended 30 June 2020	Six months ended 30 June 2019
Cash flow hedges:		
Effective portion of changes in fair value of hedging instruments recognised during the period	(92)	143
Amounts transferred to profit or loss:		
– Interest and finance charges (note 5)	79	9
– Other expenses	4	2
Deferred tax on the above items	1	(26)
	(8)	128

11 Investment Properties and Other Property, Plant and Equipment

A Investment Properties

Investment properties of the Group in Hong Kong and Mainland of China were revalued at the reporting date by Colliers International (Hong Kong) Limited (31 December 2019: Jones Lang LaSalle Limited) and Cushman & Wakefield Limited respectively. The valuations are based on the income capitalisation approach. Under this approach, the market value is derived from the capitalisation of the rental revenue to be received under existing tenancies and the estimated full market rental value to be received upon expiry of the existing tenancies with reference to the market rental levels prevailing as at the date of valuation by an appropriate single market yield rate.

Based on the valuations, the Group recognised the net decrease in fair value of HK\$5,967 million for the six months ended 30 June 2020 (2019: net increase of HK\$2,066 million) under investment property revaluation in the consolidated profit and loss account. Investment properties are revalued semi-annually and future market condition changes may result in further gains or losses to be recognised through profit and loss account in subsequent periods.

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11 Investment Properties and Other Property, Plant and Equipment

(continued)

B Other Property, Plant and Equipment

(i) Acquisitions and Disposals of Owned Assets

During the six months ended 30 June 2020, the Group acquired or commissioned assets (other than right-of-use assets) at a total cost of HK\$1,577 million (2019: HK\$1,406 million).

(ii) Valuation

All of the Group's self-occupied land and buildings are held in Hong Kong under medium-term leases and carried at fair value. All self-occupied land and buildings were revalued by using primarily the direct comparison approach assuming sale of properties in their existing state with vacant possession at the reporting date by Colliers International (Hong Kong) Limited (31 December 2019: Jones Lang LaSalle Limited). The valuation resulted in a revaluation loss of HK\$197 million (2019: gain of HK\$75 million), which, net of deferred tax credit of HK\$33 million (2019: deferred tax provision of HK\$12 million), has been recognised in other comprehensive income and accumulated in the fixed assets revaluation reserve account (note 10A).

C Right-of-use Assets

During the six months ended 30 June 2020, additions to right-of-use assets were HK\$3,337 million. This amount primarily related to additions of leasehold investment properties of HK\$3,286 million.

12 Service Concession Assets

During the six months ended 30 June 2020, the Group incurred HK\$795 million (2019: HK\$1,065 million) of expenditure for the replacement and upgrade of the Kowloon-Canton Railway Corporation ("KCRC") system ("Additional Concession Property") under the service concession arrangement in the Rail Merger, HK\$26 million (2019: HK\$11 million) and HK\$1 million (2019: HK\$nil) of expenditure for the replacement and upgrade of the concession property of the High Speed Rail ("Additional Concession Property (High Speed Rail)") and the Tuen Ma Line Phase 1 ("Additional Concession Property (Tuen Ma Line)"), respectively, under the supplemental service concession arrangements with KCRC, and HK\$10 million (2019: HK\$3 million) of expenditure for asset additions in respect of Shenzhen Metro Longhua Line ("SZL4").

SZL4 forms part of the Shenzhen Metro, which is operated by a wholly-owned subsidiary, MTR Corporation (Shenzhen) Limited ("MTRSZ"). There has been no increase in fare since MTRSZ started operating the line in 2010. In July 2020, the Shenzhen Municipal Government has publicised a fare adjustment framework for Shenzhen Metro network which will take effect on 1 January 2021. The framework sets out the mechanism of fare setting and the procedures of fare adjustment. Based on progress of the fare adjustment made to date, no impairment loss is recognised at 30 June 2020. If suitable fare increase and adjustment mechanism are not implemented, the long-term financial viability of SZL4 is expected to be impacted.

13 Railway Construction Projects under Entrustment by the HKSAR Government

A Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link ("High Speed Rail" or "HSR") Project

(a) HSR Preliminary Entrustment Agreement

On 24 November 2008, the HKSAR Government and the Company entered into an entrustment agreement for the design of and site investigation and procurement activities in relation to the HSR (the "HSR Preliminary Entrustment Agreement"). Pursuant to the HSR Preliminary Entrustment Agreement, the HKSAR Government is obligated to pay the Company the Company's in-house design costs and certain on-costs, preliminary costs and staff costs.

(b) HSR Entrustment Agreement

In 2009, the HKSAR Government decided that the Company should be asked to proceed with the construction, testing and commissioning of the HSR on the understanding that the Company would subsequently be invited to undertake the operation of the HSR under the service concession approach. On 26 January 2010, the HKSAR Government and the Company entered into another entrustment agreement for the construction, and commissioning of the HSR (the "HSR Entrustment Agreement"). Pursuant to the HSR Entrustment Agreement, the Company is responsible for carrying out or procuring the carrying out of the agreed activities for the planning, design, construction, testing and commissioning of the HSR and the HKSAR Government, as owner of HSR, is responsible for bearing and financing the full amount of the total cost of such activities (the "Entrustment Cost") and for paying to the Company a fee in accordance with an agreed payment schedule (the "HSR Project Management Fee") (subsequent amendments to these arrangements are described below). As of 30 June 2020, the Company had received full payment of the HSR Project Management Fee from the HKSAR Government.

The HKSAR Government has the right to claim against the Company if the Company breaches the HSR Entrustment Agreement (including, if the Company breaches the warranties it gave in respect of its project management services) and, under the HSR Entrustment Agreement, to be indemnified by the Company in relation to losses suffered by the HKSAR Government as a result of any negligence of the Company in performing its obligations under the HSR Entrustment Agreement or any breach of the HSR Entrustment Agreement by the Company. Under the HSR Entrustment Agreement, the Company's total aggregate liability to the HKSAR Government arising out of or in connection with the HSR Preliminary Entrustment Agreement and the HSR Entrustment Agreement (other than for death or personal injury) is subject to a cap equal to the HSR Project Management Fee and any other fees that the Company receives under the HSR Entrustment Agreement and certain fees received by the Company under the HSR

13 Railway Construction Projects under Entrustment by the HKSAR Government *(continued)*

A Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (“High Speed Rail” or “HSR”) Project *(continued)*

Preliminary Entrustment Agreement (the “**Liability Cap**”). In accordance with general principles of law, such Liability Cap could not be relied upon if the Company were found to be liable for the fraudulent or other dishonest conduct of its employees or agents, to the extent that the relevant loss had been caused by such fraudulent or other dishonest conduct. Although the HKSAR Government has reserved the right to refer to arbitration the question of the Company’s liability for the Current Cost Overrun (as defined hereunder) (if any) under the HSR Preliminary Entrustment Agreement and HSR Entrustment Agreement (as more particularly described in note 13A(c)(iv) below), up to the date of this interim report, no claim has been received from the HKSAR Government.

In April 2014, the Company announced that the construction period for the HSR project needed to be extended, with the target opening of the line for passenger service revised to the end of 2017.

On 30 June 2015, the Company reported to the HKSAR Government that the Company estimated:

- the HSR would be completed in the third quarter of 2018 (including programme contingency of six months) (the “**HSR Revised Programme**”); and
- the total project cost of HK\$85.3 billion (including contingency), based on the HSR Revised Programme.

As a result of adjustments being made to certain elements of the Company’s estimated project cost of 30 June 2015, the HKSAR Government and the Company reached agreement that the estimated project cost be reduced to HK\$84.42 billion (the “**Revised Cost Estimate**”). Further particulars relating to the Revised Cost Estimate are set out in notes 13A(c) and (e) below.

(c) HSR Agreement

On 30 November 2015, the HKSAR Government and the Company entered into an agreement (the “**HSR Agreement**”) relating to the further funding and completion of the HSR. The HSR Agreement contains an integrated package of terms (subject to conditions as set out in note 13A(c)(vi) below) and provides that:

(i) The HKSAR Government will bear and finance the project cost up to HK\$84.42 billion (which includes the original budgeted cost of HK\$65 billion plus the agreed increase in the estimated project cost of HK\$19.42 billion (the portion of the entrustment cost (up to HK\$84.42 billion) that exceeds HK\$65 billion being the “**Current Cost Overrun**”));

(ii) The Company will, if the project exceeds HK\$84.42 billion, bear and finance the portion of the project cost which exceeds that sum (if any) (the “**Further Cost Overrun**”) except for certain agreed excluded costs (namely, additional costs arising from changes in law, force majeure events or any suspension of construction contracts specified in the HSR Agreement);

(iii) The Company will pay a special dividend in cash of HK\$4.40 in aggregate per share in two equal tranches (of HK\$2.20 per share in cash in each tranche) (“**Special Dividend**”). The first tranche was paid on 13 July 2016 and the second tranche was paid on 12 July 2017;

(iv) The HKSAR Government reserves the right to refer to arbitration the question of the Company’s liability for the Current Cost Overrun (if any) under the HSR Preliminary Entrustment Agreement and HSR Entrustment Agreement (“**Entrustment Agreements**”) (including any question the HKSAR Government may have regarding the validity of the Liability Cap). The Entrustment Agreements contain dispute resolution mechanisms which include the right to refer a dispute to arbitration. Under the HSR Entrustment Agreement, the Liability Cap is equal to the HSR Project Management Fee and any other fees that the Company receives under HSR Entrustment Agreement and certain fees received by the Company under the Preliminary Entrustment Agreement. Accordingly, the Liability Cap increases from up to HK\$4.94 billion to up to HK\$6.69 billion as the HSR Project Management Fee is increased in accordance with the HSR Agreement (as it will be equal to the increased HSR Project Management Fee under the HSR Entrustment Agreement of HK\$6.34 billion plus the additional fees referred to above). If the arbitrator does not determine that the Liability Cap is invalid and determines that, but for the Liability Cap, the Company’s liability under the Entrustment Agreements for the Current Cost Overrun would exceed the Liability Cap, the Company shall:

- bear such amount as is awarded to the HKSAR Government up to the Liability Cap;
- seek the approval of its independent shareholders, at another General Meeting (at which the FSI, the HKSAR Government and their Close Associates and Associates and the Exchange Fund will be required to abstain from voting), for the Company to bear the excess liability; and
- if the approval of the independent shareholders (referred to immediately above) is obtained, pay the excess liability to the HKSAR Government. If such approval is not obtained, the Company will not make such payment to the HKSAR Government;

(v) Certain amendments are made to the HSR Entrustment Agreement to reflect the arrangements contained in the HSR Agreement, including an increase in HSR Project Management Fee payable to the Company under HSR Entrustment Agreement to an aggregate of HK\$6.34 billion (which reflects the estimate of the Company’s expected internal costs in performing its obligations under HSR Entrustment Agreement in relation to HSR project) and to reflect the HSR Revised Programme;

(vi) The arrangements under the HSR Agreement (including the payment of the Special Dividend) were conditional on:

- independent shareholder approval (which was sought at the General Meeting held on 1 February 2016); and
- Legislative Council approval in respect of the HKSAR Government’s additional funding obligations.

The HSR Agreement (and the Special Dividend) was approved by the Company’s independent shareholders at the General Meeting held on 1 February 2016 and became unconditional upon approval by the Legislative Council on 11 March 2016 of the HKSAR Government’s additional funding obligations.

NOTES TO THE UNAUDITED INTERIM FINANCIAL REPORT

13 Railway Construction Projects under Entrustment by the HKSAR Government *(continued)*

A Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (“High Speed Rail” or “HSR”) Project *(continued)*

(d) Operations of HSR

On 23 August 2018, the Company and KCRC entered into the supplemental service concession agreement for the HSR (“SSCA-HSR”) to supplement the Service Concession Agreement dated 9 August 2007 in order for KCRC to grant a concession to the Company in respect of the HSR and to prescribe the operational and financial requirements that will apply to the HSR. The commercial operation of HSR began on 23 September 2018.

(e) Based on the Company’s latest review of the Revised Cost Estimate for the agreed scope of the project and having taken account of the opinion of independent experts including one on the review of the Revised Cost Estimate, the Company believes that, although the latest final project cost is likely to come close to the Revised Cost Estimate, the Revised Cost Estimate is still achievable and there is no current need to revise further such estimate. However, the final project cost can only be ascertained upon finalisation of all contracts, some of which will involve the resolution of commercial issues and may take several years to reach settlement based on past experience.

Having considered the number of contracts yet to be finalised and the contingency allowance currently available, there can be no absolute assurance that the final project cost will not exceed the Revised Cost Estimate, particularly if unforeseen difficulties arise in the resolution of commercial issues during the process of negotiating the final accounts. In such case, under the terms of the HSR Agreement, the Company will be required to bear and finance the portion of the project cost that exceeds the Revised Cost Estimate (if any) except for certain agreed excluded costs (as more particularly described in note 13A(c)(ii) above).

(f) The Company has not made any provision in its accounts in respect of:

(i) any possible liability of the Company for any Further Cost Overrun (if any), given the Company does not currently believe based on information available to date there is any need to revise further the Revised Cost Estimate. However, the final project cost can only be ascertained upon finalisation of all contracts, some of which will involve the resolution of commercial issues and may take several years to reach settlement;

(ii) any possible liability of the Company that may be determined in accordance with any arbitration that may take place, (as more particularly described in note 13A(c)(iv) above), given that (a) the Company has not received any notification from the HKSAR Government of any claim by the HKSAR Government against the Company or of any referral by the HKSAR Government to arbitration (which, as a result of the HSR Agreement, cannot take place until after commencement of commercial operations on the HSR) (as of 30 June 2020 and up to the date of this interim report); (b) the Company has the benefit of the Liability Cap; and (c) as a result of the HSR Agreement, the Company will not make any payment to the HKSAR Government in excess of the Liability Cap pursuant to a determination of the arbitrator without the approval of its independent shareholders; and

(iii) where applicable, because the Company is not able to measure with sufficient reliability the amount of the Company’s obligation or liability (if any).

(g) During the six months ended 30 June 2020, no HSR Project Management Fee (2019: HK\$57 million) was recognised in the consolidated profit and loss account. As at 30 June 2020, the total HSR Project Management Fee and the additional fees referred to above recognised to date in the consolidated profit and loss account amounted to HK\$6,548 million (as at 31 December 2019: HK\$6,548 million).

In relation to the sufficiency of the HSR Project Management Fee, the Company estimated that the total costs to complete performance of its obligations in relation to the HSR project are likely to exceed the HSR Project Management Fee. Accordingly, an appropriate amount of provision was recognised in the profit and loss account in the prior years.

B Shatin to Central Link (“SCL”) Project

(a) SCL Agreements

The Company and the HKSAR Government entered into the SCL Preliminary Entrustment Agreement (“SCL EA1”) in 2008, the SCL Advance Works Entrustment Agreement (“SCL EA2”) in 2011, and the SCL Entrustment Agreement (“SCL EA3”) in 2012 (together, the “SCL Agreements”), in relation to the SCL.

Pursuant to the SCL EA1, the Company is responsible for carrying out or procuring the carrying out of the design, site investigation and procurement activities while the HKSAR Government is responsible for funding directly the total cost of such activities.

Pursuant to the SCL EA2, the Company is responsible for carrying out or procuring the carrying out of the agreed works while the HKSAR Government is responsible for bearing and paying to the Company all the work costs (“EA2 Advance Works Costs”). The EA2 Advance Works Costs and the Interface Works Costs (as described below) are payable by the HKSAR Government to the Company. During the six months ended 30 June 2020, HK\$80 million (2019: HK\$165 million) of costs were incurred by the Company, which are payable by the HKSAR Government. As at 30 June 2020, the amount of such costs which remained outstanding from the HKSAR Government was HK\$1,144 million (as at 31 December 2019: HK\$1,219 million).

The funding for both SCL EA1 and SCL EA2 has been obtained by the HKSAR Government.

The SCL EA3 was entered into in 2012 for the construction and commissioning of the SCL. The HKSAR Government is responsible for bearing all the work costs specified in the SCL EA3 including costs to contractors and costs to the Company (“Interface Works Costs”) (which the Company would pay upfront and recover from the HKSAR Government) except for certain costs of modification, upgrade or expansions of certain assets (including rolling stock, signalling, radio and main control systems) for which the Company is responsible under the existing service concession agreement with KCRC. The Company will contribute an amount in respect of the costs relating to such modifications, upgrades or expansions. This will predominantly be covered by the reduction in future maintenance capital expenditure which the Company would have otherwise incurred. The total sum entrusted to the Company by the HKSAR Government for the main construction works under the SCL EA3, including project management fee, is HK\$70,827 million (“Original Entrusted Amount”).

13 Railway Construction Projects under Entrustment by the HKSAR Government *(continued)*

B Shatin to Central Link (“SCL”) Project *(continued)*

The Company is responsible for carrying out or procuring the carrying out of the works specified in the SCL Agreements for a SCL Project Management Fee of HK\$7,893 million (the “**Original PMC**”). As at 30 June 2020 and up to the date of this interim report, the Company has received payments of the Original PMC from the HKSAR Government in accordance with the original agreed payment schedule. During the six months ended 30 June 2020, Original PMC of HK\$333 million (2019: HK\$441 million) was recognised in the consolidated profit and loss account. As at 30 June 2020, the total Original PMC recognised to date in the consolidated profit and loss account amounted to HK\$7,661 million (as at 31 December 2019: HK\$7,328 million).

- (b) SCL EA3 cost overrun
 - (i) *Cost to complete*

The Company has previously announced that, due to the continuing challenges posed by external factors, the Original Entrusted Amount under SCL EA3 would not be sufficient to cover the total estimated cost to complete (“**CTC**”) and would need to be revised upwards significantly. The Company carried out a detailed review of the estimated CTC for the main construction works in 2017 and submitted a revised estimated total CTC of HK\$87,328 million (“**2017 CTC Estimate**”) to the HKSAR Government on 5 December 2017, taking into account a number of factors, including issues such as archaeological relics, the HKSAR Government’s requests for additional scope and late or incomplete handover of construction sites. The 2017 CTC Estimate represented an increase to the CTC of HK\$16,501 million, including an increase in the SCL Project Management Fee payable to the Company. Since submission of the 2017 CTC Estimate to the HKSAR Government, the Company has been liaising with the HKSAR Government to facilitate their review and verification process.

The Company then carried out and completed a further review and revalidation of the CTC and, on 10 February 2020, notified the HKSAR Government, in accordance with the terms of the SCL EA3, of the latest estimate of the CTC, being HK\$82,999 million (“**2020 CTC Estimate**”), including additional project management fee payable to the Company of HK\$1,371 million (“**Additional PMC**”), being the additional cost to the Company of carrying out its remaining project management responsibilities under the SCL EA3, as detailed in note 13B(b)(ii) below but excluding the Hung Hom Incidents Related Costs in respect of which the Company has already made a provision of HK\$2 billion in its consolidated profit and loss account for the six months ended 30 June 2019 (as detailed in note 13B(c) below). The 2020 CTC Estimate represents an increase of HK\$12,172 million from the Original Entrusted Amount of HK\$70,827 million, which is less than the increase in the 2017 CTC Estimate of HK\$16,501 million.

In accordance with the terms of SCL EA3, the HKSAR Government issued its paper on 18 March 2020 to seek the approval of Legislative Council for additional funding required for the SCL Project amounting to HK\$10,801 million (“**Additional Funding**”) so that the SCL can be completed. On 12 June 2020, the Legislative Council approved the Additional Funding for the SCL Project. For the avoidance of doubt, the Additional Funding sought by the HKSAR Government and approved by the Legislative Council excluded the Hung Hom Incidents Related Costs (as detailed in note 13B(c)(ii) below) and any Additional PMC for the Company as further detailed in note 13B(b)(ii) below.

- (ii) *Additional PMC*

As mentioned above, the Company is responsible for carrying out or procuring the execution of the works specified in the existing entrustment agreements relating to the SCL Project and the HKSAR Government, as the owner of the SCL, is responsible for bearing and financing the full amount of the total cost of such activities and for paying to the Company the Original PMC of HK\$7,893 million in accordance with an agreed payment schedule. As detailed in note 13B(b)(i) above and as previously disclosed by the Company, the programme for the delivery of the SCL Project has been significantly impacted by certain key external events, including the discovery of archaeological relics in the Sung Wong Toi Station area, requests for additional scope and the late or incomplete handover by third parties of construction sites to the Company. Not only do these matters increase the cost of works they also increase the cost to the Company of carrying out its project management responsibilities under the relevant SCL entrustment agreement, this increase estimated to be around HK\$1,371 million. Regular updates have been provided to, and discussions have been held with, the HKSAR Government on the delays to the programme for the delivery of the SCL Project and the associated impacts on the CTC including the Additional PMC.

Given such significant modifications to the project programme and the associated increase in the project management costs of the Company and following the Company’s receipt of independent expert advice, the Company believes that it is entitled (in accordance with the terms of the SCL EA3) to an increase in the project management fee, to be agreed by way of good faith negotiations or otherwise determined in accordance with the provisions of the SCL EA3. Accordingly, as stated above, the Company has included the Additional PMC of HK\$1,371 million in the 2020 CTC Estimate notified to the HKSAR Government, reflecting the additional scope of work and programme extension.

However, the HKSAR Government has advised the Company that the HKSAR Government considers there has been no material modification in respect of the SCL Project and, therefore, the HKSAR Government disagrees to the inclusion of any Additional PMC in the CTC. Hence, the Additional Funding sought by the HKSAR Government and subsequently approved by the Legislative Council on 12 June 2020 did not include any Additional PMC for the Company.

Despite the fact that this matter needs to be resolved, the Company will, in the interim, continue to comply with its project management obligations under the SCL EA3 and meet the costs thereof, to allow the SCL Project to progress in accordance with the latest programme.

The Board is of the view that the Company’s entitlement to any Additional PMC should be resolved with the HKSAR Government in accordance with the terms of the SCL EA3.

Given the uncertainty and potential financial impact to the Company in connection with the Additional PMC, at the appropriate time following further developments relating to this matter, the Company will recognise a provision in its consolidated profit and loss account for an amount of up to HK\$1,371 million to reflect the additional cost to the Company of completing its remaining project management responsibilities.

13 Railway Construction Projects under Entrustment by the HKSAR Government *(continued)*

B Shatin to Central Link ("SCL") Project *(continued)*

(c) Hung Hom Incidents

As stated in the Company's announcement dated 18 July 2019, towards the end of the first half of 2018, there were allegations concerning workmanship in relation to the Hung Hom Station extension ("**First Hung Hom Incident**"). The Company took immediate steps to investigate the issues, report the Company's findings to the HKSAR Government and reserve the Company's position against relevant contractors. To address the First Hung Hom Incident, the Company submitted to the HKSAR Government a holistic proposal for the verification and assurance of the as-constructed conditions and workmanship quality of the Hung Hom Station extension.

In late 2018 and early 2019, the Company advised the HKSAR Government of an insufficiency of construction records and certain construction issues at the Hung Hom North Approach Tunnel ("**NAT**"), the South Approach Tunnel ("**SAT**") and the Hung Hom Stabling Sidings ("**HHS**"), forming an addition to the First Hung Hom Incident ("**Second Hung Hom Incident**"). To address the Second Hung Hom Incident, the Company submitted to the HKSAR Government a verification proposal for verification of the as-constructed condition and workmanship quality of these areas.

(i) Commission of Inquiry ("COI")

On 10 July 2018, the COI was set up by the HKSAR Chief Executive in Council pursuant to the Commissions of Inquiry Ordinance (Chapter 86 of the Laws of Hong Kong). The Company has cooperated fully with the COI. The COI process included hearing of evidence from factual witnesses and reviewing evidence from experts on project management and structural engineering issues. On 29 January 2019, the HKSAR Government made its closing submission to the first phase of the COI in which it stated its view that the Company ought to have provided the required skills and care reasonably expected of a professional and competent project manager but that the Company had failed to do so. On 19 February 2019, the HKSAR Government announced that the terms of reference of the COI had been expanded and approved a further extension of time for the COI to submit its report to the Chief Executive by 30 August 2019, or such time as the Chief Executive in Council may allow. Subsequently, the Chief Executive in Council extended the time for the COI to submit its final report to the Chief Executive to 31 March 2020.

On 25 February 2019, the COI submitted an interim report to the Chief Executive on its findings and recommendations on matters covered by the original terms of reference. On 26 March 2019, the HKSAR Government published the redacted interim report in which the COI, while recognising it to be an interim report, found that although the Hung Hom Station extension diaphragm wall and platform slab construction works are safe, they were not executed in accordance with the relevant contract in material aspects. The COI also made a number of comments regarding the Company's performance and systems as well as a number of recommendations for the future.

On 18 July 2019, the Company completed and submitted to the HKSAR Government two separate final reports, one in respect of the First Hung Hom Incident and one in respect of the Second Hung Hom Incident, containing, inter alia, proposals for suitable measures required at certain locations to achieve code compliance. These suitable measures have been implemented to enable the SCL Project to be completed for public use in accordance with the latest project programme.

On 22 January 2020, the HKSAR Government reiterated, in its closing submissions on factual evidence for the extended inquiry submitted to the COI, that there was failure on the part of both the Company and the contractor Leighton Contractors Asia Limited to perform the obligations which the two parties undertook for the SCL project and that the Company, which was entrusted by the HKSAR Government as the project manager of the SCL project, ought to have provided the requisite degree of skill and care reasonably expected of a professional and competent project manager.

On 27 March 2020, the COI submitted its final report to the Chief Executive on its findings and recommendations on matters covered by the original and extended terms of reference. On 12 May 2020, the HKSAR Government published the final report in which the COI determined that it is fully satisfied that, with the suitable measure in place, the station box structure will be safe and also fit for purpose. The COI also stated that it is satisfied that, with suitable measures completed, the NAT, SAT and HHS structures will be safe and fit for purpose. The suitable measures for the station box structure were completed in June 2020 and the suitable measures for the NAT, SAT and HHS structures were completed in May 2020. The COI also made a number of comments on the construction process (including regarding failures in respect thereof such as unacceptable incidents of poor workmanship compounded by lax supervision and that in a number of respects also, management of the construction endeavour fell below the standards of reasonable competence) and made recommendations to the Company for the future. Up to the date of this interim report, no claim has been received from the HKSAR Government in relation to any SCL Agreement (as detailed in note 13B(c)(iii) below).

(ii) Hung Hom Incidents Related Costs

In July 2019, the HKSAR Government accepted the Company's recommendation that the Tuen Ma Line (Tai Wai to Hung Hom Section of the SCL) should open in phases, with the first phase involving the opening of commercial service on the Tuen Ma Line from Tai Wai Station to Kai Tak Station ("**Phased Opening**") which occurred on 14 February 2020.

In order to progress the SCL Project and to facilitate the Phased Opening in the first quarter of 2020, the Company announced in July 2019 that it would fund, on an interim and without prejudice basis, certain costs arising from the Hung Hom Incidents and certain costs associated with Phased Opening (being costs for alteration works, trial operations and other costs associated with the preparation activities for the Phased Opening) ("**Hung Hom Incidents Related Costs**"), whilst reserving the Company's position as to the ultimate liability for such costs. Currently, the Company's best estimate of such costs is around HK\$2 billion in aggregate. However, there is no certainty that, ultimately, the entirety of this amount will need to be funded.

The Company and the HKSAR Government will continue discussions with a view to reaching an overall settlement in relation to the Hung Hom Incidents and their respective funding obligations relating to the CTC and the Hung Hom Incidents Related Costs. If no overall settlement is reached between the Company and the HKSAR Government within a reasonable period, the provisions of the SCL EA3 shall continue to apply (as they currently do) including in relation to such costs, and the responsibility for the funding of such costs shall be determined in accordance with the SCL EA3.

13 Railway Construction Projects under Entrustment by the HKSAR Government *(continued)*

B Shatin to Central Link (“SCL”) Project *(continued)*

After taking into account the above and in light of the Company’s decision to fund, on an interim and without prejudice basis, the Hung Hom Incidents Related Costs, the Company recognised a provision of HK\$2,000 million in its consolidated profit and loss account for the six months ended 30 June 2019. Up to 30 June 2020, the Company has committed and / or paid Hung Hom Incidents Related Costs totaling HK\$978 million, and no provision was written back during the six months ended 30 June 2020. The provision is included in “**Creditors, other payables and provisions**” in the consolidated statement of financial position.

This amount does not take into account any potential recovery from any other party (whether in the circumstances that no overall settlement is reached and / or as a result of an award, settlement or otherwise). Accordingly, if any such potential recovery becomes virtually certain, the amount of any such recovery will be recognised and credited to the Company’s consolidated profit and loss account in that financial period.

(iii) Potential Claims from and Indemnification to the HKSAR Government

The HKSAR Government has the right to claim against the Company if the Company breaches the SCL Agreements (including, if the Company breaches the warranties it gave in respect of its project management services) and, under each SCL Agreement, to be indemnified by the Company in relation to losses incurred by the HKSAR Government as a result of the negligence of the Company in performing its obligations under the relevant SCL Agreement or breach thereof by the Company. Under the SCL EA3, the Company’s total aggregate liability to the HKSAR Government arising out of or in connection with the SCL Agreements (other than for death or personal injury) is subject to a cap equal to the fees that the Company receives under the SCL Agreements. In accordance with general principles of law, such cap could not be relied upon if the Company were found to be liable for the fraudulent or other dishonest conduct of its employees or agents, to the extent that the relevant loss had been caused by such fraudulent or other dishonest conduct. Although the HKSAR Government has stated that it reserves all rights to pursue further actions against the Company and related contractors and has made the statements in its closing submission to the COI (as stated in note 13B(c)(i) above), up to the date of this interim report, no claim has been received from the HKSAR Government in relation to any SCL Agreement. It is uncertain as to whether such claim will be made against the Company in the future and, if made, the nature and amount of such claim.

(iv) The eventual outcome of the discussions between the Company and the HKSAR Government on various matters including the timing of any overall settlement in relation to the Hung Hom Incidents and their respective funding obligations relating to the Hung Hom Incidents Related Costs, the level of recovery from relevant parties and the development and eventual outcome relating to the Additional PMC (as detailed in note 13B(b)(ii) above) remain highly uncertain at the current stage. As a result, no additional provision other than the HK\$2,000 million referred to above has been made as the Company is currently not able to measure with sufficient reliability the ultimate amount of the Company’s obligation or liability arising from the SCL Project as a whole in light of the significant uncertainties involved. While no other provision on the SCL Project related matters was recognised at 30 June 2020, the Company will reassess on an ongoing basis the need to recognise a further provision in the future in light of any further developments.

(d) Phased Opening of SCL

On 11 February 2020, the Company entered into relevant agreements with the HKSAR Government and KCRC to supplement and amend the current agreements to enable the Company to operate Tuen Ma Line Phase 1 in substantially the same manner as the existing railway network for a period of two years from 14 February 2020 including with KCRC the supplemental service concession agreement (“SSCA-SCL”). Prior to the full opening of the Tuen Ma Line, the parties are obliged to commence exclusive negotiations in good faith with a view to agreeing the terms of a supplemental service concession agreement for the entire Tuen Ma Line (which is intended to replace the SSCA-SCL that was executed on 11 February 2020).

14 Property Development in Progress

Movements of property development in progress of the Group during the six months ended 30 June 2020 and the year ended 31 December 2019 are as follows:

in HK\$ million	Balance at 1 January	Expenditure	Offset against payments received from developers	Transfer out to profit or loss	Balance at 30 June/ 31 December
At 30 June 2020 (Unaudited)					
Hong Kong Property Development Projects	12,022	494	(35)	(491)	11,990
At 31 December 2019 (Audited)					
Hong Kong Property Development Projects	14,840	3,819	(662)	(5,975)	12,022

NOTES TO THE UNAUDITED INTERIM FINANCIAL REPORT

15 Properties Held for Sale

in HK\$ million	At 30 June 2020 (Unaudited)	At 31 December 2019 (Audited)
Properties held for sale		
– at cost	1,919	1,125
– at net realisable value	116	120
	2,035	1,245
Representing:		
Hong Kong property development	1,827	1,034
Mainland of China property development	208	211
	2,035	1,245

Properties held for sale represent the Group's interest in unsold properties or properties received by the Group as sharing in kind in Hong Kong, and the Group's unsold properties in Shenzhen.

Properties held for sale at net realisable value as at 30 June 2020 are stated net of provision of HK\$12 million (31 December 2019: HK\$12 million) made in order to state these properties at the lower of their cost and estimated net realisable value.

16 Derivative Financial Assets and Liabilities

The notional amounts and fair values of derivative financial assets and liabilities are as follows:

in HK\$ million	At 30 June 2020 (Unaudited)		At 31 December 2019 (Audited)	
	Notional amount	Fair value	Notional amount	Fair value
Derivative Financial Assets				
Foreign exchange forwards				
– cash flow hedges	151	3	51	1
– hedges of net investments	2,054	35	–	–
– not adopted hedge accounting	563	20	721	19
Cross currency swaps				
– fair value hedges	1,711	31	698	9
– cash flow hedges	10,243	272	8,430	139
– hedges of net investments	64	1	64	1
Interest rate swaps				
– fair value hedges	4,240	63	8,841	12
– cash flow hedges	1,250	5	1,250	14
– not adopted hedge accounting	913	1	1,913	3
	21,189	431	21,968	198
Derivative Financial Liabilities				
Foreign exchange forwards				
– fair value hedges	78	–	–	–
– cash flow hedges	331	14	321	11
– hedges of net investments	–	–	1,984	16
– not adopted hedge accounting	593	17	783	15
Cross currency swaps				
– fair value hedges	388	1	–	–
– cash flow hedges	3,634	556	5,446	350
Interest rate swaps				
– fair value hedges	6,335	16	3,785	11
– cash flow hedges	1,850	18	100	3
– not adopted hedge accounting	1,783	8	783	2
	14,992	630	13,202	408
Total	36,181		35,170	

17 Debtors and Other Receivables

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

- (i) The majority of fare revenue from Hong Kong transport operation (except for that from the High Speed Rail as described in note 17(ii) below) is collected either through Octopus Cards with daily settlement on the next working day or in cash for other ticket types. A small portion of it is collected through pre-sale agents which settle the amounts due within 21 days.
- (ii) In respect of the High Speed Rail, tickets are sold by the Company and other mainland train operators. The clearance centre of China Railway Corporation administers the revenue allocation and settlement system of the Guangzhou-Shenzhen-Hong Kong Express Rail Link and allocates the revenue of the High Speed Rail to the Company under a "section-based" approach with settlement in the following month.
- (iii) Fare revenue from SZL4 is collected either through Shenzhen Tong Cards with daily settlement on the next working day or in cash for other ticket types. Fare revenue from MTRX (formerly known as "MTR Express") in Sweden is collected through a third party financial institution with settlement within 14 days and sales through pre-sale agents are settled in the following month.
- (iv) Franchise revenue in Melbourne is collected either daily or monthly depending on the revenue nature. The majority of the franchise revenue from operations in Stockholm is collected in the transaction month with the remainder being collected in the following month. Concession revenue for TfL Rail/Elizabeth Line in London is collected once every 4 weeks. Service fees from Macao Light Rapid Transit Taipa Line are billed monthly with due dates in accordance with the terms of the service agreement.
- (v) 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.
- (vi) Amounts receivable under interest rate and currency swap agreements with financial institutions are due in accordance with the terms of the respective agreements.
- (vii) Consultancy service incomes are billed monthly for settlement within 30 days upon work completion or on other basis stipulated in the consultancy contracts.
- (viii) Debtors in relation to contracts and capital works entrusted to the Group, subject to any agreed retentions, are due within 30 days upon the certification of work in progress.
- (ix) Amounts receivable in respect of property development are due in accordance with the terms of relevant development agreements or sale and purchase agreements.

The ageing analysis of debtors based on due date is as follows:

in HK\$ million	At 30 June 2020 (Unaudited)	At 31 December 2019 (Audited)
Amounts not yet due	3,141	2,775
Overdue by 30 days	173	153
Overdue by 60 days	40	59
Overdue by 90 days	21	41
Overdue by more than 90 days	86	192
Total debtors	3,461	3,220
Other receivables and contract assets	10,537	7,949
	13,998	11,169

Included in other receivables as at 30 June 2020 was HK\$5,193 million (31 December 2019: HK\$2,813 million) in respect of property development profit in Hong Kong distributable from stakeholding funds based on the terms of the development agreements and sales and purchase agreements.

During the years ended 31 December 2017 and 2018, the Inland Revenue Department of Hong Kong ("IRD") issued notices of assessment/additional assessment for the years of assessment 2010/2011 to 2017/2018 following queries in connection with the tax deductibility of certain payments relating to the Rail Merger.

Based on the strength of advice from external senior counsel and tax advisor, the directors of the Company have determined to strongly contest the assessments raised by the IRD. The Company has lodged objections against these tax assessments and has applied to hold over the additional tax demanded. The IRD has agreed to the holdover of the additional tax demanded subject to the purchases of tax reserve certificates ("TRCs") amounting to HK\$1,816 million and HK\$462 million in 2017 and 2018 respectively. The purchases of TRCs do not prejudice the Company's tax position and the purchased TRCs were included in debtors and other receivables in the Group's consolidated statement of financial position. No additional tax provision has been made in respect of the above notices of assessment/additional assessment.

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18 Material Related Party Transactions

The FSI of the HKSAR Government, which holds approximately 75.23% of the Company's issued share capital on trust for the HKSAR Government as at 30 June 2020, is the majority shareholder of the Company. Transactions between the Group and the HKSAR Government departments or agencies, or entities controlled by the HKSAR Government, other than those transactions such as the payment of fees, taxes, leases and rates, etc. that arise in the normal dealings between the HKSAR Government and the Group, are considered to be related party transactions pursuant to HKAS 24 (revised), *Related Party Disclosures*, and are identified separately in this interim financial report.

As at 30 June 2020, amounts due from/to the HKSAR Government and other related parties in respect of material related party transactions with the Group are stated below:

in HK\$ million	At 30 June 2020 (Unaudited)	At 31 December 2019 (Audited)
Amounts due from:		
– HKSAR Government	1,715	1,783
– KCRC	2,163	1,159
– associates	120	99
	3,998	3,041
Amounts due to:		
– HKSAR Government	4,643	117
– KCRC	895	2,873
– associates	49	–
	5,587	2,990

As at 30 June 2020, the amount due from the HKSAR Government mainly related to the recoverable cost for the advanced works in relation to the Shatin to Central Link, reimbursable costs for the essential public infrastructure works in respect of the South Island Line and Kwun Tong Line Extension projects, reimbursement of the fare revenue difference in relation to the Public Transport Fare Concession Scheme for the Elderly and Eligible Persons with Disabilities, agency fee receivables and reimbursable costs in respect of West Rail property development, as well as receivables and retention for other entrustment and maintenance works.

The amount due to the HKSAR Government as at 30 June 2020 related to the 2019 final ordinary dividend payable (note 8) amounting to HK\$4,541 million as well as land administrative fees in relation to railway extensions.

The amount due from KCRC mainly related to the recoverable cost for certain capital works in accordance with the agreements in relation to the Rail Merger, as well as amounts in relation to the High Speed Rail and Tuen Ma Line Phase 1. The amount due to KCRC mainly related to the accrued portion of the fixed annual payment and variable annual payment arising from the Rail Merger and Operating Arrangements of the High Speed Rail and Tuen Ma Line Phase 1.

Details of major related party transactions entered into by the Group with the HKSAR Government in prior years that are still relevant for the current period and those with KCRC in respect of the Rail Merger and Operating Arrangements of the High Speed Rail and Tuen Ma Line Phase 1 were described in the Group's audited accounts for the year ended 31 December 2019. During the six months ended 30 June 2020, amounts recoverable or invoiced by the Company under West Rail Agency Agreement and Property Package Agreement are HK\$22 million (2019: HK\$37 million) and HK\$nil (2019: HK\$3 million) respectively and amount payable or paid by the Company under Service Concession Agreement is HK\$832 million (2019: HK\$1,881 million). Net revenue received or receivable from KCRC in respect of High Speed Rail under SSCA-HSR and Tuen Ma Line Phase 1 under SSCA-SCL amounted to HK\$1,015 million (2019: HK\$213 million).

The Company entered into entrustment agreements with the HKSAR Government for the design, site investigation, procurement activities, construction, testing and commissioning of High Speed Rail and Shatin to Central Link. Detailed description of the agreements and the amount of project management fees recognised for the six months ended 30 June 2020 are provided in notes 13A and 13B. In addition, an amount of HK\$210 million was paid/payable to the HKSAR Government during the six months ended 30 June 2020 (2019: HK\$507 million) under SCL EA3's payment arrangement with the HKSAR Government and relevant contractors.

In addition, in connection with the property developments along the railway system, the Company has been granted a land lot by the HKSAR Government in respect of the following site during the six months ended 30 June 2020:

Property development site	Land grant/land premium offer acceptance date	Total land premium in HK\$ million	Land premium settlement date
Site D of the Remaining Portion of Tseung Kwan O Town Lot No. 70	14 February 2020	2,725	19 March 2020

During the six months ended 30 June 2020, the maintenance contract with the Hong Kong Airport Authority ("HKAA") in respect of the automated people mover system ("System") serving the Hong Kong International Airport was extended to 5 January 2021. In respect of the services provided, HK\$67 million was recognised as consultancy income during the six months ended 30 June 2020 (2019: HK\$41 million).

On 18 May 2018, the Company provided a sub-contractor warranty to the HKAA as a result of obtaining a subcontract from a third party for the modification works of the existing System for a seven year period, effective from 25 September 2017 (the "Subcontract"). The Subcontract contains provisions covering the provision and modification of the power distribution, communication and control subsystems in respect of the System.

18 Material Related Party Transactions *(continued)*

During the six months ended 30 June 2020, the Group had the following transactions with its associates, namely Octopus Holdings Limited and its subsidiaries ("Octopus Group") (in Hong Kong) and NRT Group Holdings Pty Ltd and its subsidiaries ("NRT Group") (in Australia):

in HK\$ million	Six months ended 30 June 2020	Six months ended 30 June 2019
Octopus Group		
– Expenses paid or payable in respect of central clearing services provided by Octopus Group	44	79
– Fees received or receivable in respect of load agent, Octopus card issuance and refund services, computer equipment and relating services and warehouse storage space provided to Octopus Group	12	24
NRT Group		
– Fees received or receivable in respect of mobilisation, operations and maintenance as well as design and delivery services provided to NRT Group	1,258	729

19 Creditors, Other Payables and Provisions

The analysis of creditors by due dates is as follows:

in HK\$ million	At 30 June 2020 (Unaudited)	At 31 December 2019 (Audited)
Due within 30 days or on demand	7,100	7,157
Due after 30 days but within 60 days	974	1,559
Due after 60 days but within 90 days	674	774
Due after 90 days	5,148	4,978
	13,896	14,468
Rental and other refundable deposits	2,906	2,857
Accrued employee benefits	2,545	1,990
Dividends payable to other shareholders	1,495	–
Total creditors and accrued charges	20,842	19,315
Other payables and provisions (note 13B(c)(ii))	11,640	11,787
Contract liabilities	1,969	2,213
	34,451	33,315

20 Loans and Other Obligations

Notes issued by the Group during the six months ended 30 June 2020 and 2019 comprise:

in HK\$ million	Six months ended 30 June 2020		Six months ended 30 June 2019	
	Principal amount	Net consideration received	Principal amount	Net consideration received
Debt issuance programme notes	3,948	3,471	–	–

During the six months ended 30 June 2020, the Company issued HK\$2,700 million, RMB720 million (or HK\$783 million) and USD60 million (or HK\$465 million) of its unlisted debt securities in the respective currency (2019: nil).

As at 30 June 2020, there were outstanding debt securities issued by a wholly-owned subsidiary, MTR Corporation (C.I.) Limited ("MTRCI"). The obligations of the debt securities issued by MTRCI are direct, unsecured and unsubordinated to the other unsecured obligations of MTRCI which are unconditionally and irrevocably guaranteed by the Company. The obligations of the Company under the guarantee are direct, unsecured, unconditional, and unsubordinated to other unsecured and unsubordinated obligations of the Company.

During the six months ended 30 June 2020, the Group did not redeem any of its listed debt securities (2019: HK\$nil). The Group redeemed HK\$1,248 million of its unlisted debt securities (2019: HK\$200 million).

NOTES TO THE UNAUDITED INTERIM FINANCIAL REPORT

21 Deferred Tax Assets and Liabilities

A Movements of deferred tax assets and liabilities during the six months ended 30 June 2020 and the year ended 31 December 2019 are as follows:

in HK\$ million	Deferred tax arising from					Total
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Provision and other temporary differences	Cash flow hedges	Tax losses	
At 30 June 2020 (Unaudited)						
Balance as at 1 January 2020 (Audited)	13,007	778	(123)	43	(110)	13,595
Credited to consolidated profit and loss account	(35)	–	(70)	–	(32)	(137)
(Credited)/charged to reserves	–	(33)	3	(1)	–	(31)
Exchange differences	(3)	–	1	1	–	(1)
Balance as at 30 June 2020	12,969	745	(189)	43	(142)	13,426
At 31 December 2019 (Audited)						
Balance as at 1 January 2019	12,385	759	(183)	(5)	(103)	12,853
Charged/(credited) to consolidated profit and loss account	620	(5)	(76)	–	(1)	538
Charged to reserves	–	24	139	48	–	211
Acquisition of subsidiary	–	–	–	–	(12)	(12)
Exchange differences	2	–	(3)	–	6	5
Balance as at 31 December 2019	13,007	778	(123)	43	(110)	13,595

B Deferred tax assets and liabilities recognised on the consolidated statement of financial position are as follows:

in HK\$ million	At 30 June 2020 (Unaudited)	At 31 December 2019 (Audited)
Net deferred tax assets	(186)	(134)
Net deferred tax liabilities	13,612	13,729
	13,426	13,595

22 Share Capital and Shares Held for Executive Share Incentive Scheme

A Share Capital

	At 30 June 2020 (Unaudited)		At 31 December 2019 (Audited)	
	Number of shares	HK\$ million	Number of shares	HK\$ million
Ordinary shares, issued and fully paid:				
At 1 January	6,157,948,911	58,804	6,139,485,589	57,970
Shares issued in respect of scrip dividend of 2018 final ordinary dividend	–	–	13,707,539	654
Shares issued in respect of scrip dividend of 2019 interim ordinary dividend	–	–	1,494,283	71
Vesting of shares of Executive Share Incentive Scheme	–	6	–	5
Shares issued under the share option scheme	1,710,000	57	3,261,500	104
At 30 June/31 December	6,159,658,911	58,867	6,157,948,911	58,804

B New shares issued and fully paid up during the six months ended 30 June 2020 comprise:

	Number of shares	Weighted average exercise price HK\$
Employee share options exercised:		
– 2007 Share Option Scheme	1,710,000	30.88

22 Share Capital and Shares Held for Executive Share Incentive Scheme (continued)

C Movements in the number of share options outstanding are as follows:

	Six months ended 30 June 2020	Six months ended 30 June 2019
	2007 Share Option Scheme	2007 Share Option Scheme
Outstanding at 1 January	4,909,000	8,170,500
Exercised during the period	(1,710,000)	(2,499,000)
Outstanding at 30 June	3,199,000	5,671,500
Exercisable at 30 June	3,199,000	5,671,500

D During the six months ended 30 June 2020, the Company awarded Performance Shares and Restricted Shares under the Company's Executive Share Incentive Scheme to certain eligible employees of the Company. A total of 6,950 Performance Shares (2019: 244,650) and 2,334,750 Restricted Shares (2019: 2,062,150) were awarded and accepted by the grantees on 8 April 2020 (2019: 1 April 2019 and 8 April 2019). The fair value of these awarded shares was HK\$41.90 per share on 8 April 2020 (2019: HK\$48.90 per share on 1 April 2019 and HK\$48.40 per share on 8 April 2019).

E During the six months ended 30 June 2020, the Trustee of the Executive Share Incentive Scheme, pursuant to the terms of the rules and the trust deed of the Executive Share Incentive Scheme, purchased on the Hong Kong Stock Exchange a total of 2,020,000 Ordinary Shares (2019: 1,870,000) of the Company for a total consideration of approximately HK\$86 million (2019: HK\$88 million).

F During the six months ended 30 June 2020, 1,855,667 shares (2019: 2,145,215) were transferred to the awardees under the Executive Share Incentive Scheme upon vesting. The total cost of the vested shares was HK\$84 million (2019: HK\$88 million). During the six months ended 30 June 2020, HK\$6 million (2019: HK\$5 million) was credited to share capital in respect of vesting of shares whose fair values at the grant date were higher than the costs of the vested shares. During the six months ended 30 June 2020, 184,776 award shares (2019: 97,938) were forfeited.

23 Fair Value Measurement

In accordance with HKFRS 13, *Fair Value Measurement*, the level into which a fair value measurement is classified is determined with reference to the observability and significance of the inputs used in the valuation technique as follows:

Level 1: Fair value measured using only Level 1 inputs, i.e. unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date

Level 2: Fair value measured using Level 2 inputs, i.e. observable inputs which fail to meet Level 1, and not using significant unobservable inputs. Unobservable inputs are inputs for which market data are not available

Level 3: Fair value measured using significant unobservable inputs

A Fair Value Measurements of Fixed Assets

All of the Group's investment properties and self-occupied buildings measured at fair value on a recurring basis are categorised as Level 3 of the fair value hierarchy.

During the six months ended 30 June 2020, there were no transfers between Level 1 and Level 2, or transfers into or out of Level 3 in respect of the Group's investment properties and self-occupied buildings. The Group's policy is to recognise transfers between levels of fair value hierarchy as at the end of the reporting period in which they occur.

B Fair Value Measurements of Financial Instruments

(i) Financial Assets and Liabilities Carried at Fair Value

All of the Group's investments in securities were carried at fair value using Level 1 measurements, the fair value of financial assets as at 30 June 2020 was HK\$219 million (as at 31 December 2019: HK\$386 million). The Group's derivative financial instruments were carried at fair value using Level 2 measurements, as at 30 June 2020, the fair values of derivative financial assets and financial liabilities were HK\$431 million (as at 31 December 2019: HK\$198 million) and HK\$630 million (as at 31 December 2019: HK\$408 million) respectively.

There are no Level 3 measurements of financial instruments. During the six months ended 30 June 2020 and the year ended 31 December 2019, there were no transfers between Level 1 and Level 2, or transfers into or out of Level 3. The Group's policy is to recognise transfers between levels of fair value hierarchy as at the end of the reporting period in which they occur.

The discounted cash flow method, which discounts the future contractual cash flows at the current market interest rates, is the main valuation technique used to determine the fair value of the Group's borrowings and derivative financial instruments. For interest rate swaps, cross currency swaps and foreign exchange forward contracts, the discount rates used were derived from the swap curves of the respective currencies and the cross currency basis curves of the respective currency pairs at the end of the reporting period. Closing exchange rates at the end of the reporting period were used to convert value in foreign currency to local currency.

NOTES TO THE UNAUDITED INTERIM FINANCIAL REPORT

23 Fair Value Measurement *(continued)*

B Fair Value Measurements of Financial Instruments *(continued)*

(ii) Financial Assets and Liabilities Not Carried at Fair Value

The carrying amounts of the Group's financial assets and liabilities not carried at fair value are not materially different from their fair values as at 30 June 2020 and 31 December 2019 except for capital market instruments and other obligations, for which their carrying amounts and fair values are disclosed below:

in HK\$ million	At 30 June 2020 (Unaudited)		At 31 December 2019 (Audited)	
	Carrying amount	Fair value	Carrying amount	Fair value
Capital market instruments	26,894	33,493	24,204	27,528
Other obligations	1,668	1,599	1,740	1,884

The above fair value measurement is categorised as Level 2. The discount cash flow method, which discounts the future contractual cash flows at the current market interest rates, is the main valuation technique used to determine the fair value of the Group's capital market instruments and other obligations. The discount rates used were derived from the swap curves of the respective currencies at the end of the reporting period. Closing exchange rates at the end of the reporting period were used to convert value in foreign currency to local currency.

24 Cash Generated from Operations

Reconciliation of the Group's operating profit before Hong Kong property development, depreciation, amortisation and variable annual payment arising from recurrent businesses to cash generated from operations is as follows:

in HK\$ million	Six months ended 30 June 2020 (Unaudited)	Six months ended 30 June 2019 (Unaudited)
Operating profit before Hong Kong property development, depreciation, amortisation and variable annual payment from recurrent businesses	4,001	8,411
Adjustments for non-cash items	(34)	2,019
Operating profit before working capital changes	3,967	10,430
Increase in debtors and other receivables	(1,396)	(703)
Increase in stores and spares	(68)	(167)
(Decrease)/increase in creditors and other payables	(259)	404
Cash generated from operations	2,244	9,964

25 Capital Commitments

A Outstanding capital commitments as at 30 June 2020 not provided for in the accounts were as follows:

in HK\$ million	Hong Kong transport operations, station commercial and other businesses	Hong Kong railway extension projects	Hong Kong property rental and development	Mainland of China and overseas operations	Total
At 30 June 2020 (Unaudited)					
Authorised but not yet contracted for	13,220	–	2,203	9	15,432
Authorised and contracted for	16,461	152	1,212	229	18,054
	29,681	152	3,415	238	33,486
At 31 December 2019 (Audited)					
Authorised but not yet contracted for	8,476	–	2,442	9	10,927
Authorised and contracted for	13,558	170	1,183	20	14,931
	22,034	170	3,625	29	25,858

In respect of Sydney Metro City & Southwest, the Group's share of investment is expected to represent equity contribution of approximately AUD12.7 million and loans of approximately AUD47.5 million. Up to 30 June 2020, the Group has not contributed equity or loan to the project.

25 Capital Commitments *(continued)*

B The capital commitments under Hong Kong transport operations, station commercial and other businesses comprise the following:

in HK\$ million	Improvement, enhancement and replacement works	Acquisition of property, plant and equipment	Additional concession properties	Total
At 30 June 2020 (Unaudited)				
Authorised but not yet contracted for	8,529	1,009	3,682	13,220
Authorised and contracted for	12,925	352	3,184	16,461
	21,454	1,361	6,866	29,681
At 31 December 2019 (Audited)				
Authorised but not yet contracted for	4,090	746	3,640	8,476
Authorised and contracted for	10,267	246	3,045	13,558
	14,357	992	6,685	22,034

26 Impacts of COVID-19 Pandemic

The COVID-19 pandemic since early 2020 has brought about adverse impacts to the Group's operations and financial results. Detailed descriptions of the impacts are contained in other sections of the 2020 Interim Report.

27 Approval of Interim Financial Report

The interim financial report was approved by the Board on 6 August 2020.