ANNUAL REPORT 2012

KOWLOON-CANTON RAILWAY CORPORATION

CONTENTS

Managing Board & Key Management

Managing Board

Professor K C Chan GBS, JP
PhD
Chairman
Secretary for Financial Services and the Treasury of the Hong Kong Special Administrative Region Government

Eva Cheng GBS, JP (Left)
B Soc Sc
Secretary for Transport and Housing of the Hong Kong Special Administrative Region Government (up to 30 June 2012)

Professor Anthony Cheung Bing-leung GBS, JP (Right)
PhD
Secretary for Transport and Housing of the Hong Kong Special Administrative Region Government (from 1 July 2012)

Stanley Y H Ying, JP (Left)
Member of Audit Committee
Permanent Secretary for Financial Services and the Treasury (Treasury) of the Hong Kong Special Administrative Region Government (up to 24 July 2012)

Elizabeth Tse Man-yee, JP (Right)
Member of Audit Committee
Permanent Secretary for Financial Services and the Treasury (Treasury) of the Hong Kong Special Administrative Region Government (from 25 July 2012)

Francis Ho Suen-wai, JP (Left)
Permanent Secretary for Transport and Housing (Transport) of the Hong Kong Special Administrative Region Government (up to 27 May 2012)

Joseph Lai Yee-tak, JP (Right)
Permanent Secretary for Transport and Housing (Transport) of the Hong Kong Special Administrative Region Government (from 28 May 2012)

Cathy Chu, JP (Left)
Member of Audit Committee
Deputy Secretary for Financial Services and the Treasury (Treasury) of the Hong Kong Special Administrative Region Government
(up to 18 June 2012)

Mable Chan, JP (Right)
Member of Audit Committee
Deputy Secretary for Financial Services and the Treasury (Treasury) of the Hong Kong Special Administrative Region Government
(from 23 July 2012)

Lesley Y C Wong, JP
CPA, FCCA, ACA, ACIS
Chairperson of Audit Committee
Director of Accounting Services of the Hong Kong Special Administrative Region Government

Key Management

Ir James Blake, GBS, OBE, JP (Left)
FHKIE, FHKEng, FICE, FIStructE, FCIHT
Chief Officer
(up to 31 December 2012)

Edmund K.H. Leung, SBS, OBE, JP (Right)
BSc(Eng), CEng, R.P.E., FHKIE, FIMechE, FCIBSE, FIEAust., FHKEng
Chief Officer
(from 1 January 2013)

Michael J Arnold (Left)
BSc, CEng, MICE, MCIHT
Senior Manager-Administration
Company Secretary

Julian P Walsh (Right)
MA, ACA, CPA
Senior Manager-Finance

Chairman's Statement

For each year since I first became the Chairman of the KCRC, it has been my pleasant duty to report that the Corporation has again enjoyed a successful year, and 2012 was no exception. Although the Corporation showed a net accounting loss of HK$1,250 million for the year, its increasing cash operating profit and cash balances show that the Service Concession granted to the MTR Corporation has worked well. Not only do rail travelers benefit each and every day from the convenience and lower fares made possible by the integrated MTR and KCR networks, in due time Hong Kong's public purse will once again benefit from the Corporation being able to pay dividends to the HKSAR Government as its sole shareholder.

Although KCRC's primary activities since the railway merger have focused on managing its railway assets and the Service Concession granted to the MTR Corporation, it has in recent years, through its 51% shareholding in West Rail Property Development Limited (WRPDL) and with the MTR Corporation as the latter's development agent, played an important role in overseeing the property development of various large residential sites along West Rail. More significantly, the developments on those sites successfully tendered since 2011 have all been designed to provide residential units of floor area and build quality suitable to better meet the needs of the society.

In undertaking large-scale property developments in Hong Kong, the WRPDL board has made its share of contribution. As of today there are some 11,300 units along the West Rail Line either completed or under construction by developers, with sites for a further 12,200 units expected to be tendered over the coming years.

Since the middle of 2006 until the end of 2012, the Chairman of the board of directors of WRPDL and of each of its 13 subsidiary companies has been Mr James Blake, the CEO, and following the rail merger in December 2007, the Chief Officer of the Corporation. It was during his tenure that most of the sites now under construction were successfully tendered.

On behalf of the Managing Board, I would therefore like to take this opportunity to express the Corporation's heartfelt gratitude to Mr Blake for his sterling service not only as CEO and then Chief Officer of KCRC, but also in his less visible role as the Chairman of the board of WRPDL. Taking his place as the Chief Officer from 1 January 2013 is Mr Edmund K. H. Leung, who has a proven track record in Hong Kong's business and engineering sectors, including previous experience of KCRC's railway operations.

Membership of the Managing Board also saw significant changes over the year. Stepping down were Ms Eva Cheng, Mr Stanley Y H Ying, Mr Francis Ho Suen-wai and Miss Cathy Chu, with Professor Anthony Cheung Bing-leung, Ms Elizabeth Tse Man-yee, Mr Joseph Lai Yee-tak and Ms Mable Chan, respectively, being appointed in their place. As Chairman, I would like to thank all those who served on the Board during the year for their support and contributions in making 2012 once again a successful year for the Corporation.

Professor K C Chan, GBS, JP
Chairman
15 April 2013

"increasing cash operating profit and cash balances show that the Service Concession granted to the MTR Corporation has worked well"

“a combination of both strong patronage growth and a mid-year increase in fares under the Fare Adjustment Mechanism saw the Variable Annual Payment from the MTR Corporation increase substantially by 36.5%”

Chief Officer's Statement and Financial Review

2012 was again a financially successful year for the Corporation. Since I only took up the position of Chief Officer on 1 January 2013, I have to acknowledge that the credit for success in 2012 belongs to my predecessor, Mr James Blake, who stepped down at the end of the year.

With the maximum gross revenue sharing ratio under the Service Concession Agreement of 35% having been reached in 2011, a combination of both strong patronage growth and a mid-year increase in fares under the Fare Adjustment Mechanism saw the variable annual payment from the MTR Corporation increase substantially by 36.5% from HK$647 million in 2011 to HK$883 million. Including the fixed annual payment of HK$750 million, the Service Concession generated total revenue of HK$1,633 million for the year. The Corporation's ownership of the 7th to 9th floors of Citylink Plaza above Shatin Station generated additional property rental income of HK$26 million.

As regards cash operating costs and interest and finance expenses, these amounted to HK$637million for the year, with over 95% being due to the interest charges on the Corporation's HK$14.8 billion debt portfolio. Direct staff costs totalled HK$6 million, with a further expenditure of HK$25 million being incurred on outsourced support services provided by the MTR Corporation and others.

Operating profit before depreciation, amortisation and impairment amounted to HK$2,035 million, an increase of HK$394 million from 2011. Depreciation and amortisation charges were HK$3,124 million, with the net loss for the year being HK$1,250 million. With depreciation and amortisation charges being non-cash in nature and operating expenses now being substantially lower than the annual payments made by the MTR Corporation under the Service Concession Agreement, the Corporation enjoyed a healthy cash operating profit for the year.

In March 2012, the Corporation also recovered an amount of HK$4.405 billion arising from loans made earlier to West Rail Property Development Limited (WRPDL) to cover the costs of preparatory works necessary to enable the development of a number of residential sites along the West Rail Line following its opening at the end of 2003. Under an agreement signed between the HKSAR Government and the Corporation in 2000, profits earned by WRPDL from the sale of residential and commercial units on the West Rail sites are to be remitted directly to the Government.

Quickly following on from the award of the Nam Cheong Station property development tender in October 2011, tenders for three further West Rail sites were successfully awarded during 2012, two were for sites adjacent to Tsuen Wan West Station – Bayside and Cityside – and one for a site adjacent to Long Ping Station – Long Ping North. Following receipt of 18 expressions of interest from developers, tenders for the development of a fourth site close to Tsuen Wan West Station – TW6 – were invited during December, with the tender award made in January 2013. As a result of receiving the relevant upfront payments from the successful tenderers for these sites, interim dividends of some HK$6.5 billion were remitted to the Government by WRPDL during the year, with further interim dividends expected to be declared during 2013.

Sale of 1,080 units covering the first phase of the Tuen Mun Station development (Century Gateway) took place in the third quarter of the year. These units, which are of very high standard as regards design, finishes and facilities, proved extremely attractive to purchasers, many of whom appeared to be existing residents of the district looking to improve their domestic accommodation. Sales of the remaining 911 units in the second phase of this development and of the 1,720 units in the Tsuen Wan West 7 development (City Point) are expected during 2013.

The financial difficulties seen in the banking sector in recent times have resulted in downgrading of the credit ratings of most major banks. During the year the Corporation found it necessary to replace the letters of credit for one of its US cross border leases, because the then issuing bank decided to cease this business activity and no replacement bank could be found which met the required minimum credit ratings. In compliance with the terms and conditions of the lease, the Corporation purchased US$71 million of US Treasury Notes, which were then pledged to the relevant parties to the lease as necessary collateral in place of the previous letters of credit.

As mentioned in last year's statement by the Chief Officer, the Corporation has been concerned to fully understand the financial implications of the Shatin to Central Link (SCL) project, which the Government has indicated it may vest in KCRC. The construction of the SCL, the capital cost of which is predominantly being borne by the Government, will necessitate replacement of certain of the Corporation's major assets, for example, existing rolling stock and signalling systems, and changes to stations, especially along the East Rail and Ma On Shan Lines, to accommodate the new services. This has resulted in the need to accelerate depreciation for those assets which will have to be replaced ahead of their previously expected economic life.

To provide assurance that the Corporation would ultimately financially benefit if the project were to be vested in KCRC, the Government made available a copy of their consultants' financial assessment of the SCL. The consultants' assessment indicates that vesting of the completed project in the Corporation and adopting the service concession arrangements entered into with the MTR Corporation in December 2007 results in long-term positive financial benefits for KCRC. Construction of the SCL began during the year with the full support and cooperation of the Corporation in anticipation of receiving vesting of the completed project.

I must conclude my statement by expressing my personal thanks to my predecessor, James Blake, whom I have known for a good many years. James played a key role on behalf of KCRC in ensuring a smooth implementation of the rail merger in December 2007, and over the five years since the rail merger, was instrumental in leading the small management team in establishing a secure, long term business model for the Corporation. For someone in my position of coming in from outside to take up the responsibility of managing an organisation, one always gains confidence from knowing that I am inheriting an already successful, smooth running business. In the case of KCRC, I also take added pride in assuming day-to-day responsibility for one of very few local organisations that has enjoyed a history of over 100 years of serving the community of Hong Kong.

Edmund K. H. Leung, SBS, OBE, JP
BSc(Eng), CEng, R.P.E., FHKIE, FIMechE, FCIBSE, FIEAust., FHKEng
Chief Officer
15 April 2013

Corporate Governance

The Corporation maintains high standards of corporate governance. Being a statutory Corporation established in Hong Kong by the Kowloon-Canton Railway Corporation Ordinance (Chapter 372 of the Laws of Hong Kong) (the KCRC Ordinance), it is not bound by The Stock Exchange of Hong Kong Limited Listing Rules. Nonetheless, it supports the principles of good corporate governance contained in the Cadbury Committee's Code of Best Practice to the extent that they are applicable to the Corporation. As a matter of policy, the Corporation complies with The Stock Exchange of Hong Kong Limited Code of Corporate Governance Practices (the Code) as set out in Appendix 14 to the Listing Rules to the extent that they are applicable to the Corporation, International Financial Reporting Standards issued by the International Accounting Standards Board, Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the applicable disclosure requirements of the Hong Kong Companies Ordinance.

The Managing Board

The Corporation and its wholly or majority owned subsidiary companies are controlled through its Managing Board (the Board). The Board's main roles are to ensure that the Corporation complies in every respect with the provisions of the Ordinance to create value for its sole shareholder, to provide leadership to the Corporation, to approve the Corporation's strategic objectives and to ensure that the necessary financial and other resources are made available to Management to enable them to meet those objectives. The Board has a schedule of matters reserved for its approval. The specific responsibilities reserved for the Board include but are not limited to:

(a) rules for conduct of the Corporation's business;

(b) Three Year Business Plan, including revenue, expenses and capital budget for the ensuing year, annual manpower plan and pay review;

(c) annual budget;

(d) annual report and audited financial statements;

(e) recommendations with respect to dividend payments;

(f) major business strategies; and

(g) award of major contracts and significant variations to those contracts.

In addition to the above, Management must report to the Board monthly on significant developments, together with the operating and financial results, information on use of the Corporate Seal, letting of major contracts, and any other matters which may be required by the Board from time to time. The Board has delegated all other authorities to carry out the Corporation's activities to the Chief Officer.

The Roles of the Chairman and the Chief Officer

The division of responsibilities between the Chairman of the Board and the Chief Officer is clearly defined and has been approved by the Board. The non-executive Chairman leads the Board in the determination of its strategy and in the achievement of its objectives. The Chairman is responsible for the conduct of the business of the Board, ensuring its effectiveness and setting its agenda. The Chairman is not involved in the day-to-day business of the Corporation. The Chairman facilitates the effective contribution of non-executive Members of the Board and constructive relations between executive management and Members, ensuring that Members receive accurate, timely and clear information, as well as ensuring effective communication with the Corporation's sole shareholder. The Chief Officer has direct charge of the Corporation on a day-to-day basis and is accountable to the Board for the Corporation's financial and operational performance.

Members and Members' Independence

The Board currently comprises the Chairman and five other non-executive Members, all of whom are senior public office holders in the Government of the Hong Kong Special Administrative Region. All are appointed to the Board on an ex-officio basis by the Chief Executive of the Hong Kong Special Administrative Region. Members have, if required, access to independent professional advice at the Corporation's expense, in order for them to carry out their responsibilities. Notwithstanding that they are public office holders, Members are expected to be independent in their judgement. The names of Members together with their biographical details are set out on pages 2 and 3.

Professionalism

Each Member receives information about the Corporation, the role of the Board and the matters reserved for its decision, the terms of reference and membership of the Board and its committees, and the powers delegated to those committees, the Corporation's corporate governance practices and procedures, including the powers reserved for the Corporation's senior executives, and the latest financial information about the Corporation. This is supplemented by visits to key locations and meetings with key senior executives. Throughout their period in office, Members are continually updated on the Corporation's business, the competitive and regulatory environments in which it operates, corporate social responsibility matters and other changes affecting the Corporation, and the industry it operates in as a whole, by written briefing papers and meetings with senior executives. Members are also advised of their legal and other duties and obligations as a Member of the Board by the Company Secretary. They are regularly reminded of these duties and updated on changes to the legal and governance requirements which impact on the Corporation and themselves as Members of the Board.

Regular reports and papers are circulated to Members in a timely manner in preparation for Board and Committee meetings. These papers are supplemented by information specifically requested by Members from time to time. All Members receive monthly management accounts and regular management reports, which enable them to scrutinise the Corporation's and management's performance against agreed objectives.

The Company Secretary

The Company Secretary is responsible for advising the Board, through the Chairman, on all governance matters. Members have access to the advice and services of the Company Secretary.

Relations with the Sole Shareholder

To fulfil the Chairman's obligations under the Ordinance and the Code, the Chairman gives feedback to the Board on issues raised with him by the Corporation's sole shareholder. The Corporation maintains a corporate website, www.kcrc.com, containing a wide range of information of interest to all stakeholders.

Internal Control

The Board is ultimately responsible for the Corporation's system of internal control. It ensures through the Audit Committee that appropriate policies on internal control are in place and through this Committee seeks assurance that enables it to satisfy itself that the system is functioning effectively, and that the system of internal control is effective in managing risks in the manner which they are approved. Members are required to review the effectiveness of the Corporation's system of internal controls through the Audit Committee, including operational and compliance controls, risk management and the Corporation's internal control arrangements, and to consider and take appropriate action in respect of reports received from the external auditor on matters identified during the course of statutory audit work.

The Corporation views the careful management of risk as a key management activity. Managing business risk to deliver opportunities is a key element of all activities. This is done using a simple and flexible framework that provides a consistent and sustained way of implementing the Corporation's values. These business risks, which may be strategic, operational, or reputation-related, are made known to Members. The business context determines in each situation the level of acceptable risk and controls.

Board and Audit Committee Meetings

The Board usually meets quarterly, and on an ad hoc basis when appropriate. It is responsible, inter alia, for overall corporate strategy, approval of the Corporation's annual budget, major financing arrangements, and ensuring that sound administrative systems and procedures are in place. It reviews monthly the Corporation's operating results, and the progress made towards annual targets. With the position of Chief Executive Officer being left vacant from December 2007, the Board has delegated to the Chief Officer the authority for the management of day-to-day operations.

There were four Board and three Audit Committee Meetings held during the year up to 31 December 2012 and attended by Members as listed in the following table.

	Board Meetings	Audit Committee Meetings
Professor K C Chan (Note 1)	4	N.A.
Ms Eva Cheng (Note 2)	1	N.A.
Professor Anthony Cheung Bing-leung (Note 2)	2	N.A.
Mr Stanley Y H Ying (Note 3)	1	1
Ms Elizabeth Tse Man-yee (Note 3)	3	1
Mr Francis Ho Suen-wai (Note 4)	0	N.A.
Mr Joseph Lai Yee-tak (Note 4)	2	N.A.
Miss Cathy Chu (Note 5)	1	2
Ms Mable Chan (Note 5)	3	1
Mrs Lesley Y C Wong (Note 6)	4	3

Note 1. Chairman of the Board

Note 2. On 1 July 2012, Ms Eva Cheng ceased to be Secretary for Transport and Housing, and Professor Anthony Cheung Bing-leung has since taken up the post

Note 3. On 25 July 2012, Mr Stanley Y H Ying ceased to be Permanent Secretary for Financial Services and the Treasury (Treasury), and Ms Elizabeth Tse Man-yee has since taken up the post

Note 4. On 28 May 2012, Mr Francis Ho Suen-wai ceased to be Permanent Secretary for Transport and Housing (Transport), and Mr Joseph Lai Yee-tak has since taken up the post

Note 5. On 19 June 2012, Miss Cathy Chu ceased to be Deputy Secretary for Financial Services and the Treasury (Treasury). The post has since been taken up by Ms Tsang Oi-lin (19 June to 22 July 2012), and subsequently by Ms Mable Chan (from 23 July 2012)

Note 6. Chairperson of the Audit Committee

In 2012, a total of 55 decision and information papers were considered by Board Members.

Audit Committee

During the year, the Audit Committee comprised Mrs Lesley Y C Wong (Chairperson), Mr Stanley Y H Ying (up to 24 July 2012), Ms Elizabeth Tse Man-yee (from 25 July 2012), Miss Cathy Chu (up to 18 June 2012), Ms Tsang Oi-lin (from 19 June 2012 to 22 July 2012), and Ms Mable Chan (from 23 July 2012). All members of the Committee are non-executive Members. The Committee has at least one member possessing "recent and relevant experience", namely, Mrs Lesley Y C Wong, who is a certified public accountant and is also the Director of Accounting Services of the Government of the Hong Kong Special Administrative Region.

Under its terms of reference, the Audit Committee monitors the integrity of the financial statements and any formal announcements relating to the Corporation's performance. The Committee is responsible for monitoring the effectiveness of the external audit process and making recommendations to the Board in relation to the appointment, reappointment and remuneration of the external auditor. It is responsible for ensuring that an appropriate relationship between the Corporation and the external auditor is maintained, including reviewing non-audit services and fees. It also monitors the effectiveness of the Corporation's systems of internal control and the processes for monitoring and evaluating the risks facing the Corporation. The Committee reviews the effectiveness of the internal audit function, which is currently provided by the internal audit department of the MTR Corporation Limited under an outsourcing arrangement, and is responsible for recommending to the Managing Board the renewal and termination of that outsourced service function. The Committee has undertaken to review its terms of reference at least once every three years and its effectiveness and, if appropriate, will recommend to the Board any changes required as a result of the review.

The Committee meets with Management, as well as privately with both the external and internal auditors. The Committee's terms of reference are available from the Company Secretary and are displayed on the Corporation's website, www.kcrc.com. In 2012 the Audit Committee discharged its responsibilities by:

(a) reviewing the Corporation's draft financial statements prior to Board approval;

(b) reviewing the external auditor's report thereon;

(c) reviewing the appropriateness of the Corporation's accounting policies;

(d) reviewing the potential impact of the generally accepted accounting principles in Hong Kong on the Corporation's financial statements;

(e) reviewing, recommending or pre-approving audit fees or non-audit fees;

(f) reviewing the external auditor's plan for the audit of the Corporation's financial statements; and

(g) approving the annual internal audit plan and reviewing reports on the adequacy and effectiveness of systems of internal control, financial reporting and risk management.

The Audit Committee has taken on responsibility for monitoring the Corporation's whistle blowing procedures, which ensure that appropriate arrangements are in place for employees to be able to raise matters of possible impropriety in confidence, with suitable subsequent follow-up action.

Auditor's Independence and Objectivity

The Audit Committee monitors regularly and closely the non-audit services being provided to the Corporation and its subsidiary companies by its external auditor, who is appointed by the Chief Executive of the Hong Kong Special Administrative Region, to ensure that the provision of such services does not impair the external auditor's independence or objectivity. If and when appropriate the Committee will engage the services of alternative, appropriately qualified accounting firms to undertake non-audit services. When considering any non-audit work to be undertaken by the external auditor, the Committee is mindful of the need to be satisfied that the external auditor should not audit its own work, make management decisions for the Corporation or its subsidiaries, have a mutuality of financial interest with the Corporation or its subsidiaries, or be put in the role of advocate for the Corporation or its subsidiaries. The Committee also takes into consideration relevant professional and regulatory requirements so that these are not impaired by the provision of permissible non-audit services by the external auditor. Prior approval by the Audit Committee is required for any services provided by the external auditor. Any activities that may be perceived to be in conflict with the role of the external auditor must be submitted to the Committee for its consideration and approval prior to engagement. Details of the amounts paid to the external auditor during the year for audit and other services are set out in Note 7 (a) to the Financial Statements.

Report of The Members of The Managing Board

The Members of the Managing Board have pleasure in submitting herewith their report and audited financial statements for the financial year ended 31 December 2012.

Kowloon-Canton Railway Corporation Ordinance

The Kowloon-Canton Railway Corporation Ordinance (the KCRC Ordinance), enacted in 1982, established the Corporation and empowered it to operate the Kowloon-Canton Railway. Amendments in 1986 and 1998 empowered the Corporation to construct and operate Light Rail and new railways, and enabled the Government to inject equity into the Corporation to fund the construction of such new railways. Inter alia, the KCRC Ordinance contains provisions covering the appointments and roles of the Members of the Managing Board.

An amendment of the KCRC Ordinance in December 2001 provided for the separation of the functions and duties of the Chairman from those of the Chief Executive by creating the office of Chief Executive Officer of the Corporation. The Chief Executive Officer was also appointed as a Member of the Managing Board.

On 2 December 2007, following the enactment of the Rail Merger Ordinance, the MTR Corporation Limited commenced operating KCRC's railway assets by way of a service concession for an initial period of 50 years, which is extendable. KCRC retains ownership of the railway assets covered in the service concession agreement and should the MTR Corporation Limited fail to observe the terms of the agreement, there is provision for KCRC to take back and operate its assets. The Rail Merger Ordinance also made provision for the position of Chief Executive Officer to be left vacant, which the Managing Board agreed should be the case from 2 December 2007. Instead the Corporation appointed a Chief Officer, who is not a Member of the Managing Board, to head the executive management team.

Principal Activities of the Corporation

The principal activities of the Corporation are –

- railway asset holder, with responsibility for monitoring that the MTR Corporation Limited complies with the terms of the service concession agreement
- investing the annual payments from the MTR Corporation Limited
- servicing the Corporation's outstanding debts
- managing its subsidiaries

The principal activities of the subsidiary companies incorporated to facilitate the undertaking of the above activities are set out in Note 17 to the Financial Statements.

The Managing Board

The Board is the governing body of the Corporation with authority to exercise the duties conferred upon it by the KCRC Ordinance.

Members of the Board are all public officers (appointed ex-officio), being –

- Secretary for Financial Services and the Treasury, Professor K C Chan (Chairman);
- Secretary for Transport and Housing, Ms Eva Cheng, (up to 30 June 2012), and Professor Anthony Cheung Bing-leung (from 1 July 2012);

- Permanent Secretary for Financial Services and the Treasury (Treasury), Mr Stanley Y H Ying (up to 24 July 2012), and Ms Elizabeth Tse Man-yee (from 25 July 2012);
- Permanent Secretary for Transport and Housing (Transport), Mr Francis Ho Suen-wai (up to 27 May 2012), and Mr Joseph Lai Yee-tak (from 28 May 2012);
- Deputy Secretary for Financial Services and the Treasury (Treasury), Miss Cathy Chu, (up to 18 June 2012), Ms Tsang Oi-lin (from 19 June 2012 to 22 July 2012), and Ms Mable Chan (from 23 July 2012); and
- Director of Accounting Services, Mrs Lesley Y C Wong

Brief biographical details of Board Members are set out on pages 2 and 3.

Long-Term Planning, Business Planning and Financial Management Framework

Business plans, incorporating triennial forecasts of income and expenditure, are prepared each year for submission to the Managing Board. The first year of the Business Plan forms the basis for formulating the Budget for that year.

There are defined procedures and regular quality reviews of the operation of the Corporation's computerised systems to ensure the accuracy and completeness of financial records and the efficiency of data processing. There are defined procedures for the appraisal, review and approval of all major capital projects, and all major expenditure and revenue contracts. All contracts over HK$50 million and all consultancy services over HK$10 million require the approval of the Managing Board. Operating and financial reports, comparing results against their respective budgets and providing updates on significant events, are put to and considered by the Managing Board on a monthly basis.

Corporate Governance

As set out in the Corporate Governance Report, the Managing Board maintains high standards of corporate governance.

Interests in Contracts of Members of the Managing Board and Senior Executive Staff

No contracts of significance to which the Corporation or any of its subsidiaries was a party and in which a Member of the Managing Board, or Senior Executive Staff, had a material interest subsisted at the end of the year or at any time during the year.

At no time during the year was the Corporation or any of its subsidiaries a party to any arrangements to enable Members of the Managing Board, or Senior Executive Staff, to acquire benefits by means of the acquisition of shares in or debt securities of the Corporation or subsidiaries of the Corporation.

Financial Statements

The results of the Group for the year ended 31 December 2012 and the state of the Corporation's and the Group's affairs at that date are set out in the Financial Statements on pages 20 to 82.

Fixed Assets

Movements in fixed assets during the year are set out in Note 14 to the Financial Statements.

Share Capital

Details of the Corporation's share capital are set out in Note 27 to the Financial Statements. Any further contributions of capital will be determined by the Government in consultation with the Corporation.

Dividend

No dividend to the Government is proposed.

Interest and Finance Income/Expenses

Details of the Corporation's interest and finance income/expenses are set out in Note 9 to the Financial Statements.

Interest-Bearing Borrowings

Details of the Corporation's interest-bearing borrowings are set out in Note 25 to the Financial Statements.

Turnover, Financial Results and Financial Position

Details of the Corporation's turnover, financial results and financial position are set out in the Financial Statements, the Chief Officer's Statement and Financial Review, and the Five-Year Statistics of the Annual Report.

Going Concern

The Financial Statements on pages 20 to 82 have been prepared on a going concern basis. The Managing Board has approved the Corporation's budget for 2013 and is satisfied that the Corporation can operate in a viable manner for the foreseeable future.

Responsibility for the Financial Statements

The KCRC Ordinance requires the Corporation to produce financial statements. In doing so, the Corporation complies with International Financial Reporting Standards issued by the International Accounting Standards Board, Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong, the applicable disclosure requirements of the Hong Kong Companies Ordinance, and produces financial statements that give a true and fair view of the Corporation's financial results and position for the financial year to which they relate.

Auditor

In accordance with section 14B (4) of the KCRC Ordinance, KPMG were appointed as the auditor by the Chief Executive of the Hong Kong Special Administrative Region.

By order of the Managing Board

Michael J Arnold
Company Secretary
15 April 2013

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Independent auditor's report to the members of the Managing Board of the Kowloon-Canton Railway Corporation

We have audited the consolidated financial statements of the Kowloon-Canton Railway Corporation ("the Corporation") and its subsidiaries (together "the Group") set out on pages 20 to 82, which comprise the consolidated and the Corporation balance sheets as at 31 December 2012, 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 a summary of significant accounting policies and other explanatory information.

Board Members' responsibilities for the consolidated financial statements

The Board Members of the Corporation are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board, Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Kowloon-Canton Railway Corporation Ordinance and for such internal control as the Board Members determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 14B(3) of the Kowloon-Canton Railway Corporation 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.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation of the consolidated financial statements that give a true and fair view 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 Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board Members, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Corporation and of the Group as at 31 December 2012 and of the Group's loss and cash flows for the year then ended in accordance with International Financial Reporting Standards and Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the applicable disclosure requirements of the Hong Kong Companies Ordinance.

KPMG
Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong
15 April 2013

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2012 (Expressed in Hong Kong dollars)

	Note	2012 $ million	2011 $ million
Turnover	5	2,066	1,675
Operating costs before depreciation, amortisation and impairment	6	(31)	(34)
Operating profit before depreciation, amortisation and impairment	7	2,035	1,641
Depreciation and amortisation	8	(3,124)	(2,980)
Loss on disposal of fixed assets		(22)	(29)
Operating loss after depreciation, amortisation and impairment		(1,111)	(1,368)
Interest and finance income	9(a)	268	232
Interest and finance expenses	9(b)	(606)	(608)
Share of profit of associate		81	70
Loss before unrealised gains/losses		(1,368)	(1,674)
Net (losses)/gains on changes in fair value of financial instruments	10	(153)	152
Loss before taxation		(1,521)	(1,522)
Income tax	11(a)	271	1,071
Loss and total comprehensive income for the year wholly attributable to the sole shareholder of the Corporation	12	(1,250)	(451)

The notes on pages 25 to 82 form part of these financial statements.

Consolidated Balance Sheet

at 31 December 2012 (Expressed in Hong Kong dollars)

	Note	2012 $ million	2011 $ million
Assets			
Fixed assets	14(a)	64,638	66,979
Interest in leasehold land held for own use under operating leases	14(a)	4,622	4,683
Construction in progress	15	798	631
Deferred expenditure	16	1,188	1,188
Interest in associate	18	167	223
Loan to non-controlled subsidiary	19	–	4,405
Derivative financial assets	28(e)	317	487
Other financial assets	20	550	–
Interest and other receivables	21	1,024	1,314
Cash and cash equivalents	22	6,619	1,410
		79,923	81,320
Liabilities			
Interest and other payables	23	141	137
Accrued charges and provisions for capital projects	24	317	423
Derivative financial liabilities	28(e)	2	–
Interest-bearing borrowings	25	14,769	15,097
Deferred income	26	6,800	6,248
Deferred tax liabilities	11(c)	1,033	1,304
		23,062	23,209
Net Assets		56,861	58,111
Capital and Reserves			
Share capital	27(b)	39,120	39,120
Reserves		17,741	18,991
Total equity		56,861	58,111

Approved and authorised for issue by the Managing Board on 15 April 2013

Professor K C Chan
Professor Anthony Cheung Bing-leung
Members of the Managing Board

Edmund K. H. Leung
Chief Officer

The notes on pages 25 to 82 form part of these financial statements.

Corporation Balance Sheet

at 31 December 2012 (Expressed in Hong Kong dollars)

	Note	2012 $ million	2011 $ million
Assets			
Fixed assets	14(a)	64,638	66,979
Interest in leasehold land held for own use under operating leases	14(a)	4,622	4,683
Construction in progress	15	798	631
Deferred expenditure	16	1,188	1,188
Interest in associate	18	9	9
Loan to non-controlled subsidiary	19	–	4,405
Derivative financial assets	28(e)	317	487
Other financial assets	20	550	–
Interest and other receivables	21	1,024	1,314
Cash and cash equivalents	22	6,619	1,410
		79,765	81,106
Liabilities			
Interest and other payables	23	141	137
Accrued charges and provisions for capital projects	24	317	423
Derivative financial liabilities	28(e)	2	–
Interest-bearing borrowings	25	14,769	15,097
Deferred income	26	6,800	6,248
Deferred tax liabilities	11(c)	1,033	1,304
		23,062	23,209
Net Assets		56,703	57,897
Capital and Reserves			
Share capital	27(b)	39,120	39,120
Reserves	27(a)	17,583	18,777
Total equity		56,703	57,897

Approved and authorised for issue by the Managing Board on 15 April 2013

Professor K C Chan
Professor Anthony Cheung Bing-leung
Members of the Managing Board

Edmund K. H. Leung
Chief Officer

The notes on pages 25 to 82 form part of these financial statements.

Consolidated Statement of Changes in Equity

for the year ended 31 December 2012 (Expressed in Hong Kong dollars)

	Share capital $ million	Retained profits $ million	Total equity $ million
Balance at 1 January 2011	39,120	19,442	58,562
Changes in equity for 2011:			
Loss for the year	–	(451)	(451)
Total comprehensive income for the year	–	(451)	(451)
Balance at 31 December 2011 and 1 January 2012	**39,120**	**18,991**	**58,111**
Changes in equity for 2012:			
Loss for the year	**–**	**(1,250)**	**(1,250)**
Total comprehensive income for the year	**–**	**(1,250)**	**(1,250)**
Balance at 31 December 2012	**39,120**	**17,741**	**56,861**

The notes on pages 25 to 82 form part of these financial statements.

Consolidated Cash Flow Statement

for the year ended 31 December 2012 (Expressed in Hong Kong dollars)

	Note	2012 $ million	2011 $ million
Operating activities			
Net cash inflow from operations	29	2,036	768
Investing activities			
Increase in deposits with banks with more than three months to maturity when placed		(2,043)	–
Payments for capital expenditure		(152)	(134)
Interest received		64	24
Payment for purchase of other financial assets		(548)	–
Receipt of loan to non-controlled subsidiary		4,405	–
Dividend received from associate		137	55
Receipts on disposal of investments		–	432
Net cash inflow from investing activities		1,863	377
Net cash inflow before financing activities		3,899	1,145
Financing activities			
Net cash flows on repayment of loans		(300)	–
Interest paid		(594)	(600)
Net cash inflow relating to derivative financial instruments		164	158
Finance expenses paid		(3)	(3)
Net cash outflow from financing activities		(733)	(445)
Net increase in cash and cash equivalents		3,166	700
Cash and cash equivalents at 1 January		1,410	710
Cash and cash equivalents at 31 December		4,576	1,410
Analysis of the balances of cash and cash equivalents			
Cash and cash equivalents in the consolidated balance sheet		6,619	1,410
Less: deposits with banks with more than three months to maturity when placed		(2,043)	–
Cash and cash equivalents in the consolidated cash flow statement	22	4,576	1,410

The notes on pages 25 to 82 form part of these financial statements.

Notes to the Financial Statements

(Expressed in Hong Kong dollars)

1 Establishment of the Corporation

The Kowloon-Canton Railway Corporation ("the Corporation") was incorporated in Hong Kong under the Kowloon-Canton Railway Corporation Ordinance ("the Ordinance") on 24 December 1982 to undertake the operation of the Hong Kong section of the Kowloon-Canton Railway. The assets, rights and liabilities of the then existing railway were vested in the Corporation on 1 February 1983 in accordance with Section 7 of the Ordinance.

On 8 June 2007, the Legislative Council passed the Rail Merger Bill. Following agreement by the respective parties to the detailed merger transaction terms, the Rail Merger took place on 2 December 2007 (the "Appointed Day"). The Chief Executive of the HKSAR appointed six public officers as members of the Managing Board with effect from the Appointed Day. As provided for under the amendments made to the Ordinance by the Rail Merger Bill, the position of Chief Executive Officer has been left vacant, with a Chief Officer, who is not a member of the Managing Board, being appointed by the Board to be responsible for managing the day-to-day business of the Corporation.

2 Rail Merger with MTR Corporation Limited ("MTRCL")

The Rail Merger Ordinance permitted the granting of a long-term service concession (the "Service Concession") in respect of the Corporation's rail and bus operations and the sale of certain rail-related assets (the "Purchased Rail Assets"), certain subsidiaries and property-related rights and interests of the Corporation, to MTRCL.

Since the Appointed Day, the Corporation has been responsible for monitoring MTRCL's compliance with its obligations under the merger transaction, including revenue sharing, annual payments and the specified day-to-day activities of the Corporation outsourced to MTRCL. The Corporation, besides meeting its obligations under the merger transaction, retains responsibility for the management and financing of its debts, for investing any available funds and for managing its remaining subsidiaries and other assets excluded from the merger transaction (the "Excluded Assets").

Service Concession

The Service Concession grants MTRCL the right to operate the Corporation's existing railway lines (including the Kowloon Southern Link which was completed in August 2009) and other rail-related businesses ("concession assets") for a period of 50 years (the "Concession Period"). Under the Service Concession, MTRCL receives all revenues generated from the operation of the Corporation's rail network and other rail-related businesses. During the Concession Period, except for projects retained by the Corporation as specified under the Merger Framework Agreement, MTRCL is responsible for the daily operations and maintenance of the transport operations and will fund all related operating capital expenditure, including the improvement and replacement of the Corporation's railway network assets. The Corporation does not have responsibility for any railway or bus operations during the Concession Period.

2 Rail Merger with MTR Corporation Limited ("MTRCL") (continued)

Service Concession (continued)

In consideration for the Service Concession, MTRCL agreed to make a fixed annual payment of $750 million and commencing after the first 36 months, an additional variable annual payment based on revenue generated above the first $2.5 billion from the operation of the Corporation's rail network and other rail-related businesses during each financial year of MTRCL. The variable payments are computed at 10% of such revenue between $2.5 billion and $5 billion; 15% of such revenue between $5 billion and $7.5 billion; and 35% of such revenue above $7.5 billion.

The Corporation's role during the Concession Period essentially comprises the following duties:

(i) acting as the grantor of the Service Concession to MTRCL, monitoring the compliance of MTRCL with the terms of the Service Concession and receiving concession payments from MTRCL;

(ii) holding legal and beneficial title to all assets not forming part of the sale to MTRCL, such as the initial concession assets, which are defined as the physical assets including the Corporation's railway land required for the operation of the Corporation's railway system which were capitalised by the Corporation immediately prior to the Appointed Day, the Corporation's shares in the associate and the Excluded Assets; and

(iii) acting as the borrower and obligor in relation to the Corporation's existing financial obligations and contingent liabilities.

Should the Corporation undertake any new railway projects during the Concession Period, these would be subject to a service concession granted by the Corporation in favour of MTRCL, with the parties entering into a Supplemental Service Concession Agreement.

3 Significant accounting policies

(a) Statement of compliance

Although not required to do so under the Ordinance, the Corporation has prepared these financial statements in accordance with all applicable International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB"). These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and the Hong Kong Companies Ordinance. These financial statements have also been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and accounting principles generally accepted in Hong Kong. A summary of the significant accounting policies adopted by the Corporation and its controlled subsidiaries (the "Group") is set out below.

The IASB has issued certain new and revised IFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Corporation. The equivalent new and revised HKFRSs consequently issued by HKICPA have the same effective date as those issued by the IASB and are in all material respects identical to the pronouncements issued by the IASB. Note 4 provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group and the Corporation for the current and prior accounting periods reflected in these financial statements.

(b) Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements is the historical cost basis except where stated otherwise in the accounting policies set out below.

The preparation of financial statements in conformity with IFRSs and HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements with significant effect on the financial statements and major sources of estimation uncertainty are discussed in note 36.

3 Significant accounting policies (continued)

(c) Basis of consolidation

The consolidated financial statements comprise the Corporation and its controlled subsidiaries and the Group's interest in associate made up to 31 December each year.

The financial statements of certain subsidiaries held by the Corporation for the sole purpose of developing, on behalf of the Government of the HKSAR ("the Government"), commercial or residential properties along the West Rail, Phase I route are excluded from consolidation on the basis that these are not considered to be controlled subsidiaries as the Corporation has no effective control over nor beneficial interests in the net assets of these subsidiaries, other than the amount of capital provided. The Corporation is not entitled to any earnings distribution, nor is it required to ultimately fund any losses which may be sustained by these subsidiaries.

Furthermore, the financial statements of the Metropolis Management Company Limited ("MMC"), which was established for the sole purpose of rendering property management services to a commercial property, are also excluded from consolidation on the basis that, under the Equity Sub-participation Agreement which formed part of the merger transaction, the Corporation is obliged to act on MTRCL's instructions in respect of the exercise of any and all rights the Corporation has as a shareholder of MMC. All the beneficial interests to which the Corporation was previously entitled now rest with MTRCL although there has been no direct disposition of the shares of MMC to MTRCL.

(d) Investments in subsidiaries

Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a controlled subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. An investment in a non-controlled subsidiary is excluded from consolidation and is stated at cost less impairment losses, if any, in the Group's and the Corporation's balance sheets.

Intra-group balances and transactions and any unrealised profits arising from intra-group transactions with controlled subsidiaries are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions with controlled subsidiaries are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

In the Corporation's balance sheet, an investment in a controlled subsidiary is stated at cost less impairment losses, if any.

3 Significant accounting policies (continued)

(e) Interest in associate

An associate is an entity in which the Group or the Corporation has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

An investment in an associate is accounted for in the Group's consolidated financial statements under the equity method and is initially recorded at cost, adjusted for any excess of the Group's share of the acquisition-date fair values of the associate's identifiable net assets over the cost of the investment (if any). Thereafter, the investment is adjusted for the post acquisition change in the Group's share of the associate's net assets and any impairment loss relating to the investment (see note 3(l)). The Group's share of the post-acquisition post-tax results of an associate and any impairment losses for the year are recognised in profit or loss, whereas the Group's share of the post-acquisition post-tax items of an associate's other comprehensive income is recognised in other comprehensive income.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associate, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

When the Group ceases to have significant influence over an associate, it is accounted for as a disposal of the entire interest in that associate, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former associate at the date when significant influence is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset.

In the Corporation's balance sheet, an investment in an associate is stated at cost less impairment losses, if any.

The results of the associates are included in the Corporation's statement of comprehensive income to the extent of dividends received and receivable, providing the dividend in respect of a period ending on or before the Corporation's financial year and the Corporation's right to receive the dividend is established before the balance sheet date.

3 Significant accounting policies (continued)

(f) Investments in debt securities

The Group's and the Corporation's policies for investments in debt securities, other than investments in subsidiaries and associates, are as follows.

Investments in debt securities are initially stated at fair value, which is their transaction price unless fair value can be more reliably estimated using valuation techniques whose variables include only data from observable markets. These investments are subsequently accounted for as follows:

– dated debt securities that the Group and the Corporation have the positive ability and intention to hold to maturity are classified as held-to-maturity securities. Held-to-maturity securities are stated at amortised cost less impairment, if any.

Investments are recognised/derecognised on the trade date, which is the date the Group commits to purchase/sell the investments or when the investments expire.

(g) Derivative financial assets and liabilities

The Group uses derivative financial instruments to hedge its exposure to currency and interest rate risks arising from operational, financing and investment activities. In accordance with its policies, the Group does not hold or issue derivative financial instruments for trading purposes.

All the Group's derivative financial instruments are recognised initially as derivative financial assets or liabilities at fair value. The fair value of each derivative financial instrument is remeasured at each balance sheet date, with any resultant gain or loss recognised immediately in profit or loss.

– Fair value hedges

  Interest rate swaps are designated as hedges of the variability in the fair value attributable to interest rate risk of certain of the Group's fixed rate interest-bearing borrowings recognised in the financial statements.

  Changes in fair value of interest rate swaps designated as hedging instruments in a fair value hedge are recognised in profit or loss.

  When a hedging relationship ceases to meet the requirements for hedge accounting, any adjustment to the carrying amount of the then hedged item is amortised to the profit or loss over the remaining life of the item based on a recalculated effective interest rate from the date the hedging relationship ceases.

3 Significant accounting policies (continued)

(h) Fixed assets – investment properties

Investment properties comprise land and/or buildings which are owned or held under a leasehold interest to earn rental income and are held for their investment potential.

Investment properties are stated at cost less accumulated depreciation and impairment losses, if any. Depreciation is calculated to write off the cost of investment properties, using the straight-line method over the shorter of the unexpired term of leases and their estimated useful lives.

Gains or losses arising from the retirement or disposal of an investment property are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

(i) Fixed assets – property, plant and equipment

(i) Property, plant and equipment, including those assets which are the subject of the Service Concession with MTRCL, is stated in the balance sheet at cost less accumulated depreciation and impairment losses, if any.

During the Concession Period, MTRCL is responsible for the daily operations and maintenance of the railway operations and will fund all related expenditure including the improvement and replacement of the Corporation's railway network assets. Such expenditure on improvement and replacement of the Corporation's railway network assets is defined as Additional Concession Property ("ACP") pursuant to the Service Concession Agreement. According to the Service Concession Agreement, the ACP will be returned to the Corporation at no cost, together with the initial concession assets acquired by the Corporation, upon the expiry or termination of the Concession Period subject to a threshold of $115.8 billion of cumulative expenditure funded by MTRCL which will be adjusted from time to time pursuant to the provisions of the Service Concession Agreement. As the ACP will be returned together with the initial concession assets acquired by the Corporation before the Rail Merger, the ACP, although funded by MTRCL, is treated in the same way as the initial concession assets and is capitalised in the balance sheet at cost less accumulated depreciation and impairment losses, if any. The cost of ACP that is funded by MTRCL is credited to deferred income and amortised to profit or loss over the shorter of the useful life of the ACP and the remaining Concession Period.

3 Significant accounting policies (continued)

(i) Fixed assets – property, plant and equipment (continued)

Property, plant and equipment relating to rail networks and ancillary commercial activities which is the subject of the Service Concession comprises:

– buildings which are situated on leasehold land being classified as held under operating lease (see note 3(k)); and

– other items of plant and equipment including tunnels, bridges, roads, permanent way, rolling stock and other equipment.

The cost of property, plant and equipment vested by the Government has been determined as follows:

– for property, plant and equipment vested on 1 February 1983 – as determined by the Financial Secretary; and

– for property, plant and equipment vested subsequent to 1 February 1983 – based on actual cost as reflected in the Government's records.

The cost of property, plant and equipment acquired by the Group and ACP funded by MTRCL comprises:

– its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

– any costs, such as the costs of material, direct labour, an appropriate proportion of production overheads and interest and finance income/expenses directly attributable to bringing the asset to the location and condition capable of operating in the manner intended by management.

Expenditure incurred by the Group on property, plant and equipment, which is below $20,000 per item or expected to be fully used within one year, is expensed to profit or loss when incurred.

(ii) Subsequent expenditure on existing property, plant and equipment, for both concession assets and non-concession assets, is added to the carrying amount of the asset if either future economic benefits will flow to the Group or the condition of the asset will improve beyond its originally assessed standard of performance.

Expenditure incurred by the Group on repairs or maintenance of existing property, plant and equipment to restore or maintain the originally assessed standard of performance of the asset is recognised as an expense when incurred.

Expenditure incurred by MTRCL after the Appointed Day on repairs or maintenance of concession assets is borne by MTRCL.

3 Significant accounting policies (continued)

(i) Fixed assets – property, plant and equipment (continued)

(iii) Gains or losses arising from the retirement or disposal of an item of property, plant and equipment, including concession assets, are determined as the difference between the net disposal proceeds attributable to the Group, if any, and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

(j) Depreciation and amortisation

(i) Depreciation for property, plant and equipment is calculated to write off the cost of an item of property, plant and equipment less its estimated residual value, if any, using the straight-line method over its estimated useful life as follows:

	No. of years
Tunnels, bridges and roads (see note 3(j)(iii))	38-64
Buildings (see note 3(j)(iii))	15-50
Rolling stock	2.5-40
Locomotives and wagons	5-35
Lifts and escalators	20-25
Permanent way comprising rails, ballast, sleepers and concrete civil works (see note 3(j)(iii))	10-50
Machinery and equipment	3-45
Telecommunication and signalling systems and air-conditioning plant	3-50
Fare collection systems	5-20
Mobile phone systems	7-15
Tools	10-40
Furniture and fixtures	3-40
Computer and office equipment (including computer software)	3-20
Buses	4-17
Other motor vehicles	4-15

(ii) Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually. The residual value of an asset is the estimated amount that the Group could currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life.

(iii) Tunnels, bridges, roads, concrete civil works and buildings situated on leasehold land are depreciated over the shorter of the unexpired term of the related lease and their estimated useful lives.

3 Significant accounting policies (continued)

(k) Leased assets

(i) Classification of leased assets

Leases of assets under which the lessee assumes substantially all the risks and rewards of ownership are classified as finance leases. Leases of assets under which the lessor has not transferred substantially all the risks and rewards of ownership are classified as operating leases, except that property held under an operating lease that would otherwise meet the definition of an investment property may be classified as an investment property on a property-by-property basis.

(ii) Operating lease charges

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset.

Land lease premiums, land resumption costs and other costs directly associated with the acquisition of leasehold land held for own use under operating leases are amortised on a straight-line basis over the period of the lease term. The cost in relation to leasehold land vested by the Government has been determined as follows:

– vested on 1 February 1983 – as determined by the Financial Secretary; and

– vested subsequent to 1 February 1983 – based on actual cost as reflected in the Government's records or the costs incurred by the Corporation directly associated with the acquisition of leasehold land.

(l) Impairment of assets

(i) Impairment of financial assets

All financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. Objective evidence of impairment includes observable data that comes to the attention of the Group about one or more of the following loss events:

– significant financial difficulties being experienced by a debtor;

– a breach of contract, such as a default or delinquency in interest or principal payments;

– it becomes probable that the debtor will enter bankruptcy or some form of financial reorganisation; and

– significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor.

3 Significant accounting policies (continued)

(l) Impairment of assets (continued)

(i) Impairment of financial assets (continued)

If any such evidence exists, an impairment loss is determined and recognised as follows:

- For interest and other receivables that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material.

- For interest and other receivables and other financial assets carried at amortised cost, an impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (taking into account bad and doubtful debts), discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets), where the effect of discounting is material. This assessment is made collectively where these financial assets share similar risk characteristics, such as similar past due status, and have not been individually assessed as impaired. Future cash flows for financial assets which are assessed for impairment collectively are based on historical loss experience for assets with credit risk characteristics similar to the collective group.

- Impairment losses on interest and other receivables, and other financial assets are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit or loss to the extent that the cumulative impairment loss has been charged to profit or loss.

(ii) Impairment of other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that any assets, other than financial assets, may be impaired or an impairment loss previously recognised no longer exists or may have decreased.

If any such indication exists, the asset's recoverable amount is estimated.

- Calculation of recoverable amount

  The recoverable amount of an asset is the greater of its fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

3 Significant accounting policies (continued)

(l) Impairment of assets (continued)

(ii) Impairment of other assets (continued)

– Recognition of impairment losses

An impairment loss is recognised in profit or loss if the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated to reduce the carrying amount of the assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

– Reversals of impairment losses

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to profit or loss in the year in which the reversals are recognised.

(m) Construction in progress

Assets under construction and capital works for the operating railways are stated at cost incurred by the Corporation (or by MTRCL in the case of ACP) less impairment losses, if any. Costs comprise direct costs of construction, including materials, staff costs and overheads, interest and finance income/expenses and gains or losses arising from changes in fair value of pre-funding investments capitalised during the period of construction or installation and testing. Capitalisation of these costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are interrupted or completed. The assets concerned are transferred to fixed assets when substantially all the activities necessary to prepare the assets for their intended use are completed, at which time the assets begin to be depreciated in accordance with the relevant policies. Land lease premiums, land resumption costs and other related costs incurred by the Corporation for the purpose of acquiring the land on which the new railways or extensions to existing railways are to be operated are initially included in construction in progress. These costs are transferred to interest in leasehold land held for own use under operating leases when the related assets are completed and ready for their intended use at which time the costs begin to be amortised in accordance with the relevant policies.

3 Significant accounting policies (continued)

(m) Construction in progress (continued)

Costs incurred by the Corporation (or MTRCL in the case of ACP) in respect of feasibility studies on proposed railway related construction projects (including consultancy fees, in-house staff costs and overheads) are dealt with as follows:

– where the proposed projects are at a preliminary review stage with no certainty of the proposed project proceeding, the costs concerned are written off to profit or loss as incurred; and

– where the proposed projects are at a detailed study stage, having demonstrated an acceptable financial viability and having obtained the Managing Board's approval to proceed further, the costs concerned are initially dealt with as deferred expenditure and then transferred to construction in progress after the relevant project agreements are reached with the Government.

(n) Deferred expenditure

Deferred expenditure relates to costs incurred for proposed railway related construction projects which will be transferred to construction in progress after the relevant project agreements are reached with the Government. The composition of costs and their capitalisation criteria follow that of construction in progress as set out in note 3(m).

(o) Property development

When the Corporation determines or reaches agreement with property developers to develop a site for resale or for rent, the carrying amount of the leasehold land and existing buildings on the development site are transferred to properties under development. Costs related to the respective projects incurred by the Corporation are also dealt with as properties under development until such time that profit on the development is recognised by the Corporation.

Profits on property development undertaken in conjunction with property developers are recognised in profit or loss as follows:

– where the Corporation receives payments from property developers as a consequence of their participation in a project to develop a property, such payments are set off against the balance in properties under development in respect of that project. Any surplus amounts of payments received from property developers in excess of the balance in properties under development are transferred to deferred income. In such circumstances, further costs subsequently incurred by the Corporation in respect of that project are charged against the related balance of deferred income and any excess is charged to properties under development to the extent it is considered to be recoverable. The balance of deferred income is credited to profit or loss when the property enabling works are completed and acceptable for development and after taking into account the outstanding risks and obligations in connection with the development, if any, retained by the Corporation. The balance of properties under development not previously offset by payments received from property developers is charged to profit or loss where the costs are considered to be irrecoverable, together with provision for losses, if any, borne by the Corporation in respect of the development;

3 Significant accounting policies (continued)

(o) Property development (continued)

– where the Corporation receives a share of profits from the sale of properties, profits are recognised upon the issue of occupation permits provided that the amounts of revenue and related costs can be measured reliably; and

– where the Corporation retains certain assets of the development, profits are measured based on the fair value of such assets and are recognised at the time of receipt after taking into account the costs incurred by the Corporation in respect of the development and the outstanding risks, if any, retained by the Corporation in connection with the development.

(p) Loan to non-controlled subsidiary

Loan to non-controlled subsidiary is a non-derivative financial asset without fixed or determinable repayment terms and is not quoted in an active market. It arose when the Group entered into a shareholding agreement with the Government for the formation of a sub-group of the Corporation under an intermediate holding company, West Rail Property Development Limited ("WRPDL"), to undertake all property developments along the West Rail, Phase I route. Loan to non-controlled subsidiary is initially recognised at fair value, which is equivalent to cost, and thereafter is stated at cost less impairment losses, if any.

(q) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand, demand deposits with banks and other financial institutions and short-term, highly liquid investments. Cash equivalents are readily convertible into known amounts of cash with an insignificant risk of changes in value and have a maturity of less than three months at acquisition.

For the purposes of the consolidated cash flow statement, cash equivalents exclude bank deposits with a maturity of more than three months when placed but include bank overdrafts that are repayable on demand and form an integral part of the Group's cash management.

(r) Interest and other receivables

Interest and other receivables are initially recognised at fair value and thereafter are stated at amortised cost using the effective interest method less impairment losses, if any, except where the present value is not determinable because there is no fixed repayment term. In such cases, interest and other receivables are stated at cost less impairment losses, if any.

3 Significant accounting policies (continued)

(s) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, the unhedged portion of interest-bearing borrowings is stated at amortised cost with any difference between the cost and redemption value being recognised in profit or loss over the period of the borrowings using the effective interest method.

Subsequent to initial recognition, the carrying amount of the portion of interest-bearing borrowings, which is the subject of a fair value hedge, is remeasured and the change in fair value attributable to the risk being hedged is recognised in profit or loss to offset the effect of the gain or loss on the related hedging instrument.

(t) Interest and other payables

Interest and other payables are initially recognised at fair value and thereafter are stated at amortised cost except where the present value is not determinable because there are no fixed payment terms. In such cases, other payables are stated at cost.

(u) Employee benefits

(i) Short term employee benefits and contributions to defined contribution retirement plans

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees.

(ii) Termination benefits

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

(v) Income tax

(i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or direct in equity, respectively.

(ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date and any adjustment to tax payable in respect of previous years.

3 Significant accounting policies (continued)

(v) Income tax (continued)

(iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

All deferred tax assets, to the extent that it is probable that future taxable profits will be available against which the assets can be utilised, are recognised. All deferred tax liabilities are recognised.

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

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

(iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Group or the Corporation has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Group or the Corporation intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  - the same taxable entity; or

  - different taxable entities which intend to realise the current tax assets and settle the current tax liabilities on a net basis in the same period.

3 Significant accounting policies (continued)

(w) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Corporation has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(x) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

(i) Concession income

Different components of concession income are recognised in profit or loss as follows:

- Fixed annual payments of $750 million and variable annual payments based on revenue generated from the operation of the Corporation's rail network and other rail-related businesses are recognised when earned during the Concession Period;

- The upfront payment received less the cost of Purchased Rail Assets for the Service Concession and the assets and liabilities assumed by MTRCL are amortised over the Concession Period on a straight-line basis; and

- ACP funded by MTRCL is recognised as deferred income and amortised over the shorter of its useful life and the remaining Concession Period.

(ii) Interest income

Interest income is recognised as it accrues using the effective interest method.

3 Significant accounting policies (continued)

(x) Revenue recognition (continued)

(iii) Rental income

Rental income receivable under operating leases is recognised in profit or loss in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the use of the leased asset. Lease incentives granted are recognised in profit or loss as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognised as income in the accounting period in which they are earned.

(iv) Other income

Other income is recognised once the related services or goods are delivered and the related risks and rewards of ownership have been transferred.

(y) Lease out and lease back transactions

A series of lease out and lease back transactions with third parties is linked and accounted for as one arrangement when the overall economic effect cannot be understood without reference to the series of transactions as a whole and when the series of transactions is closely interrelated, negotiated as a single arrangement and takes place concurrently or in a continued sequence.

The primary purpose of such arrangements is to achieve a particular tax result for the third parties in return for a fee. The arrangements do not, in substance, involve a lease under IAS 17 and HKAS 17 since the Group retains all the risks and rewards incidental to the ownership of the underlying assets and enjoys substantially the same rights to their use as before the transactions were entered into. The transactions are, therefore, not accounted for as leases.

Where commitments to make long-term lease payments have been defeased by the placement of security deposits or by the advance of loans to third parties, they are not recognised in the balance sheet. Where commitments and deposits or advances of loans to third parties meet the definition of a liability and an asset, they are recognised in the balance sheet.

The income and expenses arising from the arrangements are accounted for on a net basis in order to reflect the overall commercial effect of the transactions. The net amounts are accounted for as deferred income and are amortised over the applicable lease terms of the transactions.

3 Significant accounting policies (continued)

(z) Translation of foreign currencies

Foreign currency transactions during the year are translated into Hong Kong dollars at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the foreign exchange rates ruling at the balance sheet date.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into Hong Kong dollars using the foreign exchange rates ruling at the dates the fair value was determined.

Exchange gains and losses are recognised in profit or loss.

(aa) Interest and finance income/expenses

(i) Interest and finance income includes:

- interest income from bank deposits and investments;
- interest income arising from delayed reimbursement from MTRCL relating to property development enabling works;
- realised gains arising from derivative financial instruments designated as hedges for borrowings;
- net gains on redemption and disposal of investments; and
- net exchange gains arising from foreign currency transactions.

(ii) The Group's interest and finance income arising from non-derivative financial assets are not classified as at fair value through profit or loss, except for those financial assets that include embedded derivatives with economic characteristics and risks different from that of the host contracts.

Interest and finance income is credited to profit or loss in the period in which it is earned.

(iii) Interest and finance expenses include:

- interest payable on borrowings;
- finance expenses including amortisation of discounts/premiums and ancillary costs incurred in connection with the arrangement of borrowings calculated using the effective interest rate;
- realised losses arising from derivative financial instruments designated as hedges for borrowings;
- net realised losses on redemption and disposal of investments; and
- net exchange losses arising from foreign currency transactions.

3 Significant accounting policies (continued)

(aa) Interest and finance income/expenses (continued)

(iv) The Group's interest and finance expenses arising from non-derivative financial liabilities are not classified as at fair value through profit or loss.

Interest and finance expenses are expensed in profit or loss in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

(ab) Related parties

(a) A person, or a close member of that person's family, is related to the Group if that person:

(i) has control or joint control over the Group;

(ii) has significant influence over the Group; or

(iii) is a member of the key management personnel of the Group or the Group's parent.

(b) An entity is related to the Group if any of the following conditions applies:

(i) The entity and the Group are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party.

(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

(v) The entity is a post-employment benefit plan for the benefit of employees of either the Group or an entity related to the Group.

(vi) The entity is controlled or jointly controlled by a person identified in (a).

(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

3 Significant accounting policies (continued)

(ac) Segment reporting

Operating segments, and the amounts of each segment item reported in the financial statements, are identified from the financial information provided regularly to the Group's direct management team for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

4 Changes in accounting policies

The IASB has issued several amendments to IFRSs that are first effective for the current accounting period of the Group and the Corporation. The equivalent revised HKFRSs consequently issued by HKICPA have the same effective date as those issued by the IASB and are in all material respects identical to the pronouncements issued by IASB. Of these, the following development is relevant to the Group's financial statements:

– Amendments to IFRS 7 and HKFRS 7, Financial instruments: Disclosures – Transfers of financial assets

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

The impacts of this development are discussed below:

– Amendments to IFRS 7 and HKFRS 7, Financial instruments: Disclosures

The amendments to IFRS 7 and HKFRS 7 require certain disclosures to be included in the financial statements in respect of transferred financial assets that are not derecognised in their entirety and for any continuing involvement in transferred financial assets that are derecognised in their entirety, irrespective of when the related transfer transaction occurred. However, an entity need not provide the disclosures for the comparative period in the first year of adoption. The Group did not have any significant transfers of financial assets in previous periods or the current period which require disclosure in the current accounting period under the amendments.

5 Turnover

Turnover principally represents revenue from the Service Concession after eliminating inter-company transactions. The amounts of revenue recognised in turnover during the year are as follows:

	2012 $ million	2011 $ million
Service Concession income		
– fixed and variable annual payments	1,633	1,397
– amortisation of upfront payment and net liabilities transferred to MTRCL	83	83
Income relating to ACP funded by MTRCL	176	130
Property services	26	31
Income from lease out and lease back transactions	15	34
Income relating to property development	133	–
	2,066	1,675

6 Operating costs before depreciation, amortisation and impairment

	2012 $ million	2011 $ million
Staff costs	6	6
Government rent and rates	1	1
Cost of services acquired (including services outsourced to MTRCL of $13 million (2011: $16 million))	19	22
Others	5	5
	31	34

7 Operating profit before depreciation, amortisation and impairment

(a) Operating profit before depreciation, amortisation and impairment is arrived at after charging/(crediting):

	2012 $ million	2011 $ million
Auditor's remuneration	2	2
Emoluments of the Chief Officer who is not a Member of the Managing Board	1	1
and after crediting:		
Rentals receivable from operating leases less direct outgoings of $2 million (2011: $1 million) (including contingent rentals of nil (2011: nil))	(24)	(31)

7 Operating profit before depreciation, amortisation and impairment (continued)

(b) Fees for Members of the Managing Board including the Chairman are shown below:

	2012 $'000	2011 $'000
Chairman		
Professor K C Chan in the capacity of Secretary for Financial Services and the Treasury	–	–
Members		
Professor Anthony Cheung Bing-leung in the capacity of Secretary for Transport and Housing#	–	–
Ms Eva Cheng in the capacity of Secretary for Transport and Housing##	–	–
Mr Joseph Lai Yee-tak in the capacity of Permanent Secretary for Transport and Housing (Transport)&	–	–
Mr Francis Ho Suen-wai in the capacity of Permanent Secretary for Transport and Housing (Transport)&&	–	–
Ms Elizabeth Tse Man-yee in the capacity of Permanent Secretary for Financial Services and the Treasury (Treasury)^	–	–
Mr Stanley Y H Ying in the capacity of Permanent Secretary for Financial Services and the Treasury (Treasury)^^	–	–
Ms Mable Chan in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury)@	–	–
Ms Tsang Oi-lin in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury)@@	–	–
Miss Cathy Chu in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury)@@@	–	–
Mrs Lesley Y C Wong in the capacity of Director of Accounting Services*	–	–
Mr K T Li in the capacity of Director of Accounting Services**	–	–
	–	–

Professor Anthony Cheung Bing-leung in the capacity of Secretary for Transport and Housing from 1 July 2012.
Ms Eva Cheng in the capacity of Secretary for Transport and Housing up to 30 June 2012.
& Mr Joseph Lai Yee-tak in the capacity of Permanent Secretary for Transport and Housing (Transport) from 28 May 2012.
&& Mr Francis Ho Suen-wai in the capacity of Permanent Secretary for Transport and Housing (Transport) up to 27 May 2012.
^ Ms Elizabeth Tse Man-yee in the capacity of Permanent Secretary for Financial Services and the Treasury (Treasury) from 25 July 2012.
^^ Mr Stanley Y H Ying in the capacity of Permanent Secretary for Financial Services and the Treasury (Treasury) up to 24 July 2012.
@ Ms Mable Chan in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury) from 23 July 2012.
@@ Ms Tsang Oi-lin in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury) from 19 June 2012 to 22 July 2012.
@@@ Miss Cathy Chu in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury) up to 18 June 2012.
* Mrs Lesley Y C Wong in the capacity of Director of Accounting Services from 20 January 2011.
** Mr K T Li in the capacity of Director of Accounting Services up to 19 January 2011.

7 Operating profit before depreciation, amortisation and impairment (continued)

(c) Emoluments of the Chief Officer who is not a Member of the Managing Board include fixed remuneration which comprises base pay, allowances and gratuities and benefits-in-kind. Details of emoluments are shown below:

	2012 $ million	2011 $ million
Mr James Blake #	1.29	1.36

Mr James Blake was the Chief Officer up to 31 December 2012 and was succeeded by Mr Edmund K. H. Leung as the Chief Officer from 1 January 2013.

The ranges of remuneration set out below include the five highest paid employees of the Corporation.

	No. of employees	
	2012	2011
The remuneration of the highest five employees ranges from		
$2,000,001 – $3,000,000	1	1
$1,000,001 – $2,000,000	2	2
Nil – $1,000,000	2	2

8 Depreciation and amortisation

	2012 $ million	2011 $ million
Depreciation:		
– investment properties	2	3
– other assets	3,009	2,844
	3,011	2,847
Amortisation:		
– amortisation of interest in leasehold land held for own use under operating leases	113	133
	3,124	2,980

9 Interest and finance income/expenses

(a) Interest and finance income

	2012 $ million	2011 $ million
Interest income from deposits	67	14
Interest income from MTRCL relating to property development enabling works	17	21
Interest income from other financial assets	1	16
Interest income from non-derivative financial assets	85	51
Realised gains arising from derivative financial instruments	164	173
Exchange gain (net)	19	8
	268	232

(b) Interest and finance expenses

	2012 $ million	2011 $ million
Interest expenses on loans	603	604
Finance expenses	3	3
Interest and finance expenses on non-derivative financial liabilities	606	607
Realised losses arising from derivative financial instruments	–	1
	606	608

10 Net (losses)/gains on changes in fair value of financial instruments

	2012 $ million	2011 $ million
Net (losses)/gains on derivative financial instruments	(172)	139
Net gains arising from hedged interest – bearing borrowings	19	18
Net unrealised losses on investments designated as at fair value through profit or loss	–	(5)
	(153)	152

11 Income tax

(a) Income tax in the consolidated statement of comprehensive income represents:

	2012 $ million	2011 $ million
Current tax		
Provision for Hong Kong Profits Tax at 16.5% (2011: 16.5%) of the estimated assessable profits for the year	–	–
Deferred tax credit		
Origination and reversal of temporary differences	(271)	(1,071)
	(271)	(1,071)

The Corporation sustained a loss for tax purposes during the year and has accumulated tax losses carried forward of approximately $30,200 million at 31 December 2012 (2011: approximately $28,400 million) which are available to set off against future assessable profits. The tax losses do not expire under current tax legislation.

(b) Reconciliation between tax credit and accounting loss at applicable tax rates:

	2012 $ million	2011 $ million
Loss before taxation	(1,521)	(1,522)
Tax credit on accounting loss before taxation at 16.5% (2011: 16.5%)	(251)	(251)
Tax effect of non-deductible expenses	50	39
Tax effect of non-taxable income	(70)	(53)
Reversal of tax provision made in prior years #	–	(806)
Actual tax credit	(271)	(1,071)

\# Following clarification with the Inland Revenue Department that the gain on sale of certain property development rights under the Rail Merger was capital in nature, a provision of $806 million for taxation related to this gain, made in prior years, was reversed in 2011.

11 Income tax (continued)

(c) Deferred tax assets and liabilities of the Group and the Corporation recognised:

The components of deferred tax (assets)/liabilities of the Group and the Corporation recognised in the Group's and the Corporation's balance sheets and the movements during the year are as follows:

The Group and the Corporation

	Future benefit of tax losses $ million	Depreciation allowances in excess of the related depreciation $ million	Total $ million
At 1 January 2011	(3,555)	5,930	2,375
(Credited)/charged to profit or loss	(1,135)	64	(1,071)
At 31 December 2011	(4,690)	5,994	1,304
At 1 January 2012	**(4,690)**	**5,994**	**1,304**
(Credited)/charged to profit or loss	**(300)**	**29**	**(271)**
At 31 December 2012	**(4,990)**	**6,023**	**1,033**

12 Loss for the year wholly attributable to the sole shareholder of the Corporation

Of the consolidated loss for the year amounting to $1,250 million (2011: $451 million), a loss of $1,194 million (2011: $466 million) has been dealt with in the financial statements of the Corporation.

13 Segment reporting

The Group manages its businesses as a whole as the Service Concession is the only reporting segment and virtually all of the turnover and operating loss is derived from activities in Hong Kong. The financial statements are already presented in a manner consistent with the way in which information is reported internally to the Group's direct management team for the purposes of resource allocation and performance assessment. Accordingly, no business and geographical segment information is disclosed in accordance with IFRS 8 and HKFRS 8.

14 Fixed assets and interest in leasehold land held for own use under operating leases

(a) The Group and the Corporation

	Fixed assets						
	Investment properties $ million	Tunnels, bridges, roads and permanent way $ million	Buildings $ million	Rolling stock $ million	Other equipment $ million	Total $ million	Interest in leasehold land held for own use $ million
Cost:							
At 1 January 2011	70	28,990	31,044	11,217	19,744	91,065	6,599
Transfer from construction in progress	–	56	87	204	211	558	–
Additions/(reversal of over-accruals)	–	2	(1)	12	(9)	4	(823)
Purchase of ACP by MTRCL	–	–	–	–	33	33	–
Disposals	–	(22)	(1)	(55)	(42)	(120)	–
Reclassifications	–	13	(70)	25	31	(1)	1
At 31 December 2011	70	29,039	31,059	11,403	19,968	91,539	5,777
At 1 January 2012	70	29,039	31,059	11,403	19,968	91,539	5,777
Transfer from construction in progress	–	64	14	171	473	722	–
Additions	–	–	–	–	3	3	–
Purchase of ACP by MTRCL	–	–	–	–	19	19	–
Disposals	–	(25)	(1)	(39)	(86)	(151)	–
Reclassifications	–	(11)	(34)	–	(7)	(52)	52
At 31 December 2012	70	29,067	31,038	11,535	20,370	92,080	5,829
Accumulated depreciation, amortisation and impairment:							
At 1 January 2011	34	3,767	4,957	4,041	9,005	21,804	961
Charge for the year	3	687	764	403	990	2,847	133
Written back on disposals	–	(11)	–	(42)	(38)	(91)	–
Reclassifications	–	1	(5)	2	2	–	–
At 31 December 2011	37	4,444	5,716	4,404	9,959	24,560	1,094
At 1 January 2012	37	4,444	5,716	4,404	9,959	24,560	1,094
Charge for the year	2	691	764	590	964	3,011	113
Written back on disposals	–	(13)	–	(35)	(81)	(129)	–
At 31 December 2012	39	5,122	6,480	4,959	10,842	27,442	1,207
Carrying amounts:							
At 31 December 2012	31	23,945	24,558	6,576	9,528	64,638	4,622
At 31 December 2011	33	24,595	25,343	6,999	10,009	66,979	4,683

14 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

(b) Permanent way principally comprises the cost of rail tracks, sleepers, track base and ballast.

(c) Other equipment comprises lifts and escalators, telecommunication and signalling systems, machinery, furniture and fixtures, motor vehicles and computer and office equipment.

(d) The minimum total future amounts receivable by the Group and the Corporation under non-cancellable operating leases are expected to be received as follows:

	2012 $ million	2011 $ million
Within one year	19	22
After one year but within five years	23	13
After five years	3	–
	45	35

(e) The Group and the Corporation have previously entered into a number of individually structured transactions or arrangements with unrelated parties to lease out and lease back assets which include rolling stock, signalling equipment, revenue collection equipment and railway infrastructure. Under each arrangement, the Group and the Corporation have leased the assets to an overseas investor, who has prepaid all the rentals in relation to a lease agreement. Simultaneously, the Group and the Corporation have leased the assets back from the overseas investor and the commitments to make long-term lease payments as set out in pre-determined schedules have been defeased by the placement of security deposits or by the advance of loans to third parties that are not recognised in the balance sheet (see note 3(y)). The Group and the Corporation have an option to purchase the overseas investor's leasehold interest in the assets at a pre-determined date for a fixed or agreed amount and it is the intention of the Group and the Corporation to exercise such purchase options. As long as the Group and the Corporation comply with the requirements of the lease agreements, the Group and the Corporation will continue to be entitled to quiet enjoyment of and continued possession, use or operation of the assets subject to these arrangements. The arrangements have been entered into with investors in the United States.

14 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

(e) As at 31 December 2012, a portion of the Group's and the Corporation's assets (including assets replaced during the lease periods) with a total cost of $9,011 million (2011: $8,898 million) and net book value of $3,359 million (2011: $3,635 million) is covered by seven arrangements (2011: seven arrangements). Four arrangements involve rolling stock, with basic lease terms of 17 to 28 years. Two arrangements, one involving signalling equipment and the other involving the revenue collection system, have a basic lease term of 15 years. The remaining arrangement involving railway infrastructure has basic lease terms of between 24 years and 27 years. Since the Group and the Corporation retain risks and rewards incidental to ownership of the underlying assets in respect of each arrangement and enjoy substantially the same rights to their use as before the arrangements were entered into, no adjustment has been made to fixed assets. As a result of these arrangements, the Group and the Corporation have received cash of $8,878 million at the inception of the arrangements. Assuming exercise of the purchase option in each arrangement, the obligations to make long-term lease payments over the duration of the relevant leases by the Group and the Corporation are expected to be funded by the proceeds to be generated from existing deposits and investments, which are not recognised in the balance sheet, over the relevant lease periods. The total estimated net present value of these obligations at the inception of the arrangements amounted to $8,414 million.

The total net amounts of cash received by the Group and the Corporation from the arrangements have been recorded as deferred income and are being amortised to profit or loss over the applicable lease terms of the arrangements.

Under these lease arrangements, letters of credit were arranged by the Group and the Corporation to secure the lease obligations. During the year, a letter of credit arranged under one of the seven lease arrangements expired and the Group and the Corporation acquired other financial assets as replacement to pledge against the lease obligations (see note 20).

(f) In compliance with IAS 16 and HKAS 16 which require an annual review of the estimated useful lives of fixed assets, a review of the estimated useful lives of all major fixed asset categories was undertaken by in-house engineers of MTRCL during the year. As a result, the depreciation charge for the year increased by $134 million.

14 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

(g) The carrying value of the Group's and the Corporation's interest in leasehold land held in Hong Kong is $4,622 million (2011: $4,664 million) under medium-term leases (less than 50 years) and nil (2011: $19 million) under long-term leases (50 years or above).

(h) During 2009, the Corporation reclassified certain floors of Citylink Plaza at Sha Tin Station, which are leased out under operating leases, from held for own use to investment property as a result of a change in the terms of the land grant. The revised land grant allows the Corporation to sell these floors separately from the railway network on which Citylink Plaza is situated. At 31 December 2012, the fair value of investment properties as assessed by management amounted to $1,703 million (2011: $1,732 million), which was estimated with reference to recent average transaction prices of properties with comparable rental value.

15 Construction in progress

Construction in progress comprises:

The Group and the Corporation

	2012 $ million	2011 $ million
Balance at 1 January	**631**	525
Costs incurred during the year	**40**	50
Purchase of ACP by MTRCL	**849**	614
Transfer to fixed assets or leasehold land	**(722)**	(558)
Balance at 31 December	**798**	631

16 Deferred expenditure

(a) Deferred expenditure comprises:

The Group and the Corporation

	2012 $ million	2011 $ million
Shatin to Central Link		
Balance at 1 January and 31 December	**1,188**	1,188

(b) The Government has indicated that the Shatin to Central Link ("the SCL"), upon completion, is likely to be vested in the Corporation and operated by MTRCL through an additional or supplemental service concession arrangement. A suitable arrangement of vesting the SCL in the Corporation will be made in due course with Government policy approval properly sought. Although the final details of the arrangement are subject to Government policy approval as noted above, management are confident that the recovery of the costs incurred to date by the Corporation on the SCL will be achieved over the duration of the additional or supplemental service concession arrangement with MTRCL.

(c) As at 31 December 2012, land related costs totalling approximately $6 million (2011: $6 million) directly associated with the acquisition of leasehold land for the purpose of the SCL are included in the balance of deferred expenditure. These costs will be transferred to interest in leasehold land when the land is vested in the Corporation by the Government, at which time the costs will begin to be amortised in accordance with the relevant policies.

17 Investments in subsidiaries

	Corporation	
	2012 $ million	2011 $ million
Unlisted shares, at cost	**–**	–

17 Investments in subsidiaries (continued)

Details of the subsidiaries listed by principal activities are as follows:

Name of company	Place of incorporation and operation	Number of issued and fully paid ordinary shares	Par value of each share	Percentage of shares held by the Corporation
Asset Leasing				
Buoyant Asset Limited	Hong Kong	100	$10	100%
Advanced Asset Limited	Hong Kong	100	$10	100%
Quality Asset Limited	Hong Kong	100	$10	100%
Kasey Asset Limited	Hong Kong	100	$10	100%
Circuit Asset Limited @	Hong Kong	100	$10	100%
Shining Asset Limited	Hong Kong	100	$10	100%
Fluent Asset Limited	Hong Kong	100	$10	100%
Bowman Asset Limited	Cayman Islands	1,000	US$1	100%
Statesman Asset Limited	Cayman Islands	1,000	US$1	100%
Non-controlled subsidiaries				
Property development:				
West Rail Property Development Limited, and its 13 wholly owned subsidiaries*	Hong Kong	51 'A' 49 'B'	$10 $10	100% Nil
Property management:				
The Metropolis Management Company Limited**	Hong Kong	25,500 'A' 24,500 'B'	$1 $1	100% Nil

@ At 31 December 2012, Circuit Asset Limited was in the process of de-registration from the Companies Registry as the related leasing transaction was terminated in 2011.

* These subsidiaries are held by the Corporation for the sole purpose of developing commercial or residential property along the West Rail, Phase I route on behalf of the Government. Their financial statements are excluded from consolidation as the Corporation has no effective control over nor beneficial interests in the net assets of these subsidiaries, other than the amount of capital provided.

** The subsidiary is held by the Corporation for the sole purpose of rendering property management services to a commercial property. The financial statements are excluded from consolidation on the basis that, under the Equity Sub-participation Agreement which formed part of the merger transaction, the Corporation is obliged to act on MTRCL's instructions in respect of the exercise of any and all rights the Corporation has as a shareholder of the MMC. All the beneficial interests to which the Corporation was previously entitled now rest with MTRCL although there has been no direct disposition of the shares of MMC to MTRCL.

A summary of consolidated financial information of WRPDL and its subsidiaries based on the management accounts of these companies as of 31 December is as follows:

	2012 $ million	2011 $ million
Assets	16,013	13,387
Liabilities	2,663	6,302
Equity	13,350	7,085
Turnover	13,580	11,800
Profit after taxation for the year	12,775	8,735

18 Interest in associate

The interest in associate is as follows:

	Group		Corporation	
	2012 $ million	2011 $ million	**2012 $ million**	2011 $ million
Unlisted shares, at cost	**–**	–	**9**	9
Share of net assets	**167**	223	**–**	–
	167	223	**9**	9

Details of the associate, which is incorporated and operates in Hong Kong, are as follows:

Name of company	Number of issued and fully paid ordinary shares	Par value of each share	Percentage of shares held
Octopus Holdings Limited	42,000,000	$1	22.1%

A summary of financial information of the associate based on its consolidated management accounts as of 31 December is as follows:

	2012		2011	
	100% $ million	**Group's effective interest (22.1%) $ million**	100% $ million	Group's effective interest (22.1%) $ million
Assets	**3,693**	**816**	3,738	826
Liabilities	**2,938**	**649**	2,728	603
Equity	**755**	**167**	1,010	223
Turnover	**811**	**179**	704	156
Profit after tax for the year	**368**	**81**	317	70

19 Loan to non-controlled subsidiary

On 24 February 2000, the Corporation and the Government entered into a shareholding agreement (the "Shareholding Agreement") for the formation of a sub-group of the Corporation under an intermediate holding company, WRPDL, to undertake all property developments along the West Rail, Phase I route. The issued share capital of WRPDL comprises 51 ordinary "A" shares and 49 ordinary "B" shares, which are held by the Corporation and the Government respectively. The holders of ordinary "A" shares are not entitled to any distribution by WRPDL other than a return of capital, and the holders of ordinary "B" shares are entitled to all dividends declared by WRPDL and a return of capital. In other words, the Corporation is not entitled to any earnings distribution, nor is it required to ultimately fund any losses which may be sustained by WRPDL and its subsidiaries.

Subsidiaries of WRPDL have been formed to handle the property developments along the West Rail, Phase I route. The Government will receive the profits less losses from the developments whereas the Corporation was to recover the on-costs for the handling of the property developments along the route.

Since the Appointed Day, the Corporation, WRPDL and its subsidiaries (the "WRPDL Group") have appointed MTRCL as an agent to handle the property developments and an agency fee is payable by each subsidiary of WRPDL to MTRCL as remuneration. All costs incurred up to the Appointed Day in relation to the West Rail property developments were funded by loans from the Corporation to WRPDL bearing interest at an annual rate of 1% over the Corporation's average cost of funds in the preceding year. The Corporation agreed to stop accruing further interest on the loan with effect from 1 January 2008.

The loan to WRPDL (including accrued interest up to December 2007) was fully recovered in March 2012, following the successful award of the tender for the Nam Cheong property development site in late 2011.

20 Other financial assets

Other financial assets comprise:

The Group and the Corporation

	2012 $ million	2011 $ million
Held-to-maturity debt securities – unlisted	550	–

During the year, the Group and the Corporation acquired certain financial assets to replace the expired letter of credit arranged under one of the lease arrangements as pledge of the lease obligations (see note 14(e)).

21 Interest and other receivables

(a) Interest and other receivables comprise:

The Group and the Corporation

	2012 $ million	2011 $ million
Interest receivable	6	3
Debtors, deposits, prepayments and revenue in arrears	66	66
Amount due from MTRCL relating to property under development	19	445
Amount due from MTRCL	933	800
	1,024	1,314

The amount due from MTRCL relating to property under development represents property development enabling work costs incurred by the Corporation. The amount will be reimbursed from MTRCL once the joint venture for the respective property development site is formed in accordance with the Merger Framework Agreement.

(b) Interest and other receivables are expected to be recovered as follows:

The Group and the Corporation

	2012 $ million	2011 $ million
Within one year	1,014	1,308
After one year	10	6
	1,024	1,314

(c) Included in interest and other receivables are debtors with the following ageing analysis:

The Group and the Corporation

	2012 $ million	2011 $ million
Current	53	55
Deposits, prepayments and revenue in arrears	13	11
	66	66

22 Cash and cash equivalents

Cash and cash equivalents comprise:

The Group and the Corporation

	2012 $ million	2011 $ million
Deposits with banks		
– within three months to maturity when placed	4,556	1,351
– more than three months to maturity when placed	2,043	–
Cash at bank and in hand	20	59
Cash and cash equivalents in the balance sheets	6,619	1,410
Less: deposits with banks with more than three months to maturity when placed	(2,043)	–
Cash and cash equivalents in the consolidated cash flow statement	4,576	1,410

23 Interest and other payables

(a) Interest and other payables comprise:

The Group and the Corporation

	2012 $ million	2011 $ million
Interest payable	113	114
Deposits and advances	12	14
Creditors and accrued charges	16	9
	141	137

(b) Interest and other payables are expected to be settled as follows:

The Group and the Corporation

	2012 $ million	2011 $ million
Within one year	135	129
After one year	6	8
	141	137

23 Interest and other payables (continued)

(c) Included in interest and other payables are interest payable and creditors with the following ageing analysis:

The Group and the Corporation

	2012 $ million	2011 $ million
Due within one month or on demand	24	25
Due between one month to three months	12	12
Due between three months to six months	80	81
Total interest payable and creditors	116	118
Deposits and advances	12	14
Accrued charges	13	5
	141	137

24 Accrued charges and provisions for capital projects

The balance includes accrued charges and provisions for claims on land resumption and business losses related to capital projects. Accrued charges will be settled upon certification of work done. Provisions for claims relate to the West Rail, East Rail Extensions and Kowloon Southern Link projects.

The balance includes an aggregate amount of $317 million (2011: $423 million) payable to the Government for accrued charges and provisions for claims in relation to the West Rail, East Rail Extensions and Shatin to Central Link projects. The provisions for claims amounted to $311 million (2011: $402 million).

The movement of provisions for claims related to capital projects is as follows:

The Group and the Corporation

	2012 $ million	2011 $ million
Balance at 1 January	402	1,247
Amount utilised	(91)	(21)
Reversal of provisions for claims	–	(824)
Balance at 31 December	311	402

During 2011, the Corporation reviewed the status of potential claims outstanding and assessed that the prospects for settlement of certain of these outstanding claims was remote. Accordingly, a provision for claims amounting to $824 million was reversed.

24 Accrued charges and provisions for capital projects (continued)

Accrued charges and provisions for capital projects are expected to be settled or utilised as follows:

The Group and the Corporation

	2012 $ million	2011 $ million
Within one year	45	22
After one year	272	401
	317	423

25 Interest-bearing borrowings

(a) Interest-bearing borrowings comprise:

The Group and the Corporation

	2012		2011	
	Carrying amount $ million	Fair value $ million	Carrying amount $ million	Fair value $ million
Capital market instruments				
HK dollar retail notes due 2013 – see (c) below	698	712	692	736
HK dollar notes due 2013 – see (d) below	813	813	840	840
US dollar notes due 2014 – see (d) below	389	437	390	457
HK dollars notes due 2012 – see (e) below	–	–	299	301
HK dollars notes due 2014 – see (e) below	399	408	398	415
HK dollars notes due 2019 – see (e) below	1,287	1,447	1,285	1,393
HK dollars notes due 2024 – see (e) below	413	493	413	480
US dollars notes due 2019 – see (e) below	5,802	6,533	5,813	6,436
HK dollars notes due 2021 – see (e) below	494	597	493	578
HK dollars notes due 2021 – see (e) below	740	861	740	830
HK dollars notes due 2019 – see (e) below	434	499	434	482
HK dollars notes due 2015 – see (e) below	1,000	1,044	1,000	1,051
HK dollars notes due 2013 – see (e) below	800	802	800	804
	13,269	14,646	13,597	14,803
Bank loans – see (f) below	1,500	1,500	1,500	1,500
	14,769	16,146	15,097	16,303

(Expressed in Hong Kong dollars)

25 Interest-bearing borrowings (continued)

(b) The fair values of capital market instruments were determined using discounted cash flow techniques.

(c) The Corporation issued 4.80% notes due 2013 with an aggregate nominal value of $700 million at a premium on 6 June 2003. All the notes issued are unsecured and rank equally with all of the Corporation's other unsecured senior indebtedness.

(d) The Corporation issued 7.77% notes due 2014 with an aggregate nominal value of US$50 million at a discount on 17 November 1999, and 4.65% notes due 2013 with an aggregate nominal value of $800 million at par on 9 June 2003 under its US$3 billion medium term note programme. All the notes issued are unsecured and rank equally with all of the Corporation's other unsecured senior indebtedness.

(e) The Corporation issued the following notes under its 2009 US$3 billion medium term note programme:

Date of issue	Nominal value	Interest rate	Maturity	Pricing
28 April 2009	$300 million	2%	2012	At a discount
28 April 2009	$400 million	2.65%	2014	At a discount
28 April 2009	$1.3 billion	3.5%	2019	At a discount
15 May 2009	$415 million	4.13%	2024	At a discount
18 May 2009	US$750 million	5.125%	2019	At a discount
15 June 2009	$500 million	3.88%	2021	At a discount
9 July 2009	$750 million	3.82%	2021	At a discount
24 July 2009	$435 million	3.64%	2019	At a discount
2 February 2010	$1 billion	2.8%	2015	At par
20 May 2010	$800 million	1.3%	2013	At par

All the notes issued are unsecured and rank equally with all of the Corporation's other unsecured senior indebtedness.

(f) As at 31 December 2012, all bank loans are unsecured and interest-bearing at rates ranging from 1.06% (2011: 0.97%) to 1.14% (2011: 1.05%) per annum.

(g) The covenants attached to the Corporation's interest-bearing borrowings are customary ones.

25 Interest-bearing borrowings (continued)

(h) The interest-bearing borrowings were repayable as follows:

	2012 $ million	2011 $ million
Within one year	**2,311**	1,799
After one year but within two years	**788**	2,332
After two years but within five years	**2,500**	1,788
After five years	**9,170**	9,178
	14,769	15,097

26 Deferred income

(a) The balance of deferred income at 31 December 2012 includes cash received from property developers for property development sites along East Rail and Ma On Shan Rail; cash receipts arising from the lease out and lease back arrangements; the upfront payment received less the cost of Purchased Rail Assets for the Service Concession; assets and liabilities assumed by MTRCL as part of the merger transaction; and the cost of ACP funded by MTRCL less related amortisation. Under the property package of the Rail Merger, the Corporation shall continue to be responsible for the funding of the property enabling works for the eight development sites sold to MTRCL. The cash received from property developers will be set off against costs to be incurred by the Corporation in respect of each property development. The unutilised balance will be credited to profit or loss when the property enabling works are completed and accepted for development and after taking into account the outstanding risks and obligations in connection with the development, if any, retained by the Corporation. The balance relating to the lease out and lease back arrangements is being amortised and credited to profit or loss over the applicable lease terms. The balance relating to the net upfront payment received for the Service Concession and assets and liabilities assumed by MTRCL is being amortised and credited to profit or loss over the Concession Period. The balance relating to ACP is being amortised to profit or loss over the shorter of the useful life of the ACP and the remaining Concession Period.

(b) Movements in deferred income comprise:

The Group and the Corporation

	2012 $ million	2011 $ million
Balance at 1 January	**6,248**	5,873
Net amount received and receivable/(paid and payable)	**97**	(24)
Deferred income relating to ACP funded by MTRCL	**868**	647
Recognised in profit or loss	**(413)**	(248)
Balance at 31 December	**6,800**	6,248

26 Deferred income (continued)

(c) Deferred income is expected to be recognised in profit or loss as follows:

The Group and the Corporation

	2012 $ million	2011 $ million
Within one year	**281**	234
After one year	**6,519**	6,014
	6,800	6,248

27 Capital, reserves and dividends

(a) Movements in components of equity

The reconciliation between the opening and closing balances of each component of the Group's consolidated equity is set out in the consolidated statement of changes in equity. Details of the changes in the Corporation's individual components of equity between the beginning and the end of the year are set out below:

The Corporation

	Share capital $ million	Retained profits $ million	Total $ million
Balance at 1 January 2011	39,120	19,243	58,363
Changes in equity for 2011:			
Total comprehensive income for the year	–	(466)	(466)
Balance at 31 December 2011 and 1 January 2012	**39,120**	**18,777**	**57,897**
Changes in equity for 2012:			
Total comprehensive income for the year	**–**	**(1,194)**	**(1,194)**
Balance at 31 December 2012	**39,120**	**17,583**	**56,703**

(i) Included in the retained profits of the Group is an amount of $158 million (2011: $214 million) being the retained profits attributable to the associate.

(ii) Pursuant to the relevant provisions of the Ordinance, the reserves available for distribution comprise an amount out of the whole or part of the profits of the Corporation in any financial year after making allowance for any accumulated loss at the end of the financial year prior to the year in which the distribution is declared. The fair value change of financial assets and liabilities, net of related deferred tax, recognised in retained profits are not available for distribution to the sole shareholder because they are not realised profits of the Corporation. As at 31 December 2012, the amount of reserves available for distribution to the sole shareholder amounted to $17,350 million (2011: $18,416 million).

27 Capital, reserves and dividends (continued)

(b) Share Capital

	2012		2011	
	No. of shares	$ million	No. of shares	$ million
Authorised:				
Shares of $100,000 each	425,000	42,500	425,000	42,500
Issued and fully paid:				
At 31 December	391,200	39,120	391,200	39,120

(c) Capital management

The Corporation's capital includes share capital and reserves.

The entire issued share capital of the Corporation is held by the Financial Secretary Incorporated.

Pursuant to the relevant provisions of the Ordinance, the Corporation may declare dividends to the Government as its sole shareholder. The Financial Secretary may, after consultation with the Corporation and after taking into account the extent of its loans and other obligations, direct the Corporation to declare a dividend.

28 Financial risk management and fair values

In the normal course of its business, the Group is exposed to a variety of financial risks: credit risk, interest rate risk, currency risk and liquidity risk. The Group uses derivative financial instruments to hedge certain risk exposures.

The Managing Board has approved policies in respect of credit risk, interest-rate risk, currency risk, use of derivative financial instruments and investment of surplus funds. As part of its risk management, the Group identifies and evaluates the financial risks and, where appropriate, hedges those risks in accordance with the policies established by the Managing Board.

The Group documents at the inception of each hedging transaction the relationship between the hedging instrument and hedged item, as well as its risk management objective and strategy for undertaking the transaction. The Group also documents its assessment, both at inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values of the hedged items.

28 Financial risk management and fair values (continued)

(a) Credit risk

The Group's credit risk is primarily attributable to its held-to-maturity debt securities, its deposits and over-the-counter derivative financial instruments entered into for hedging purposes.

The Group has no significant concentrations of credit risk. It has policies in place that limit the amount of credit exposure to any financial institution with which the Group has transactions. The Group can only invest in debt securities issued by or place deposits with financial institutions that meet the established credit rating or other criteria. Derivative counterparties are limited to high-credit-quality financial institutions. The exposures to these credit risks are monitored on an ongoing basis.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial assets and liabilities, in the balance sheets.

The Group and the Corporation

	2012 $ million	2011 $ million
Loan to non-controlled subsidiary	–	4,405
Other financial assets	550	–
Interest rate swaps	246	269
Currency swaps	71	218
Interest and other receivables	1,024	1,314
	1,891	6,206

28 Financial risk management and fair values (continued)

(b) Interest rate risk

(i) Hedging

The Group's interest rate risk arises from its long-term borrowings. Borrowings at variable rates expose the Group to cash flow interest rate risk. Borrowings at fixed rates expose the Group to fair value interest rate risk. The Group aims to maintain the proportion of its fixed rate borrowings at between 30% and 75% of total borrowings. At 31 December 2012, 53% (2011: 54%) of total borrowings were at fixed rates.

The Group enters into receive-fixed-pay-floating interest rate swaps to hedge the fair value interest rate risk arising from fixed rate borrowings as well as to achieve an appropriate mix of fixed and floating rate exposure.

At 31 December 2012, the Group had interest rate swaps with a notional contract amount of $800 million (2011: $800 million) which qualify as fair value hedges. These interest rate swaps are stated at fair value with changes in fair value being recognised in profit or loss to offset the effect of the gain or loss on the related hedged portion of interest-bearing borrowings.

The net fair value of interest rate swaps which qualify as fair value hedges, entered into by the Group at 31 December 2012 was $13 million (assets) (2011: $40 million (assets)).

(ii) Fair value through profit or loss

For interest rate swaps where the hedging relationships do not qualify as fair value hedges or the Corporation does not opt for hedge accounting, changes in their fair values are recognised in profit or loss.

At 31 December 2012, the Group had such interest rate swaps with a notional contract amount of $4,635 million (2011: $4,635 million) and net fair value of $233 million (assets) (2011: $229 million (assets)), which comprises assets of $233 million (2011: $229 million) and liabilities of nil (2011: nil).

28 Financial risk management and fair values (continued)

(b) Interest rate risk (continued)

(iii) Sensitivity analysis

The sensitivity analysis below indicates the instantaneous change in the Group's loss after taxation (and retained profits) that would arise assuming that a general increase/decrease of 100 basis points (bps) in interest rates had occurred at the balance sheet date and such changes had been applied to re-measure those financial instruments held by the Group which expose the Group to fair value risk at the balance sheet date. In respect of the exposure to cash flow interest rate risk arising from floating rate non-derivative instruments held by the Group at the balance sheet date, the impact on the Group's loss after taxation (and retained profits) is estimated as an annualised impact on interest expense or income of such a change in interest rates. The analysis is performed on the same basis for 2011.

Other than for currency swaps where the forward exchange rates are slightly changed by a parallel shift in the interest rates of the underlying currencies, all other variables, in particular spot foreign currency rates, remain constant.

The estimated impact of a general increase/decrease of 100 basis points in interest rates, with all other variables held constant other than the exception mentioned above, on the Group's and the Corporation's loss after taxation (and retained profits) is shown below:

The Group and the Corporation

	2012		2011	
	$ million +100 bps	$ million -100 bps	$ million +100 bps	$ million -100 bps
Effect on profit or loss:				
Interest rate swaps	(107)	101	(148)	153
Currency swaps	2	63	(7)	7
Interest-bearing borrowings	3	(2)	10	(8)
(Increase)/decrease in loss after taxation	(102)	162	(145)	152

28 Financial risk management and fair values (continued)

(c) Currency risk

The Group derives its revenues almost entirely in Hong Kong dollars and is, therefore, exposed to currency risk arising only from borrowings, purchases and capital expenditure payments in relation to the development of new railways that are denominated in foreign currencies.

The Corporation uses forward exchange contracts and currency swaps to hedge its foreign exchange risk. The Corporation's risk management policy is to hedge its foreign currency borrowings into either Hong Kong dollars or United States dollars and limit its exposure to United States dollars to no greater than 30% of its total borrowings.

The Corporation may have investments in debt securities and other financial assets from time to time. Where these investments are denominated in foreign currencies other than United States dollars or Hong Kong dollars, the Corporation hedges the exposure into either United States dollars or Hong Kong dollars.

(i) Recognised assets and liabilities

Changes in the fair value of currency swaps that could not effectively hedge recognised monetary liabilities denominated in foreign currencies are recognised in profit or loss. The net fair value of currency swaps used by the Corporation as economic hedges of monetary assets and liabilities in foreign currencies at 31 December 2012 and recognised as net derivative financial assets was $69 million (2011: $218 million (assets)), comprising assets of $71 million (2011: $218 million) and liabilities of $2 million (2011: nil).

(ii) Fair value through profit or loss

In respect of other receivables and other payables denominated in currencies other than the functional currency, the Corporation ensures that the net exposure is kept to an acceptable level by buying or selling foreign currencies at spot or forward rates where necessary.

All the Group's borrowings are denominated in either Hong Kong dollars or United States dollars. Given this, management does not expect that there will be any significant currency risk associated with the Group's borrowings.

28 Financial risk management and fair values (continued)

(c) Currency risk (continued)

(iii) Exposure to currency risk

Based on the notional amounts of the financial assets and liabilities, the following table shows the Group's and the Corporation's exposure at the balance sheet date to currency risk arising from recognised assets or liabilities denominated in a currency other than the functional currency of the Group.

The Group and the Corporation

	US dollars million (Expressed in foreign currency)
2012	
Other financial assets	71
Cash and cash equivalents	50
Currency swaps	800
Interest and other payables	(5)
Interest-bearing borrowings	(800)
Overall net exposure	116
2011	
Other financial assets	–
Cash and cash equivalents	54
Currency swaps	800
Interest and other payables	(5)
Interest-bearing borrowings	(800)
Overall net exposure	49

28 Financial risk management and fair values (continued)

(c) Currency risk (continued)

(iv) Sensitivity analysis

The following table indicates the instantaneous change in the Group's loss after taxation (and retained profits) that would have arisen upon changes to foreign exchange rates to which the Group had exposure at the balance sheet date, assuming all other risk variables remained constant. Such exposure relates to the portion of United States dollars borrowings, currency swaps, and other assets and liabilities, such as deposits and future contract payments, denominated in foreign currencies.

	Increase/ (decrease) in foreign exchange rate	2012 Decrease/ (increase) in loss after taxation $ million	2011 Decrease/ (increase) in loss after taxation $ million
US dollars	1%	**20**	14
	(1%)	**(20)**	(14)

Results of the analysis as presented in the above table represent an aggregation of the instantaneous effects on the Group's loss after taxation (and retained profits) measured in the respective functional currencies, translated into Hong Kong dollars at exchange rates, based on direct quotes, prevailing at the balance sheet date for presentation purposes.

The sensitivity analysis assumes that the change in foreign exchange rates had been applied to re-measure those financial instruments held by the Group which expose the Group to foreign currency risk at the balance sheet date. The analysis is performed on the same basis for 2011.

(d) Liquidity risk

Liquidity risk represents the Group's ability to meet its contractual obligations. The Group evaluates its liquidity requirements on an ongoing basis. It employs projected cash flow analyses to forecast its future funding requirements. The Group's approach to manage liquidity is to ensure there will be sufficient liquidity to meet its liabilities when they fall due, under both normal and stressed conditions.

The Group aims to secure committed credit facilities well ahead of funding needs. This protects the Group against adverse market conditions which may result in difficulties in raising funds to meet payment obligations. The Group has put in place committed revolving facilities and uncommitted stand-by facilities to cater for short-term liquidity requirements.

28 Financial risk management and fair values (continued)

(d) Liquidity risk (continued)

The following table shows the time periods after the balance sheet date during which contractual payments, presented on an undiscounted basis, are due to be made. These payments include, inter alia, interest payments computed using contractual rates (for fixed rate instruments) and rates prevalent at the balance sheet date (for floating rate instruments), in respect of the Group's and the Corporation's non-derivative and derivative financial liabilities which are due to be paid.

The Group and the Corporation

	Contractual undiscounted cash outflow					
	Within 1 year or on demand $ million	More than 1 year but less than 2 years $ million	More than 2 years but less than 5 years $ million	More than 5 years $ million	Total $ million	Carrying amount at 31 December $ million
2012						
Interest and other payables	(135)	(1)	–	(5)	(141)	141
Interest rate swaps	–	–	–	–	–	(246)
Currency swaps						
– outflow	(270)	(660)	(807)	(6,214)	(7,951)	2
– inflow	299	688	898	6,285	8,170	(71)
Interest-bearing borrowings	(2,877)	(1,294)	(3,822)	(10,079)	(18,072)	14,769
	(2,983)	(1,267)	(3,731)	(10,013)	(17,994)	14,595
2011						
Interest and other payables	(129)	(4)	(1)	(3)	(137)	137
Interest rate swaps	–	–	–	–	–	(269)
Currency swaps						
– outflow	(270)	(270)	(1,199)	(6,482)	(8,221)	–
– inflow	300	300	1,290	6,602	8,492	(218)
Interest-bearing borrowings	(898)	(2,881)	(4,731)	(10,522)	(19,032)	15,097
	(997)	(2,855)	(4,641)	(10,405)	(18,898)	14,747

28 Financial risk management and fair values (continued)

(e) Fair value

(i) Financial instruments carried at fair value

The following table presents the carrying value of financial instruments measured at fair value at the balance sheet date across the three levels of the fair value hierarchy defined in IFRS 7 and HKFRS 7, Financial Instruments: Disclosures, with the fair value of each financial instrument categorised in its entirety based on the lowest level of input that is significant to that fair value measurement. The levels are defined as follows:

– Level 1 (highest level): fair values measured using quoted prices (unadjusted) in active markets for identical financial instruments

– Level 2: fair values measured using quoted prices in active markets for similar financial instruments, or using valuation techniques in which all significant inputs are directly or indirectly based on observable market data

– Level 3 (lowest level): fair values measured using valuation techniques in which any significant input is not based on observable market data

The Group and the Corporation

	Level 1 $ million	Level 2 $ million	Level 3 $ million	Total $ million
2012				
Assets				
Derivative financial assets				
– interest rate swaps	–	246	–	246
– currency swaps	–	71	–	71
	–	317	–	317
Liabilities				
Derivative financial liabilities				
– currency swaps	–	(2)	–	(2)
	–	(2)	–	(2)
2011				
Assets				
Derivative financial assets				
– interest rate swaps	–	269	–	269
– currency swaps	–	218	–	218
	–	487	–	487

28 Financial risk management and fair values (continued)

(e) Fair value (continued)

(ii) Fair values of financial instruments carried at other than fair value

The carrying amounts of the Group's and the Corporation's financial instruments carried at cost or amortised cost are not materially different from their fair values as at 31 December 2012 and 2011 except as follows:

The Group and the Corporation

	2012		2011	
	Carrying amount $ million	Fair value $ million	Carrying amount $ million	Fair value $ million
Assets				
Loan to non-controlled subsidiary	–	–	4,405	4,405
Other financial assets	550	552	–	–
	550	552	4,405	4,405
Liabilities				
Interest-bearing borrowings	(14,769)	(16,146)	(15,097)	(16,303)
	(14,769)	(16,146)	(15,097)	(16,303)

(f) Estimation of fair value

The following summarises the major methods and assumptions used in estimating the fair values of financial assets and liabilities.

(i) Other financial assets

The fair value of financial assets traded in active markets was based on quoted market prices at the balance sheet date.

(ii) Interest rate swaps and currency swaps

The fair value of interest rate swaps and currency swaps was based on the present value of the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account prevailing interest rates, foreign exchange rates and creditworthiness of the swap counterparties. Discounted cash flow techniques were used in determining the fair value of swaps.

28 Financial risk management and fair values (continued)

(f) Estimation of fair value (continued)

(iii) Loan to non-controlled subsidiary and interest-bearing borrowings

Where applicable, fair value was calculated based on discounted cash flows of expected future principal and interest payments.

(iv) Discount rates used for determining fair value

The Corporation used the applicable yield curve at the balance sheet date plus an appropriate constant credit spread to discount financial assets and liabilities. The interest rates used were as follows:

	2012	2011
Interest rate swaps, currency swaps	0.18% – 1.22%	0.23% – 1.86%
Interest-bearing borrowings	0.52% – 3.15%	0.52% – 3.70%

29 Notes to the consolidated cash flow statement

Reconciliation of operating loss after depreciation, amortisation and impairment to net cash inflow from operations

	2012 $ million	2011 $ million
Operating loss after depreciation, amortisation and impairment	(1,111)	(1,368)
Depreciation and amortisation	3,124	2,980
Loss on disposal of fixed assets	22	29
Increase in other receivables	(612)	(604)
Increase/(decrease) in other payables and deferred income	613	(269)
Net cash inflow from operations	2,036	768

30 Related parties

The Corporation is wholly owned by the Government. The Corporation has entered into transactions with the Government in respect of the developments of the West Rail, Phase I route, East Rail Extensions and Kowloon Southern Link which are considered to be related party transactions under IAS 24 and HKAS 24 and these are disclosed in notes 1, 3(c) and (i), 6, 16(b) and (c), 17, 19 and 24 to the financial statements. Transactions with Government departments and agencies in the course of their normal dealings with the Corporation are not considered to be related party transactions.

Members of the Managing Board, the key management who are not Members of the Managing Board and parties related to them are also related parties of the Corporation. During the year there were no significant transactions with any such parties other than their remuneration which is disclosed in note 7 to the financial statements.

MTRCL is considered to be a related party of the Corporation under IAS 24 and HKAS 24 as they share a common shareholder, the Government. The Corporation has entered into transactions with MTRCL since the Appointed Day which are considered to be related party transactions and these are disclosed in notes 2, 3(c), (i), (m) and (x), 5, 6, 9(a), 14, 15, 17, 19, 21 and 26 to the financial statements.

Major related party transactions entered into by the Group in prior years which are still relevant for the current year comprise:

(i) On 15 September 1998, the Government approved the construction of West Rail, Phase I to be undertaken by the Corporation. The West Rail Project Agreement, which set out how the project was to be undertaken and the respective obligations of the Government and the Corporation in terms of the financing, design, construction and operation of West Rail, Phase I, was signed on 23 October 1998. On 24 February 2000, the Corporation and the Government entered into a shareholding agreement for undertaking all property developments along the West Rail, Phase I route (note 19).

(ii) The Corporation entered into a project agreement for the East Rail Extensions with the Government on 28 February 2003. The project agreement provided for the financing, design, construction and operations of the East Rail Extensions and related services and facilities.

30 Related parties (continued)

(iii) The Corporation entered into a project agreement for the financing, design, construction and operation of Kowloon Southern Link with the Government on 6 October 2005. Under the terms of the KSL Project Agreement, the Corporation is responsible for, and will finance the entire capital cost of constructing the Kowloon Southern Link, along with the costs of the removal, replacement, modification or improvement of existing facilities affected by or required as a consequence of the construction of the Kowloon Southern Link.

(iv) The Corporation accepted an offer from the Government to allow the Corporation to proceed with the development of the sites at Ho Tung Lau, Wu Kai Sha and Tai Wai Maintenance Centre in March 2003, October 2005 and July 2006 respectively.

31 Outstanding commitments

Commitments outstanding in respect of capital expenditure not provided for in the financial statements were as follows:

The Group and the Corporation

	2012 $ million	2011 $ million
Fixed assets – property, plant and equipment		
– authorised and contracted for	9	17
– authorised but not contracted for	55	80
Balance at 31 December	64	97

32 Retirement benefit scheme

The Group operates a Mandatory Provident Fund Scheme ("MPF Scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance. The MPF Scheme is a defined contribution retirement plan administrated by independent trustees. Under the MPF Scheme, the employer and its employees are required to make contributions to the plan at 5% of the employees' relevant income, subject to a cap of monthly relevant income which was adjusted from $20,000 to $25,000 effective from 1 June 2012.

33 Debt facilities

(a) Total unutilised debt facilities available to the Group and the Corporation comprise:

	2012 $ million	2011 $ million
Short-term uncommitted revolving credit facilities	**400**	500
Overdraft facilities	**30**	30
Letters of credit for leveraged leases	**1,486**	2,037
Revolving loan facility	**1,000**	1,000
	2,916	3,567

(b) The unutilised debt facilities are expected to expire as follows:

	2012 $ million	2011 $ million
Floating rate		
– expiring within one year	**827**	1,568
– expiring after one year	**2,089**	1,999
	2,916	3,567

34 Contingent liabilities

At 31 December 2012, the Group had contingent liabilities arising from the land resumption claims and certain contractors' claims in respect of the construction of the Kowloon Southern Link, West Rail and East Rail Extensions projects. The Group has made provisions in the financial statements at 31 December 2012 for its best estimate of amounts which are likely to be payable in connection with these claims which the Group is in the process of resolving. The details of the provisions are set out in note 24 to the financial statements.

35 Impairment of railway assets

At 31 December 2012, the Group assessed whether there was any indication of impairment of the Group's railway assets at that date in accordance with the Group's accounting policies for the assessment of asset impairment by comparing the key determinant factors, such as inflation, cost of debt, expected return on equity, to those of 2011.

As a result of this assessment, management considers that no indication of impairment of the railway assets of the Group exists at 31 December 2012 and, accordingly, that no provision for impairment of the Group's railway assets is required at that date.

36 Accounting estimates and judgements

(a) Key sources of estimation uncertainty

Note 28 contains information about the assumptions and their risk factors relating to financial instruments. Other key sources of estimation uncertainty include the assessment of useful lives for depreciation of fixed assets (see note 3(j)), assessment of provisions and contingent liabilities (see notes 3(w), 24 and 34), determination of the recoverability of deferred tax assets (see note 11(c)), assessment of the possibility of implementation of the Shatin to Central Link project (see note 16(b)) and assessment of the outstanding risk and obligations in recognition of profit from property development (see note 26).

(b) Critical accounting judgements in applying the Group's accounting policies

Critical accounting judgements in applying the Group's accounting policies include the classification of revenue and expenditure as capital or revenue in nature (see note 3(i)(i)), the classification of revenue and cost-recovery, the classification of operating leases or lease-out and lease-back transactions (see note 3(k)(i) and (y)), transfers from construction in progress to fixed assets (see note 3(m)), assessment of controlled and non-controlled subsidiaries (see note 3(c)), the categorisation of financial assets and liabilities, adoption of hedge accounting (see note 28) and impairment of railway assets (see note 35).

(Expressed in Hong Kong dollars)

37 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting year ended 31 December 2012

Up to the date of issue of these financial statements, the IASB and HKICPA have issued a number of amendments and five new standards which are not yet effective for the year ended 31 December 2012 and which have not been adopted in these financial statements.

The Group is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Group's and the Corporation's results of operations and financial position.

In addition, the following developments may result in new or amended disclosures in the financial statements:

	Effective for accounting periods beginning on or after
Amendments to IFRS 1 & HKAS 1, Presentation of financial statements – Presentation of items of other comprehensive income	1 July 2012
IFRS 10 & HKFRS 10, Consolidated financial statements	1 January 2013
IFRS 12 & HKFRS 12, Disclosure of interests in other entities	1 January 2013
IFRS 13 & HKFRS 13, Fair value measurement	1 January 2013
IFRS 27 & HKAS 27, Separate financial statements (2011)	1 January 2013
IFRS 28 & HKAS 28, Investments in associates and joint ventures	1 January 2013
IFRS 19 & Revised HKAS 19, Employee benefits	1 January 2013
Annual Improvements to HKFRSs 2009-2011 Cycle	1 January 2013
Amendments to IFRS 7 & HKFRS 7, Financial instruments: Disclosures – Offsetting financial assets and financial liabilities	1 January 2013
Amendments to IFRS 32 & HKFRS 32, Financial instruments: Presentation – offsetting financial assets and financial liabilities	1 January 2014
IFRS 9 & HKFRS 9, Financial instruments	1 January 2015

Five-Year Statistics

FINANCIAL (HK$ million)	2012	2011	2010	2009	2008
Statement of Comprehensive Income					
Turnover	2,066	1,675	1,013	921	870
Operating profit before depreciation, amortisation and impairment	2,035	1,641	979	828	819
Net interest and finance expenses	338	376	560	1,178	912
Loss before unrealised gains/losses	(1,368)	(1,674)	(2,639)	(3,178)	(2,675)
Loss after unrealised gains/losses and taxation	(1,250)	(451)	(2,034)	(2,761)	(1,815)
Balance Sheet					
Fixed assets (including interest in leasehold land held for own use under operating leases)	69,260	71,662	74,899	76,521	71,757
Construction in progress	798	631	525	994	6,926
Deferred expenditure	1,188	1,188	1,188	1,613	1,612
Loan to non-controlled subsidiary	–	4,405	4,405	4,405	4,406
Other financial assets	550	–	435	402	3,095
Cash and cash equivalents	6,619	1,410	710	8,872	2,493
Other assets	1,508	2,024	1,277	1,129	1,180
Total assets	79,923	81,320	83,439	93,936	91,469
Interest-bearing borrowings	14,769	15,097	15,117	23,059	17,503
Deferred tax liabilities	1,033	1,304	2,375	2,774	3,356
Deferred income	6,800	6,248	5,873	5,441	5,001
Other liabilities	460	560	1,512	2,053	2,252
Total liabilities	23,062	23,209	24,877	33,327	28,112
Equity	56,861	58,111	58,562	60,609	63,357
Key financial data					
Return on equity (%)	(2)	(1)	(3)	(5)	(3)
Debt/equity ratio	1:3.9	1:3.8	1:3.9	1:2.6	1:3.6
Debt to total capitalisation (%)	21	21	21	28	22
Interest cover (times)	3.9	3.2	1.6	0.8	0.9

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