

# Report of the Members of the Board

The members of the Board have pleasure in submitting their Report and the summary financial statements for the financial year ended 31 December 2001.

## Principal Activities of the Group

The principal activities of the Company and its subsidiaries are:

- A** the operation of a mass transit railway system with lines from Central to Tsuen Wan (Tsuen Wan Line), from Yau Ma Tei to North Point (Kwun Tong Line), from Chai Wan to Sheung Wan (Island Line), from Hong Kong to Tung Chung (Tung Chung Line) and from Hong Kong to the Hong Kong International Airport at Chek Lap Kok (Airport Express Line);
- B** property development at locations relating to the railway system including the Tseung Kwan O Extension;
- C** related commercial activities, including the letting of advertising space and marketing of commercial franchises on the railway system, property management and leasing management of investment properties;
- D** the design, construction, financing and operation of the Tseung Kwan O Extension;
- E** the planning and construction of future extensions to the railway system; and
- F** the operation of a smart card system by Octopus Cards Limited (formerly Creative Star Limited), a subsidiary of the Company, for the collection of payments for both transport and non-transport applications.

## Dividend

The Directors have recommended a final dividend of HK\$0.28 per Ordinary Share to be payable to shareholders whose names appear on the Register of Members of the Company on 8 April 2002. Subject to the passing of the necessary resolution at the forthcoming Annual General Meeting, such dividend will be payable on 14 June 2002, in cash in Hong Kong dollars, with a scrip dividend alternative.

## Members of the Board

Members of the Board who served during the year were Jack So Chak-kwong (Chairman and Chief Executive), Cheung Yau-kai, Raymond Ch'ien Kuo-fung, David Gordon Eldon, David Wylie Gairns, Edward Ho Sing-tin, Lo Chung-hing, the Commissioner for Transport (Robert Charles Law Footman), the Secretary for Transport (Nicholas Ng Wing-fui) and

Denise Yue Chung-yee. Jack So Chak-kwong and Denise Yue Chung-yee retired by rotation at the Annual General Meeting on 17 May 2001 and were re-elected as members of the Board.

Raymond Ch'ien Kuo-fung and Lo Chung-hing will retire by rotation at the forthcoming Annual General Meeting (in accordance with the Company's Articles of Association) and offer themselves for re-election.

Brief biographical details for Board Members are set out on page 12.

## Alternate Directors

The Alternate Directors in office during the year were Martin Mckenzie Glass (for Denise Yue Chung-yee), Dorothy Chan (for Commissioner for Transport) and the Deputy Secretaries for Transport (for Secretary for Transport).

## Executive Directorate

The members of the Executive Directorate who served during the year were Jack So Chak-kwong (Chairman and Chief Executive), a member of the Board of Directors, and Russell John Black, William Chan Fu-keung, Philip Gaffney, Thomas Ho Hang-kwong, Clement Kwok King-man and Leonard Bryan Turk. On 31 January 2002 Clement Kwok King-man resigned as Finance Director, and, on 1 February 2002, Lincoln Leong Kwok-kuen was appointed as the new Finance Director.

Biographical details for members of the Executive Directorate during the year are set out on page 12.

## Corporate Governance

The Company is committed to high standards of corporate governance.

The management of the Company's business is vested in the Board of Directors. Pursuant to the Company's Articles of Association and the protocol adopted by the Board of Directors, the Board of Directors has delegated the day-to-day management of the Company's business to the Executive Directorate but the Board of Directors has reserved to itself certain powers, such as the approval of the Company's financial statements, dividends, significant changes in accounting policy, its annual operating budget, certain material contracts, certain financing arrangements and major investments, risk management strategy, treasury policies and fare structures.

The Board of Directors meets regularly and members of the Board receive information between meetings about developments in the Company's business. All members of the Board of Directors have full and timely access to the relevant information and may take independent professional advice if necessary. As an integral part of good corporate governance the following committees have been set up:

#### **Audit Committee**

The Audit Committee has a majority of its members appointed from the independent non-executive Directors. It meets four times each year to review the completeness, accuracy and fairness of the financial statements of the Company and to consider the nature and scope of internal and external audit reviews as well as the effectiveness of the systems of internal control. Internal control systems have been designed to allow the Board of Directors to monitor the Group's overall financial position and to protect its assets. The purpose is to assure against material financial misstatement or loss. The Board of Directors is responsible for these systems, and appropriate authorisations and guidelines are in place. The Audit Committee Chairman also prepares an annual report to the Board of Directors covering its activities for the year and highlighting issues which the Chairman deems significant. There were four meetings of the Audit Committee in 2001. The members of the Audit Committee during the year comprised David Wylie Gairns (chairman), Cheung Yau-kai and the Commissioner for Transport (Robert Charles Law Footman), all of whom are non-executive Directors.

#### **Remuneration Committee**

The Remuneration Committee meets regularly to consider human resources issues, including the terms and conditions of employment, remuneration, and retirement benefits of the Chairman and Chief Executive and members of the Executive Directorate. The members of the Remuneration Committee during the year comprised Raymond Ch'ien Kuo-fung (chairman), Edward Ho Sing-tin and Denise Yue Chung-yeo, all of whom are non-executive Directors.

#### **Nominations Committee**

The Nominations Committee carries out the process of recommending and nominating candidates to fill vacancies on the Board of Directors. A person may be appointed as a member of the Board of Directors at any time either by the shareholders in general meeting or by

the Board of Directors upon the recommendation of the Nominations Committee. Directors who are appointed by the Board of Directors must retire at the first annual general meeting after their appointment. In either case, the Directors so elected and appointed are eligible for re-election and re-appointment. At each annual general meeting of the Company, one third of the Directors (or such number as is nearest to and less than one third) are required to retire from office by rotation (excluding the Directors appointed by the Chief Executive of Hong Kong SAR under the MTR Ordinance). The members of the Nominations Committee are David Gordon Eldon (chairman), Lo Chung-hing and the Secretary for Transport (Nicholas Ng Wing-fui), all of whom are non-executive Directors.

The Company has complied throughout the year with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("HKSE"), except that non-executive Directors of the Company are not appointed for a specific term but are subject (save for those appointed pursuant to Section 8 of the MTR Ordinance) to retirement by rotation and re-election at the Company's annual general meetings in accordance with Articles 87 and 88 of the Company's Articles of Association.

The Company received the Diamond Award in the Public Sector Category in 2000 and the Special Mention Honour in the Hang Seng Index Category in 2001 for Best Corporate Governance Disclosure from the Hong Kong Society of Accountants.

#### **Internal Audit**

The Company's Internal Audit Department plays a major role, in support of and in collaboration with, the Company's management, in monitoring the internal governance of the Company. Key tasks of the Department include:

- Unrestricted access to review all aspects of the Company's activities and internal controls;
- Comprehensive audits of the practices, procedures, expenditure and internal controls of all business and support units and subsidiaries on a regular basis;
- Conduct of special reviews and/or investigations and reports both on a regular and as-needed basis.

The Company's Internal Auditor reports directly to the Chairman and has direct access to the Audit Committee.

#### **Ethical Culture**

The Board of Directors has adopted a Code of Conduct to be followed by all staff in dealing with colleagues, customers, clients, suppliers, contractors and consultants. Such Code of Conduct is designed to create a culture of ingrained set of values and beliefs for staff and involves a common understanding of what is right and wrong in the course of business dealings and outlines the methods of resolving ethical problems encountered in the workplace.

#### **Policies**

The Board has adopted risk strategies on the following matters:

- A** Construction and insurance;
- B** Finance;
- C** Treasury risk management;
- D** Safety risk management;
- E** Security management;
- F** Environmental management.

No changes to such policies may be made without the approval of the Board of Directors.

#### **Summary Financial Statements**

The state of affairs of the Group as at 31 December 2001 and of its results for the year are set out in the summary financial statements on pages 18 to 23.

#### **Ten-Year Statistics**

A summary of the results and of the assets and liabilities of the Group together with some major operational statistics for the last ten years are set out on pages 10 and 11.

#### **Fixed Assets and Railway Construction in Progress**

Movements in fixed assets and railway construction in progress during the year are set out in Note 4 to the summary financial statements.

#### **Movements in Reserves**

Movements in reserves during the year are set out in Note 6 to the summary financial statements.

#### **Share Capital**

As at 31 December 2000, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5 billion of which were issued and credited as fully paid. During the year, the Company issued a total of 55,229,742 Ordinary Shares. Of this number:

**A** 2,098,000 Ordinary Shares were issued by the Company pursuant to the exercise of share options which had been granted under the Company's Pre-Global offering Share Option Scheme. In respect of each Ordinary Share issued, the relevant exercising share option holder paid HK\$8.44 to the Company;

**B** 18,235,023 Ordinary Shares were issued by the Company in order to satisfy shareholders' scrip dividend elections in respect of the final dividend of the Company for the year ended 31 December 2000 (for which the cash dividend was HK\$0.10 per Ordinary Share); and

**C** 34,896,719 Ordinary Shares were issued by the Company in order to satisfy shareholders' scrip dividend elections in respect of the interim dividend of the Company for the six months ended 30 June 2001 (for which the cash dividend was HK\$0.14 per Ordinary Share).

As at 31 December 2001, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,055,229,742 of which were issued and credited as fully paid.

#### **Redemption of Listed Securities**

There was no purchase, sale or redemption of the Company's or any of its subsidiaries' debt securities listed on the stock exchanges during the year.

#### **Donations**

During the year, a total of HK\$278,300 was donated, of which HK\$275,800 went to the Community Chest of Hong Kong.

#### **Internal Controls**

The Board of Directors is responsible for ensuring that there is in place a satisfactory system of internal controls. The main objectives are to ensure adherence to the Company's control policies so that the Company's assets are safeguarded and that the financial records are complete and accurate.

A function of the Audit Committee is to review the effectiveness of the system of internal controls from information provided by the Executive Directorate and management of the Company and by the auditors.

## Reporting and Monitoring

There is a comprehensive budgeting system for all operational and business activities, with an annual budget approved by the Board of Directors. Monthly results of the Company's operations, businesses and projects are reported against the budget to the Board of Directors and updated forecasts for the year are prepared regularly.

## Treasury Management

The Company's Treasury Department operates within approved guidelines from the Board. It manages the Company's debt profile according to the Preferred Financing Model which defines the preferred mix of financing instruments, fixed and floating rate debt, maturities, interest rate risks, currency exposure and financing horizon. The model is reviewed and refined periodically to reflect changes in the Company's financing requirements and market environment. Derivative financial instruments such as interest rate swaps and currency swaps are used only as hedging tools to manage the Group's interest rate and currency risks. Prudent guidelines and procedures are in place to control the Company's derivatives activities, including a comprehensive credit risk management system for monitoring counterparty credit exposure using the Value-at-Risk approach. There is also appropriate segregation of duties within the Company's Treasury Department.

Major financing transactions and guidelines for derivatives transactions including credit risk management framework are approved at the Board level.

## Capital and Revenue Expenditure

There are defined procedures for the appraisal, review and approval of major capital and revenue expenditures. All project expenditure over 0.2% of the net assets of the Company and the employment of consultancy services over 0.1% of the net assets of the Company require the approval of the Board.

## Bonds and Notes Issued

The Group issued bonds and notes during the year ended 31 December 2001, details of which are set out in Note 5 to the summary financial statements. Such bonds and notes were issued in order to meet the Group's general corporate funding requirements, including the financing of new capital expenditure and the refinancing of maturing debts.

## Electronic Data

There are defined procedures and regular quality reviews on the operation of computer systems to ensure the accuracy and completeness of financial records and efficiency of data processing.

## Interests in Contracts of Members of the Board and the Executive Directorate

Save for one loan made by the Company to a member of the Executive Directorate, details of which are set out in Note 2B to the summary financial statements, and the deed of indemnity, details of which are set out in the section below headed "Transactions in connection with the Privatisation Share Offer of the Company", no contracts of significance, to which the Company or any of its subsidiaries was a party and in which a member of the Board or a member of the Executive Directorate had a material interest, subsisted at the end of the year or at any time during the year.

## Board Members and Executive Directorate's Interests in Shares

At 31 December 2001, the interests of the members of the Board of Directors and the Executive Directorate in the equity securities of the Company as recorded in the register required to be kept under section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI") or as otherwise notified to the Company and the HKSE pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:

### Ordinary Shares

Member of the Board of Directors or Executive Directorate	Number of Ordinary Shares
Jack So Chak-kwong	46,142
Russell John Black	23,142
William Chan Fu-keung	23,100
Philip Gaffney	23,677
Thomas Ho Hang-kwong	26,284
Leonard Bryan Turk	25,256
Clement Kwok King-man	27,284

## Options to subscribe for Ordinary Shares granted under the Share Option Scheme, as referred to in Note 2C to the summary financial statements

Member of Board of Directors or Executive Directorate	Date granted	Options held at 1 January 2001	Period during which rights exercisable (day/month/year)	Options vested during the year	Options exercised during the year	Price per share paid on exercise of options	Options outstanding at 31 December 2001	Weighted average closing price of share immediately before options were exercised
Jack So Chak-kwong	20/9/2000	1,599,000	5/4/01–11/9/10	533,000	–	–	1,599,000	–
Russell John Black	20/9/2000	1,066,000	5/4/01–11/9/10	355,500	21,000	HK\$8.44	1,045,000	HK\$10.50
William Chan Fu-keung	20/9/2000	1,066,000	5/4/01–11/9/10	355,500	21,000	HK\$8.44	1,045,000	HK\$10.10
Philip Gaffney	20/9/2000	1,066,000	5/4/01–11/9/10	355,500	21,000	HK\$8.44	1,045,000	HK\$10.10
Thomas Ho Hang-kwong	20/9/2000	1,066,000	5/4/01–11/9/10	355,500	22,000	HK\$8.44	1,044,000	HK\$10.15
Leonard Bryan Turk	20/9/2000	1,066,000	5/4/01–11/9/10	355,500	21,000	HK\$8.44	1,045,000	HK\$10.50
Clement Kwok King-man	20/9/2000	1,066,000	5/4/01–11/9/10	355,500	273,000	HK\$8.44	793,000	HK\$10.07

Save as disclosed above:

A there were no interests held as at 31 December 2001 by any members of the Board of Directors or Executive Directorate of the Company in securities of the Company and its associated corporations (within the meaning of the SDI); and

B during the year ended 31 December 2001, no member of the Board of Directors or Executive Directorate nor any of their spouses or children under 18 years of age held any rights to subscribe for equity or debt securities of the Company nor had there been any exercises of any such rights by any of them,

as recorded in the register kept by the Company under section 29 of the SDI or otherwise notified to the Company and the HKSE pursuant to the Model Code for Securities Transaction by Directors of Listed Companies.

## Major Suppliers and Customers

Less than 30% in value of supplies (which were not of a capital nature) purchased during the year ended 31 December 2001 was attributable to the Company's five largest suppliers. Less than 30% in value of the Company's turnover during the year ended 31 December 2001 was attributable to the Company's five largest customers combined by value.

## Going Concern

The summary financial statements on pages 18 to 23 have been prepared on a going concern basis. The Board of Directors has reviewed the Company's budget for 2002, together with the longer-term forecast for the following five years and is satisfied that the Company has sufficient resources to continue as a going concern for the foreseeable future.

By order of the Board

Leonard B. Turk  
Secretary to the Board  
Hong Kong, 28 February 2002

## Substantial Shareholders' Interests

Set out below is the name of the party which was interested in 10 per cent or more of the nominal value of the share capital of the Company and the respective relevant numbers of shares in which it was interested as at 31 December 2001 as recorded in the register kept by the Company under Section 16(1) of the SDI:

Name	No. of Ordinary Shares
Financial Secretary Incorporated (in trust on behalf of the Government)	3,869,799,423