

AUDIT COMMITTEE REPORT

As disclosed in the Corporate Governance Report of this Annual Report on pages 102 to 131, the Board recently restructured the Company's Board Committees with a view to enhancing Board effectiveness and ensuring that the Board was fit for purpose for supporting the implementation of the new Corporate Strategy. As a result of this restructuring, the Audit Committee has, with effect from 1 February 2022, taken up certain duties of the former Risk Committee, including regularly reviewing the Company's enterprise risk management ("ERM") framework (one of the Company's key internal controls) and associated policies and procedures and assessing, on an annual basis, the effectiveness of the ERM function. The Audit Committee has therefore been renamed as the Audit & Risk Committee (referred to as the "Committee" in this Report) on the same date.

During the year ended 31 December 2021, the Committee consisted of six Non-executive Directors, five of whom were Independent Non-executive Directors of the Company. Subsequent to the restructuring of the Board Committees and as at the date of this Report, the Committee consists of seven Non-executive Directors, six of whom are Independent Non-executive Directors of the Company. None of the Committee members was or is a partner or former partner of KPMG, the Company's external auditor. Details of the Committee's membership and their attendance records during 2021 are set out on pages 119 to 121 of this Annual Report.

Following the restructuring, the Finance Director (the "FD"), the Head of Internal Audit (the "Head of IA") and the Legal & Governance Director (or their respective delegates) and representatives of the external auditor are required to attend all meetings of the Committee. The Committee meets at least once every quarter and the Chairman of the Committee or any two members of the Committee or the external auditor or the FD may request additional meetings if they consider necessary. The Committee may, upon request, approve the appointment of the Company's external auditor for undertaking non-audit work.

TERMS OF REFERENCE OF THE COMMITTEE

The Terms of Reference of the Committee (the "ToR") have been updated in February 2022 following the renaming of the Committee and the amendments to its scope of responsibilities. The updated ToR are available on the respective websites of the Company (www.mtr.com.hk) and the Stock Exchange.

DUTIES OF THE COMMITTEE

In 2021, under the ToR in place at that time, the duties of the Committee primarily comprised the following:

- Overseeing the relationship with the Company's external auditor, including making recommendations to the Board on the appointment of and any change to the Company's external auditor and communicating with the external auditor on financial matters of the Company;
- Reviewing the financial information of the Company, including monitoring the integrity of financial statements;
- Overseeing the Company's financial reporting system and internal control procedures, including overseeing the adequacy of the resources and competence of the Company's accounting and financial reporting functions; and
- Overseeing the Company's Internal Audit function, including liaison with the Head of IA, approval of the annual internal audit plan of the Company and receiving periodic reports from the Head of IA.

More details on the duties of the Committee are set out in the ToR.

Further information relating to risk management and internal controls for the year ended 31 December 2021 can be found in the "Risk Management and Internal Control Systems" section of the Corporate Governance Report on pages 123 to 127 of this Annual Report.

Reporting to the Board

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

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

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

WORK PERFORMED BY THE COMMITTEE IN 2021

In 2021, the Committee held four regular meetings. Representatives of the external auditor, the FD and the Head of IA and/or the Acting Head of IA attended all four regular meetings to report and answer questions about their work. In addition, relevant Members of the Executive Directorate were invited to join certain presentations to the Committee. The Committee also held private sessions with the external auditors without the presence of Management during the year.

The Committee devoted its attention to the review of the Company's annual and interim results announcement/accounts at the March 2021 and August 2021 meetings respectively, allowing more time to review and discuss the Company's internal controls, internal audit and other activities at the June 2021 and November 2021 regular meetings.

Acting through the former Risk Committee and the Committee, in 2019 the Board mandated a review of the Company's internal control and risk management systems. In 2020, an external consultant was appointed to conduct a deep-dive assessment of the Company's existing Three Lines of Defence ("3LoD") framework, with a view to identifying any gaps or improvements in the framework. The results of this assessment were presented to and endorsed by the former Risk Committee and the Committee in late 2020. Over the course of 2021, the Company has strengthened its Second Line of Defence through the establishment of an independent Assurance Management Department, which has been complemented by new technical and engineering Centres of Excellence and a new Strategic Assurance Review Board which serves to coordinate and focus assurance activities as well as to highlight any insights or concerns to relevant Executives. The new 3LoD model and framework was successfully piloted within the Capital Works Business Unit in late 2021 and will be rolled out in a phased manner to other business units starting in early 2022.

Other major work performed by the Committee in 2021 included:

Financial

- Reviewed the draft 2020 Annual Report and Accounts and 2021 Interim Report and Accounts, including the financial impact of the Company's railway construction projects under entrustment by the HKSAR Government, and the relevant disclosure notes in the said Accounts and made recommendations on the same for the Board's approval;
- Received updates on the valuations of the Group's Hong Kong property assets and Mainland China investment properties;
- Received updates on the latest budget status of the Company's railway construction projects under entrustment by the HKSAR Government;
- Received a preview of the 2021 interim and annual accounting and financial reporting issues;
- Received reports on the pre-project agreement cost summary of new railway projects under the Railway Development Strategy 2.0; and
- Reviewed the revised Financial Delegation Framework for submission to the Board.

Internal Audit and Internal Control

- Reviewed Risk Management and Internal Control Systems Effectiveness for 2020 for submission to the Board (focused on the internal control system, as the risk management system effectiveness was separately reviewed and endorsed by the former Risk Committee);
- Reviewed the Report on Evaluation of Effectiveness of Internal Audit Department for 2020;
- Reviewed the Continuing Connected Transactions for 2020;
- Received a review report on the cost control exercised over the Company's Hong Kong property developments;
- Reviewed Internal Audit Department's six-monthly Reports;
- Approved the 2022 Internal Audit Plan; and
- Received a report on Internal Audit coverage across the Company's Hong Kong Business and Mainland China and International Businesses.

External Auditor

- Received KPMG's reports on the salient features of the 2020 Annual Accounts and 2021 Interim Accounts respectively;
- Considered KPMG's independence and other relevant factors when approving the appointment of KPMG in providing non-audit services; pre-approved the engagement of KPMG to provide non-audit services; and noted KPMG's confirmation of independence in its audit report in respect of the 2020 Annual Accounts and 2021 Interim Accounts respectively;
- Approved KPMG's fee proposal for the 2021 annual audit and the 2022 interim review, as well as other audit related and tax services; and
- Reviewed KPMG's audit plan for the year ended 31 December 2021.

Governance

- Reviewed the report on compliance with statutes and regulations, Operating Agreement and Rail Merger Related Agreements in 2020 and outstanding litigation/potential litigation; and
- Reviewed summaries of the Audit/Risk/Governance Committee Minutes of various subsidiaries of the Company.

For work performed by the former Risk Committee during 2021, please refer to the Risk Committee Report on pages 140 to 141 of this Annual Report.

Subsequent to the restructuring of the Board Committees and up to the date of this Report, the Committee has held a meeting to, among other matters, conduct a review of the Company's internal control and ERM system effectiveness for the year ended 31 December 2021, with delegated authority from the Board, and formed the view that the internal control and ERM system is overall effective and adequate.

RE-APPOINTMENT OF EXTERNAL AUDITOR

The Committee was satisfied with KPMG's work, its independence and objectivity, and therefore recommended the re-appointment of KPMG (which has indicated its willingness to continue in office) as the Group's external auditor for 2022 for approval by the Company's Shareholders at the 2022 Annual General Meeting.

Dr Eddy Fong Ching
Audit & Risk Committee Chairman
Hong Kong, 10 March 2022

This Audit Committee Report has been reviewed and endorsed by the Audit & Risk Committee.