

*Management of Government  
Investment Incomes*

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## Executive Summary

1. This research studies the management of Government investment incomes by analyzing the financial arrangements, corporate governance and reporting arrangements of selected bodies in Hong Kong, which comprise the Kowloon-Canton Railway Corporation (KCRC), the Airport Authority (AA), the MTR Corporation Limited (MTRCL) and the Hong Kong Science and Technology Parks Corporation (HKSTPC).

### Financial arrangements

2. KCRC and MTRCL were consistently profitable between 1997 and 2003. AA suffered losses from 1998-99 to 1999-2000, but recorded profits from 2000-01 to 2003-04. HKSTPC recorded a profit in 2001-02, but suffered a loss in 2002-03.
3. In regard to the authority responsible for declaring dividends, the Boards of MTRCL and HKSTPC are empowered to determine the amount of dividends payable. In the cases of KCRC and AA, although their Boards determine the amount of dividends payable, they are statutorily required to seek the agreement of the Financial Secretary (FS) on such recommendations.
4. The selected bodies studied take into account similar factors when determining the amount of dividends payable, which are the prevailing financial situation and future capital requirements.
5. KCRC, AA and MTRCL have not signed any memorandum of understanding or agreement with the Government for a dividend payout policy. HKSTPC is the only body in this research which has recently signed a shareholder agreement with the Government to cover the dividend payout policy.
6. The Government received cash dividends from KCRC: HK\$300 million in 1997-98 and HK\$620 million in 2003-04. As regards MTRCL, the Government received cash dividends: HK\$647 million in 1997-98, HK\$1,252 million in 1998-99, HK\$371.7 million in 2001-02 and HK\$470 million in 2002-03, and scrip dividends: 48 873 554 shares in 2001-02, 87 991 070 shares in 2002-03 and 108 213 287 shares in 2003-04. However, the Government did not receive any dividends from HKSTPC since its establishment. Whilst AA did not pay any dividend to the Government previously, AA has declared to pay a dividend of HK\$380 million to the Government in 2003-04. The Government will credit the dividend into its account in 2004-05. The accounting arrangement of crediting cash dividends is to credit them into the General Revenue Account. For scrip dividends, it is reflected in the increased gross total shareholdings of the entities concerned under "Statement of Investments" of the Capital Investment Fund.
7. KCRC, AA and MTRCL have not made any loans from the Loan Fund, but HKSTPC has obtained loans made available under the Loan Fund. Interests on the loan are credited to the Loan Fund as "Interest on Loans".

8. The Government has granted land to KCRC, AA and MTRCL for residential and/or commercial developments. However, the Government does not have information on the current value of the land granted to these bodies.
9. In regard to land premia, the Government received HK\$58.96 million in 1997-98, HK\$8.2 million in 1999-2000, HK\$160 million in 2000-01 and HK\$1,322 million in 2002-03 from KCRC. In the case of MTRCL, the Government received HK\$9,984 million in 1997-98, HK\$302 million in 1998-99, HK\$10,886 million in 1999-2000, HK\$8,456 million in 2000-01, HK\$1,941 million in 2001-02, HK\$2,476 million in 2002-03 and HK\$1,228 million in 2003-04. However, the Government did not receive any land premia from AA and HKSTPC since their establishment. As for the accounting arrangement, land premia are credited into the Capital Works Reserve Fund.
10. In the cases of KCRC, AA and HKSTPC, the Legislative Council (LegCo) monitors their financial arrangements through approving the public funding proposals for specific projects and purposes, and receiving their reports and financial statements. As for MTRCL, LegCo monitors the financial arrangements only through approving the public funding proposals for specific projects and purposes.

#### Corporate governance

11. The Administration has 100% ownership of KCRC, AA and HKSTPC, as well as 76% ownership of MTRCL. However, the voting power of the Administration in the Boards of KCRC, AA, MTRCL and HKSTPC is 20%, 23.1%, 27.3% and 6.3% respectively.
12. The Chief Executive of the Hong Kong Special Administrative Region (CE) is responsible for appointing the Chairman of KCRC, AA and HKSTPC. In the case of MTRCL, as long as the Government remains the beneficial majority owner, CE is empowered to appoint its Chairman.
13. In regard to KCRC and AA, CE appoints all Board members, with the exception of the Chief Executive Officer (CEO). The Board of the body concerned is empowered to appoint its CEO, which is subject to the approval of CE. As for MTRCL, being a listed company, the appointing arrangement is different. Non-executive directors may be appointed either by the shareholders in a general meeting or by the Board upon the recommendation of the Nominations Committee. CE appoints "additional directors". As regards HKSTPC, FS appoints the Board members.
14. The criteria for appointing the Chairman and Board members of the selected bodies studied primarily include: personal capabilities, leadership, expertise, experience, integrity and commitment to public service.

15. The selected bodies studied have established various committees carrying out major functions of the Boards and have employed an external auditor to audit the financial statements. Contrary to the other three selected bodies, HKSTPC does not have any audit committee established under the Board.
16. The Boards of the selected bodies studied are responsible for approving the annual budgets, which are prepared by the senior management. For HKSTPC, the Board-approved annual budget is statutorily required to be submitted to FS for his acceptance.
17. The selected bodies studied do not present their annual budgets to LegCo and do not solicit views and comments from LegCo Members on revenue and expenditure estimates.
18. In regard to the procedures for appointing CEO and determining the remuneration and conditions of service, the selected bodies studied adopt different arrangements. In the case of KCRC, the Board decides on the appointment of CEO, including his terms and conditions of service, subject to the prior approval of CE. As for AA, the appointment of CEO requires the prior approval of CE, but his financial package is determined by the Board. In regard to MTRCL, the Board has the authority to appoint CEO and determine the terms of remuneration. As regards HKSTPC, the Board appoints CEO and determines the terms and conditions of his service, which are subject to the prior approval of FS.
19. With regard to determining the remuneration packages of senior management staff and adjusting the annual remuneration packages, the Boards of KCRC, AA and HKSTPC consider comparable levels in the market. As for MTRCL, there is no public information available. As regards share option benefits, MTRCL is the only body in this research which has offered such benefits to its senior staff.

#### Reporting arrangements

20. The statutory reporting arrangements of KCRC, AA and HKSTPC to the Administration are the same. To monitor the operations of these three bodies studied, the Administration is empowered to: (a) appoint the Chairman and Board members; (b) approve the appointment of CEO; (c) obtain the required information; and (d) receive annual reports and financial statements. However, in the case of MTRCL, the Administration, being the largest shareholder of the listed company, is authorized to (a) appoint the Chairman and Board members and (c) obtain the required information only.
21. The statutory reporting arrangements of KCRC, AA and HKSTPC to LegCo are also the same, which are: (a) briefing relevant panels and bills committees; (b) seeking the approval of public funding for specific projects and purposes; and (c) submitting annual reports and financial statements. The reporting arrangements of MTRCL are: (a) briefing relevant panels and bills committees although such arrangement is not a statutory requirement; and (b) seeking the approval of public funding for specific projects and purposes only.

# Management of Government Investment Incomes

## Chapter 1 - Introduction

### 1.1 Background

1.1.1 At the meeting of the Legislative Council (LegCo) Panel on Financial Affairs (FA Panel) held on 14 March 2002 when the research report entitled *"Practices of Overseas Jurisdictions in Building up or Maintaining Their Fiscal Reserves"* published by the Research and Library Services Division (RLSD) was presented, Members noted that detailed information on Government investment incomes was not readily available in the public domain. It would therefore be difficult to monitor how far Government investment incomes were ploughed back to the General Revenue Account (GRA) for financing specific social services or contingent relief measures.

1.1.2 On 16 May 2002, the then Secretary for the Treasury provided information on the sources of Government investment incomes and investment returns for the period 1996-97 to 2000-01 to Members vide LC Paper No. CB(1) 1772/01-02(01) dated 17 May 2002. However, detailed information on the Government's investments on equity holdings with respect to financial arrangements, corporate governance and reporting arrangements to the Government and LegCo remained not available.

1.1.3 Members raised similar concerns on various subsequent occasions. At the meeting held in July 2002, members of the then "Subcommittee on matters relating to the implementation of railway development projects" (the Subcommittee) considered the draft Penny's Bay Rail Link (PBRL) Project Agreement. They were concerned about the scope and extent of powers of the Financial Secretary (FS) in relation to the management of dividends and other incomes generated from the Government's investments in public and private companies. Members were also concerned about whether proper mechanisms were in place to ensure that the exercise of such powers was properly accounted for by the executive authorities to LegCo. The Subcommittee requested that the above policy issues should be further discussed by the FA Panel.

1.1.4 Similar concerns were raised in the discussion on the appropriate mechanism for financing the West Kowloon Cultural District Development project and the role of LegCo in monitoring the development of that project.

1.1.5 To address Members' concerns regarding the management of Government investment incomes, RLSA proposed to conduct in-depth research on this subject to assist Members in analyzing the financial arrangements, corporate governance and reporting arrangements of selected bodies in Hong Kong, particularly on the following aspects:

- (a) funding arrangements of selected bodies;
- (b) financial arrangements between the Government and the selected bodies;
- (c) corporate governance of the selected bodies; and
- (d) reporting arrangements of the selected bodies to the Government and LegCo.

1.1.6 The proposed research outline was endorsed by the FA Panel at its meeting on 5 January 2004.

## **1.2 Selection of bodies studied**

1.2.1 The Government's investments in equity holdings are presented in the Statement of Investments under the Capital Investment Fund<sup>1</sup> (CIF), which are listed in Table 1 on page 3. There are 10 such investments in equity holdings. (Please see Appendix I for details of CIF.)

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<sup>1</sup> CIF finances investments in and loans to public sector bodies which are not part of the Government structure and other such bodies as the Finance Committee (FC) of LegCo may specify. It was established with effect from 1 April 1990 by a resolution passed by LegCo under section 29(1) of the Public Finance Ordinance (PFO) (Cap. 2) on 14 March 1990. Amendments to this resolution were passed by LegCo on 6 November 1991 to include provisions for Government borrowings to be credited to CIF and for repayments and payments of interest and expenses relating to such borrowings, to be made from CIF.

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**Table 1 — Government's total investments in equity holdings**

<b>Investment in equity holdings</b>	<b>Government's total investments (at end-March 2004)</b>
Airport Authority	HK\$36,648.0 million
Asian Development Bank	HK\$87.2 million
Hong Kong Science and Technology Parks Corporation	HK\$250.0 million
Hong Kong International Theme Parks Limited	HK\$5,229.6 million
IEC Holdings Limited	HK\$256.6 million
Kowloon-Canton Railway Corporation	HK\$39,120 million
MTR Corporation Limited	HK\$26,884.8 million
New Hong Kong Tunnel Company Limited	HK\$56.3 million
Applied Research Council	HK\$175.0 million
Tradelink Electronic Commerce Limited	HK\$61.1 million
<b>Total equity holdings</b>	<b>HK\$108,768.7 million</b>

Source: The Treasury Branch. (March 2004) *Accounts of the Government for the year ended 31 March 2004*, page 340.

1.2.2 As at end-March 2004, the Government's three largest investments were the Kowloon-Canton Railway Corporation (KCRC), the Airport Authority (AA) and the MTR Corporation Limited (MTRCL), which amounted to HK\$39.1 billion, HK\$36.6 billion and HK\$26.8 billion respectively. Owing to the substantial size of these investments, the performance of their returns should play a significant role in affecting the Government's financial well-being. Dividends and other incomes generated by these investments, when distributed to the Government, should help reduce the Government's budget deficit. Therefore, RLSD has selected KCRC, AA and MTRCL in this research.

1.2.3 Since KCRC, AA and MTRCL are all transport investments, a Government investment in a different type of business is included in this research. Such an investment should be in operation for a few years and the amount of investment should be of a certain magnitude. RLSD has chosen the Hong Kong Science and Technology Parks Corporation (HKSTPC) because it has been in operation since May 2001 and is the Government's fifth largest investment.

### **1.3 Scope of the research**

1.3.1 The scope of the research, as agreed by the Panel, covers:

Chapter 1 — Introduction

Chapter 2 — Kowloon-Canton Railway Corporation

Chapter 3 — Airport Authority

Chapter 4 — MTR Corporation Limited

Chapter 5 — Hong Kong Science and Technology Parks Corporation

Chapter 6 — Analysis

1.3.2 Chapter 1 provides the background information of the research.

1.3.3 Chapters 2 to 5 discuss the following aspects of the selected bodies:

#### Background information

- (a) legislation enacted to establish the selected bodies;
- (b) principal activities undertaken;

#### Financial arrangements

- (c) financial highlights of the selected bodies;
- (d) dividends and other incomes payable to the Government for the period 1997-98 to 2002-03 and crediting such incomes into the Government's accounts;
- (e) financial arrangements between the Government and the selected bodies;
- (f) role of LegCo in monitoring the financial arrangements of the selected bodies;

Corporate governance

- (g) organizational structure;
- (h) formation and responsibilities of the management Board;
- (i) extent of authority of the Chairman and senior management staff over the budget and financing of the selected bodies;
- (j) procedures for appointing the Chairman and senior management staff and determining their remuneration and conditions of service;
- (k) decision-making process of the Board; and

Reporting arrangements

- (l) arrangements for reporting to the Government and the Legislative Council.

1.3.4 Chapter 6 analyzes the parameters listed in (a) to (l) above with respect to the aforementioned bodies.

**1.4 Additional information requested by the Financial Affairs Panel**

1.4.1 At the working meeting of the members of the FA Panel held on 15 July 2004 for the discussion on the draft research report, members agreed that the Government should be invited to provide information on some specific areas in the research report:

Principal activities undertaken by the selected bodies

- (a) the background and rationale for allowing the selected bodies to undertake property development projects and commercial activities not related to their principal function of operations;
- (b) whether the involvement in property development projects is a deviation from the policy intent of their establishment or any agreement between the Government and the bodies concerned;

Financial arrangements

- (c) the value, size and lease term of all land parcels granted by the Government to each of the selected bodies;

- (d) whether the Government has reviewed its policy of subsidizing commercially-operated infrastructural projects in the form of land grants;

*Land premium*

- (e) the method, assumptions, valuation components and criteria adopted by the Government in assessing land premium paid by the selected bodies;

*Availability of detailed information on Government investment incomes*

- (f) whether the Government plans to make the amount of cash dividends, land premia and loan interests, and the total number of scrip dividends received from the selected bodies and other similar bodies publicly available;

*Plough-back of investment incomes to Government revenue*

- (g) the rationale of not requiring the plough-back of investment incomes to Government revenue mandatory and of the different arrangements adopted by the selected bodies for declaring dividends;

Corporate governance

*Appointment of the Chairman and Board members of the selected bodies*

- (h) the criteria for appointing the Chairman and Board members of KCRC, MTRCL and HKSTPC;

*Appointment of the Chief Executive Officer (CEO) and senior staff of the selected bodies*

- (i) the method of appointing CEO to the selected bodies;
- (j) the number of ex-civil servants who have joined the senior management of the selected bodies;

*Remuneration packages of CEO and other members of the senior management of the selected bodies*

- (k) policies and criteria for determining the remuneration packages of CEO and other members of the senior management of the selected bodies;

*Voting power of public officers in the Boards of the selected bodies*

- (l) in what manner could the arrangement of appointing public officers in the Boards of the selected bodies be able to protect the Government's investment interests;

Reporting arrangements

- (m) the Government's role in relation to both the budgetary process and the approval of the annual budgets of the selected bodies; and
- (n) the rationale of not requiring the selected bodies to present and explain the details of the annual reports and financial statements to LegCo.

## **1.5 Methodology**

1.5.1 The research involves a combination of information collection and analysis. In addition to making reference to materials available in the LegCo Library, RLSD also uses reference materials acquired through the Internet and outside sources.

## Chapter 2 — Kowloon-Canton Railway Corporation

### 2.1 Background information

#### Legislation enacted to establish the Kowloon-Canton Railway Corporation

2.1.1 The Kowloon-Canton Railway Corporation (KCRC) was incorporated under the Kowloon-Canton Railway Corporation Ordinance (KCRCO) (Cap. 372) on 24 December 1982 to undertake the operation of the Hong Kong section of the Kowloon-Canton Railway and to construct and operate a light rail transit system in the North West New Territories of Hong Kong.<sup>2</sup> The assets, rights and liabilities of the then existing railway were vested in KCRC on 1 February 1983 in accordance with section 7 of KCRCO.

2.1.2 Amendments to KCRCO in 1986 and 1998 empowered KCRC to construct and operate new railways and enabled the Government to inject equity funding into KCRC for construction of the new railways. At present, KCRC is a statutory body, which is wholly owned by the Financial Secretary Incorporation (FSI)<sup>3</sup> on behalf of the Government.<sup>4</sup>

2.1.3 According to the "Statement of Investments" of CIF, the Government's investment in KCRC for the financial year ended 31 March 2004 amounted to HK\$39,120 million, which was entirely in cash.

#### Principal activities undertaken

2.1.4 According to section 4(1) of KCRCO, KCRC is empowered to:

- (a) construct the North-west Railway and any other railway that the Secretary for the Environment, Transport and Works authorizes KCRC to construct;
- (b) operate the railways for the use of the public;
- (c) extend and improve the railways;

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<sup>2</sup> East Rail (the former Kowloon-Canton Railway or KCR) came into service in 1910. Prior to 1982, KCR had operated as a government department. With the enactment of KCRCO in December 1982, KCRC was established as a separate entity from the Government.

<sup>3</sup> Under section 2 of the Financial Secretary Incorporation Ordinance (Cap. 1015), FSI is "a corporation sole constituted by the person who for the time being performing the duties of the office of FS."

<sup>4</sup> Section 8(5) of KCRCO provides that all KCRC shares allotted to the Government under KCRCO shall be registered in the books of KCRC in the name of FSI and held by him in trust on behalf of the Government.

- (d) operate bus services within the North-west Transit Service Area; and
- (e) engage in such other activities, and perform such other functions, as the Chief Executive of the Hong Kong Special Administrative Region (CE) may, after consultation with KCRC, permit or assign to it by order published in the Gazette.

2.1.5 KCRC is also required under section 12(1) of KCRCO to conduct its business in a prudent commercial manner.<sup>5</sup>

2.1.6 In practice, the principal activities undertaken by KCRC are:

- (a) the operation of East Rail running between East Tsim Sha Tsui and the boundary at Lo Wu;
- (b) the operation of West Rail<sup>6</sup> running between the North West New Territories and urban Kowloon;
- (c) the operation of Light Rail;<sup>7</sup>
- (d) the operation of the Ma On Shan Rail (MOSR)<sup>8</sup>;
- (e) the operation of cross-boundary passenger and freight traffic in association with Mainland railway authorities;
- (f) the development of property projects with joint-venture partners along its railway networks;
- (g) the development of associated commercial activities, including sale of advertising, marketing of concessions and property leasing;
- (h) the operation of feeder bus services;
- (i) the construction of the Lok Ma Chau Spur Line (LMCSL);
- (j) the planning and design of the Shatin to Central Link (SCL) and the Kowloon Southern Link (KSL); and
- (k) the operation of the octopus cards system,<sup>9</sup> which collects payments for both transport and non-transport applications.

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<sup>5</sup> Section 12(1) of KCRCO provides that: *"The Corporation shall conduct its business according to prudent commercial principles and shall ensure as far as possible that, taking one year with another, its revenue is at least sufficient to meet its expenditure."*

<sup>6</sup> It was opened in December 2003.

<sup>7</sup> This system was formerly a stand-alone transit service and is now a feeder service for West Rail.

<sup>8</sup> It was opened in December 2004.

<sup>9</sup> KCRC owns 22.1% of the issued shares of the Octopus Cards Limited.

Background and rationale for allowing the railway corporations to undertake property development projects and commercial activities not related to their principal function of railway operations

2.1.7 The Administration has explained that KCRC<sup>10</sup> operates under prudent commercial principles. Property development provides a source of income to the corporation to support the financial viability of railway projects and contributes to future rail patronage from the immediate catchment areas created by the property developments. In conjunction with its railway construction activities, KCRC has been involved in the development of residential and commercial properties above and adjacent to railway stations and depots under agreements with private developers. Profits from these development ventures have been used to supplement associated railway returns, thereby contributing to an improved rate of return on the investment cost of constructing new railway lines.

2.1.8 The Administration has elaborated that with KCRC being held responsible for the entire station site of a typical development project, the above-station or depot development can be optimally planned and utilized. Under this approach, the necessary infrastructure to support the development and any property enabling works is provided at the most appropriate time in the most efficient way. This co-ordinated approach can ensure that the comprehensive development can be completed successfully.

2.1.9 According to the Administration, the integration of property and station developments ensures that safety and operational aspects of the railway are safeguarded. With the same organization managing the development and railway, responsibilities are clearly defined and any impacts of the property development on the railway can be properly managed.

2.1.10 In response to Members' concern that whether the involvement of KCRC in property development projects and related commercial activities is a deviation from the policy intent of its establishment or any agreement between the Government and KCRC, the Administration has stated that KCRC is set up for the development and operation of the railway networks in Hong Kong. The businesses that KCRC currently engages in are not in conflict with this goal.

Possible merger of the Kowloon-Canton Railway Corporation and the MTR Corporation Limited

2.1.11 On 24 February 2004, the Government announced that KCRC and MTRCL<sup>11</sup> had been invited to start negotiations on a possible merger. The negotiations were to be conducted on the basis of the following key parameters set by the Government:

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<sup>10</sup> The explanation provided by the Government also applies to MTRCL.

<sup>11</sup> The Government is the sole owner of KCRC and is currently holding about 76% of the issued shares of MTRCL, which is a listed company.

- (a) adoption of a more objective and transparent fare adjustment mechanism;
- (b) abolition of the second boarding charge and review of the fare structure with the objective of reducing fares;
- (c) early resolution of interchange arrangements for rail projects under planning, notably SCL;
- (d) assurance of job security for the frontline staff of both corporations at the time of the merger;
- (e) provision of seamless interchange arrangements in the long run; and
- (f) conclusion of the negotiations by 31 August 2004.

2.1.12 The Government asked KCRC and MTRCL to give a clear understanding in respect of all parameters set out in the above paragraph, and to submit the outcome of their negotiations, including preliminary transaction terms and the framework of a draft integrated operating agreement with key terms on, inter alia, a fare adjustment mechanism and measures to deal with service disruption.

2.1.13 On 16 September 2004, the Government received a joint report<sup>12</sup> prepared by KCRC and MTRCL on the outcome of their discussion on the feasibility of a merger of the two corporations. The Government has stated that it is committed to conducting further discussion with the railway corporations and examining their report before deciding on the way forward on the possible merger.

2.1.14 MTRCL has pointed out that as the Government currently owns 100% of KCRC and approximately 76% of MTRCL, any transaction involving the Government will be treated as a connected transaction under the Listing Rules. Hence, the merger will be subject to the approval of independent shareholders of MTRCL.

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<sup>12</sup> The report submitted by the two railway corporations also includes a joint assessment on how the proposed Express Rail Link (ERL), which is an express railway between Hong Kong and Guangzhou, can be accommodated in the local railway network, as requested by the Government in August 2004.

## 2.2 Financial arrangements

### Financial highlights of the Kowloon-Canton Railway Corporation for the period 1997 to 2003

2.2.1 Table 2 presents the financial highlights of KCRC for the period 1997 to 2003. From the consolidated income statement, it can be seen that the turnover value steadily increased from HK\$3,718 million in 1997 to HK\$4,830 million in 2002, but then decreased modestly to HK\$4,426 million in 2003.

2.2.2 While the operating profit of KCRC grew between 1997 and 2003, profit after taxation showed a different trend, with the 1997 figure being higher than the 2003 figure. In 1997, profit after taxation amounted to HK\$3,263 million, of which HK\$2,308 million (71%) came from property development. In 2003, profit after taxation was HK\$1,910 million, which did not include any property development profit. In sum, property development profit played a significant role in determining profit after taxation in 1997 but not so afterwards.

2.2.3 There are two issues which may affect KCRC's future property development profit. First, in October 2003, the Government reached an understanding with KCRC not to put any property developments up for tender having regard to the soft property market conditions. This arrangement was maintained until the end of 2004.

2.2.4 Second, KCRC only obtains profits from those developments to be built along East Rail, Light Rail and MOSR. In the case of the far larger property sites along West Rail, the project agreement entered into with the Government requires that KCRC acts only as the agent of the Government in their development. The profits from the development of these sites are required to be returned to the Government. Hence, KCRC will not benefit directly from the property developments along West Rail, although these new developments will be a source of patronage for the railway.

2.2.5 The consolidated balance sheet shows that both total assets and liabilities continuously increased during the period, which was mainly due to the construction of new railway networks. In regard to the return rate on net assets, it remained stable at the range of 3.7% - 4.7% between 1999 and 2002, but dropped to 2.3% in 2003.

**Table 2 — Financial highlights of KCRC for the period 1997 to 2003 (HK\$ million)**

	1997	1998	1999	2000	2001	2002	2003
<b>Consolidated income statement</b>							
Turnover	3,718	4,137	4,426	4,731	4,797	4,830	4,426
Operating profit/(loss) before depreciation	1,769	2,032	2,249	2,571	2,572	2,659	2,297
Property development profit	2,308	88	71	87	24	94	Nil
Profit before taxation	3,640	1,717	1,844	2,289	2,436	2,662	1,910
Profit after taxation	3,263	1,639	1,903	2,288	2,435	2,210	1,381
<b>Consolidated balance sheet</b>							
Assets	15,866	31,945	58,291	70,419	82,537	86,108	89,204
Liabilities	(1,549)	(1,692)	(11,703)	(21,518)	(22,957)	(26,596)	(28,999)
Share capital	2,120	16,620	31,120	31,120	39,120	39,120	39,120
Shareholders' funds	14,317	30,253	46,588	48,901	59,580	59,512	60,205
Return rate on net assets (%)	22.8%	5.4%	4.1%	4.7%	4.1%	3.7%	2.3%
Debt/equity ratio	Nil	Nil	1:5.6	1:3.0	1:3.5	1:3.4	1:3.0

Source: KCRC.

**Payment of dividends and other incomes for the Government**

2.2.6 The Financial Services and the Treasury Bureau (FSTB) has indicated that the Government received from KCRC HK\$300 million in 1997-98 and HK\$620 million in 2003-04 (see Table 3 below), and no dividends during the years between the two financial years. In accordance with section 14(3) of KCRCO, any dividends received from KCRC are credited into GRA.

**Table 3 — Dividends<sup>1</sup> and land premia received by the Government for the period 1997-98 to 2003-04 (HK\$ million)**

	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04
Dividends	300	Nil	Nil	Nil	Nil	Nil	620
Land premia	58.96	Nil	8.2	160	Nil	1,322	Nil

Note: 1. The dividends received represent the dividends distributed in the previous year.

Source: FSTB.

*Dividends*

2.2.7 In regard to the dividend payout policy:

- (a) KCRC has not signed any memorandum of understanding or agreement with the Government for a dividend payout policy; and
- (b) there is no dividend payout policy agreed between KCRC and the Government. Each year, KCRC determines the amount of dividends payable based on the prevailing financial position of KCRC and then writes to the Secretary for Financial Services and the Treasury to seek the agreement of the Financial Secretary (FS) to accepting KCRC's recommendation of dividends payable in accordance with section 14 of KCRCO.

2.2.8 When determining the amount of dividends payable, KCRC takes into account the following factors:

- (a) the financial position of KCRC;
- (b) the net profit for the year and retained earning;
- (c) capital expenditure required in the coming years, particularly West Rail, East Rail Extensions and other new railway projects;
- (d) credit ratings of KCRC; and
- (e) expectation of investors if KCRC were privatized or listed.

2.2.9 RLSD has requested FSTB to explain why the Government did not receive any dividends from KCRC between 1998-99 and 2002-03 during which KCRC was profitable. FSTB has replied that under section 14(1) of KCRCO, KCRC may declare and pay dividends to the Government in the amount of the whole or part of its profits in any financial year. In arriving at the decision of not paying any dividends to the Government, the Board had considered the overall financial position of KCRC.

*Property development projects*

2.2.10 The Government has granted a total of 297 668 sq m of land to KCRC for residential and commercial developments. (Please see Appendix II for the size and lease term of all land parcels granted to KCRC.) However, the Government does not have the information on the current value of the land granted to KCRC.

2.2.11 KCRC currently holds 10 property investment projects, totalling 82 122 sq m in gross floor area (GFA). (Please see Appendix III for details.) In addition, KCRC has nine proposed property development projects, which are estimated to be completed between 2007 and 2015. According to FSTB, the estimated profit for KCRC and the Government from these proposed projects is HK\$2,977 million and HK\$3,181 million respectively.

2.2.12 FSTB has also pointed out that the provisions in relation to land granted for property developments for new projects are embedded in the relevant project agreements. In general, the project agreements specify the property development sites associated with the projects and the financial arrangements for sharing the property development profits. Other provisions on land vesting to KCRC are set out in sections 4(3), 7 and 7A of KCRCO.

#### *Members' concerns on land policy*

2.2.13 During the motion debate on "Review of land policy" at the LegCo meeting held on 16 June 2004<sup>13</sup>, Members expressed that the present land policy had strong inadequacies in servicing the needs of the society due to inappropriate allocation and management of the valued land resources. They suggested that there was an immediate need to review the policies of land supply, utilization and allocation in relation to infrastructural development, particularly the commercially-operated ones such as KCRC, AA and MTRCL. In addition, the existing land policy should be revised so that the limited land supply could only be allocated through a market-driven mechanism, apart from the non-commercial infrastructural developments for public purposes.

2.2.14 Members agreed that disposing public land for private use through open and competitive bidding ensured that the market forces of supply and demand determined the price of land. The Government could then gain the maximum financial benefits, avoid disorderly property development and safeguard the interest of Hong Kong people. However, in reality, land parcels were often transferred into private hands through other means.

2.2.15 Members pointed out that the Government had used land as indirect subsidy for commercially-operated projects. If these infrastructural projects were financially viable, no government subsidy should be provided. If these projects were not financially viable, the Government should provide the operators cash subsidies in a transparent manner, not in the hidden form of private land grants.

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<sup>13</sup> The motion without legislative effect was passed.

2.2.16 Members believed that the railway companies' reliance on receiving land subsidy was unhealthy and unsustainable. There were also doubts as to whether the Government should provide MTRCL, a listed company, land subsidies which benefited its shareholders at the expense of Hong Kong people.

#### *Assessment of land premia*

2.2.17 FSTB has elaborated that the selected bodies are required to pay land premia<sup>14</sup> at full market value (FMV) for their property development activities<sup>15</sup>. In effect, FMV means the best price at which the sale of the land may reasonably be expected to have achieved unconditionally for cash consideration on the date of valuation assuming:

- (a) a willing seller;
- (b) that, prior to the date of valuation, there has been a reasonable period (having regard to the nature of the land and the state of the property market) for proper marketing, for the agreement of price and terms and for the completion of the sale; and
- (c) that no account is taken of any additional bid by a purchaser with a special interest.

2.2.18 When assessing the land premium, in the case of KCRC, the Government has adopted the "green field site" principle<sup>16</sup>, which requires that the valuation of FMV of a property development site is assessed on the basis of no railway development. The Government has explained that the rationale of this arrangement is that the railway development is considered as an investment made by KCRC, not the Government.

2.2.19 According to the Hong Kong Institute of Surveyors (HKIS)<sup>17</sup>, it is not aware that the "green field site principle" has been adopted in other land premium cases.

2.2.20 RLSD has also asked the Government, HKIS and academics the question of whether the adoption of the "green field site" principle for the two railway corporations may lead to below-market land premium paid by them. The Government has replied that since the valuation is on FMV basis, the premium paid by the railway corporations is the market value of the site instead of a "below-market" value.

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<sup>14</sup> The Government does not consider land premia received from the selected bodies as investment incomes.

<sup>15</sup> Land premia relating to the land for railway, airport or science park operation are not included in this research.

<sup>16</sup> The "green field site" principle also applies to MTRCL.

<sup>17</sup> HKIS has also pointed out that apart from the MTRCL initial public offering prospectus which has mentioned the "green field site" principle, it is not aware of any other document in the public domain which has discussed this principle.

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2.2.21 However, HKIS has presented a different view. It believes that the application of the "green field site" principle in the premium assessment for the railway corporations imposes an important assumption (in relation to the availability of the railway development) into the valuation process and thus would have significant implications for the premium assessment. Other things being equal, the availability of railway development would normally enhance accessibility and thus land values.

2.2.22 An academic has commented that if a KCRC/MTRCL project is going to benefit by the presence of the railway station/line extension, the increase in land value due to the railway factor should be taken into account. If not, there is a potential under-valuation of the site, and this treatment is considered unfair when compared to the situations involving private developers. Overall, the application of the "green field site" principle in the premium assessment is regarded as implicitly creating indirect subsidy to the railway corporations.

#### *Amount of land premia*

2.2.23 The amount of land premia received by the Government was HK\$58.96 million in 1997-98, HK\$8.2 million in 1999-2000, HK\$160 million in 2000-01 and HK\$1,322 million in 2002-03. However, no land premia were received by the Government in 1998-99, 2001-02 and 2003-04 as KCRC did not make any land transactions during those years. Like all land premia collected by the Government, land premia received from KCRC are credited into the Capital Works Reserve Fund (CWRP).

#### *Others*

2.2.24 Since KCRC did not obtain any loan under the Loan Fund, no interest was received by the Government for the period 1997-98 to 2003-04.

#### Role of the Legislative Council in monitoring the financial arrangements of the Kowloon-Canton Railway Corporation

2.2.25 LegCo is vested with the powers to examine and approve budgets introduced by the Government under Article 73 of the Basic Law. In addition to the budget, the Government's revenue proposals which cause either higher or lower government revenue also require the prior approval of LegCo.<sup>18</sup> (Please see Appendix IV for the discussion on the role of LegCo in relation to the approval of budget and revenue proposals.)

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<sup>18</sup> An example of revenue proposal which generates higher government revenue is the Revenue Bill 2003, which sought to implement the proposals on first registration tax for motor vehicles announced in the 2003-04 Budget. Meanwhile, an example of revenue proposal which causes lower government revenue is the Revenue (No.3) Bill 2003, which sought to implement two of the tax concession proposals announced in the 2003-04 Budget, namely enhanced tax concessions for qualifying debt instruments, and exemption from fixed stamp duty for unit trusts.

2.2.26 LegCo is not empowered to play any role in relation to the declaration of dividends by KCRC. However, LegCo may monitor the financial arrangements of KCRC through approving public funding proposals and receiving KCRC's annual report and financial statements.

2.2.27 In effect, the Government is required to seek LegCo's approval to inject equity into KCRC on major projects, e.g. West Rail, and to approve funding through CWRP for requisite essential public infrastructural works for railway projects, e.g. East Rail Extensions and West Rail.

2.2.28 In addition, as stipulated in section 14B(5) of KCRCO, KCRC shall, within three months of the receipt of the auditor's report on its accounts for a financial year, furnish:

- (a) a report on the affairs of KCRC for that year;
- (b) a copy of its accounts; and
- (c) the auditor's report on the accounts,

to FS who shall table such documents before LegCo.

### **2.3 Corporate governance**

2.3.1 According to the 2003 annual report of KCRC, KCRC complied throughout the year with the Code of Best Practice as set out by the Hong Kong Stock Exchange (HKSE) in Appendix 14 to the Listing Rules where applicable, although it was not required to do so. By doing so, KCRC intended to project an image of maintaining high standards of corporate governance.

#### The Board

##### *Functions*

2.3.2 Pursuant to section 3(2) of KCRCO, the Board is the governing body of KCRC with authority to exercise the statutory powers of KCRC, which are set out in section 4(1) of KCRCO. (See paragraph 2.1.4 above for details.)

2.3.3 In practice, the Board is responsible, inter alia, for overall company strategies, acquisition and divestment policies, approval of KCRC's annual estimates of revenue and expenditure, major financing arrangements, determination of passenger fares and freight charges, and for ensuring that sound administrative systems and procedures are in place. It also reviews KCRC's monthly operating results, safety record, and the progress made towards annual targets. The Board has delegated the management of day-to-day affairs to the executive management.

#### *Membership of the Board*

2.3.4 Section 3(2) of KCRCO provides that the Board shall comprise a non-executive Chairman<sup>19</sup>, an ex-officio Chief Executive Officer (CEO) and between four and eight non-executive Board members. KCRCO was amended in December 2001, providing for the separation of the functions and duties of the Chairman from those of the then newly created CEO post<sup>20</sup>. This arrangement aims at encouraging greater transparency and responsiveness of KCRC.

2.3.5 Currently, the Board comprises the Chairman, an acting CEO and eight non-executive Board members. Among the non-executive Board members, five belong to the banking, law, surveying, accounting and academia sectors. Another Board member is a legislator and the remaining two Board members are public officers, who are the Secretary for the Environment, Transport and Works, and the Secretary for Financial Services and the Treasury.

#### *Appointment*

2.3.6 In accordance with section 3(2) of KCRCO, CE appoints the Chairman and other Board members, except CEO. CEO is appointed by the Board, subject to the prior approval of CE.

2.3.7 In regard to the criteria for appointing the Chairman and Board members other than CEO, the criteria include personal capabilities, leadership, expertise, experience, integrity and commitment to public services.

2.3.8 The term of the Board members, as specified in the First Schedule of KCRCO, is that Board members who are not public officers shall be appointed for a term not exceeding three years. The appointment for each term is normally two years.

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<sup>19</sup> The current Chairman is Mr Michael Tien, who took office on 24 December 2001.

<sup>20</sup> The previous CEO Mr K Y Yeung retired at the end of 2003. KCRC does not have a CEO for the time being and Mr Samuel Lai is the acting CEO.

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*Handling conflicts of interest*

2.3.9 Declarations of interest for the Board members (including CEO) is required under paragraph 6 of Schedule 1 to KCRCO which stipulates that a Board member who is directly or indirectly interested in a contract or transaction made or proposed to be made by KCRC shall disclose his or her interest at a Board meeting and the disclosure shall be recorded in the minutes of the Board. The Board member concerned shall not, without the permission of the Chairman, take part in the deliberation and shall not vote on the contract.

*Honorarium of the Chairman and Board members*

2.3.10 The Chairman and Board members receive honorarium for their services. The 2003 figures were:

- (a) Chairman: HK\$220,000 per annum; and
- (b) Board members: HK\$110,000 per annum.

2.3.11 In regard to the non-executive Board members who are public officers, KCRC pays the honorarium to the Government rather than to the individuals concerned. CEO receives no honorarium for his membership of the Board.

*Meetings*

2.3.12 The Board meets regularly each month.

Committees carrying out major functions of the Board

2.3.13 Five committees have been established under the Board to oversee specific aspects of KCRC's operations and to make appropriate recommendations to the Board for decision. With effect from 1 February 2003, the membership of each of these committees, with the exception of the Audit Committee, has been expanded with the Board appointing to each committee a number of expert members. The addition of these expert members, who are not Board members, is intended to strengthen the role of the committees in advising the Board. The principal terms of reference of these committees are as follows:

*Audit Committee*

2.3.14 This Committee reviews the annual accounts prior to their submission for approval by the Board, monitors accounting policies, considers matters relating to management and internal controls, and receives and appraises reports from the internal and external auditors.<sup>21</sup>

*Finance Committee*

2.3.15 KCRC's Treasury Department, which reports to the Finance Committee, operates within a set of strategies, policies and guidelines, which are defined by the Board to cover funding, cash investment and risk management. The Finance Committee deals with the investment of surplus funds and advises the Board on KCRC's strategies for the financing of future major capital projects.

*Strategic Human Resource Committee*

2.3.16 This Committee reviews and makes recommendations to the Board with respect to the appointments, terminations of appointment and remuneration of senior management staff who are not Board members. It also recommends to the Board the appropriate levels of remuneration of all staff.

*Capital Projects Committee*

2.3.17 This Committee keeps under review and makes recommendations to the Board on subjects relating to the East Rail Extensions, SCL, KSL and other new railway-related capital projects, excluding property development.

*Property Committee*

2.3.18 This Committee oversees property development matters and considers proposals to generate additional revenue from the land and property held by KCRC.

Extent of authority of the Chairman and senior management staff over the annual budget and financing of the Kowloon-Canton Railway Corporation

2.3.19 The financing strategies and plans of KCRC are updated by the senior management at least once a year, and are subject to scrutiny by its Finance Committee and approval of the Board.

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<sup>21</sup> The Internal Audit Department reviews the internal controls of all major financial and operational activities and reports to the Audit Committee.

2.3.20 KCRC has explained that the annual business plan and annual budget are formulated with inputs from all levels of staff. The senior management is actively involved in deriving the departmental/divisional/corporation annual budget by way of setting key financial assumptions, objectives and several rounds of review of the draft annual budget. At each stage of the budgeting process, the senior management will present its recommendations to the Board before seeking the Board's approval of the final annual budget.

2.3.21 In October each year, the senior management provides the Board with the proposed assumptions to be used in updating KCRC's financial base case and three-year business plan. Following the Board's decisions on the assumptions, in November, the senior management submits the updated financial base case and three-year business plan to the Board for approval. Based on the approved financial base case and three-year business plan, in December, the senior management submits the draft annual estimates of revenue and expenditure for the following financial year to the Board for approval. If approved, the estimates become the approved annual budget for the following financial year.

#### Relationship between the Kowloon-Canton Railway Corporation and the Legislative Council over its annual budget

2.3.22 Although KCRC has no statutory obligation to present its annual budget to LegCo, RLSD has enquired KCRC how far it solicits views and comments from LegCo Members on revenue and expenditure estimates and other related matters, such as initiatives to achieve work targets and objectives. According to KCRC, section 12 of KCRCO already requires the Corporation to conduct its business according to prudent commercial principles. KCRCO does not require KCRC to seek the prior approval of FC of LegCo for its annual budget. It also does not solicit views and comments from LegCo Members on revenue and expenditure estimates.

#### Role of the external auditor in relation to financial control

2.3.23 Under section 14B (4) of KCRCO, an external auditor shall be appointed by CE after consultation with KCRC. The external auditor is responsible for auditing the financial statements in accordance with generally accepted accounting principles. The auditor's report is contained in the annual report of KCRC. However, there is no value for money audit report published by either internal or external auditors on KCRC.

2.3.24 KCRC is not put under the scrutiny of the Director of Audit; hence, there is also no value for money audit study conducted by the Audit Commission.

### Procedures for appointing senior management staff and determining their remuneration and conditions of service

2.3.25 The Board decides on the composition of the selection board and the selection criteria for the appointment of CEO. In addition, under KCRCO, the appointment of CEO, including the terms and conditions of such appointment, requires the prior approval of CE.

2.3.26 The Board, with the advice of the Strategic Human Resource Committee, also decides on KCRC's second-tier senior executive management appointments (i.e. the rank immediately below that of CEO, namely senior directors and directors) and those key senior staff who report directly to CEO (i.e. the four general managers responsible for the company secretariat, human resources, corporate affairs and internal audit respectively.)

### Remuneration policies

2.3.27 In considering the remuneration packages of senior management staff, the Board is advised by the Strategic Human Resource Committee which has expert members appointed from outside KCRC. The Board also considers market conditions.

2.3.28 KCRC is in the process of reviewing its whole pay and conditions structure, with a view to benchmarking itself against comparable companies in Hong Kong. The Board will consult staff on the findings of the study in due course, and may consider making the findings more widely available outside KCRC.

### Remuneration packages of senior management staff

2.3.29 As at mid-March 2003, the remuneration packages of CEO and executive directors were as follows:

- (a) CEO: HK\$5.5 million;
- (b) two senior directors: averaged HK\$4.3 million; and
- (c) six directors: averaged HK\$3.4 million.

2.3.30 The remuneration packages were in line with the levels proposed by the Hay Group in June 2002.

Procedures adopted and criteria considered by the Board when reviewing remuneration packages of senior management staff

2.3.31 The posts of all executive staff are ranked according to the Hay Job Evaluation System. KCRC undertakes a survey of 13 comparable benchmark companies to determine the median pay for different ranks of staff on an annual basis. The Board then decides whether or not to adjust, and, if so, by how much, the pay of staff in the light of the survey results.

## **2.4 Reporting arrangements**

2.4.1 Under KCRCO, KCRC is responsible to the Government through the following arrangements:

- (a) the Chairman and Board members, with the exception of CEO, are appointed by CE;
- (b) the appointment of CEO requires the prior approval of CE;
- (c) KCRC is required to provide such information to CE as he may specify; and
- (d) KCRC is required to submit its annual report, as well as the audited financial statements and the auditor's report on these statements to FS for acceptance.

2.4.2 KCRC is answerable to LegCo through the following:

- (a) attending meetings of LegCo and its committees and answering questions;<sup>22</sup>
- (b) reporting its performance in KCRC's financial statements and annual report which are tabled before LegCo; and
- (c) seeking the approval of public funding for specific projects and purposes.

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<sup>22</sup> Section 6A of KCRCO requires the Chairman and CEO to attend meetings of LegCo and its committees and answer questions.

## Chapter 3 — Airport Authority

### 3.1 Background information

#### Legislation enacted to establish the Airport Authority

3.1.1 The Airport Authority (AA) is the statutory body which operates and maintains the Hong Kong International Airport (HKIA), and is wholly owned by FSI on behalf of the Government. It was formally established on 1 December 1995 as the permanent successor to the Provisional Airport Authority through the reconstitution of that body which had itself been established in 1990 upon the enactment of the Airport Authority Ordinance (AAO) (Cap. 483).

3.1.2 In accordance with the Land Grant<sup>23</sup> signed on 1 December 1995, the Government has granted to AA up to the year 2047 the legal rights to the entire airport site at Chek Lap Kok (CLK) together with the rights necessary to develop such site for the purposes of its business.

3.1.3 The Airport Authority (Permitted Airport-related Activities) Order was made under AAO in October 2002 to allow AA to engage in or carry out any airport-related activities at any place in or outside Hong Kong.

3.1.4 According to the "Statement of Investments" of CIF, the Government's investment in AA for the financial year ended 31 March 2004 amounted to HK\$36,648.0 million, which was entirely in cash.

#### Principal activities undertaken

3.1.5 According to section 5(1) of AAO, AA's statutory purpose is to provide, operate, develop and maintain Hong Kong's airport at CLK, in order to maintain Hong Kong's status as a centre of international and regional aviation. Pursuant to these responsibilities, AA may also engage in airport-related activities in trade, commerce or industry at CLK, and carry out any airport-related activities at any place in or outside Hong Kong. AA is also required under section 6(1) of AAO to conduct its business according to prudent commercial principles.

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<sup>23</sup> Under AAO, the Land Grant refers to an agreement and conditions of grant made by the Director of Lands which specifies an area of land at or in the vicinity of CLK which it is thereby agreed to be leased to AA.

3.1.6 Since the opening of the airport at CLK in July 1998, AA's principal activities have been the management, operation, planning and development of HKIA.<sup>24</sup> It also engages in airport-related commercial and industrial activities at CLK.

3.1.7 AA's subsidiary, Aviation Security Company Limited, is engaged in the provision of aviation security services at the airport.

#### Proposed privatization of the Airport Authority

3.1.8 In August 2003, the Government announced that it would commence work in preparation for the proposed privatization of AA.<sup>25</sup> In the following few months, the Government studied various privatization options and considered the key issues involved. After the study, the Government has formulated the way forward for the proposed privatization of AA. As a first step, AA is required to return about HK\$6 billion of equity capital to the Government through capital restructuring prior to privatization.<sup>26</sup>

3.1.9 According to the Government, in pursuing partial privatization of AA, the key objectives are to:

- (a) strengthen market discipline in the running of the airport for greater efficiency and more commercial opportunities;
- (b) enhance AA's access to the capital market;
- (c) introduce an additional quality stock to add diversity to the local financial markets;
- (d) offer an opportunity for Hong Kong people to participate in the success of a well-managed company with strong growth potential; and
- (e) strengthen Government finance in the short to medium term.

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<sup>24</sup> HKIA has received a number of international accolades since its opening in 1998: (a) awarded the world's best airport title for the fourth consecutive year in 2004, according to the largest independent survey of air passengers of its kind conducted by the Skytrax Research in London; and (b) named Cargo Airport of the Year in 2003 by the London-based air cargo trade publication Air Cargo News for the second consecutive year.

<sup>25</sup> The Panel on Economic Services of the Legislative Council, (2004) 23 February. *Privatization of Airport Authority*, LC Paper No. CB(1) 1017/03-04(05).

<sup>26</sup> The Government has injected about HK\$36.6 billion for the establishment of AA.

3.1.10 After considering the options for privatizing AA,<sup>27</sup> the Government has decided that privatizing AA through an initial public offering (IPO) followed by a listing on the Hong Kong Stock Exchange (HKSE) is the preferred option. To enable AA to be privatized by means of IPO, a new company will be formed under the Companies Ordinance (Cap. 32). All the assets, properties, rights and obligations of AA will be vested in this new company through a privatization bill, which will also set the regulatory framework after privatization. After this corporatization process, the Government will launch an IPO and dispose of a certain percentage of its new AA shares, which will be traded in HKSE.

3.1.11 The Government will retain appropriate powers over the privatized AA to ensure safe and efficient operation of the airport, and compliance with the obligations under the Basic Law<sup>28</sup> and other international treaties relating to civil aviation applicable to Hong Kong.

3.1.12 As discussed in paragraph 3.1.8 above, the Government has proposed that AA should return about HK\$6 billion of equity capital to the Government through capital restructuring prior to privatization. The Airport Authority (Amendment) Bill 2004 was introduced into LegCo on 24 March 2004 for this purpose and was passed on 9 June 2004. A resolution was also passed on 16 June 2004 regarding the return of equity capital amounting to HK\$6 billion in cash by AA to the Government. The privatization bill will be prepared and the Government will review the timetable for its introduction into LegCo after further consultations.

## **3.2 Financial arrangements**

### Financial highlights of the Airport Authority for the period 1997-98 to 2003-04

3.2.1 Table 4 presents the financial highlights of AA for the period 1997-98 to 2003-04. From the consolidated income statement, it can be seen that the turnover value rose from HK\$3,773 million in 1998-99<sup>29</sup> to HK\$5,417 million in 2002-03, but dropped to HK\$5,037 million in 2003-04 due to the outbreak of Severe Acute Respiratory Syndrome. Another observation is that AA has started recording profit since 2000-01, amounting to HK\$71 million in 2000-01, HK\$236 million in 2001-02, HK\$502 million in 2002-03 and HK\$386 million in 2003-04.

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<sup>27</sup> The options included sale to strategic investors, securitization, issue of exchangeable bond and sale to the Exchange Fund.

<sup>28</sup> The Government has stated that Articles 128 - 130 of the Basic Law are directly relevant to airport operations.

<sup>29</sup> Since HKIA started operations on 6 July 1998, the 1997-1998 consolidated income figures are not available.

3.2.2 As manifested in the consolidated balance sheet, the return rate on net assets improved from 0.2% in 2000-01 to 1.0% in 2003-04, which nonetheless remained a modest figure.

**Table 4 — Financial highlights of AA for the period 1997-98 to 2003-04 (HK\$ million)**

	1997-98	1998-99 <sup>1</sup>	1999-2000	2000-01	2001-02	2002-03	2003-04
<b>Consolidated income statement</b>							
Turnover	N/A <sup>2</sup>	3,773	5,055	5,159	5,274	5,417	5,039
Operating profit before depreciation	N/A	1,491	1,998	2,358	2,502	2,665	2,347
Profit/(Loss) before taxation	N/A	(384)	(163)	77	243	631	488
Minority interests <sup>3</sup>	N/A	(4)	(5)	(3)	(5)	(4)	0
Profit/(Loss) after taxation and minority interests	N/A	(388)	(168)	71	236	502	386
<b>Consolidated balance sheet</b>							
Assets	47,945	52,617	51,584	49,990	48,858	48,934	50,275
Liabilities	(11,297)	(16,357)	(15,492)	(13,827)	(12,459)	(11,956)	(12,911)
Share capital	36,648	36,648	36,648	36,648	36,648	36,648	36,648
Shareholders' funds	36,648	36,260	36,092	36,163	36,399	36,978	37,364
Return rate on net assets (%)	N/A	(1%)	(0.5%)	0.2%	0.6%	1.4%	1.0%
Debt/equity ratio (%)	N/A	1:4.7	1:4.7	1:4.8	1:4.3	1:4.7	1:4.8

- Notes: 1. This refers to the period between 6 July 1998 (commencement of civil aviation at CLK) and 31 March 1999.
2. N/A means not available.
3. According to the accounting practices, a parent company which owns less than 100% but more than 50% of a subsidiary presents the value of the remaining ownership (the minority ownership) on the consolidated income statement. In such cases, minority interest is shown as either a liability or an equity item on the statement, and the income (or loss) owed to the minority owners is subtracted from (or added to) the parent's income to arrive at the net income figure.

Source: AA.

### Payment of dividends and other incomes for the Government

3.2.3 FSTB has stated that the Government did not receive any dividends or land premia from AA for the period 1998-99 to 2003-04. Meanwhile, AA has declared to pay a dividend of HK\$380 million to the Government in 2003-04, which will be credited into the Government's account in 2004-05. In accordance with section 26(1) of AAO, cash dividends received from AA are credited into GRA.

3.2.4 Regarding AA's dividend payout policy:

- (a) it has not signed any memorandum of understanding or agreement with the Government for a dividend payout policy; and
- (b) it does not have a formal dividend payout policy. According to section 26 of AAO, AA is allowed to declare and pay a dividend to general revenue out of realized profits at an amount to be directed by FS after consultation with AA and having had regard to its financial position.

3.2.5 RLSD has requested FSTB to explain why the Government did not receive any dividends from AA between 2000-01 and 2002-03 as it was profitable during this period. FSTB's reply is that the Board had considered the overall financial position of AA in arriving at the decision.

3.2.6 Since AA did not obtain any loan under the Loan Fund, no interest was received by the Government for the period 1998-99 to 2003-04.

### Property development projects

3.2.7 The Government has granted a total of 12 559 482 sq m of land to AA for the development of the Hong Kong International Airport and emergency back-up aviation fuel receiving facility. However, the current value of the land granted to AA is not available.

3.2.8 As regards AA's property developments, the only existing development is Airport Regal Hotel, which generates an estimated annual income of HK\$16 million. AA has two future development projects, which are the Asia World-Expo (i.e. an exhibition centre at the airport) and a second airport hotel. (See Appendix V for details.)

3.2.9 The Government has explained the rationale of AA in developing the Asia World-Expo in that the purposes of the establishment of AA are set out in section 5 of AAO. Apart from the main function of providing, operating, developing and maintaining an airport for civil aviation, AA may also engage in or carry out airport-related activity in trade, commerce or industry. These activities are complementary to its core service of airport operation.

### Land premia

3.2.10 AA has borne the costs of site formation and the provision of services (such as water and roads) of the airport island. As the costs borne by AA have exceeded the total land premium of the airport island, the airport island is granted to AA at nominal premium.

3.2.11 AA was not engaged in any residential and commercial development projects; hence, no land premia were paid to the Government for this purpose. Land premia paid, if any, are credited into CWRP.

### Role of the Legislative Council in monitoring the financial arrangements of the Airport Authority

3.2.12 LegCo is not empowered to play any role in relation to the declaration of dividends by AA. However, LegCo can monitor the financial arrangements of AA through approving public funding proposals and receiving AA's annual report and financial statements.

3.2.13 As discussed above, the Government has injected about HK\$36.6 billion for the establishment of AA. The injections were approved by FC of LegCo.

3.2.14 In addition, according to section 32(5) of AAO, FS shall cause a copy of the following documents to be laid on the table of LegCo:

- (a) a report on the affairs of AA for that year;
- (b) a copy of its statement of accounts for that year; and
- (c) a copy of the auditor's report for that year.

## **3.3 Corporate governance**

3.3.1 As set out in the 2003-04 annual report of AA, AA is committed to maintaining high standards of corporate governance. Although not required under AAO, AA has complied with the disclosure provision of the Companies Ordinance (Cap. 32). AA has also voluntarily complied, to the extent applicable, with the Code of Best Practice as set out by HKSE in Appendix 14 to the Listing Rules. The following describes the fundamental structure by which AA is governed:

## The Board

### *Functions*

3.3.2 The Board focuses its attention on high-level issues and decisions such as, inter alia, major corporate strategies and policies, significant investments and capital projects, material acquisitions and disposal of assets, key financial plans, senior executive appointments and human resources related matters, and award of major contracts. The Board has delegated the management of day-to-day affairs to the executive management.

### *Membership of the Board*

3.3.3 Section 3(3)(a) of AAO provides that the Board shall comprise a non-executive Chairman<sup>30</sup>, an ex-officio Chief Executive Officer<sup>31</sup> (CEO) and between eight and 15 non-executive Board members, provided that the number of non-executive Board members who are public officers shall not exceed the number of other non-executive Board members. This means that the majority of the Board members must not be public officers.

3.3.4 Currently, the Board consists of the Chairman, CEO and 11 non-executive Board members. Among the non-executive Board members, seven belong to the law, stock exchange, banking, property, technology, trade and investment sectors. Another Board member is a legislator and the remaining three Board members are public officers, who are the Secretary for Economic Development and Labour, the Secretary for Financial Services and the Treasury, and the Director-General of Civil Aviation.

### *Appointment*

3.3.5 Under section 3(3)(c) of AAO, the appointment of the Chairman and Board members (with the exception of CEO who is an ex-officio member of the Board) is the responsibility of CE.

3.3.6 Section 3(3)(d) of AAO also stipulates that the Chairman and Board members appointed should have wide experience in air or other forms of transport, or in industrial, commercial, financial, consumer or labour matters, or in administration. According to the Economic Development and Labour Bureau, factors such as personal capabilities, expertise, experience and integrity are also considered.

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<sup>30</sup> The Chairman shall be a Hong Kong permanent resident within the meaning of the Immigration Ordinance (IO) (Cap. 115). The current Chairman of AA is Dr Victor Fung Kwok-king GBS. He was first appointed to the Board in June 1999 and was re-appointed in June 2002.

<sup>31</sup> The current CEO of AA is Dr David J Pang, who was appointed in January 2001.

3.3.7 Section 11(1) of AAO has empowered CE to determine the term of office of the Chairman and Board members. The appointment for each term is normally three years.

#### *Honorarium of the Chairman and Board members*

3.3.8 The Chairman and Board members receive honorarium for their services. The 2003 figures were:

- (a) Chairman: HK\$220,000 per annum; and
- (b) Board members: HK\$110,000 per annum.

3.3.9 In regard to the non-executive Board members who are public officers, AA pays the honorarium to the Government rather than to the individuals concerned.

#### *Meetings*

3.3.10 The proceedings of the Board adhere to the standards which are in accordance with the current best practice in Hong Kong with regard to corporate governance. Board meetings are held regularly and as required. In 2003-04, eight Board meetings were held, and the average attendance rate was 78%. Board meetings are normally attended by the executive directors as well.

#### Committees carrying out major functions of the Board

3.3.11 The Board has established five standing committees to consider matters relating to specialized areas and to advise the Board or, where appropriate, to decide on behalf of the Board on such matters. Meetings of these committees are normally attended by relevant executive directors and other senior staff of AA. The principal terms of reference of these committees are as follows:

*Audit Committee*

3.3.12 Pursuant to section 31 of AAO, AA is required to establish an Audit Committee. It considers matters relating to internal<sup>32</sup> and external audit, the annual financial statements and internal control. The Audit Committee may regulate its own procedures and business, and consider any matter relating either to the financial affairs of AA or to audits. The Chairman and members of the Audit Committee are all non-executive Board members. The Audit Committee met once in 2003-04 and dealt with the quarterly internal audit activities reports by circulation.

*Finance Committee*

3.3.13 The Finance Committee is responsible for considering and reviewing financial strategies, financial plans, capital and operating budgets, results of operations, proposed borrowings and financial risk management policy, and making recommendations to the Board on such matters. The Committee met five times in 2003-04.

*Human Resources Committee*

3.3.14 The Human Resources Committee considers matters relating to salaries and terms and conditions of service of AA's employees and makes recommendations to the Board on such matters. The Committee also considers and advises the Board on other staffing issues including manpower planning, variable compensation and retirement schemes. The Committee met three times in 2003-04.

*Business Development Committee*

3.3.15 The Business Development Committee is responsible for considering and advising the Board on commercial and business matters with respect to the development of the airport and its associated properties.

*Works Committee*

3.3.16 The Works Committee is responsible for considering works, service and maintenance contracts and matters relating thereto.

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<sup>32</sup> The Internal Audit monitors the compliance with internal control procedures focusing on those areas of AA's activities with the greatest perceived risk. The annual internal audit programme is reviewed and endorsed by the Audit Committee.

### Executive Committee

3.3.17 The CEO chairs the Executive Committee which comprises the Finance Director, Commercial Director, Airport Management Director, Legal Director, Human Resources and Administration Director, Chief Information Officer and Chief Communication Officer. The Committee provides CEO with comments and views from diverse perspectives of the executive management to facilitate him in making balanced decisions within AA or in formulating recommendations to be put forward to the Board for consideration. The Executive Committee meets on a weekly basis.

### Extent of authority of the Chairman and senior management staff over the annual budget and financing of the Airport Authority

3.3.18 Each year the senior management of AA prepares a rolling five-year business plan and annual budget for review by the Business Development Committee and the Finance Committee prior to the approval by the Board. A copy of the approved five-year business plan is also submitted to FS for record.

3.3.19 According to AA, its senior management takes a prudent approach in the preparation of its annual budget, ensuring achievement of business objectives and financial goals as set out in its business plan through effective and efficient use of its resources, at the same time mindful of the responsibility entrusted to AA in strengthening Hong Kong's position as an aviation and logistics hub.

### Relationship between the Airport Authority and the Legislative Council over its annual budget

3.3.20 AA does not present its annual budget to LegCo. It also does not solicit views and comments from LegCo Members on revenue and expenditure estimates. According to AA, it operates according to prudent commercial principles, as stipulated in AAO. Since the annual budget involves commercially sensitive information, AA does not consider it appropriate to disclose it.

### Role of the external auditor in relation to financial control

3.3.21 Under section 32 of AAO, an external auditor shall be appointed by AA, subject to the approval of CE. The external auditor is responsible for auditing the financial statements of AA in accordance with generally accepted accounting principles. The auditor's report is contained in the annual report of AA. However, there is no value for money audit report published by either internal or external auditors on AA.

3.3.22 AA is not put under the scrutiny of the Director of Audit; hence, there is also no value for money audit report published on AA by the Audit Commission.

### Procedures for appointing senior management staff and determining their remuneration and conditions of service

3.3.23 Pursuant to section 15 of AAO, the Board is empowered to appoint AA employees. For the appointment of CEO and other senior management staff, the following procedures are followed:

- (a) Once the need to create or fill a vacancy has been identified, a position brief will be prepared.
- (b) For CEO appointment, the Board forms a selection panel<sup>33</sup> led by the Chairman in search of an appropriate candidate. An executive search firm is appointed to assist with the actual selection process. Under section 15(1)(a) of AAO, the appointment requires the prior approval of CE. The financial package of CEO is determined by the Board.
- (c) For filling other vacant senior executive vacancies, the Board forms a selection panel which is normally presided by the Chairman of the Human Resources Committee plus one or more Board members. CEO is required to work out the related terms and conditions as per the approved organization practice.

### Remuneration policy

3.3.24 The remuneration package of CEO is the result of an independent study taking into consideration of the market norm and the specific scope of responsibilities. When there is a need for initiating such study, the Human Resources Unit under the Human Resources and Administration Director will recommend several consulting firms for the Human Resources Committee and the Chairman to consider. The Human Resources Committee and the Chairman will select a specific consulting firm to prepare the recommendation.

3.3.25 Remuneration packages of directors are part of the annual salary and benefits survey exercise. Results of such surveys are reported to the Human Resources Committee. Remuneration of directors will then follow the market surveys and be established accordingly, provided that movements are within the Board-approved guidelines. CEO is required to determine the corresponding remuneration packages.

3.3.26 On an annual basis, market conditions and salary ranges for CEO and directors are reported to the Economic Development and Labour Bureau and also the Director of Administration. Full disclosure of the remuneration of directors and CEO in AA's annual report is a standard practice of AA.

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<sup>33</sup> In the most recent exercise of appointing a new CEO for AA, the selection panel comprised the Chairman from each of the five Board Committees (viz Human Resources, Audit, Business Development, Finance and Works).

### Remuneration packages of senior management staff

3.3.27 As at March 2003, the remuneration packages for CEO and executive directors were as follows:

- (a) CEO: HK\$6.57 million; and
- (b) five executive directors: HK\$1.29 million - HK\$3.59 million.

3.3.28 According to the Hay Report, the proposed remuneration level of CEO was HK\$5.94 million. Hence, it can be seen that the remuneration level of CEO was higher than the Hay Group's recommended level by HK\$630,000.

3.3.29 AA has explained that the cash remuneration of CEO is HK\$6.07 million (HK\$500,000 being fringe benefits). This is in line with the Hay Report, which has provided flexibility for the bodies concerned to pay individual executives a higher or lower remuneration depending on the individual's special skills, capabilities and performance.

3.3.30 The remuneration packages of the second-tier senior management were in line with the levels proposed by the Hay Group.

### Procedures adopted and criteria considered by the Board when reviewing remuneration packages of senior management staff

3.3.31 AA follows commercial principles in establishing its salary ranges according to the market place and close comparison with competing companies. On an annual basis, a full report from the most junior level to the director level is produced. The report takes into consideration of all major salary surveys within Hong Kong and takes into account salary and fringe benefits. Based on the survey findings, the management recommends salary and benefits ranges and adjustment of the salary and benefits ranges if warranted.

## **3.4 Reporting arrangements**

3.4.1 Under AAO, AA is responsible to the Government through the following arrangements:

- (a) the Chairman and Board members, with the exception of CEO, are appointed by CE;
- (b) the appointment of CEO requires the approval of CE;

- (c) AA is required to submit its annual report, as well as the audited financial statements and the auditor's report on these statements to FS for acceptance;
- (d) any permitted airport-related activity of AA which amounts to over 2.5% of AA's issued share capital requires the approval of FS; and
- (e) the rolling five-year business plan is required to be submitted to FS for record.

3.4.2 AA is answerable to LegCo through a number of channels:

- (a) briefing relevant panels<sup>34</sup> and bills committees;
- (b) reporting its performance in AA's financial statements and annual report which are tabled before LegCo; and
- (c) seeking the approval of public funding for specific projects and purposes.

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<sup>34</sup> Through appropriate panels such as the Panel on Economic Services and the Panel on Transport, AA briefs Members of particular projects which may be of interest to the general public.

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## Chapter 4 — MTR Corporation Limited

### 4.1 Background information

#### Legislation enacted to establish the MTR Corporation Limited

4.1.1 The Mass Transit Railway Corporation (MTRC) was established in 1975 under the Mass Transit Railway Corporation Ordinance (Cap. 270) to construct and operate a mass transit railway (MTR) system in Hong Kong. As a statutory corporation, it was wholly-owned by FSI in trust on behalf of the Government. To enable MTRC to draw on equity for the construction of railways which include the Airport Railway, the Government injected capital into MTRC several times between 1980s and mid-1990s, after obtaining the approval of FC.

4.1.2 In March 1999, the then FS announced in his budget speech the proposed sale of a minority interest through an IPO. A key element in the privatization process was the enactment in March 2000 of the new Mass Transit Railway Ordinance (MTRO) (Cap. 556) which came into effect on 30 June 2000. Pursuant to section 37 of MTRO, on the same day, the entire properties, rights and liabilities of MTRC were vested in the MTR Corporation Limited (MTRCL), which was incorporated in April 2000.

4.1.3 Following the IPO, MTRCL was listed on HKSE in October 2000. The Government, being the largest shareholder of MTRCL, owns some 76% of the issued shares at present. To support MTRCL in its provision of quality railway services and expansion of transport infrastructure in Hong Kong, the Government has committed to holding at least 50% shareholding in MTRCL for at least 20 years from the date of the listing.

4.1.4 According to the "Statement of Investments" of CIF, the Government's investment in MTRCL for the financial year ended 31 March 2004 amounted to HK\$26,884.8 million,<sup>35</sup> which was entirely in cash.

#### Difficulties encountered in obtaining the required information on the MTR Corporation Limited

4.1.5 RLSD has requested MTRCL for the information required for the research. However, MTRCL has replied that it is a listed company and is therefore subject to the obligations set out in the Listing Rules. MTRCL is prohibited from selective distribution of information to any persons, bodies or investors. MTRCL has provided to RLSD several public documents, i.e. annual reports and IPO prospectus.

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<sup>35</sup> The figure has netted off the sale of the issued share capital of MTRCL during the IPO, and the distribution of bonus shares and scrip dividends by MTRCL.

4.1.6 RLSD has sought the advice of the Legal Service Division (LSD) of the LegCo Secretariat on the refusal of MTRCL to disclose information. LSD has confirmed that MTRCL does not have the obligation to disclose to RLSD any corporate information. Since MTRCL is a company incorporated under the Companies Ordinance, the provisions in the Companies Ordinance are applicable as far as the disclosure of the company's information is concerned. As a listed company, MTRCL has a duty to provide certain information to HKSE, including a list of Board directors and details of connected transactions and price-sensitive matters.

4.1.7 Section 11 of MTRO provides that the Secretary for the Environment, Transport and Works may require MTRCL to provide copies of the records kept by MTRCL relating to the railway such as the number and carrying capacity of trains in use, the number of passengers carried, etc. However, there is no provision in MTRO which requires MTRCL to provide information to the Government relating to the internal administration of MTRCL. Although representatives of the Government sitting on the Board of Directors of MTRCL may have access to such information in their capacity as directors of MTRCL, individual directors cannot disclose the information unless authorized by the Board and in accordance with relevant laws and regulations.

#### Principal activities undertaken

4.1.8 Under section 4 of MTRO, MTRCL is granted the franchise, for a period of 50 years from the appointed day (i.e. 30 June 2000) to:

- (a) operate MTR, including any extension to the railway; and
- (b) construct any extension to the railway.

The terms and conditions agreed between the Government and MTRCL with respect to the franchise granted<sup>36</sup> are set out in the operating agreement.

4.1.9 In practice, MTRCL operates six lines: Tsuen Wan Line, Kwun Tong Line, Tseung Kwan O Line, Island Line, Tung Chung Line and Airport Express Line.

4.1.10 In addition to railway operations, MTRCL is engaging in the development of key residential and commercial projects above existing stations and along new line extensions as well as many other commercial activities associated with MTR, including rental of retail and poster advertising space. MTRCL has retained a number of shopping centres in its developments for long-term investment. It also provides property management services.

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<sup>36</sup> The Chief Executive in Council is empowered to approve the extension of MTRCL's franchise. For details, please see section 5 of MTRO.

4.1.11 MTRCL also offers consultancy services in the areas of expertise required in the planning, construction, operation, maintenance and up-grading of railways plus property development to organizations worldwide.<sup>37</sup> For example, MTRCL entered into an Agreement in Principle for a build-operate-transfer (BOT) project with the Shenzhen Municipal Government for the construction of Phase 2 of Line 4 of the proposed Shenzhen metro system and the operation of Line 4 for a term of 30 years. The total investment of the project will be approximately RMB6 billion (HK\$6.4 billion).<sup>38</sup>

4.1.12 MTRCL's subsidiary, Octopus Cards Limited<sup>39</sup>, operates the octopus cards system.

#### Background and rationale for allowing the railway corporations to undertake property development projects and commercial activities not related to their principal function of railway operations

4.1.13 The Government has explained the background and rationale for allowing MTRCL and KCRC to undertake property development projects and commercial activities not related to their principal function of railway operations. For details, please refer to paragraphs 2.1.7 – 2.1.10 on page 10.

#### Possible merger of the MTR Corporation Limited and the Kowloon-Canton Railway Corporation

4.1.14 The discussion on the possible merger of MTRCL and KCRC has been presented in paragraphs 2.1.11 - 2.1.14 on pages 10 - 11.

## **4.2 Financial arrangements**

### Financial highlights of the MTR Corporation Limited for the period 1997 to 2003

4.2.1 Table 5 below shows the financial highlights of MTRCL for the period 1997 to 2003. From the profit and loss account, it can be seen that the turnover value increased from HK\$6,574 million in 1997 to HK\$7,594 million in 2003, an increase of 16%.

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<sup>37</sup> The consultancy services include: (a) project preliminaries such as financial proposals and feasibility studies; (b) project planning, design and construction; (c) railway operation and maintenance; and (d) railway support services.

<sup>38</sup> One of the principles of the project is the acquisition of property development rights directly from the Shenzhen Municipal Government at stations and the depot along Line 4 with an aggregate gross floor area of 2.9 million square metres by the project company.

<sup>39</sup> MTRCL holds 57.4% of the issued shares of the Octopus Cards Limited.

4.2.2 MTRCL was consistently profitable between 1997 and 2003. The profit before taxation rose from HK\$2,783 million in 1997 to HK\$5,198 million in 2003. In Table 5, property development profit played an increasingly significant role in contributing to profit before taxation, as it soared from HK\$276 million in 1997 to HK\$5,369 million in 2003. In October 2003, having regard to the soft property market conditions, the Government reached an understanding with MTRCL not to put any property developments up for tender until September 2004.

4.2.3 Table 5 also sets out the consolidated balance sheet which shows a rise in both total assets and loans and obligations under finance leases over the time period. It might be due to the construction of new railway networks.

**Table 5 — Financial highlights of MTRCL for the period 1997 to 2003 (HK\$ million)**

	1997	1998	1999	2000	2001	2002	2003
<b>Profit and loss account</b>							
Turnover	6,574	6,981	7,252	7,577	7,592	7,686	7,594
Profit on property development	276	1,419	2,030	3,376	3,248	3,755	5,369
Operating profit before depreciation	3,805	4,720	5,523	7,290	7,301	7,769	9,116
Profit before taxation	2,783	2,819	2,116	4,069	4,278	4,213	5,198
<b>Consolidated balance sheet</b>							
Total assets	75,428	82,104	87,250	92,565	98,126	101,119	102,366
Loans and obligations under finance leases	(10,875)	(16,897)	(23,177)	(27,203)	(31,385)	(33,508)	(32,025)
Shareholders' funds	41,815	42,601	45,115	50,355	53,893	53,574	57,292

Sources: FSTB and MTRCL.

## Payment of dividends and other incomes for the Government

### *Dividends*

4.2.4 The Government received from MTRCL cash dividends of HK\$647 million in 1997-98, HK\$1,252 million in 1998-99, HK\$371.7 million in 2001-02 and HK\$470 million in 2002-03. No cash dividends were received by the Government in 1999-2000, 2000-01 and 2003-04. Under the Penny's Bay Rail Link<sup>40</sup> (PBRL) project agreement, the Government waived the cash portion of the dividends payable by MTRCL to the Government starting from 2002 interim, i.e. the full committed amount of HK\$798 million (at present value on 1 January 2002) of dividends that would otherwise be payable in the next few years, as financial support to PBRL. Therefore, the Government did not receive any 2002 interim and final dividends, nor 2003 interim and final dividends. (Some LegCo Members expressed serious concerns over the financing arrangements of PBRL. For details, please see paragraphs 4.2.9 - 4.2.11 below.)

4.2.5 In addition, the Government received scrip dividends from MTRCL<sup>41</sup>: 48 873 554 shares in 2001-02, 87 991 070 shares in 2002-03 and 108 213 287 shares in 2003-04. No scrip dividends were received by the Government prior to the listing of MTRCL in October 2000. (See Table 6 below for details.)

**Table 6 — Dividends<sup>1</sup> and land premia received by the Government for the period 1997-98 to 2003-04**

	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04
Dividends	HK\$647 million	HK\$1,252 million	Nil	Nil	HK\$371.7 million plus 48,873,554 shares as scrip dividends	HK\$470 million plus 87,991,070 shares as scrip dividends	No cash dividend but received 108,213,287 shares as scrip dividends
Land premia	HK\$9,984 million	HK\$302 million	HK\$10,886 million	HK\$8,456 million	HK\$1,941 million	HK\$2,476 million	HK\$1,228 million

Note: 1. The dividends received represent the dividends distributed in the previous year.

Source: FSTB.

<sup>40</sup> In July 2002, MTRCL signed the project agreement with the Government for the design, construction, financing and operation of PBRL, connecting the future Hong Kong Disneyland with the MTR network. The estimated capital cost of PBRL is HK\$2 billion. Detailed design for PBRL has been substantially completed and construction works are being undertaken. The rail link is forecast to be completed by July 2005 to meet the target opening date of the Disneyland.

<sup>41</sup> MTRCL was listed as a public company in October 2000. Dividends received by the Government have been divided into cash and scrip dividends starting from 2001-02. As set out in the IPO prospectus, in respect of the final dividend for the financial year ending 31 December 2000 and any dividends declared in respect of each of the three financial years ending 31 December 2003, the Government would elect to receive all or part of its entitlement to dividends in the form of shares to the extent necessary to ensure that a maximum of 50% of the total dividends paid by MTRCL in respect of the relevant financial year would be in form of cash. For details, please see page 166 of the IPO prospectus.

4.2.6 Cash dividends received from MTRCL are credited into GRA in accordance with section 58 of MTRO.<sup>42</sup> The scrip dividends received in a particular financial year are reflected in the increased gross total shareholdings of the entities concerned under "Statement of Investments" of CIF in the Accounts of the Government for each financial year published by the Treasury Branch of FSTB.

4.2.7 According to the IPO prospectus, the amount of dividends paid to shareholders will depend upon a number of factors, including:

- (a) MTRCL's earnings;
- (b) capital requirements;
- (c) general financial condition; and
- (d) any factors considered relevant by the Board.

4.2.8 Following the partial privatization and public listing of MTRCL on HKSE in October 2000, the Government currently owns approximately 76% of the issued shares. Despite the majority ownership by the Government, MTRCL is independently managed on commercial principles. MTRCL is financially independent and does not rely on any subsidy from the Government.

4.2.9 In July 2002, under section 38(1)(a) of the Public Finance Ordinance (PFO), the Administration waived its claims for dividends so as to provide financial support to MTRCL for the PBRL project. The Administration stated that the dividend waiver option was entirely lawful and the time schedule of the PBRL project was very tight. Given that PBRL was an integral part of the overall Hong Kong Disneyland (Disneyland) development, deferral of PBRL might affect the cost and schedule of other works of Disneyland.

4.2.10 At the meetings of the Subcommittee held in July 2002, some LegCo Members raised the following concerns regarding the financing arrangement of the PBRL project:

- (a) rationale for the Government to waive the dividends
  - In view of the huge budget deficit at that time, it might not be in the best interest of the general public for the Government to waive its claims for HK\$798 million worth of dividends that it could have received from MTRCL.

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<sup>42</sup> Section 58(1) of MTRO provides that monies received by FSI, or from the sale of or other dealing in shares in MTRCL held by FSI, form part of the general revenue. Cash dividends, although not expressly mentioned in section 58(1), are monies which FSI receives in his capacity as the person holding the MTRCL shares. Hence, cash dividends are credited into GRA.

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- If waived dividend was considered akin to Government equity, the Administration should have put forward a funding proposal for Members to consider in LegCo.

(b) legal basis of dividend waiver

- It was doubtful as to whether section 38 of PFO could be relied upon as the legal basis for the waiver of dividends for the PBRL project. LSD was of the view that any dividends payable by MTRCL should be dealt with in the manner specified in the relevant specific provisions in MTRO and should accordingly be managed in accordance with the relevant provisions concerning revenue under PFO.

4.2.11 In reviewing the PBRL case, some LegCo Members expressed grave concern about the scope and extent of FS's powers in relation to the management of dividends and other incomes generated from the Government's investments in public and private companies. Members were also concerned about whether proper mechanisms were in place to ensure that the exercise of such powers was properly accounted for by the executive authorities to LegCo. Members agreed that the policy issues involved should be further discussed by the FA Panel. (Please see Appendix VI for details.)

*Property development projects*

4.2.12 The Government has granted a total of 2 088 742 sq m of land to MTRCL for residential and commercial developments. However, the Government does not have information on the current value of the land granted to MTRCL.

4.2.13 Under MTRCL's Operating Agreement, for any new railway project, the Government and MTRCL will agree upon the terms which detail the land required for construction and operation of that new railway project to be provided to MTRCL at a land premium in accordance with the Government's land policy at the relevant time. The Government and MTRCL will also agree upon what property development rights should be provided to MTRCL in order to implement the new railway project.

4.2.14 MTRCL has a total of 48 property projects completed or under development. Among them, 20 projects are along the urban subway line, 21 projects are along the Airport Railway Line, five projects are along the Tseung Kwan O Line, and one project is on the Siu Ho Wan depot. In addition, a "Theme Village" is being developed at Ngong Ping. (See Appendix VII for the size and lease term of all land parcels granted to MTRCL for residential and commercial developments.)

4.2.15 As at December 2003, MTRCL had developed 51 920 residential flats, 615 083 sq m (GFA) office space, 518 221 sq m (GFA) commercial space and 184 075 sq m (GFA) government, institutional and community facilities. (Please see Appendix VIII for details.)

#### *Members' concerns on land policy*

4.2.16 The discussion on Members' concerns on land policy has been presented in paragraphs 2.2.13 - 2.2.16 on pages 15 – 16.

#### *Assessment of land premia*

4.2.17 MTRCL is required to pay land premia at FMV for its property development activities. Same as KCRC, when assessing the land premium, the Government has adopted the "green field site" principle, which requires that the valuation of FMV of a property development site is assessed on the basis of no railway development.<sup>43</sup>

4.2.18 The discussions on the methodology of assessing land premia and the question of whether the adoption of the "green field site" principle may lead to "below-market" land premium paid by the two railway corporations have been presented in paragraphs 2.2.17 – 2.2.22 on pages 16 – 17.

#### *Amount of land premia*

4.2.19 The Government received land premia from MTRCL, amounting to HK\$9,984 million in 1997-98, HK\$302 million in 1998-99, HK\$10,866 million in 1999-2000, HK\$8,456 million in 2000-01, HK\$1,941 million in 2001-02, HK\$2,476 million in 2002-03 and HK\$1,228 million in 2003-04. The land premia received from MTRCL are credited into CWRF.

#### *Others*

4.2.20 Since MTRCL did not obtain any loan under the Loan Fund, no interest was received by the Government for the period 1997-98 to 2003-04.

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<sup>43</sup> The IPO prospectus of MTRCL states that "*the amount of land premium paid by the Company [MTRCL] will be assessed on a "full market value" basis, ignoring the presence of the railway for the first land grants made by the Government to the Company for property development rights in relation to each new railway project granted to the Company and, if applicable, for the first premium amount payable for property development rights in relation to each development phase of such a new railway project (in each case, other than depot sites).*" For details, see page 107 of the IPO prospectus.

### Role of the Legislative Council in monitoring the financial arrangements of the MTR Corporation Limited

4.2.21 LegCo is not empowered to play any role in relation to the declaration of dividends by MTRCL. At the same time, unlike the arrangements of the other selected bodies studied, MTRCL is not required to table its annual report or financial statements before LegCo.

4.2.22 However, any Government's proposal for providing public funding to MTRCL is subject to the approval of FC of LegCo although it is a listed company.

## **4.3 Corporate governance**

4.3.1 According to the 2003 annual report of MTRCL, MTRCL has complied with the Code of Best Practice as set out in Appendix 14 to the Listing Rules, except that non-executive directors of MTRCL (save for those appointed pursuant to section 8 of MTRO) are not appointed for a specific term but are subject to retirement by rotation and re-election at MTRCL's annual general meetings in accordance with MTRCL's Articles of Association<sup>44</sup> (Articles).

### The Board

#### *Functions*

4.3.2 As MTRCL is not a public body, MTRO has not set out any statutory functions of the Board. Pursuant to the Articles and the Protocol adopted by the Board, the Board has delegated the day-to-day management of MTRCL's business to the executive directorate, and focuses its attention on matters affecting MTRCL's finances and shareholders, including the preparation, monitoring and/or determination of financial statements, dividend policies, significant changes in accounting policy, the annual operating budget, certain material contracts, strategies for future growth, major financing arrangements and major investments, risk management strategies, treasury policies and fare structures.

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<sup>44</sup> The Articles of Association provides investors with important information on MTRCL's strategic policies, including changes in capital, capital reserve, borrowing powers and dividends.

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### *Membership of the Board*

4.3.3 There are no statutory requirements regarding the composition of the Board. Currently, the Board comprises the Chairman<sup>45</sup>, the Chief Executive Officer<sup>46</sup> (CEO) and seven non-executive directors (one of them being the Secretary for Financial Services and the Treasury, with others belonging to the banking, architecture, accounting, academia and social services sectors). The Board also has two "additional directors", who are public officers (i.e. the Secretary for the Environment, Transport and Works, and the Commissioner for Transport.)

### *Appointment*

4.3.4 Under the Articles, as long as the Government remains the beneficial owner of the majority of the issued shares, CE is empowered to appoint the Chairman of the MTRCL. The current Chairman of MTRCL is appointed for a term of three years.

4.3.5 In regard to the appointment of a director, he or she may be appointed either by the shareholders at a general meeting or by the Board upon the recommendation of the Nominations Committee. At the annual general meeting of MTRCL, at least one-third of the directors that are not public officers are required to retire from office by rotation.

4.3.6 CE may, pursuant to section 8 of MTRO, appoint up to three persons as "additional directors". Directors appointed in this way can only be removed from office by CE. These directors are not subject to any requirement to retire by rotation nor will they be counted in the calculation of the number of directors who must retire by rotation. In all other aspects, "additional directors" are treated for all purposes in the same way as other directors.

4.3.7 In regard to the criteria for appointing the Chairman and the "additional directors", the Environment, Transport and Works Bureau has explained that the factors considered include personal capabilities, leadership, expertise, experience, integrity and commitment to public service. RLSD has not been able to obtain information on the criteria for appointing the non-executive directors.

### *Handling conflicts of interest*

4.3.8 For CEO and senior management staff, the issue of conflict of interests is handled in accordance with the Listing Rules.

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<sup>45</sup> In April 2003, the Board decided to split the roles of the Chairman and Chief Executive after Mr Jack So's contract as both the Chairman and Chief Executive expired during the year. The new arrangement of a non-executive Chairman and a Chief Executive Officer aims to encourage greater transparency and responsiveness of MTRCL. The current Chairman of MTRCL is Dr. Raymond Ch'ien Kuo-fung, who was appointed in July 2003.

<sup>46</sup> Mr. Chow Chung-kong took office in December 2003.

*Remuneration of the Chairman and Board members*

4.3.9 According to the 2003 annual report of MTRCL, the remuneration levels of the Chairman and Board members in 2003 were within the following bands:

- (a) Chairman: HK\$500,001 - HK\$1,000,000 per annum; and
- (b) Board members: up to HK\$250,000 per annum.

*Meetings*

4.3.10 The Board of Directors held 12 meetings in 2003 and the average attendance rate was 85%.

Committees carrying out major functions of the Board

4.3.11 MTRCL has established an Audit Committee, a Remuneration Committee and a Nominations Committee in accordance with the Articles. Each of these committees comprises entirely non-executive directors.

*Audit Committee*

4.3.12 The Audit Committee meets four times each year to review the completeness, accuracy and fairness of MTRCL's financial statements and to consider the nature and scope of internal and external audit reviews. It also assesses the effectiveness of the systems of internal control<sup>47</sup>, which have been designed to allow the Board of Directors to monitor MTRCL's overall financial position and to protect its assets. The purpose is to guard against material financial misstatement or loss. The Audit Committee Chairman prepares an annual report for the Board of Directors covering the Committee's activities for the year and highlighting issues which he or she deems significant.

4.3.13 The average attendance rate of the four meetings held by the Audit Committee in 2003 was 83%. The external auditors, the Finance Director and the Head of the Internal Audit Department attend the Committee meetings to answer questions on the reports or their work.

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<sup>47</sup> The Internal Audit Department plays a role in support of and in collaboration with MTRCL's management, in monitoring the internal governance of MTRCL. The department has unrestricted access to information, allowing it to review all aspects of MTRCL's network of risk management, control and governance processes. On a regular basis, it conducts audits of the practices, procedures, expenditure and internal controls of all business and support units and subsidiaries. It also conducts ad-hoc reviews or investigations on demand. The Internal Auditor reports directly to the Chairman of the Board and the Audit Committee.

*Remuneration Committee*

4.3.14 The Remuneration Committee considers human resources issues, including the terms and conditions of employment, remuneration and retirement benefits of the Chairman, CEO and members of the executive directorate. There was one meeting of the Remuneration Committee in 2003 and the attendance rate was 100%.

*Nominations Committee*

4.3.15 The Nominations Committee carries out the process of recommending and nominating candidates to fill vacancies on the Board of Directors. There was one meeting of the Nominations Committee in 2003 and the attendance rate was 100%.

Extent of authority of the Chairman and senior management staff over the annual budget and financing of the MTR Corporation Limited

4.3.16 According to MTRCL, there is a budgeting system for all operational and business activities, with an annual budget subject to approval by the Board of Directors. Monthly results of MTRCL's operations, businesses and projects are reported against the annual budget to the Board of Directors, and updated forecasts for the year are prepared regularly.

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

Relationship between the MTR Corporation Limited and the Legislative Council over its annual budget

4.3.18 MTRCL does not present its annual budget to LegCo or solicit views and comments from LegCo Members on revenue and expenditure estimates.

Role of the external auditor in relation to financial control

4.3.19 MTRCL employs an external auditor to audit the financial statements in accordance with generally accepted accounting principles. The auditor's report is included in the annual report of MTRCL. However, there is no value for money audit report published by either internal or external auditors on MTRCL.

4.3.20 MTRCL is not put under the scrutiny of the Director of Audit; hence, there is no value for money audit report on MTRCL published by the Audit Commission.

### Procedures for appointing senior management staff and determining their remuneration and conditions of service

4.3.21 The Board is empowered to appoint the staff of MTRCL and determine their remuneration and conditions of service. In regard to the appointment of CEO, the 2003 annual report of MTRCL has provided that:

*"The Board was of the view that both the Nominations Committee and the Remuneration Committee should be involved in the process of appointing a new CEO. For this purpose, the Board resolved in April 2003 to establish a Board Search Committee. The members of the Board Search Committee were the Chairman of the Nominations Committee, the Chairman of the Remuneration Committee and the Secretary for Financial Services and the Treasury. The Board Search Committee held several meetings during the year and made a recommendation on the appointment of Mr. Chow Chung-kong as CEO and a Board member with effect from 1 December 2003, as well as his terms of remuneration."<sup>48</sup>*

4.3.22 RLSD has not been able to obtain information regarding the procedure for appointing executive directors and determining their remuneration and conditions of service.

### Remuneration policies

4.3.23 RLSD has not been able to obtain the information on remuneration policies, which is not available in the public domain.

### Remuneration packages of senior management staff

4.3.24 In 2003, the remuneration packages of CEO and executive directors were as follows:

- (a) CEO: HK\$680,000<sup>49</sup> (for December 2003); and
- (b) six directors: HK\$4.3 million - HK\$5.11 million.

4.3.25 Since the incumbent CEO took office only in December 2003, there is no information on his annual remuneration. The Hay Group's proposed level was HK\$6.72 million.

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<sup>48</sup> MTRCL. (2003) *Annual Report*, page 46.

<sup>49</sup> The incumbent CEO was appointed in December 2003. The figure represents the salary for December 2003 only.

4.3.26 The remuneration packages of the second-tier senior management were in line with the levels proposed by the Hay Group.

4.3.27 MTRCL has granted share option benefits<sup>50</sup> to its senior management. In response to RLSD's enquiry regarding the rationale and procedures of granting share option benefits to the staff by MTRCL, FSTB has explained that senior staff's remuneration is closely tied to MTRCL's long-term performance so that management interest is aligned with that of the shareholders. MTRCL provides "one-off" share options to Executive Directors and senior staff under the following two schemes<sup>51</sup>:

- (a) Pre-Global Offering Share Option Scheme (adopted on 20 September 2000); and
- (b) New Joiners Share Option Scheme (adopted on 16 May 2002).

4.3.28 The granting of options to eligible staff is made in accordance with the Scheme Rules. When granting share option benefits to the Executive Directors, further approval from the Remuneration Committee is sought.

4.3.29 Table 7 lists those senior management staff who were granted share options and the number of share options received. Under these two schemes, a total of 48 833 200 options was granted to staff of MTRCL.

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<sup>50</sup> The exercise price of a share option is HK\$8.44 per share. For reference, MTRCL is currently traded at around HK\$12.

<sup>51</sup> FSTB has not provided the details of the two schemes.

**Table 7 — Share option benefits offered to MTRCL staff**

<b>Executive directorate</b>	<b>Date granted</b>	<b>No. of options granted</b>
<b>Pre-Global Offering Option Scheme</b>		
Jack So, ex-Chairman	20 September 2000	1 599 000
Philip Gaffney, Managing Director – Operations and Business Development	20 September 2000	1 066 000
Russell John Black, Project Director	20 September 2000	1 066 000
William Chan, Human Resources Director	20 September 2000	1 066 000
Thomas Ho, Property Director	20 September 2000	1 066 000
Leonard Bryan Turk, Legal Director	20 September 2000	1 066 000
Other eligible employees	20 September 2000	40 343 000
<b>New Joiners Share Option Scheme</b>		
Lincoln Leong, Finance Director	1 August 2003	1 066 000
Other eligible employees	1 August 2003	495 200

Source: FSTB.

4.3.30 FSTB has not provided information on the criteria of granting share option benefits to the senior management of MTRCL and the Administration's role in ensuring the schemes may not be abused. Nonetheless, FSTB has remarked that MTRCL conducts regular review on its compensation package (including long-term incentive plans). The due approval-seeking process will be followed should there be any need to change the share option schemes.

Procedures adopted and criteria considered by the Board when reviewing remuneration packages of senior management staff

4.3.31 RLSD has not been able to obtain information on the procedures adopted and criteria considered by the Board when reviewing remuneration packages of senior management staff.

#### 4.4 Reporting arrangements

4.4.1 Being a listed company on HKSE, MTRCL has to comply with the obligations set out in the Listing Rules and is accountable to its shareholders. It is required to hold an annual general meeting, which provides a forum for direct communication between the Board and MTRCL's shareholders. The shareholders can raise questions on MTRCL's operations and financial information.

4.4.2 In addition, under MTRO and the Articles, MTRCL is responsible to the Government through the following arrangements:

- (a) requiring the approval of the Chief Executive in Council for granting the franchise to operate railway;
- (b) requiring the approval of CE when appointing the Chairman and "additional directors";
- (c) providing copies of the records to the Secretary for Environment, Transport and Works with respect to the business and affairs of MTRCL in connection with the franchise<sup>52</sup>;
- (d) paying financial penalty if MTRCL has not complied with any provision of MTRO or the operating agreement; and
- (e) carrying out works in the interest of safety as the Secretary for Environment, Transport and Works may require.

4.4.3 MTRCL is also answerable to LegCo through the following:

- (a) briefing relevant panels and bills committees, although such arrangement is not a statutory requirement; and
- (b) seeking approval for public funding for specific projects and purposes.

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<sup>52</sup> These records include: (a) the number and carrying capacity of trains in use or under maintenance; (b) the number of journeys undertaken and the total distance travelled; (c) the number of passengers carried; (d) the receipts; (e) details of any incident causing a service breakdown of 20 minutes or more; and (f) the maintenance of trains.

## Chapter 5 — Hong Kong Science and Technology Parks Corporation

### 5.1 Background information

#### Legislation enacted to establish the Hong Kong Science and Technology Parks Corporation

5.1.1 The Hong Kong Science and Technology Parks Corporation (HKSTPC) was established on 7 May 2001 under the Hong Kong Science and Technology Parks Corporation Ordinance (HKSTPCO) (Cap. 565) through the merger of the Hong Kong Industrial Estates Corporation, the Hong Kong Industrial Technology Centre Corporation and the Provisional Hong Kong Science Park Company Limited. Upon the establishment of HKSTPC, all rights, obligations, assets and liabilities of the aforesaid merging entities were vested in HKSTPC in accordance with section 37 of HKSTPCO and the entities dissolved.

5.1.2 According to the "Statement of Investments" of CIF, the Government's investment in HKSTPC for the financial year ended 31 March 2004 amounted to HK\$250.0 million, which was entirely in cash.

#### Principal activities undertaken

5.1.3 Pursuant to section 6(1) of HKSTPCO, the objectives of HKSTPC are to:

- (a) establish or develop any premises where activities related to the purposes prescribed in (b), (c) or (d) are, or are to be, carried out, and to manage and control the land and other facilities comprised in such premises;
- (b) facilitate the research and development and application of technologies in the manufacturing and service industries in Hong Kong;
- (c) support the development, transfer and use of new or advanced technologies in Hong Kong; and
- (d) engage in such activities or to perform such functions as the Chief Executive in Council may, after consultation with HKSTPC, permit or assign to it by order published in the Gazette.

5.1.4 Section 7 of HKSTPCO also requires that HKSTPC should conduct its business according to prudent commercial principles.

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5.1.5 Section 8(1) of HKSTPCO further sets out the general powers of HKSTPC:

- (a) to do, in any part of the world, such things as are expedient for or conducive to the attainment of the purposes of HKSTPC or of any purpose reasonably incidental to or consequential upon any of those purposes; and
- (b) to do any things referred to in paragraph (a) jointly with other persons.

5.1.6 In practice, HKSTPC undertakes the following activities to fulfil the statutory purposes and powers contained in HKSTPCO:

- (a) providing quality infrastructure and support facilities such as the Hong Kong Science Park<sup>53</sup> and three Industrial Estates<sup>54</sup> for innovation and technology development in the focused clusters<sup>55</sup> and the upgrading of manufacturing and service industry capabilities;
- (b) providing full-service incubation-technology programmes<sup>56</sup> for technology start-ups; and
- (c) fostering partnership and collaboration between industries<sup>57</sup> and universities<sup>58</sup>/applied research institutes through consulting, training and research programmes.

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<sup>53</sup> The Science Park is located on the Tolo Harbour waterfront in Pak Shek Kok. It is designed to accommodate companies of all sizes and at all stages of development and to promote interaction and innovation at both local and global levels.

<sup>54</sup> All rights, obligations, assets and liabilities of the Hong Kong Industrial Estates Corporation were transferred to HKSTPC on 7 May 2001. Hence, HKSTPC currently offers developed land in its three industrial estates (i.e. Tai Po, Yuen Long and Tseung Kwan O) at cost to both manufacturing and service industries with new or improved technology and processes which cannot operate in multi-storey buildings.

<sup>55</sup> The four focused clusters are electronics, biotechnology, precision engineering and information technology/telecommunications industries.

<sup>56</sup> The programme aims to assist technology start-ups in the vulnerable inception stages. Companies which have joined the programme benefit from a package of assistance: (a) technical and management assistance; (b) promotion, legal and business matching assistance; and (c) ready-to-use office space.

<sup>57</sup> HKSTPC introduces business/technology co-operations among Science Park tenants, incubation companies as well as outside companies and professional/trade associations. This industry networking aims to create a common platform to build relationships, explore business opportunities and exchange ideas among peers.

<sup>58</sup> HKSTPC has signed a memorandum of understanding with six universities in Hong Kong to bridge the commercial sector and academia.

## 5.2 Financial arrangements

### Financial highlights of the Hong Kong Science and Technology Parks Corporation for the period 2001-02 to 2002-03

5.2.1 Table 8 presents the financial highlights of HKSTPC for the period 2001-02 to 2002-03.<sup>59</sup> From the consolidated income statement, it can be seen that HKSTPC suffered a loss after taxation<sup>60</sup> of HK\$45.1 million in 2002-03, after recording a profit after taxation of HK\$51.1 million in 2001-02. Another observation is that from the consolidated balance sheet, HKSTPC did not bear any debt in 2002-03.

**Table 8 — Financial highlights of HKSTPC for the period 2001-02 to 2002-03 (HK\$)**

	2001-02	2002-03
<b>Consolidated income statement</b>		
Turnover <sup>1</sup>	228,754,589	114,251,501
Operating profit/(loss) before depreciation	73,083,377	(11,812,585)
Profit/(loss) before taxation	51,053,414	(45,079,025)
Profit/(loss) after taxation	51,053,414	(45,079,025)
<b>Consolidated balance sheet</b>		
Assets	2,108,915,968	2,716,533,868
Liabilities	(221,464,960)	(120,681,885)
Share capital	1,836,397,594	1,836,397,594
Shareholders' funds	1,887,451,008	1,842,371,983
Return rate on net assets (%)	2.7%	(2.45%)
Debt/equity ratio (%)	6.81%	0%

Note: 1. Turnover represents premia from leasing of completed premises, premia from re-grant of surrendered premises, rental income and other operating incomes.

Source: HKSTPC.

<sup>59</sup> HKSTPC published the 2003-04 figures by the end of December 2004. Nevertheless, those figures are not included in this research due to time constraints.

<sup>60</sup> In accordance with section 25 of HKSTPCO, HKSTPC is exempt from profits tax.

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Payments of dividends, land premia and loan interests to the Government

5.2.2 The Government did not receive any dividends and land premia from HKSTPC for the period 2001-02 to 2003-04. However, the Government received interests of HK\$8,447,509 in 2001-02 and HK\$5,033,790 in 2002-03 for the loan to Tseung Kwan O Industrial Estate made available under the Loan Fund<sup>61</sup> (see Table 9 below.) Since the loan was paid up in 2002-03, the Government did not receive any interests in 2003-04.

5.2.3 In regard to the way of crediting dividends, land premia and loan interests into the Government's accounts, pursuant to section 18(3) of HKSTPCO, any dividend declared shall be paid into GRA. As regards land premia, if any, they are credited into CWRF. As for loan interests received by the Government, they are credited to the Loan Fund as "Interest on Loans".

**Table 9 — Interests on the Loan Fund received by the Government for the period 2001-02 to 2003-04 (HK\$)**

	2001-02	2002-03	2003-04
Interests on the Loan Fund	8,447,509	5,033,790	Nil

Source: FSTB.

Dividend payout policy

5.2.4 There was no agreement between HKSTPC and the Government on the dividend payout policy prior to December 2004. At that time, the Board determined whether to declare any dividends, on the basis of the prevailing financial situation as empowered under section 18 of HKSTPCO.

5.2.5 HKSTPC finalized and signed a shareholder agreement, which covered the dividend payout policy, with the Government in December 2004. In effect, the shareholder agreement does not require HKSTPC to pay dividends to the Government on a mandatory basis.

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<sup>61</sup> On 16 March 1990, FC of LegCo approved a commitment of HK\$900 million to provide a loan to the then Hong Kong Industrial Estates Corporation (HKIEC) to meet the development costs of the Tseung Kwan O Industrial Estate. The then HKIEC borrowed a total of HK\$226.4 million. This loan was repayable in seven annual instalments commencing a year after the completion of the first phase of the estate in 1997-98. The interest was set at 5% per annum on the outstanding balance loan.

5.2.6 According to the shareholder agreement, HKSTPC may declare and pay dividends to the Government based on several factors. HKSTPC agrees that the views and opinions of FS in relation to the declaration or payment of dividends by HKSTPC as expressed in the context of the annual estimates, corporate plan and the ten-year financial projections as well as other relevant factors are the considerations in the exercise of its discretion to declare and pay dividends under section 18 of HKSTPCO. If the views and opinions of HKSTPC differ from those of FS, HKSTPC is required to give valid reasons and supporting documents to FS for considerations.

5.2.7 FS reserves the right to declare any part of the moneys of HKSTPC to be surplus moneys and direct the payment of such surplus moneys into GRA.

#### Property development projects

5.2.8 The Government has granted a total of 2 262 734 sq m of land to HKSTPC at nominal land premium for the development of industrial estates, industrial technology centre and science park, which are technology infrastructures to provide land or premises to facilitate the growth and development of technology-based industries in Hong Kong. The current value of the land granted to HKSTPC is not available. Meanwhile, HKSTPC has not engaged in any residential and commercial developments. (See Appendix IX for the land grant to HKSTPC.)

#### Financial arrangements between the Government and the Hong Kong Science and Technology Parks Corporation

5.2.9 HKSTPC did not pay any dividends to the Government in 2001-02, even though it recorded a profit in that financial year. According to FSTB, the Board had considered the overall financial position of HKSTPC before arriving at the decision.

#### Role of the Legislative Council in monitoring the financial arrangements of the Hong Kong Science and Technology Parks Corporation

5.2.10 LegCo is not empowered to play any role in relation to the declaration of dividends by HKSTPC. However, LegCo can monitor the financial arrangements of HKSTPC through approving public funding proposals and receiving HKSTPC's annual report and financial statements.

5.2.11 The Government is required to seek LegCo's approval on injecting equity to HKSTPC on major construction projects such as the Science Park.

5.2.12 In addition, according to section 24 of HKSTPCO, FS shall cause a copy of the following documents to be laid on the table of LegCo within the financial year immediately following the one to which the documents are related:

- (a) a report on the activities of HKSTPC for that financial year;
- (b) a copy of its statement of accounts in respect of the financial year; and
- (c) a copy of the auditor's report in respect of the financial year.

### **5.3 Corporate governance**

#### The Board

##### *Functions*

5.3.1 Pursuant to section 4 of HKSTPCO, HKSTPC shall have a Board, which is the governing body of HKSTPC. The Board is required to perform the statutory powers of HKSTPC, which are set out in paragraph 5.1.5 above.

##### *Membership of the Board*

5.3.2 Sections 1(1)(a) and 1(1)(b) of Schedule 2 of HKSTPCO stipulate the composition of the Board, which consists of the Chairman and between eight and 16 Board members. A Board member may be a public officer.

5.3.3 Currently, the Board consists of the Chairman<sup>62</sup> and 15 non-executive Board members. Among the non-executive Board members, 10 belong to the industry, finance, investment, trade, property, accounting and publishing sectors, four Board members are university professors and one member is a public officer, who is the Permanent Secretary for Commerce, Industry and Technology (Communications and Technology).

##### *Appointment*

5.3.4 According to sections 1(1)(a) and 1(1)(b) of Schedule 2 of HKSTPCO, the Chairman is appointed by CE, whereas the Board members are appointed by FS.

5.3.5 The criteria for appointing the Chairman and the Board members take into account the need to optimize the mix of skills, expertise and experience.

5.3.6 The term of office of the Chairman, as set out in Schedule 2 of HKSTPCO, is determined by CE. In regard to a Board member (not being a public officer), the term of office shall not exceed three years. Upon the expiry of the term of office, he or she may be re-appointed. In the case of a public officer appointed as a Board member, the term of office is determined at the discretion of FS.

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<sup>62</sup> The Chairman of HKSTPC is Mr. Victor Lo Chung-wing.

*Honorarium of the Chairman and Board members*

5.3.7 The Chairman and Board members do not receive any honorarium.

*Meetings*

5.3.8 The Board meets regularly on a quarterly basis. Based on special requirements, the Board may meet on a monthly basis.

Committees carrying out major functions of the Board

5.3.9 Establishment of committees is stipulated under section 9 of HKSTPCO. There are currently three committees established by the Board: the Finance and Administration Committee, the Business Development and Admission Committee, and the Projects and Facilities Committee.

5.3.10 Audit functions are generally performed by the Finance and Administration Committee, and there is no Audit Committee under the Board.

*Finance and Administration Committee*

5.3.11 The Finance and Administration Committee recommends to the Board major changes in the organizational structure, and the terms and conditions of service of HKSTPC's employees, including remuneration, allowances and annual salary adjustment. This Committee also approves the appointment, posting, contract renewal, disciplinary actions and dismissal of general and senior managers.

*Business Development and Admission Committee*

5.3.12 The Committee approves applications for admission as tenants and grantees, and approves the implementation of individual marketing programmes and activities in accordance with the plans approved by the Board.

*Projects and Facilities Committee*

5.3.13 The Committee recommends to the Board matters concerning development projects, including master development plan and appointment of main consultants and contractors, approves agreements and contracts with consultants and contractors, and monitors the progress and budgetary controls of the projects.

### Extent of authority of the Chairman and senior management staff over the annual budget and financing of the Hong Kong Science and Technology Parks Corporation

5.3.14 The senior management prepares an annual budget, which is subject to the approval of the Board on the advice of the Finance and Administration Committee. Section 22(1) of HKSTPCO further stipulates that the Board-approved annual budget should be submitted to FS for his acceptance. In practice, the annual budget for the subsequent financial year is submitted to FS no later than 1 February of the current financial year.

### Relationship between the Hong Kong Science and Technology Parks Corporation and the Legislative Council over its annual budget

5.3.15 HKSTPC does not present its annual budget to LegCo and does not solicit views and comments from LegCo Members on revenue and expenditure estimates. According to HKSTPC, the present financial arrangements have struck a reasonable balance between the need for HKSTPC to operate as a separate legal entity with autonomy to conduct its business according to prudent commercial principles, and the accountability required regarding the use of public funds.

### Role of the external auditor in relation to financial control

5.3.16 HKSTPC employs an external auditor to audit the financial statements in accordance with generally accepted accounting principles. The auditor's report is contained in the annual report of HKSTPC. However, there is no value for money audit report published by either internal or external auditors on HKSTPC.

5.3.17 HKSTPC is not put under the scrutiny of the Director of Audit; hence, there is also no value for money audit report study conducted by the Audit Commission.

### Procedures for appointing senior management staff and determining their remuneration and conditions of service

5.3.18 The authorities who are responsible for appointing CEO<sup>63</sup> and senior management staff, and determining their remuneration and conditions of service are:

- (a) under section 14(1) of HKSTPCO, the Board shall, subject to the prior approval of FS, appoint CEO and determine the terms and conditions of his service;
- (b) the Board appoints the vice presidents<sup>64</sup>, and determines the terms and conditions of service; and

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<sup>63</sup> The current CEO of HKSTPC is Mr. C. D. Tam, who took office in April 2002.

<sup>64</sup> The three vice presidents head the following divisions: Marketing and Admission, Business Development and Technology Support, and Projects and Facilities.

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- (c) the Finance and Administration Committee appoints general and senior managers, and determines their terms and conditions of service.

5.3.19 The appointment procedure is as follows:

- (a) approval of creation of a post by the Board;
- (b) detailed job description and requirements for the post; and
- (c) recruitment under an open and competitive process.<sup>65</sup> Candidates for vice presidents shall be interviewed by a recruitment committee constituted by Board members and CEO.

#### Remuneration policies

5.3.20 In determining remuneration packages, HKSTPC considers comparable positions in the market. The offered packages should be within the range of the relevant grade as stated in HKSTPC's remuneration structure.

5.3.21 HKSTPC reports annually to the Secretary for Commerce, Industry and Technology on the detailed remuneration arrangements for its senior executives and their compliance with established principles of the Hay Group study.

#### Remuneration packages of senior management staff

5.3.22 As at end-January 2004, the remuneration packages of CEO, vice presidents and general managers were:

- (a) CEO: HK\$4 million;
- (b) three vice presidents: averaged HK\$2.284 million; and
- (c) two general managers: averaged HK\$1.404 million.

5.3.23 In the Hay Report published in June 2002, the proposed remuneration level of CEO was HK\$3.58 million. Hence, the current remuneration level of CEO is higher than the Hay Group's recommended level by HK\$400,000. HKSTPC has no plan to adjust the remuneration package of CEO, as it does not wish to change the terms of ongoing contracts of the senior executives. The existing contract of CEO is for three years, which will expire at the end of March 2005.

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<sup>65</sup> A recruitment panel consisting of the Chairman, the Commissioner of Innovation and Technology and three non-official Directors was set up when recruiting CEO in 2002. A recruitment agency was appointed to undertake the recruitment exercise.

5.3.24 The remuneration packages of the second and third-tier senior management were in line with the levels proposed by the Hay Group.

Procedures adopted and criteria considered by the Board when reviewing remuneration packages of senior management staff

5.3.25 HKSTPC has not made any salary adjustments since its establishment in May 2001. In determining the remuneration packages, references are made to the findings of the consultancy company employed. To gather additional market information, HKSTPC plans to conduct a survey of remuneration packages of its senior management through the use of relevant benchmarking companies for comparison in 2004-05.

## **5.4 Reporting arrangements**

5.4.1 Under HKSTPCO, HKSTPC is responsible to the Government through the following arrangements:

- (a) providing information to CE as he may specify;
- (b) requiring the approval of CE when appointing the Chairman;
- (c) requiring the approval of FS when appointing the Board members and CEO;
- (d) requiring the approval of FS on the HKSTPC's authorized capital structure, investment, payments into general revenue and estimates of income and expenditure; and
- (e) submitting its annual report, as well as the audited financial statements and the auditor's report on these statements to FS for acceptance.

5.4.2 HKSTPC is answerable to LegCo through the following:

- (a) briefing relevant panels and bills committees;
- (b) reporting its performance through tabling its financial statements and annual report before LegCo; and
- (c) seeking the approval of public funding for specific projects and purposes.

## Chapter 6 — Analysis

### 6.1 Comparative analysis of the selected bodies studied

6.1.1 The findings of this study are summarized in Table 11 on pages 78 – 95, which compares a list of related parameters with respect to the selected bodies studied.

### 6.2 Extent of control over the management of Government investment incomes

#### By the Administration

##### *Mandatory plough-back of investment incomes to Government Revenue*

6.2.1 Although the selected bodies studied recorded profits in most of the past few years, they might not be required to pay dividends to the Government:

- (a) KCRC was consistently profitable from 1997 to 2003, but no dividends were paid to the Government between 1998-99 and 2002-03;
- (b) AA was profitable from 2000-01 to 2003-04, but no dividends were paid to the Government in 2000-01 and 2001-02;
- (c) MTRCL was consistently profitable from 1997 to 2003, but no cash dividends were paid to the Government in 1999-2000 and 2000-01; and
- (d) HKSTPC recorded a profit in 2001-02, but no dividends were paid to the Government in that financial year.

6.2.2 Based on the findings of the research on the selected bodies studied, there is no provision in the respective ordinances or memoranda of understanding or agreements signed with the Government to make the plough-back of investment incomes to Government Revenue mandatory. In effect, the management Boards of the respective selected bodies are empowered to declare any dividends payable. In arriving at the decision, the relevant Board takes into account the overall financial position of the body concerned.

6.2.3 In the cases of KCRC and AA, the Boards are required under the respective ordinances to seek the agreement of FS on their recommendation of the amount of dividend payable. As such, the factor of the Government's budget situation may be taken into account. However, this arrangement is not applicable to MTRCL and HKSTPC. In the case of HKSTPC, the dividend payout policy is covered in a shareholder agreement signed in December 2004.

6.2.4 Regarding the rationale behind such arrangements, the Administration has explained that under the respective ordinances, KCRC and AA may declare and pay into GRA dividends on shares issued to the Government. In addition, FS, after consultation with the corporation concerned and having regard to the financial position of the corporation and its subsidiaries (if any), may direct the corporation to declare and pay to GRA a dividend of an amount specified by him.

6.2.5 MTRCL is a listed company, with the Government being its majority shareholder. The arrangement for declaration of dividends by MTRCL is governed by the relevant provisions under the Companies Ordinance and its Memorandum and Articles of Association.

6.2.6 The HKSTPC Board would consider its prevailing financial situation when considering whether to declare dividends as empowered under HKSTPCO. Under this ordinance, FS reserves the right to declare any parts of the moneys of HKSTPC to be surplus moneys and direct the payment of such surplus moneys into GRA.

#### *Voting power of public officers in the Board of the selected bodies*

6.2.7 The Administration has appointed public officers to the respective Board of the selected bodies studied to monitor their operations. Table 10 below sets out the percentage of ownership and the percentage of voting power of public officers on the Boards of KCRC, AA, MTRCL and HKSTPC. The Administration has 100% ownership of KCRC, AA and HKSTPC, as well as 76% ownership of MTRCL.

6.2.8 The number of public officers appointed by the Administration to the Boards of KCRC, AA, MTRCL<sup>66</sup> and HKSTPC is two, three, three and one respectively. There is no evidence that public officers have more power than the other Board members in making decisions and casting votes. The voting power of the Administration on the Boards of KCRC, AA, MTRCL and HKSTPC is 20%, 23.1%, 27.3% and 6.3% respectively.

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<sup>66</sup> The Secretary for Financial Services and the Treasury, who is not appointed by the Administration, is included in the total.

6.2.9 Although the Administration is the sole or majority owner of the selected bodies studied, its voting power on the respective Boards ranges from 6.3% to 27.3%. Therefore, the public officers do not have absolute influence on the Board's decision on dividend declaration.

**Table 10 — Percentage of ownership by the Administration and the percentage of voting power of public officer(s) on the Board of KCRC, AA, MTRCL and HKSTPC**

	KCRC	AA	MTRCL	HKSTPC
Percentage of ownership by the Administration	100%	100%	76%	100%
Number of public officer(s) appointed to the Board	2	3	3	1
Number of Board members (including the Chairman)	10	13	11	16
Percentage of voting power of public officer(s) on the Board	20%	23.1%	27.3%	6.3%

6.2.10 The Administration has explained that the arrangement of appointing public officers to the Boards of the selected bodies can protect the Government's investment interests. The selected bodies are required by legislation to conduct their business under prudent commercial principles. People with wide experience in related fields are appointed to the Board to ensure that the Board will be served by members with balanced and wide experience for the benefit of corporate development. Activities and policies of the corporations, including payment of dividends, would require the endorsement of the Boards. These safeguards and arrangements help ensure that the Government's investment interests are protected.

6.2.11 The Administration has not conducted any specific studies to evaluate the effectiveness of appointing policy secretaries to the respective Boards to enforce the Government's monitoring role. Nonetheless, it has kept under review the monitoring arrangement, which is essentially the relevant policy secretaries monitoring the operation of the corporations in areas under their respective portfolios. As Board members of these corporations, the Government representatives work with other members of the Board to discharge duties, including setting development strategies, scrutinizing budgets and overseeing the operation of the corporations. The Administration has added that the arrangement of appointing public officers to the Board of the selected bodies has been working well.

### By the Legislature

#### *Role of the Legislative Council in relation to dividend declaration*

6.2.12 LegCo is vested with the powers to examine and approve budgets introduced by the Government under Article 73 of the Basic Law. In addition to the budget, revenue proposals and other financial proposals require the prior approval of LegCo. Revenue proposals which cause higher or lower government revenue require the prior approval of LegCo.<sup>67</sup> However, LegCo is not empowered to play any role in relation to the declaration of dividends of the selected bodies studied.

#### *Role of the Legislative Council in relation to waiver of dividends*

6.2.13 Although direct injection of public funds into the selected bodies requires LegCo's approval, it does not have any role in the Government's further investment through waiver of dividends, as illustrated by the case of MTRCL's PBRL project.

6.2.14 In reviewing the PBRL case, some LegCo Members expressed grave concern about the scope and extent of FS's powers in relation to the management of dividends and other incomes generated from the Government's investment in public and private companies. Members were also concerned about whether proper mechanisms were in place to ensure that the exercise of such powers was properly accounted for by the executive authorities to LegCo.

### By internal or external auditors

#### *Availability of value for money audit reports*

6.2.15 The selected bodies studied employ external auditors to audit the financial statements in accordance with generally accepted accounting principles. The auditor's report is included in the respective annual reports. However, there are no value for money audit reports published by either internal or external auditors.

6.2.16 The selected bodies studied are not put under the scrutiny of the Director of Audit; hence, there are no value for money audit studies conducted by the Audit Commission.

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<sup>67</sup> See paragraph 2.2.13 and Appendix IV for details.

6.2.17 The Administration has explained the rationale for not putting the selected bodies under the scrutiny of the Director of Audit in that the selected bodies all operate under prudent commercial principles. The respective Board is responsible for monitoring the financial performance of each body, which is reflected in its financial statements.

### **6.3 Property development and commercial activities undertaken by the selected bodies**

#### The Kowloon-Canton Railway Corporation and the MTR Corporation Limited

6.3.1 Under the respective ordinances, the principal activities undertaken by KCRC and MTRCL are the construction and operation of railway systems in Hong Kong. However, in practice, KCRC and MTRCL are also engaging in residential and commercial developments.

6.3.2 The Government has granted a total of 297 668 sq m of land to KCRC for residential and commercial developments. At present, KCRC holds 10 investment properties, totalling 82 122 sq m in gross floor area (GFA). In addition, it has nine proposed property development projects, which are estimated to be completed between 2007 and 2015.

6.3.3 As regards MTRCL, the Government has granted it a total of 2 088 742 sq m of land for residential and commercial developments. MTRCL has a total of 48 property projects completed or under development. Among them, 20 projects are along the urban subway line, 21 projects are along the Airport Railway Line, five projects are along the Tseung Kwan O Line, and one project is on the Siu Ho Wan depot. In addition, a "Theme Village" is being developed at Ngong Ping.

6.3.4 In addressing to the question of whether the involvement of the two railway corporations in property development is a deviation from the policy intent of their establishment or any agreement between the Government and the corporations concerned, the Administration has referred to the background and rationale for allowing the two railway corporations to undertake property development projects and commercial activities not related to their principal function of railway operations.

6.3.5 According to the Administration, KCRC and MTRCL operate under prudent commercial principles. Property development provides a source of income to the corporations to support the financial viability of railway projects and contributes to future rail patronage from the immediate catchment areas created by the property developments. In conjunction with their railway construction activities, KCRC and MTRCL have been involved in the development of residential and commercial properties above and adjacent to railway stations and depots under agreements with private developers. Profits from these development ventures have been used to supplement associated railway returns, thereby contributing to an improved rate of return on the investment of new railway lines.

6.3.6 The Administration has elaborated that with KCRC and MTRCL being held responsible for the entire station site of a typical development project, the above-station or depot development can be optimally planned and utilized. Under this approach, the necessary infrastructure to support the development and any property enabling works is provided at an appropriate time in an efficient way. This co-ordinated approach can ensure that the comprehensive development can be completed successfully.

6.3.7 In addition, the integration of property and station developments ensures that safety and operational aspects of the railway are safeguarded. With the same organization managing the development and railway, responsibilities are clearly defined and any impacts of the property development on the railway can be properly managed.

6.3.8 With regard to the concern that the involvement of KCRC and MTRCL in property development and related commercial activities may be a deviation from the policy intent of their establishment or any agreement between the Government and the corporations concerned, the Administration has stated that the two corporations are set up for the development and operation of the railway networks in Hong Kong. The businesses that the two corporations currently engage in are not in conflict with this goal.

#### The Airport Authority

6.3.9 The Government has granted a total of 12 559 482 sq m of land to AA for the development of the Hong Kong International Airport and emergency back-up aviation fuel receiving facility. As regards AA's property developments, the only existing development is Airport Regal Hotel, which generates an estimated annual income of HK\$16 million. AA has two future development projects, which are the Asia World-Expo (i.e. an exhibition centre at the airport) and a second airport hotel.

6.3.10 The Administration has explained that under section 5 of AAO, AA is empowered to engage in or carry out airport-related activity in trade, commerce or industry. The activities undertaken by AA are complementary to its core service of airport operation.

#### The Hong Kong Science and Technology Parks Corporation

6.3.11 The Government has granted a total of 2 262 734 sq m of land to HKSTPC at nominal land premium for the development of industrial estates, industrial technology centre and science park, which are technology infrastructures to provide land or premises to facilitate the growth and development of technology-based industries in Hong Kong.

6.3.12 The Administration has stated that HKSTPC has not engaged in any residential and commercial developments for sale or for any other purposes. In addition, HKSTPC does not have a property development portfolio.

### **6.4 Review of land policy**

6.4.1 Members expressed serious concern over the Government's policy of subsidizing commercially-operated infrastructural projects in the form of land grants during the motion debate on "Review of land policy" at the LegCo meeting held on 16 June 2004. Hence, RLSD has asked the Administration if it has reviewed the land policy in relation to the debate.

6.4.2 The Administration has replied that the prevailing land policy is very clear and has been in existence for years. Under such policy, sites are put up for open bidding and granted to the highest bidder. This is a fair and reasonable arrangement, which is based on the principles of free market and fair competition.

6.4.3 Where the granting of land is to facilitate certain government policies in order to maximize social benefits, each land grant arrangement is considered on a case-by-case basis by the policy bureaux and departments concerned.

## **6.5 Applying the "green field site" principle to the Kowloon-Canton Railway Corporation and the MTR Corporation Limited when assessing the land premia**

6.5.1 In the cases of KCRC and MTRCL, when assessing the land premia, the Government has adopted the "green field site" principle, which requires that the valuation of FMV of a property development site is assessed on the basis of no railway development. The Government has explained that the rationale of this arrangement is that the railway development is considered as an investment made by KCRC or MTRCL, not the Government.

6.5.2 According to HKIS, it is not aware that the "green field site principle" has been adopted in other land premium cases.

6.5.3 The Government has stated that since the valuation is on FMV basis, the premium paid by the railway corporations is the market value of the site instead of a "below-market" value.

6.5.4 However, HKIS has presented a different view. It believes that the application of the "green field site" principle in the premium assessment for the railway corporations imposes an important assumption (in relation to the availability of the railway development) into the valuation process and thus would have significant implications for the premium assessment. Other things being equal, the availability of railway development would normally enhance accessibility and thus land values.

6.5.5 An academic has commented that if a KCRC/MTRCL project is going to benefit by the presence of the railway station/line extension, the increase in land value due to the railway factor should be taken into account. If not, there is a potential under-valuation of the site, and this treatment is considered unfair when compared to the situations involving private developers. Overall, the application of the "green field site" principle in the premium assessment is regarded as implicitly creating indirect subsidy to the railway corporations.

## **6.6 Extent of control over the annual budgets of the selected bodies**

### By the selected bodies

6.6.1 In regard to KCRC, AA and HKSTPC, the senior management of the respective bodies prepares an annual budget for review by one or more designated committees established under the Board. The annual budget is also subject to the approval of the Board. For KCRC and AA, the Board-approved annual budget is not required to be submitted to the Administration for acceptance, whereas HKSTPC is subject to such requirement.

6.6.2 As for MTRCL, the senior management prepares an annual budget. However, there is no publicly available information regarding whether there is any designated committee established under the Board for reviewing the annual budget. In line with the practice of the other bodies studied, its annual budget is also subject to the approval of the Board.

#### By the Administration

6.6.3 There is no information on whether the Administration plays any role in relation to both the budgetary process and approval of the annual budget for all of the selected bodies except HKSTPC.

6.6.4 The Administration has explained its roles in relation to the budgetary process and approval of their annual budgets. KCRC, AA and MTRCL are corporations operating under prudent commercial principles. Annual budgets are approved by their respective Boards. Government members of the Board take part in the Board business including the approval of the annual budget. Together with other Board members, they critically examine the proposed budget.

#### By the Legislature

6.6.5 LegCo does not have any role in scrutinizing the annual budgets of the selected bodies studied. However, LegCo is empowered to approve the annual budget of Government bureaux and departments and Government agencies, including those responsible for supervising the selected bodies. Therefore, the annual budgets of the selected bodies studied are not subject to the same level of scrutiny as for Government bureaux and departments and Government agencies.

### **6.7 Extent of control over remuneration packages of senior management**

#### By the selected bodies

6.7.1 In the cases of KCRC and AA, the Board considers the remuneration packages of the senior management based upon market conditions and advice of a designated committee. Although there is no designated committee for advising the Board in determining the remuneration packages of the senior management of HKSTPC, its Board takes into account comparable positions in the market. As regards MTRCL, the information on the extent of control over the remuneration packages of the senior management is not publicly available.

6.7.2 On several occasions, some Members have raised concern over the lack of transparency of remuneration policies governing the senior management of major public bodies, particularly scant public information on these policies. They consider that the transparency of the determination procedure of the remuneration packages of the senior management should be enhanced.<sup>68</sup>

#### By the Administration

6.7.3 In the cases of AA and MTRCL, the Administration does not play any role in determining the respective CEOs' remuneration package. On the other hand, for KCRC and HKSTPC, the remuneration package of CEO is subject to approval of the Administration.

6.7.4 As for the determination of the remuneration packages of the second and third-tier senior management of the selected bodies studied, the Administration does not play any role. The remuneration packages of the second and third-tier senior management are in line with the levels proposed by the Hay Group.

6.7.5 According to the Administration, for MTRCL, the Board appointed three of its members to form a selection committee to act on its behalf in the appointment exercise of the new CEO in 2003. The terms and conditions of employment, remuneration and retirement benefits were considered by the committee. The Secretary for Financial Services and the Treasury, being one of the committee members, participated in the process of determining the new CEO's remuneration packages.

6.7.6 In respect of AA, under section 15(4) of AAO, the remuneration of AA's CEO shall be determined by AA. Government members on the AA Board perform their role simply as Board members in monitoring AA's activities, including the determination of its CEO's remuneration packages.

#### By the Legislature

6.7.7 LegCo does not have any role in determining the remuneration packages of the senior management of the selected bodies.

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<sup>68</sup> For details, please see the *Minutes of the Meeting of LegCo Panel on Public Service held on 3 July 2002*, LC Paper No. CB(1) 171/02-03, and the debates of the motion without legislative effect on "Reviewing the Pay Adjustment Mechanisms of Statutory Bodies and the Hong Kong Monetary Authority" on 12 December 2001, which was passed by LegCo.

## 6.8 Transparency and accountability

### Availability of detailed information on Government investment incomes

6.8.1 The *Accounts of the Government* for each financial year is normally tabled at LegCo in November each year. It contains information about GRA and other accounts, such as CIF and CWRF. However, the information on Government investment incomes is not clearly reflected in GRA and other accounts. In particular:

- (a) while it is required under the respective ordinances that the cash dividends paid by KCRC, AA, MTRCL and HKSTPC to the Government are credited into GRA, the amount of cash dividends paid by each of these bodies is not reflected in GRA;
- (b) the scrip dividends paid by MTRCL are not reflected in the "Statement of Investments" of CIF; and
- (c) land premia received, which are not regarded as investment incomes by the Government, are credited into CWRF. However, the amount of land premia paid by each of the selected bodies is not reflected in CWRF.

6.8.2 In the light of the above, it is difficult for LegCo and the public to monitor the performance of the Government's investment in individual bodies.

### Role of the Legislative Council in examining the annual reports and financial statements

6.8.3 KCRC, AA and HKSTPC are required by law to table their annual reports and financial statements before LegCo. However, there is no statutory requirement for the senior managements of these bodies to present their annual reports and financial statements. In practice, they attend the relevant panel meetings to report and answer questions on their operations and financial situation. The Administration has explained that, when necessary, the committees of LegCo may invite the Administration or the body concerned to attend their meetings to answer questions raised by Members.

6.8.4 MTRCL is not required to table its annual report and financial statements before LegCo, but the relevant information is published and easily accessible by the public. LegCo may invite the Administration to attend its meetings to answer questions on MTRCL raised by Members.

### Appointment of the Chairman and Board members of the selected bodies

6.8.5 The Chairman and Board members of KCRC, AA and HKSTPC are appointed by the Government. In the case of MTRCL, the appointment of the Chairman and several directors is made by the Government owing to the status of the Government being the largest shareholder.

6.8.6 As regards AA, there are statutory requirements for the appointment of the Chairman and Board members. However, in the cases of KCRC, MTRCL and HKSTPC, the selection criteria of the appointments are not set out in the respective ordinances.

6.8.7 In regard to the appointment of the Chairman and Board members of the selected bodies, the Administration has explained that when considering the appointment, factors such as personal capabilities, leadership, expertise, experience, integrity and commitment to public services are taken into account. The Government will carefully assess the suitability of prospective candidates having regard to the above factors and taking into account the need to optimize the mix of skills, expertise and experience.<sup>69</sup>

### Appointment of the Chief Executive Officer and senior staff of the selected bodies

6.8.8 For KCRC, the Board decides on the composition of the selection board and the selection criteria for the appointment of CEO. In addition, under KCRCO, the appointment to the service of the corporation of CEO, including the terms and conditions of such appointment, requires the prior approval of CE.

6.8.9 In the most recent exercise of appointing a new CEO for AA, the Board first agreed to the composition of the selection panel which comprised the Chairman from each of the five Board Committees. An executive search firm was then appointed to assist with the actual selection process. The approval of CE was obtained before the appointment of the selected candidate in accordance with section 15(1) of AAO.

6.8.10 For MTRCL, the responsibility and authority to appoint CEO rest with its Board. In the CEO appointment exercise in 2003, the Board appointed three members to form a selection committee to act on its behalf in the selection of the new CEO. The selection criteria were determined by the committee. The selection was based on the assessment of the candidates' profile against job requirement.

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<sup>69</sup> The Government's policy on appointing the Chairman and Board members of the advisory and statutory bodies is set out in the publication entitled *Review of the Role and Functions of Public Sector Advisory and Statutory Bodies – Consultation Paper* issued by the Home Affairs Bureau in April 2003. One of the principles is that the best people for the job should be appointed to an advisory or statutory body.

6.8.11 The CEO of HKSTPC was hired through open recruitment. A recruitment panel consisting of the Chairman of the Board, the Commissioner of Innovation and Technology and three non-official Directors of HKSTPC was set up. A recruitment agency was appointed to undertake the recruitment exercise, which included a search through the recruitment agency's global database, advertisement and other sources. Potential candidates were short-listed by the recruitment agency based on their professional assessment of the candidate's suitability in undertaking the duties of CEO.

6.8.12 In response to RLSD's enquiry, the Administration has provided that AA and HKSTPC have one ex-civil servant at their respective top three tiers of management. However, there has been no ex-civil servant recruited directly from the civil service to take up positions at the top three tiers of management in KCRC, MTRCL and HKSTPC in the past five years.

#### Disclosure of remuneration policies

6.8.13 Detailed information on remuneration policies of the selected bodies is not made available in the public domain, including:

- (a) the procedure for determining the remuneration packages of the senior management;
- (b) factors for determining the remuneration packages of the senior management; and
- (c) factors for making annual adjustments.<sup>70</sup>

6.8.14 As the information on policies and criteria for determining the remuneration packages of CEOs and senior management of the selected bodies is not available in the public domain, RLSD has requested the selected bodies to provide the details. With the exception of MTRCL, KCRC, AA and HKSTPC have provided the requested information.

6.8.15 In the cases of KCRC, AA and HKSTPC, the policies and criteria for determining the remuneration packages of CEO and senior management are similar. The respective Board considers comparable positions in the market and adjusts the salary and benefits ranges applicable to the corresponding corporation if warranted.

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<sup>70</sup> However, some public bodies in other places have adopted a more open practice. For instance, the Bank of England and the Financial Services Authority of the United Kingdom have provided detailed information on remuneration policies, salary structures and levels in their annual reports. In the United States, the remuneration policies of the financial bodies such as the Federal Reserve System and the Federal Deposit Insurance Corporation are set out in the federal statute. For details, please see the research report entitled *The Governance of the Hong Kong Monetary Authority and Comparable Authorities in Hong Kong and Overseas Jurisdictions* published by RLSD on 30 April 2003, RP04/02-03.

6.8.16 RLSD has asked the Administration whether there is any plan to address the public concern that the remuneration levels of persons holding key positions in public bodies are on the high side. The reply is that the current remuneration packages of the senior executives are broadly in line with the recommended ranges as set out in the consultant report of the Review of Remuneration of Senior Executives in Statutory and Other Bodies commissioned by the Government. The remuneration packages of the senior management staff in these corporations are determined by the respective Boards of the corporations and the Administration keeps track of their remuneration levels.

#### Share option benefits offered by the MTR Corporation Limited

6.8.17 MTRCL is the only case in this study to have granted share option benefits to its staff, totalling 48 833 200 share options. The Administration has explained that senior staff's remuneration is closely tied to MTRCL's long-term performance and management interest is aligned with that of the shareholders.

6.8.18 FSTB has not provided information on the criteria adopted by MTRCL in granting share option benefits to the senior management.

#### Establishment of an audit committee

6.8.19 According to the Code of Best Practice, to enhance the accountability arrangement, an audit committee comprising mostly non-executive directors should be established to consider matters relating to internal and external audit, annual financial statements and internal control of an organization. In this research, only HKSTPC has not established an audit committee under the Board to look into financial reporting and internal control issues.

6.8.20 The Administration has explained the rationale of HKSTPC's arrangement. The Board of HKSTPC approved the incorporation of the functions of its Audit Committee into its Finance and Administration Committee in December 2003. Such functions, which have recently been finalized, include, inter alia, internal control issues and review of the annual financial statements.

**Table 11 — An overall comparison of the selected bodies studied**

	<b>Kowloon-Canton Railway Corporation (KCRC)</b>	<b>Airport Authority (AA)</b>	<b>MTR Corporation Limited (MTRCL)</b>	<b>Hong Kong Science and Technology Parks Corporation (HKSTPC)</b>
<b>Background information</b>				
Regulatory legislation	Kowloon-Canton Railway Corporation Ordinance (KCRCO)(Cap. 372).	Airport Authority Ordinance (AAO)(Cap. 483).	Mass Transit Railway Ordinance (MTRO) (Cap. 556).	Hong Kong Science and Technology Parks Corporation Ordinance (HKSTPCO) (Cap. 565).
Statutory status	Yes, the Government owns 100% of the issued share capital.	Yes, the Government owns 100% of the issued share capital.	No, it was a statutory corporation before October 2000, but has been a listed company on the Hong Kong Stock Exchange (HKSE) since then. The Government owns about 76% of the issued shares.	Yes, the Government owns 100% of the issued share capital.
Principal activities undertaken	Constructs and operates the railway system; and engages in commercial and residential property developments.	Operates and maintains the Hong Kong International Airport (HKIA); and develops the Asia World-Expo.	Constructs and operates the mass transit railway system; and engages in commercial and residential property developments.	Develops and maintains three industrial estates, one science park and one industrial technology centre.
Issue affecting ownership	Possible merger of KCRC and MTRCL.	Proposed privatization of AA.	Possible merger of MTRCL and KCRC.	Nil.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Financial arrangements</b>				
Financial highlights	Consistently profitable from 1997 to 2003.	As HKIA started operations on 6 July 1998, the 1997-98 consolidated income figures are not available.  AA suffered losses in 1998-99 and 1999-2000, but recorded profits from 2000-01 to 2003-04.	Consistently profitable from 1997 to 2003.	As HKSTPC was established on 7 May 2001, the 1997-2000 financial figures are not available.  HKSTPC recorded a profit in 2001-02, but suffered a loss in 2002-03 (2003-04 figures are not covered in this research due to time constraints).
Authority responsible for declaring dividends	The Board of KCRC determines the amount of dividends payable and seeks the agreement of FS on such recommendation in accordance with section 14 of KCRCO.	The Board of AA determines the amount of dividends payable and seeks the agreement of FS on such recommendation in accordance with section 26 of AAO.	The Board of MTRCL.	The Board of HKSTPC.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Financial arrangements (cont'd)</b>				
Factors considered when determining the amount of dividends payable	(a) The financial position of KCRC; (b) the net profit for the year and retained earning; (c) capital expenditure required in the coming years, particularly West Rail, East Rail Extensions and other new railway projects; (d) credit ratings of KCRC; and (e) expectation of investors if KCRC were privatized or listed.	The financial position of AA.	(a) MTRCL's earnings; (b) capital requirements; (c) general financial condition; and (d) any factors considered relevant by the Board.	The prevailing financial situation of HKSTPC.
Memorandum of understanding or agreement signed with the Government regarding dividend payout	Nil.	Nil.	Nil.	Yes. The dividend payout policy is covered in a shareholder agreement between HKSTPC and the Government, which was signed in December 2004.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Financial arrangements (cont'd)</b>				
Dividends received by the Government	The Government received HK\$300 million in 1997-98 and HK\$620 million in 2003-04. No dividends were received by the Government between the two financial years.	Nil, the Government did not receive any dividends from 1998-99 to 2003-04. However, the Government will receive a dividend of HK\$380 million in 2004-05.	Cash dividends: the Government received HK\$647 million in 1997-98, HK\$1,252 million in 1998-99, HK\$371.7 million in 2001-02 and HK\$470 million in 2002-03. However, no cash dividends were received by the Government in 1999-2000, 2000-01 and 2003-04.  Scrip dividends: the Government received 48 873 554 shares in 2001-02, 87 991 070 shares in 2002-03 and 108 213 287 shares in 2003-04. However, no scrip dividends were received by the Government in 1997-98, 1998-99, 1999-2000 and 2000-01.	Nil, the Government did not receive any dividends from 2000-01 to 2003-04.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Financial arrangements (cont'd)</b>				
Crediting dividends into the Government's account	Cash dividends are credited into the General Revenue Account (GRA).	Cash dividends will be credited into GRA.	Cash dividends are credited into GRA. Scrip dividends are reflected in the increased gross total shareholdings of the entities concerned under "Statement of Investments" of the Capital Investment Fund (CIF).	Cash dividends, if any, are credited into GRA.
Interests on the Loan Fund received by the Government	Nil.	Nil.	Nil.	Yes, the Government received HK\$8,447,509 in 2001-02 and HK\$5,033,790 in 2002-03 for the loan made available under the Loan Fund.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Financial arrangements (cont'd)</b>				
Crediting interests into the Government's account	Interests, if any, are credited to the Loan Fund as "Interest on Loans".	Interests, if any, are credited to the Loan Fund as "Interest on Loans".	Interests, if any, are credited to the Loan Fund as "Interest on Loans".	Interests are credited to the Loan Fund as "Interest on Loans".
Engaging in commercial and/or residential property developments	Yes.	Yes.	Yes.	No.
Land premia received by the Government	The Government received HK\$58.96 million in 1997-98, HK\$8.2 million in 1999-2000, HK\$160 million in 2000-01 and HK\$1,322 million in 2002-03. However, no land premia were received by the Government in 1998-99, 2001-02 and 2003-04 as KCRC did not make any land transactions during these years.	Nil.	The Government received HK\$9,984 million in 1997-98, HK\$302 million in 1998-99, HK\$10,886 million in 1999-2000, HK\$8,456 million in 2000-01, HK\$1,941 million in 2001-02, HK\$2,476 million in 2002-03 and HK\$1,228 million in 2003-04.	Nil.
Crediting land premia into the Government's account	Land premia are credited into the Capital Works Reserve Fund (CWRF).	Land premia, if any, are credited into CWRF.	Land premia are credited into CWRF.	Land premia, if any, are credited into CWRF.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	<b>KCRC</b>	<b>AA</b>	<b>MTRCL</b>	<b>HKSTPC</b>
<b>Financial arrangements (cont'd)</b>				
Financial arrangements between the Government and the selected bodies regarding dividend declaration	The Board of the respective bodies studied is empowered to declare any dividends. In arriving at the decision, the Board considers the overall financial position of the respective body concerned.			
Statutory provisions on the role of the Legislative Council (LegCo) in monitoring the financial arrangements of the selected bodies	LegCo approves public funding proposals and receives the annual report and financial statements.	LegCo approves public funding proposals and receives the annual report and financial statements.	LegCo approves public funding proposals.	LegCo approves public funding proposals and receives the annual report and financial statements.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Corporate governance</b>				
Membership of the Board	<p>The Chairman, an acting Chief Executive Officer (CEO) and eight non-executive Board members.</p> <p>Among the non-executive Board members, five belong to the banking, law, surveying, accounting and academia sectors, one Board member is a legislator and the other two Board members are public officers.</p>	<p>The Chairman, CEO and 11 non-executive Board members.</p> <p>Among the non-executive Board members, seven belong to the law, stock exchange, banking, property, technology, trade and investment sectors, one Board member is a legislator and the other three Board members are public officers.</p>	<p>The Chairman, CEO, seven non-executive directors and two "additional directors".</p> <p>The seven non-executive directors belong to the Government, banking, architecture, accounting, academia and social services sectors. The two "additional directors" are public officers.</p>	<p>The Chairman and 15 non-executive Board members.</p> <p>Among the non-executive Board members, 10 belong to the industrial, finance, investment, trade, property, accounting and publishing sectors. Additionally, four non-executive Board members are university professors and the remaining member is a public officer.</p>
Authority for appointing the Chairman	Chief Executive of the Hong Kong Special Administrative Region (CE).	CE.	As long as the Government remains the beneficial majority owner, CE is empowered to appoint the Chairman of MTRCL.	CE.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Corporate governance (cont'd)</b>				
Authority for appointing other Board members	CE appoints the other Board members, with the exception of CEO. CEO is appointed by the Board, subject to the prior approval of CE.	CE appoints the other Board members, with the exception of CEO. CEO is appointed by the Board, subject to the prior approval of CE.	Non-executive directors may be appointed either by the shareholders at a general meeting or by the Board upon the recommendation of the Nominations Committee. CE appoints "additional directors".	Financial Secretary (FS).
Criteria for appointing the Chairman and Board members	Criteria include personal capabilities, leadership, expertise, experience, integrity and commitment to public service.	Under AAO, the Chairman and Board members appointed should have wide experience in air or other forms of transport, or in industry, commercial, financial, consumer or labour matters, or in administration. Factors such as personal capabilities, expertise, experience and integrity are also considered.	When appointing the Chairman and "additional directors", the Government considers factors such as personal capabilities, leadership, expertise, experience, integrity and commitment to public service. RLSD has not been able to obtain information on the criteria for appointing the non-executive directors.	The selection criteria take into account the need to optimize the mix of skills, expertise and experience.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Corporate governance (cont'd)</b>				
Honorarium/remuneration of the Chairman and Board members (2003 figures)	(a) Chairman: HK\$220,000 per annum; and (b) Board members: HK\$110,000 per annum.	(a) Chairman: HK\$220,000 per annum; and (b) Board members: HK\$110,000 per annum.	(a) Chairman: HK\$500,001 - HK\$1,000,000 per annum; and (b) Board members: up to HK\$250,000 per annum.	Chairman and Board members are appointed without receiving any honorarium.
Committees carrying out major functions of the Board	Five committees: (a) Audit Committee; (b) Finance Committee; (c) Strategic Human Resource Committee; (d) Capital Projects Committee; and (e) Property Committee.	Five committees: (a) Audit Committee; (b) Finance Committee; (c) Human Resources Committee; (d) Business Development Committee; and (e) Works Committee.	Three committees: (a) Audit Committee; (b) Remuneration Committee; and (c) Nominations Committee.	Three committees: (a) Finance and Administration Committee; (b) Business Development and Admission Committee; and (c) Projects and Facilities Committee.
External auditor employed to audit financial statements	Yes.			

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	<b>KCRC</b>	<b>AA</b>	<b>MTRCL</b>	<b>HKSTPC</b>
<b>Corporate governance (cont'd)</b>				
Extent of authority of the Chairman and senior management staff over budgeting and financing	The senior management prepares an annual business plan and annual budget for review by the Finance Committee of KCRC. The annual budget is subject to the approval of the Board.	The senior management prepares a rolling five-year business plan and annual budget for review by the Business Development Committee and the Finance Committee of AA. The annual budget is subject to the approval of the Board. A copy of the approved five-year business plan is submitted to FS for record.	There is a budgeting system for all operational and business activities. The senior management prepares an annual budget, which is subject to the approval of the Board.	The senior management prepares an annual budget, which is subject to the approval of the Board on the advice of the Finance and Administration Committee. Under HKSTPCO, the Board-approved annual budget is submitted to FS for his acceptance.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Corporate governance (cont'd)</b>				
LegCo's involvement in scrutinizing annual budgets and revenue and expenditure estimates	<p>KCRC does not present its annual budget to LegCo and does not solicit views and comments from LegCo Members on revenue and expenditure estimates.</p> <p>KCRC does not require KCRC to seek the prior approval of the Finance Committee (FC) of LegCo for its annual budget.</p>	<p>AA does not present its annual budget to LegCo and does not solicit views and comments from LegCo Members on revenue and expenditure estimates.</p> <p>The annual budget includes information on both revenue and expenditure sides and involves commercially sensitive information, it is therefore not appropriate for disclosure outside AA.</p>	<p>MTRCL does not present its annual budget to LegCo and does not solicit views and comments from LegCo Members on revenue and expenditure estimates.</p>	<p>HKSTPC does not present its annual budget to LegCo and does not solicit views and comments from LegCo Members on revenue and expenditure estimates.</p> <p>The present financial arrangements have struck a reasonable balance between the need for HKSTPC to operate as a separate legal entity with autonomy to conduct its business according to prudent commercial principles, and the accountability required regarding the use of public funds.</p>

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Corporate governance (cont'd)</b>				
Procedures for appointing senior management staff and determining their remuneration and conditions of service	<p>The Board decides on the appointment of CEO, including his terms and conditions of service, subject to the prior approval of CE.</p> <p>The Board, with the advice of the Strategic Human Resource Committee, decides on KCRC's second-tier senior executive management appointments, including their terms and conditions of service.</p>	<p>For CEO appointment, the Board forms a selection panel led by the Chairman in search of an appropriate candidate. The appointment requires the prior approval of CE. The financial package of CEO is determined by the Board.</p> <p>For filling other vacant senior executive positions, the Board forms a selection panel, which is normally presided by the Chairman of the Human Resources Committee plus one or more Board members. CEO is required to work out the related terms and conditions as per the approved organization practice.</p>	<p>For CEO appointment, a Board Search Committee is established. The Board Search Committee consists of the Chairman of the Nominations Committee, the Chairman of the Remuneration Committee and a non-executive director, who is from the Government. The Board Search Committee makes a recommendation on the appropriate candidate to the Board, which has the authority to appoint CEO and determine the terms of remuneration.</p>	<p>The Board appoints CEO and determines the terms and conditions of his service, subject to the prior approval of FS.</p> <p>The Board appoints the vice presidents and determines the terms and conditions of service.</p> <p>The Finance and Administration Committee appoints general and senior managers, and determines their terms and conditions of service.</p>

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Corporate governance (cont'd)</b>				
Remuneration policy	In considering the remuneration packages of senior management staff, the Board is advised by the Strategic Human Resource Committee which has expert members appointed from outside KCRC. The Board also considers market conditions.	<p>The package of CEO is the result of an independent study taking into consideration of the market norm and the specific scope of responsibilities.</p> <p>Remuneration packages of directors are determined during the annual salary and benefits survey exercise. Results of such surveys are reported to the Human Resources Committee. Remuneration of directors is established according to the market surveys, provided that changes are within the Board-approved guidelines. CEO is required to determine the corresponding remuneration packages.</p>	RLSD has not been able to obtain the required information.	In determining the remuneration packages, HKSTPC considers comparable positions in the market. The offered packages should be within the range of the relevant grades as stated in HKSTPC's remuneration structure.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Corporate governance (cont'd)</b>				
Remuneration packages of senior management staff	<p>March 2003:</p> <p>(a) CEO: HK\$5.5 million;</p> <p>(b) two senior directors: averaged HK\$4.3 million; and</p> <p>(c) six directors: averaged HK\$3.4 million.</p> <p>The remuneration packages were in line with the levels proposed by the Hay Group in June 2002.</p>	<p>March 2003:</p> <p>(a) CEO: HK\$6.57 million; and</p> <p>(b) five executive directors: HK\$1.29 million - HK\$3.59 million.</p> <p>Although the remuneration package of CEO was higher than the Hay Group's recommended level by HK\$630,000, this was in line with the Hay Report, which allows individual executives to have higher or lower remuneration depending on the individuals' special skills, capabilities and performance.</p> <p>The remuneration packages of the second-tier senior management were also in line with the levels proposed by the Hay Group.</p>	<p>2003:</p> <p>(a) CEO (appointed in December 2003): HK\$680,000 (December 2003 salary); and</p> <p>(b) six directors: HK\$4.3 million - HK\$5.11 million.</p> <p>Since CEO took office in December 2003, the annual figure is not available. For reference, the Hay Group's proposed level was HK\$6.72 million.</p> <p>The remuneration packages of the second-tier senior management were in line with the levels proposed by the Hay Group.</p>	<p>Jan 2004:</p> <p>(a) CEO: HK\$4 million;</p> <p>(b) three vice presidents: averaged HK\$2.284 million; and</p> <p>(c) two managers: averaged HK\$1.404 million.</p> <p>The remuneration package of CEO was higher than the Hay Group's recommended level by HK\$400,000. HKSTPC has explained that the Board has intended to modify the remuneration packages of the senior management. However, any adjustment would not affect the existing contracts. As for CEO, his existing contract is between 1 April 2002 and 31 March 2005.</p> <p>The remuneration packages of the second and third-tier senior management were in line with the levels proposed by the Hay Group.</p>

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Corporate governance (cont'd)</b>				
Share option benefits offered	Nil.	Nil.	Yes.	Nil.
Procedures for reviewing remuneration packages of senior management staff	The posts of all executive staff are ranked according to the Hay Job Evaluation Scheme. Each year KCRC undertakes a survey of 13 comparable benchmark companies to determine the median pay for different ranks of staff. The Board decides whether or not to adjust, and, if so, by how much, the pay of staff in the light of the survey results.	AA follows commercial principles in establishing its salary ranges according to the market place and close comparison with competing companies. On an annual basis, a full report from the most junior level to the director level is produced. The report takes into consideration all major salary surveys within Hong Kong and considers salary and benefits together. Based on the survey findings, the management recommends salary and benefits ranges and movement of the salary and benefits ranges if warranted.	RLSD has not been able to obtain the required information.	HKSTPC has not made any salary adjustments since the establishment of HKSTPC in May 2001. In determining the remuneration packages, references are made to the findings of the consulting company employed. To gather additional market information, HKSTPC plans to conduct a new survey of remuneration packages of its senior management through the use of relevant benchmarking companies for comparison in 2004-05.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	KCRC	AA	MTRCL	HKSTPC
<b>Reporting arrangements to the Government</b>				
Appointing the Chairman and Board members by the Government	Yes.	Yes.	Yes, the Chairman and "additional directors".	Yes.
Approving the appointment of CEO by the Government	Yes.	Yes.	No.	Yes.
Providing information to the Government if required	Yes.			
Submitting annual report and financial statements to the Government	Yes.	Yes.	No, but the Board directors who are public officers receive the annual report and financial statements.	Yes.
Other important arrangements for reporting to the Government	Nil.	(a) Any permitted airport-related activity of AA which amounts to over 2.5% of AA's issued share capital requires the approval of FS. (b) The rolling five-year business plan is required to be submitted to FS for record.	(a) Granting the franchise to operate railway requires the approval of the Chief Executive in Council. (b) It pays financial penalty if it does not comply with any provision of MTRO or the operating agreement. (c) It carries out works in the interest of safety as the Government may require.	HKSTPC's authorized capital structure, investment, payments into general revenue and estimates of income and expenditure requires the approval of FS.

**Table 11 — An overall comparison of the selected bodies studied (cont'd)**

	<b>KCRC</b>	<b>AA</b>	<b>MTRCL</b>	<b>HKSTPC</b>
<b>Reporting arrangements to LegCo</b>				
Briefing relevant panels and bills committees	Yes, being a government body, it is required to do so.	Yes, being a government body, it is required to do so.	Yes, MTRCL is a listed company and practises such arrangement, although it is not a statutory requirement.	Yes, being a government body, it is required to do so.
Seeking the approval for public funding	Yes.			
Submitting annual report and financial statements to LegCo	Yes.	Yes.	No.	Yes.

**Appendix I****Capital Investment Fund**

A1.1 On 1 April 1990, LegCo established CIF by Resolution for the purpose of financing investments in the Mass Transit Railway Corporation (which became MTRCL on 30 June 2000), KCRC, the Hong Kong Housing Authority, the New Hong Kong Tunnel Company Limited and such other bodies as FC might specify. On 6 November 1991, LegCo passed an amendment to the Resolution to include provisions for government borrowings to be credited to CIF and for repayments, and payments of interest and expenses relating to such borrowings, to be made from CIF.

A1.2 The Resolution provides, inter alia, that —

- (a) CIF be administered by FS who may delegate his power of administration to other public officers;
- (b) there be credited to CIF —
  - (i) all sums received by way of repayment of any loan or advance made from CIF under sub-paragraph (c) below;
  - (ii) subject to MTRO (Cap. 556) and KCRCO (Cap. 372), all sums received by way of interest or dividend or under profit-sharing arrangements on the investments, loans or advances under sub-paragraph (c) below;
  - (iii) such appropriations from the general revenue as may be approved by LegCo for the purpose of CIF;
  - (iv) all sums received from the sale or other disposal of all or part of any investment made under sub-paragraph (c) or (e) below;
  - (v) all sums received by way of interest or dividend on money invested under sub-paragraph (e) below;
  - (vi) all such other sums as may be received for the purpose of CIF;  
and
  - (vii) sums borrowed under section 3 of the Loans Ordinance (LO) (Cap. 61) where the resolution of LegCo approving the borrowing so stipulates;

**Appendix I (cont'd)**

- (c) FS may expend moneys from CIF for the purpose of —
  - (i) meeting the liabilities assumed, under terms and conditions already approved as at 31 March 1990 by FC;
  - (ii) financing loans, advances and investments (including investments by way of waived land premium, donated works or other benefits (other than cash)) to or in such persons as may be approved by FC, in accordance with such terms and conditions as may be specified by FC; and
  - (iii) repaying or, where appropriate, paying the principal and interest of and expenses incurred in relation to sums borrowed under section 3 of LO where the sums have been credited to CIF;
- (d) the Director of Accounting Services shall, under the authority of a funds warrant issued by FS, pay from CIF such sums as may be required to meet expenditure from CIF;
- (e) FS may, in his discretion, authorize the investment of moneys forming the unexpended balance held in CIF at any time in interest-bearing securities in such manner as he may determine; and
- (f) FS may from time to time transfer from CIF to the general revenue any balance held in CIF which is not in his opinion reasonably required for the purpose of CIF.

Source: Hong Kong Special Administrative Region Government. (March 2004) *Estimates for the year ending 31 March 2005 Volume II — Fund Accounts*, page 113.

## Appendix II

**Land grant to the Kowloon-Canton Railway Corporation for residential  
and commercial developments**

<b>Location</b>	<b>Name of development</b>	<b>Lot no.</b>	<b>Site area (sq m)</b>	<b>Lease term</b>
Hung Hom	The Metropolis	KIL 11077	50 058	14.2.1997 - 30.6.2047
Mongkok	Grand Century Place	KIL 10991	24 100	19.10.1993 - 30.6.2047
Sha Tin	Man Lai Court	STT 320	8 823	29.7.1988 - 30.6.2047
Sha Tin	Royal Ascot	STTL 411	89 970	8.12.1993 - 30.6.2047
Sha Tin	Ho Tung Lau	STT 470	26 687	50 years from 3.3.2003
Tuen Mun	Pierhead Garden	TMTL 291	19 350	2.4.1986 - 30.6.2047
Tuen Mun	Sun Tuen Mun Centre	TMTL 289	55 870	12.8.1986 - 30.6.2047
Tuen Mun	Hanford Garden	TMTL 359	22 810	21.10.1991 - 30.6.2047

Source: FSTB.

## Appendix III

**Kowloon-Canton Railway Corporation's property development portfolios  
and projects**

**KCRC's property development portfolios**

<b>Property investment held:</b>	<b>Gross floor area (GFA) (sq m)</b>
<b>Office Building</b>	
Citylink Plaza	21 909
KCRC Hung Hom Building	5 576
<b>Shopping Centres</b>	
Citylink Plaza	3 045
Pierhead Plaza	9 984
Sun Tuen Mun Shopping Centre	14 000
Shops in Man Lai Court	420
Hanford Plaza	3 200
Plaza Ascot	10 000
<b>Residential units</b>	
Royal Ascot	2 784
Trackside Villas	11 204
<b>Total</b>	<b>82 122</b>
Gross revenue in 2003 <sup>1</sup>	82 122

Notes: 1 The gross revenue generated from the portfolios refers to the total income from the investment properties without deduction of costs.

## Appendix III (cont'd)

## KCRC's property development projects

	Estimated completion year <sup>2</sup>
Ho Tung Lau (Site A)	2007
Wu Kai Sha	2008-2009
Nam Cheong*	2008-2015
Yuen Long*	2008-2010
Tuen Mun*	2009-2011
Tsuen Wan West – TW7*	2008-2009
Tsuen Wan West – Bayside*	2009-2011
Tusen Wan West – Cityside*	2009
Tai Wai Maintenance Centre	2009-2011
Estimated gross revenue <sup>3</sup>	HK\$82,275 million
Estimated profit <sup>4 and 5</sup>	HK\$6,158 million
Estimated profit for KCRC	HK\$2,977 million
Estimated profit for the Government	HK\$3,181 million

Notes: 2 The estimated completion year is subject to change depending upon successful tendering of sites.

3 The estimated gross revenue refers to the estimated value of Sales Proceeds of the development projects as at 31 May 2004, prior to deduction of costs incurred by joint venture developers.

4 The estimated profit, after deducting costs from the gross revenue, will have to be shared between KCRC and the joint venture developers.

5 KCRC only acts as the Government's agent in the development of the West Rail property sites (those marked with\*) and the Government will share the property development profits of those sites with the joint venture developers.

Source: FSTB.

**Appendix IV****Role of the Legislative Council in relation to the approval of budget and financial proposals**

A2.1 LegCo is vested with the powers to examine and approve budgets introduced by the Government under Article 73 of the Basic Law<sup>71</sup>. The arrangements for the submission of the annual estimates of revenue and expenditure of the Government to LegCo for its approval are set out in PFO which provides for the control and management of the public finances of Hong Kong. FS may propose changes to the approved Estimates of Expenditure.

The budget*Estimates of expenditure*

A2.2 Each year, FS lays before LegCo the Government's estimates of revenue and expenditure. He delivers the annual budget speech at a meeting of LegCo, outlining the Government's budgetary proposals and moving the second reading of the Appropriation Bill, which gives legal effect to the annual expenditure proposals contained in the budget.

A2.3 After the motion for the second reading of the Appropriation Bill has been proposed in LegCo, the debate thereon is adjourned. The expenditure proposals in the budget, consolidated in the Estimates of Expenditure, may be referred by the President to FC for detailed examination before consideration of the Appropriation Bill in LegCo.

A2.4 FC holds special meetings to examine the Estimates of Expenditure to ensure that the provision sought is no more than is necessary for the execution of approved policies. These special meetings are normally held in public. After the special meetings, the Chairman of FC presents a report to LegCo.

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<sup>71</sup> As provided for in Article 73 of the Basic Law, LegCo exercises the following powers and functions: (a) to enact, amend or repeal laws in accordance with the provisions of the Basic Law and legal procedures; (b) to examine and approve budgets introduced by the Government; (c) to approve taxation and public expenditure; (d) to receive and debate the policy addresses of the Chief Executive; (e) to raise questions on the work of the Government; and (f) to debate any issue concerning public interests.

**Appendix IV (cont'd)**

A2.5 Upon the resumption of the debate on the second reading of the Appropriation Bill, Members may speak on the financial and economic state of Hong Kong and the general principles of Government policies and administration as indicated by the Appropriation Bill and the Estimates. To enable all Members to have a chance to speak on the Bill, LegCo holds its meeting on two consecutive days. The Government responds to Members' speeches at the following meeting, during which Members will vote on the second reading of the Bill. Amendments to the Bill, if any, should comply with Rule 69 of the Rules of Procedure and are dealt with in committee of the whole Council after the second reading of the Bill. The Bill is passed when it receives the third reading.

Revenue proposals

A2.6 The revenue proposals made by FS in his budget speech are introduced in the form of bills or subsidiary legislation for consideration by LegCo. To protect public revenue, CE has the power under the Public Revenue Protection Ordinance (Cap. 120) to make public revenue protection orders to give immediate effect to such bills or subsidiary legislation.

A2.7 It is important to note that revenue proposals which cause either higher or lower government revenue require the prior approval of LegCo, which is illustrated by the following examples.

A2.8 An example of revenue proposal which generates higher government revenue is the Revenue Bill 2003. This Bill sought to implement the proposals on first registration tax for motor vehicles announced in the 2003-04 Budget. The Bill was passed by LegCo on 25 June 2003. The Government estimated that it would be able to raise an additional HK\$350 million in recurrent revenue in a full year.

A2.9 An example of revenue proposal which causes lower government revenue is the Revenue (No.3) Bill 2003. This Bill sought to implement two of the tax concession proposals announced in the 2003-04 Budget, namely enhanced tax concessions for qualifying debt instruments<sup>72</sup> (QDIs), and exemption from fixed stamp duty for unit trusts. This Bill was passed by LegCo on 5 November 2003. The tax concession for QDIs was estimated to cost government revenue around HK\$17 million a year, while the financial implications of the exemption for unit trusts would be minimal.

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<sup>72</sup> QDIs are specified high quality debt instruments.

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**Appendix IV (cont'd)**Other financial proposals

A2.10 During a financial year, FS may propose to FC changes to the approved Estimates of Expenditure. These proposals are considered at the regular meetings of FC or, if they are related to public works or establishment matters, considered initially by the relevant subcommittees of FC before submission to FC for its approval.

Closing of account

A2.11 Expenditure arising from any changes to the approved Estimates of Expenditure is charged to the relevant expenditure head. At the close of account for any financial year, if it is found that the expenditure charged to any head is in excess of the sum appropriated for that head by the Appropriation Ordinance for that year, the excess shall be included in a Supplementary Appropriation Bill which shall be introduced to LegCo as soon as practicable after the close of the financial year.

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**Appendix V**
**Land grant to the Airport Authority for property development projects**
**Land grant to AA**

<b>Location</b>	<b>Name of development</b>	<b>Lot no.</b>	<b>Site area (sq m)</b>	<b>Lease term</b>
Airport Island	HK International Airport	RP of Chep Lap Kok Lot No.1 & Ext.	12 550 689.4	1.12.1995 - 30.6.2047
Sha Chau, Tuen Mun	Emergency back-up aviation fuel receiving facility	TMTL No. 404	8 793	6.12.1995 - 30.6.2047

**Major property development projects**

	<b>Major property development projects</b>	<b>Estimated annual income</b>
Existing development	Airport Regal Hotel	HK\$16 million
Future developments	(a) Asia World-Expo (i.e. an exhibition centre at the airport) (b) Second airport hotel	No immediate income to AA in the next five years. Not yet available as the project is still under tender.

Source: FSTB.

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**Appendix VI****Major concerns over financing arrangements of the Penny's Bay Rail Link project**

A3.1 Some LegCo Members expressed serious concern over the financing arrangements of the Penny's Bay Rail Link (PBRL) Project when the issue was brought up in LegCo. At the meeting of the then Subcommittee on matters relating to the implementation of railway development projects (the Subcommittee) held on 9 July 2002, the Government briefed members on its proposed agreement to provide funding support to MTRCL for the PBRL project by waiving its claims for dividends otherwise payable by MTRCL to the Government as a shareholder.

A3.2 The Project Agreement approved by the Chief Executive in Council set out how the PBRL project would be undertaken, and the respective obligations of the Government and MTRCL for the design, construction, operation and financing of PBRL. In order to bring the projected rate of return to a minimum acceptable commercial level,<sup>73</sup> it had been estimated that the Government support to fill a funding gap of HK\$798 million (in present value) was required. In order to close the funding gap, the Government had agreed to waive its claim for HK\$798 million worth of dividends otherwise payable by MTRCL to the Government as a shareholder over the following few years.

A3.3 Against this background, some Members raised the following concerns:

- (a) rationale for the Government to waive the dividends; and
- (b) legal basis of dividend waiver.

**Rationale for the Government to waive the dividends**

A3.4 In the Subcommittee meetings, some Members expressed that in view of the huge budget deficit, it would be quite generous for the Government to waive its claims for HK\$798 million worth of dividends that could have received from MTRCL. This waiver option might not be in the best interest of the general public.

A3.5 Members were also concerned about the guiding principles behind the choice of dividend waiver as a means of funding support for railway development bypassing LegCo for funding approval. Instead of bypassing LegCo, the Government should have put forward a funding proposal for Members' consideration.

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<sup>73</sup> It was estimated that PBRL would generate a less than commercial rate of return which was defined in the IPO prospectus of MTRCL as between 1% to 3% above the cost of capital of MTRCL.

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**Appendix VI (cont'd)**Legal basis of dividend waiver

A3.6 When deliberating the financing arrangements for PBRL, some Members queried the legal basis for providing funding support for PBRL in the form of waived dividends. The Administration remarked that the provision they relied on was section 38(1)(a) of PFO<sup>74</sup>. The Subcommittee asked LSD to prepare an analysis on the legal basis for providing funding support for PBRL in the form of waived dividends.

A3.7 In this regard, LSD studied sections 42<sup>75</sup> and 58<sup>76</sup> of MTRO and section 38 of PFO.<sup>77</sup> The conclusion of the study was that there might be doubt as to whether section 38 of PFO could be relied upon as the legal basis for the proposed waiver of dividends for the PBRL project. LSD was of the view that any dividends declared and payable by MTRCL should be dealt with in the manner specified in the relevant specific provisions in MTRO and should be managed in accordance with the relevant provisions concerning general revenue under PFO.<sup>78</sup>

A3.8 In response, the Administration argued that the dividend waiver option was entirely lawful and remarked that the time schedule of the PBRL project was very tight. Given that PBRL is an integral part of the overall Hong Kong Disneyland (Disneyland) development, deferral of the construction of PBRL might affect the cost and schedule of other works of the entire development.<sup>79</sup>

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<sup>74</sup> Section 38(1)(a) of PFO provides that: "... the Financial Secretary may — (a) abandon, remit or waive any claims by or on behalf of the Government."

<sup>75</sup> Under section 42 of MTRO, the shares issued by MTRCL to the Government are held by the Financial Secretary Incorporated in trust on behalf of the Government.

<sup>76</sup> Section 58(1) of MTRO provides that: "... monies received by the Financial Secretary Incorporated as the person holding shares in the Corporation, or from the sale of or other dealing in shares in the Corporation which are held by the Financial Secretary Incorporated, form part of the general revenue."

<sup>77</sup> The legal opinion was circulated to Members vide LC Paper No. LS133/01-02.

<sup>78</sup> LSD pointed out that this case also applied to KCRC. LSD was of the view that any dividends declared and payable by KCRC should be dealt with in the manner specified in the relevant provisions in KCRCO and should accordingly be managed in accordance with the relevant provisions concerning general revenue under PFO.

<sup>79</sup> The Government's response to the analysis prepared by LSD was circulated to Members vide LC Paper No. CB(1)2322/01-02(01).

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**Appendix VI (cont'd)**

A3.9 At the Subcommittee meeting held on 24 July 2002, the Legal Adviser (LA) took Members through the paper he prepared for the Subcommittee, which set out his comments on the Administration's paper.<sup>80</sup> In sum, LA believed that:

*"there were no firm legal grounds for him to advise categorically that the conclusions reached by the Administration would not be able to stand up challenge in law. However, whether the proposed exercise of power by FS under section 38(1)(a) of PFO to waive the share dividends to be declared by MTRCL was appropriate would be a matter for the Administration to justify to the satisfaction of Members ...the Administration's approach in interpreting section 38(1)(a) of PFO was an example of "pushing the envelope", i.e. stretching statutory interpretation to its very limits. ... it might be opportune to consider whether the legislative framework provided by PFO for the control and management of public finances of Hong Kong met current needs of Hong Kong."*<sup>81</sup>

A3.10 Some Members expressed serious doubts about the legality of the Administration's proposed course of action. They also emphasized the importance of maintaining the checks and balances between LegCo and the Government. The decisions of waiving the dividends were made by the Government alone without any scrutiny by FC. Hence, the public interest might not be adequately safeguarded.

A3.11 On the other hand, some other Members held a different view. For example, A Member expressed support for the construction of PBRL to serve Disneyland. While emphasizing the importance of LegCo's power in monitoring public expenditure, he remarked that it was the Government's prerogative to present financial proposals to FC. Notwithstanding the reservations about the justifications presented by the Administration for the proposed dividend waiver, it was considered that the early construction of PBRL was in line with the public interest as it could create much needed employment opportunities in Hong Kong. In this connection, the Member proposed a motion urging the Administration to speed up the delivery of PBRL and provide regular progress report to the Subcommittee. All in all, the Subcommittee, as a whole, had reservations about the Government's proposed dividend waiver for financing the railway project.

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<sup>80</sup> For details, please see LC Paper No. LS137/01-02.

<sup>81</sup> *Minutes of Meeting of the Subcommittee on Matters Relating to the Implementation of Railway Development Projects of the Legislative Council.* (2002) 24 July. LC Paper No. CB(1)708/02-03, paragraph 16.

**Appendix VI (cont'd)**

A3.12 Another Member considered that PBRL should not be given the go-ahead without first establishing the legality of the proposed dividend waiver. He proposed another motion urging the Administration not to execute the project agreement for PBRL, pending further deliberation by FC on the Government's proposal to waive its claim for HK\$798 million worth of dividends that it could otherwise expect to receive as a shareholder from MTRCL during the following few years.

A3.13 The first motion urging for speedy delivery of PBRL was passed by the Subcommittee. The Chairman invited the Administration to take note of the motion passed by the Subcommittee. In view of Members' general support for the Disneyland development, she called on the Administration to ensure the timely completion of PBRL to tie in with the scheduled opening of Disneyland. In addition, the Administration should also address Members' concerns about the exercise of FS's discretion under section 38(1)(a) of PFO in the context of FA Panel's discussion.

## Appendix VII

**Land grant to the MTR Corporation Limited  
for residential/commercial development projects**

A. Urban line

<b>MTR station</b>	<b>Name of development</b>	<b>Lot no.</b>	<b>Site area (sq m)</b>	<b>Lease term</b>
Chai Wan	New Jade Garden	CWIL 120	9 594	75 years from 15.5.1985 renewable for another 75 years.
Heng Fa Chuen	Heng Fa Chuen	CWIL 121 RP	230 762.30 (including Heng Fa Chuen, Heng Fa Villa and Chai Wan MTR Depot)	75 years from 3.4.1985 renewable for another 75 years.
Shaukeiwan	Perfect Mount Garden	SIL 796	5 450	75 years from 13.2.1985 renewable for another 75 years.
Sai Wan Ho	Felicity Garden	SIL 795	5 956	31.3.1987 - 30.6.2047
Taikoo	Kornhill	IL 8566 RP	120 860.28	75 years from 27.4.1984 renewable for another 75 years.
Fortress Hill	Fortress Metro Tower	IL 8557	5 260	75 years from 17.5.1985 renewable for another 75 years.
Tin Hau	Park Towers	IL8560	5 821	75 years from 19.6.1985 renewable for another 75 years.
Causeway Bay	Sogo Department Store	IL 8583	1 002	75 years from 17.5.1984 renewable for another 75 years.

## Appendix VII (cont'd)

A. Urban line (cont'd)

<b>MTR station</b>	<b>Name of development</b>	<b>Lot no.</b>	<b>Site area (sq m)</b>	<b>Lease term</b>
Causeway Bay	The Goldmark	IL 8584	477.9	75 years from 21.12.1984 renewable for another 75 years.
Wanchai	Southorn Garden	IL 8562	5 258	75 years from 23.5.1985 renewable for another 75 years.
Admiralty	Admiralty Centre	IL 8423	5 710	75 years from 18.8.1978 renewable for another 75 years
Admiralty	Fairmont House	IL 8508	1 285	75 years from 18.5.1981 renewable for another 75 years
Central	Worldwide House	IL 8432	2 932.6	75 years from 15.4.1978 renewable for another 75 years
Sheung Wan	Hongway Garden	IL 8561	2 040	75 years from 11.1.1985 renewable for another 75 years
Choi Hung	Choi Hung Station Development	NKIL6179	3 197	50 years from 12.11.2001
Kowloon Bay	Telford Gardens	NKIL 5744 (including the depot)	161 047.35	29.6.1977 - 30.6.2047
Kowloon Bay	Telford Plaza – Hang Seng Tower	NKIL 6201	7 358	12.1.1994 - 30.6.2047
Tsuen Wan	Luk Yeung Sun Chuen	TWTL 256 (including the depot)	132 020	30.6.1981 - 30.6.2047 (earliest date of possession for part of the lot: 15.10.1978)
Kwai Fong	New Kwai Fong Garden	KCTL 375	18 269.97	8.3.1982 - 30.6.2047
Kwai Hing	Sun Kwai Hing Gardens	KCTL 377	16 289.973	11.3.1982 - 30.6.2047

## Appendix VII (cont'd)

B. Airport Railway Line

<b>MTR station</b>	<b>Name of development</b>	<b>Lot no.</b>	<b>Site area (sq m)</b>	<b>Lease term</b>
Hong Kong	One International Finance Centre	IL 8898	57 100	21.5.1997 - 30.6.2047
	Two International Finance Centre			
	Four Seasons Hotel and Service Suites			
Kowloon	The Waterfront	KIL11080	135 403	8.7.1996 - 30.6.2047
	Sorrento			
	Package 3 under construction by Sun Hung Kai Properties Limited (SHK)			
	The Harbourside			
	Package 5, 6 & 7 (residential/commercial /service apartment/hotel development under construction by SHK)			
Olympic	HSBC Centre	KIL11068	10 965	8.5.1995 - 30.6.2047
Olympic	Bank of China Centre	KIL11074	66 204	8.5.1995 - 30.6.2047
	Island Harbourview			
Olympic	Park Avenue	KIL 11991	65 829	10.1.1997 - 30.6.2047
	Central Park			
Olympic	Residential development under construction by SHK (Package 3)	KIL 11151	17 192	50 years from 4.3.2002

## Appendix VII (cont'd)

B. Airport Railway Line

MTR station	Name of development	Lot no.	Site area (sq m)	Lease term
Tsing Yi	Tierra Verde	TYTL 132	54 000	7.3.1996 - 30.6.2047
Tsing Yi	Public Transport Interchange cum Lorry Park near Tsing Yi Station	TYTL 135	15 300	18.9.1996 - 30.6.2047
Tung Chung	Tung Chung Crescent	TCTL 1	30 812	16.8.1995 - 30.6.2047
Tung Chung	Citygate	TCTL 2	33 311	27.9.1995 - 30.6.2047
Tung Chung	Seaview Crescent	TCTL 3	21 265	1.5.1996 - 30.6.2047
Tung Chung	Coastal Skyline	TCTL 4	63 700	26.3.1997 - 30.6.2047
Tung Chung	Caribbean Coast	TCTL 5	67 900	26.6.1997 - 30.6.2047

C. Tseung Kwan O Line

MTR station	Name of development	Lot no.	Site area (sq m)	Lease term
Tiu Keng Leng	Development (name not known) above Tiu Keng Leng Station	TKOTL73	32 334	50 years from 11.2.2003
Tseung Kwan O	Development (name not known) in Area 57a	TKOTL 74	3 637	50 years from 28.3.2002
Tseung Kwan O	Development (name not known) in Area 55b	TKOTL 75	11 877	50 years from 28.3.2002
Hang Hau	Residence Oasis	TKOTL 24	17 964	50 years from 22.10.2002
Area 86 Tseung Kwan O	Dream City (and Depot)	TKOTL 70	326 751	50 years from 16.5.2002

## Appendix VII (cont'd)

D. Depots

Location	Lot no.	Site area (sq m)	Lease term
Chai Wan	CWIL 121 RP	230 762.3 (approx. net area including Heng Fa Chuen, Heng Fa Villa and Chai Wan MTR Depot)	75 years from 3.4.1985 renewable for another 75 years.
Kowloon Bay	NKIL5744 (including Telford Gardens)	161 047.35	29.6.1977 - 30.6.2047
Tsuen Wan	TWTL 256 (including Luk Yeung Sun Chuen)	132 020	30.6.1981 - 30.6.2047 (earliest date of possession for part of the lot: 15.10.1978)
Siu Ho Wan	DD 346 Lot 143	300 707	15.9.1995 - 30.6.2047
Tseung Kwan O	TKOTL 70	326 751 (including "Dream City")	50 years from 16.5.2002

E. Projects other than the above

Location	Name of development	Lot no.	Site area (sq m)	Lease term
Ngong Ping	Complementary "Theme Village" development	DD Ngong Ping Lot 238	15 900	30 years from 24.12.2003

Source: FSTB.

## Appendix VIII

**Properties developed and to be developed by the MTR Corporation Limited  
(as at December 2003)**

**Properties developed by the MTR Corporation Limited**

	<b>Residential (No. of flats)</b>	<b>Office GFA (sq m)</b>	<b>Commercial GFA (sq m)</b>	<b>Government, institutional and community facilities GFA (sq m)</b>
Telford Gardens/ Telford Plaza	4 992	52 482	83 201	909
World-Wide House	-	33 314	7 141	-
Admiralty Centre	-	72 290	18 114	-
Argyle Centre	-	26 308	-	-
Luk Yeung Sun Chuen	4 000	-	15 548	13 562
New Kwai Fong Gardens	1 264	-	4 484	540
Sun Kwai Hing Gardens	600	-	7 317	10 321
Fairmont House	-	20 886	-	-
Kornhill/Kornhill Gardens	8 828	-	104 170 <sup>1</sup>	9 640
Fortress Metro Towers	757	-	6 791	-
Vicwood Plaza	-	29 618	7 239	-
Hongway Garden	412	-	2 544	-
Perfect Mount Gardens	760	-	1 119	19 830
New Jade Garden	1 488	-	11 100	5 400
Southorn Garden	480	-	2 646	40 918
Heng Fa Chuen/ Heng Fa Villa	6 560	-	26 742	20 120
Park Towers	493	-	1 207	18 897
Felicity Garden	732	-	-	13 386

## Appendix VIII (cont'd)

**Properties developed and to be developed by the MTR Corporation Limited  
(as at December 2003)**

**Properties developed by the MTR Corporation Limited**

	<b>Residential (No. of flats)</b>	<b>Office GFA (sq m)</b>	<b>Commercial GFA (sq m)</b>	<b>Government, institutional and community facilities GFA (sq m)</b>
HSBC Centre	-	83 000	1 900	-
Island Harbourview/ Olympian City One/ Olympian Tower/Olympian City Two/Park Avenue/Central Park	5 250	28 000	60 500	16 002
One and Two International Finance Centre/IFC Mall	-	254 186	59 458	-
Tierra Verde/Maritime Square	3 500	-	46 170	925
Tung Chung Crescent/Citygate/ Seaview Crescent/Coastal skyline/Caribbean Coast	7 268	14 999	50 830	1 205
Union Square The Waterfront, Sorrento, the Harbourside	4 536	-	-	12 420
<b>Total</b>	<b>51 920</b>	<b>615 083</b>	<b>518 221</b>	<b>184 075</b>

Note: 1 A total of 104 170 sq m commercial space in GFA comprises retail office and hotel areas.

Source: FSTB.

## Appendix VIII (cont'd)

**Properties developed and to be developed by the MTR Corporation Limited  
(as at December 2003)**

**Properties under development along Airport Railway**

	<b>Residential (No. of flats)</b>	<b>Office GFA (sq m)</b>	<b>Retail GFA (sq m)</b>	<b>Hotel GFA (sq m)</b>	<b>No. of parking spaces</b>
Hong Kong Station	-	-	-	102 250	-
Kowloon Station (Union Square)	1 274	181 778 - 235 778	82 750	163 472 - 217 472	2 155
Olympic Station	1 572	-	-	-	300
Tung Chung Station	5 180	-	4 996	22 000	1 782
<b>Total</b>	<b>8 026</b>	<b>181 778 - 235 778</b>	<b>87 746</b>	<b>287 722 - 341 722</b>	<b>4 237</b>

Note: The areas of government, institution and community (GIC) facilities are excluded from the figures presented in this table.

**Properties under development along Tseung Kwan O Line**

	<b>Residential (No. of flats)</b>	<b>Office GFA (sq m)</b>	<b>Retail GFA (sq m)</b>	<b>Hotel GFA (sq m)</b>	<b>No. of parking spaces</b>
Tsueng Kwan O Station (Area 55b & 57a)	1 862	-	15 514	-	329
Hang Hau Station	2 130	-	3 500	-	369
Tiu Keng Leng Station	3 772	-	16 800	-	587
<b>Total</b>	<b>7 764</b>	<b>-</b>	<b>35 814</b>	<b>-</b>	<b>1 285</b>

Note: The areas of government, institution and community facilities are excluded from the figures presented in this table.

Source: FSTB.

## Appendix IX

## Land grant to the Hong Kong Science and Technology Parks Corporation

Location	Name of development	Lot no.	Site area (sq m)	Lease term
Kowloon Tong	The Tech Centre	NKIL 6128	5 713	17.9.1992 - 30.6.2047
Tai Po	Hong Kong Science Park	TPTL 171 (Phase I)	80 000	50 years from 30.12.2000
		TPTL 182 (Phase II)	77 320	50 years from 18.11.2003
Tai Po	Tai Po Industrial Estate (totalling 662 280 sq m)	TPTL 1	48.96 ha	12.5.1977 - 30.6.2047
		Ext to TPTL 1	6 760	6.6.2002 - 30.6.2047
		TPTL 13	13.172 ha	2.3.1983 - 30.6.2047
		Ext to TPTL13	2.07 ha	14.6.1991 - 30.6.2047
		Ext to TPTL 13 & Ext	1.35 ha	3.3.1993 - 30.6.2047
Yuen Long	Yuen Long Industrial Estate	YLTL 313 & Ext	672 365	21.11.1981 - 30.6.2047
Tseung Kwan O	Tseung Kwan O Industrial Estate	TKOTL 39 & Exts	765 056	14.10.1994 - 30.6.2047

Source: FSTB.

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