TAIWAN SEMICONDUCTOR MANUFACTURING CO LTD
Form 6-K
April 18, 2007

Table of Contents

1934 Act Registration No. 1-14700
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 6-K
REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16 OF
THE SECURITIES EXCHANGE ACT OF 1934
For the month of April 2007
Taiwan Semiconductor Manufacturing Company Ltd.
(Translation of Registrant s Name Into English)
No. 8, Li-Hsin Rd. 6,
Hsinchu Science Park,
Taiwan
(Address of Principal Executive Offices)

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.)

Form 20-F þ Form 40-F o

(Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.)

Yes o No þ

(If Yes is marked, indicated below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82: __________.)

Table of Contents

Taiwan Semiconductor Manufacturing Company Limited
Financial Statements for the
Years Ended December 31, 2006 and 2005 and
Independent Auditors Report

Table of Contents

INDEPENDENT AUDITORS REPORT

The Board of Directors and Shareholders
Taiwan Semiconductor Manufacturing Company Limited

We have audited the accompanying balance sheets of Taiwan Semiconductor Manufacturing Company Limited as of December 31, 2006 and 2005, and the related statements of income, changes in shareholders equity and cash flows for the years then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the Rules Governing the Audit of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China. Those rules and standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Taiwan Semiconductor Manufacturing Company Limited as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, requirements of the Business Accounting Law and Guidelines Governing Business Accounting with respect to financial accounting standards, and accounting principles generally accepted in the Republic of China.

Table of Contents

We have also audited, in accordance with the Rules Governing the Audit of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China, the consolidated financial statements of Taiwan Semiconductor Manufacturing Company Limited and subsidiaries as of and for the years ended December 31, 2006 and 2005, and have expressed an unqualified opinion on the consolidated financial statements.
January 11, 2007

Notice to Readers

The accompanying financial statements are intended only to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdiction. The standards, procedures and practices to audit such financial statements are those generally accepted and applied in the Republic of China.

For the convenience of readers, the auditors report and the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language auditors report and financial statements shall prevail.

- 2 -

Table of Contents

Taiwan Semiconductor Manufacturing Company Limited
BALANCE SHEETS
DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Par Value)

	2006		2005	
	Amount	**%**	**Amount**	**%**
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 4)	$ 100,139,709	17	$ 85,383,583	17
Financial assets at fair value through profit or loss (Notes 2, 3 and 5)	44,601		1,380,905	1
Available-for-sale financial assets (Notes 2, 3 and 6)	25,967,061	5	46,452,838	9
Held-to-maturity financial assets (Notes 2, 3 and 7)	8,510,823	2	602,509	
Notes and accounts receivable	16,278,164	3	20,591,818	4
Receivables from related parties (Note 23)	16,869,509	3	21,050,604	4
Allowance for doubtful receivables (Note 2)	(690,931)		(976,344)	
Allowance for sales returns and others (Note 2)	(2,751,065)		(4,269,969)	(1)
Other receivables from related parties (Note 23)	449,266		1,797,714	1
Other financial assets (Note 3)	653,460		1,106,030	
Inventories, net (Notes 2 and 8)	19,152,214	3	16,257,955	3
Deferred income taxes assets (Notes 2 and 16)	7,832,000	1	7,013,000	1
Prepaid expenses and other current assets (Note 3)	1,221,199		1,171,773	
Total current assets	193,676,010	34	197,562,416	39
LONG-TERM INVESTMENTS (Notes 2, 3, 6, 7, 9 and 10)				
Investments accounted for using equity method	101,044,356	18	51,076,803	10
Available-for-sale financial assets	6,647,511	1		
Held-to-maturity financial assets	28,973,495	5	28,775,308	6
Financial assets carried at cost	712,843		807,490	
Total long-term investments	137,378,205	24	80,659,601	16
PROPERTY, PLANT AND EQUIPMENT (Notes 2, 11 and 23)				
Cost				
Buildings	96,961,851	17	90,769,622	18
Machinery and equipment	527,850,728	92	459,850,773	91
Office equipment	8,659,225	2	7,850,035	1
	633,471,804	111	558,470,430	110

Accumulated depreciation	(417,467,250)	(73)	(359,191,829)	(71)
Advance payments and construction in progress	12,230,805	2	14,867,032	3
Net property, plant and equipment	228,235,359	40	214,145,633	42
GOODWILL (Note 2)	1,567,756		1,567,756	
OTHER ASSETS				
Deferred income tax assets (Notes 2 and 16)	5,761,127	1	6,759,955	2
Deferred charges, net (Notes 2 and 12)	5,593,068	1	6,681,144	1
Refundable deposits	1,306,234		83,642	
Assets leased to others, net (Note 2)	67,145		72,879	
Others			6,789	
Total other assets	12,727,574	2	13,604,409	3
TOTAL	$ 573,584,904	100	$ 507,539,815	100

	2006		2005	
	Amount	%	Amount	%
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Financial liabilities at fair value through profit or loss (Notes 2, 3 and 5)	$ 10,751		$ 234,279	
Accounts payable	6,143,679	1	8,052,106	1
Payables to related parties (Note 23)	3,326,916	1	3,242,197	1
Income tax payable (Notes 2 and 16)	7,850,418	1	3,815,888	1
Accrued expenses and other current liabilities (Notes 3 and 14)	7,903,867	1	7,980,715	1
Payables to contractors and equipment suppliers	10,669,523	2	8,859,230	2
Current portion of bonds payable (Note 13)	7,000,000	1		
Total current liabilities	42,905,154	7	32,184,415	6
LONG-TERM LIABILITIES				
Bonds payable (Note 13)	12,500,000	2	19,500,000	4
Other long-term payables (Note 14)	1,271,896		1,511,100	
Other payables to related parties (Notes 23 and 25)	403,375		1,100,475	
Total long-term liabilities	14,175,271	2	22,111,575	4

OTHER LIABILITIES				
Accrued pension cost (Notes 2 and 15)	3,530,116	1	3,461,392	1
Guarantee deposits (Note 25)	3,809,961	1	2,892,945	1
Deferred credits (Notes 2 and 23)	1,183,118		1,259,139	
Total other liabilities	8,523,195	2	7,613,476	2
Total liabilities	65,603,620	11	61,909,466	12
CAPITAL STOCK - NT$10 PAR VALUE				
Authorized: 27,050,000 thousand shares				
Issued: 25,829,688 thousand shares in 2006				
24,730,025 thousand shares in 2005	258,296,879	45	247,300,246	49
CAPITAL SURPLUS (Notes 2 and 18)	54,107,498	10	57,117,886	11
RETAINED EARNINGS (Note 18)				
Appropriated as legal capital reserve	43,705,711	8	34,348,208	7
Appropriated as special capital reserve	640,742		2,226,427	
Unappropriated earnings	152,778,079	26	106,196,399	21
	197,124,532	34	142,771,034	28
OTHERS (Notes 2, 3 and 22)				
Cumulative translation adjustments	(1,191,165)		(640,742)	
Unrealized gains on financial instruments	561,615			
	(629,550)		(640,742)	
TREASURY STOCK (AT COST, Notes 2 and 20)				
33,926 thousand shares in 2006 and 32,938 thousand shares in 2005	(918,075)		(918,075)	
Total shareholders equity	507,981,284	89	445,630,349	88
TOTAL	$ 573,584,904	100	$ 507,539,815	100

The accompanying notes are an integral part of the financial statements.

- 3 -

Table of Contents

Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2006		2005	
	Amount	%	Amount	%
GROSS SALES (Notes 2 and 23)	$ 319,210,148		$ 270,315,064	
SALES RETURNS AND ALLOWANCES (Note 2)	5,328,513		5,726,700	
NET SALES	313,881,635	100	264,588,364	100
COST OF SALES (Notes 17 and 23)	164,163,235	52	149,344,315	56
GROSS PROFIT	149,718,400	48	115,244,049	44
OPERATING EXPENSES (Notes 17 and 23)				
Research and development	14,601,385	5	13,395,801	5
General and administrative	7,190,422	2	7,485,011	3
Marketing	1,626,734	1	1,349,413	1
Total operating expenses	23,418,541	8	22,230,225	9
INCOME FROM OPERATIONS	126,299,859	40	93,013,824	35
NON-OPERATING INCOME AND GAINS				
Equity in earnings of equity method investees, net (Notes 2 and 9)	5,526,727	2		
Interest income (Notes 2 and 3)	3,382,868	1	2,506,769	1
Settlement income (Note 25)	967,506	1	950,046	
Technical service income (Notes 23 and 25)	670,297		491,267	
Gain on disposal of property, plant and equipment and other assets (Notes 2 and 23)	596,459		494,374	
Valuation gain on financial instruments, net (Notes 2, 3, 5 and 22)	33,850			
Foreign exchange gain, net (Notes 2 and 3)			2,572,560	1
Others (Note 23)	419,020		366,344	
Total non-operating income and gains	11,596,727	4	7,381,360	2
NON-OPERATING EXPENSES AND LOSSES				

Loss on settlement and disposal of financial instruments, net (Notes 2, 3 and 5)	1,623,882	1	3,742,312	2
Interest expense (Note 3)	661,200		1,180,484	
Foreign exchange loss, net (Note 2)	412,726			
Loss on disposal of property, plant and equipment (Note 2)	240,985		59,992	
Equity in losses of equity method investees, net (Notes 2 and 9)			1,052,045	

(Continued)

Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2006 Amount	2006 %	2005 Amount	2005 %
Valuation loss on financial instruments, net (Notes 2, 3, 5 and 22)	$		$ 337,160	
Others	151,294		203,768	
Total non-operating expenses and losses	3,090,087	1	6,575,761	2
INCOME BEFORE INCOME TAX	134,806,499	43	93,819,423	35
INCOME TAX EXPENSE (Notes 2 and 16)	(7,550,582)	(2)	(244,388)	
NET INCOME BEFORE CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	127,255,917	41	93,575,035	35
CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES, NET OF TAX BENEFIT OF NT$82,062 THOUSAND (Note 3)	(246,186)			
NET INCOME	$ 127,009,731	41	$ 93,575,035	35

	2006 Before Income Tax	2006 After Income Tax	2005 Before Income Tax	2005 After Income Tax
EARNINGS PER SHARE (NT$, Note 21)				
Basic earnings per share	$ 5.21	$ 4.93	$ 3.64	$ 3.63
Diluted earnings per share	$ 5.21	$ 4.92	$ 3.64	$ 3.63

Certain pro forma information (after income tax) is shown as follows, based on the assumption that the Company s stock held by subsidiaries is treated as an investment instead of treasury stock (Notes 2 and 20):

	2006	2005
NET INCOME BEFORE CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	$ 127,338,237	$ 93,881,698
NET INCOME	$ 127,092,051	$ 93,881,698

EARNINGS PER SHARE (NT$)				
Basic earnings per share	$	4.92	$	3.64
Diluted earnings per share	$	4.92	$	3.64

The accompanying notes are an integral part of the financial statements. (Concluded)

Table of Contents

Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Dividends Per Share)

pital Stock n s)	Amount	Capital Surplus	Retained Earnings Legal Capital Reserve	Special Capital Reserve	Unappropriated Earnings	Total	Others Cumulative Translation Adjustments	Unrealized Gain on Financial Instruments	Total
4	$ 232,519,637	$ 56,537,259	$ 25,528,007	$	$ 88,202,009	$ 113,730,016	$ (2,226,427)	$	$ (2,226,427)
			8,820,201		(8,820,201)				
				2,226,427	(2,226,427)				
					(3,086,215)	(3,086,215)			
2	3,086,215				(3,086,215)	(3,086,215)			
					(46,504,097)	(46,504,097)			
2	11,626,024				(11,626,024)	(11,626,024)			
					(231,466)	(231,466)			
					93,575,035	93,575,035			
		71,405							
							1,585,685		1,585,685
7	68,370	202,559							
		84,285							

		222,378							
5	247,300,246	57,117,886	34,348,208	2,226,427	106,196,399	142,771,034	(640,742)		(640,742)
			9,357,503		(9,357,503)				
				(1,585,685)	1,585,685				
					(3,432,129)	(3,432,129)			
3	3,432,129				(3,432,129)	(3,432,129)			
					(61,825,061)	(61,825,061)			
0	3,709,504				(3,709,504)	(3,709,504)			
					(257,410)	(257,410)			
0	3,709,504	(3,709,504)							
					127,009,731	127,009,731			
		187,095							
							(550,423)		(550,423)
0	145,496	429,701							

		82,320							
								242,248	242,248
								319,367	319,367
8	$ 258,296,879	$ 54,107,498	$ 43,705,711	$ 640,742	$ 152,778,079	$ 197,124,532	$ (1,191,165)	$ 561,615	$ (629,550)

The accompanying notes are an integral part of the financial statements.

Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 127,009,731	$ 93,575,035
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	66,699,455	67,991,423
Amortization of premium/discount of financial assets	2,399	120,872
Loss on disposal of available-for-sale financial assets, net	485	150,081
Equity in losses (earnings) of equity method investees, net	(5,526,727)	1,052,045
Dividends received from equity method investees	626,367	668,464
Gain on disposal of investments accounted for using equity method investees, net	(26,031)	(583)
Gain on disposal of financial assets carried at cost, net	(212)	(2,919)
Loss on impairment of financial assets carried at cost	36,608	
Gain on disposal of property, plant and equipment and other assets, net	(355,474)	(434,382)
Deferred income taxes	179,828	(3,278,952)
Loss on idle assets	44,072	131,849
Donation of idle assets		7,207
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Financial assets and liabilities at fair value through profit or loss	1,112,776	10,739
Notes and accounts receivable	4,313,654	(5,264,937)
Receivables from related parties	4,181,095	(4,914,565)
Allowance for doubtful receivables	(285,413)	(4,117)
Allowance for sales returns and others	(1,518,904)	942,055
Other receivables from related parties	985,419	(1,243,126)
Other financial assets	(99,109)	64,288
Inventories	(2,894,259)	(2,086,010)
Prepaid expenses and other current assets	(49,426)	(84,341)
Increase (decrease) in:		
Accounts payable	(1,908,427)	1,563,489
Payables to related parties	(612,381)	(1,224,371)
Income tax payable	4,034,530	3,435,985
Accrued expenses and other current liabilities	157,262	(1,001,293)
Accrued pension cost	68,724	360,196
Deferred credits	(95,745)	95,744
Net cash provided by operating activities	196,080,297	150,629,876
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of:		
Available-for-sale financial assets	(98,679,832)	(99,436,242)

Held-to-maturity financial assets	(18,554,027)	(14,199,142)
Financial assets carried at cost	(12,940)	(48,536)
Investments accounted for using equity method	(5,515,466)	(3,392,619)
Property, plant and equipment	(77,215,811)	(73,659,014)

(Continued)

Table of Contents

Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars)

	2006	2005
Proceeds from disposal of:		
Available-for-sale financial assets	$ 73,212,019	$ 101,609,384
Financial assets carried at cost	71,191	16,599
Investments accounted for using equity method	37,946	65,076
Property, plant and equipment and other assets	1,277,729	2,087,236
Redemption of held-to-maturity financial assets upon maturity	10,410,000	14,595,394
Proceeds from return of capital by investee	162,354	
Increase in deferred charges	(1,272,355)	(847,721)
Decrease (increase) in refundable deposits	(1,222,592)	1,771
Net cash used in investing activities	(117,301,784)	(73,207,814)
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash dividends paid for common stock	(61,825,061)	(46,504,097)
Cash bonus paid to employees	(3,432,129)	(3,086,215)
Increase in guarantee deposits	917,016	2,480,552
Proceeds from exercise of employee stock options	575,197	270,929
Bonus to directors and supervisors	(257,410)	(231,466)
Repayment of long-term bonds payable		(10,500,000)
Net cash used in financing activities	(64,022,387)	(57,570,297)
NET DECREASE IN CASH AND CASH EQUIVALENTS	14,756,126	19,851,765
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	85,383,583	65,531,818
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 100,139,709	$ 85,383,583
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 661,200	$ 1,212,449
Income tax paid	$ 3,189,528	$ 87,351
INVESTING ACTIVITIES AFFECTING BOTH CASH AND NON-CASH ITEMS		
Acquisition of property, plant, and equipment	$ 79,026,104	$ 51,363,935

Decrease (increase) in payables to contractors and equipment suppliers	(1,810,293)	22,295,079
Cash paid	$ 77,215,811	$ 73,659,014
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Current portion of bonds payable	$ 7,000,000	$
Current portion of other payables to related parties (under payables to related parties)	$ 688,591	$ 693,956
Current portion of other long-term payable (under accrued expenses and other current liabilities)	$ 617,892	$ 869,072
Transfer of available-for-sale financial assets and other net assets to investments accounted for using equity method (Note 6)	$ 39,687,637	$

The accompanying notes are an integral part of the financial statements. (Concluded)

- 8 -

Table of Contents

Taiwan Semiconductor Manufacturing Company Limited
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(Amounts in Thousands of New Taiwan Dollars, Unless Specified Otherwise)

1. GENERAL

Taiwan Semiconductor Manufacturing Company Limited (the Company or TSMC), a Republic of China (R.O.C.) corporation, was incorporated as a venture among the Government of the R.O.C., acting through the Development Fund of the Executive Yuan; Philips Electronics N.V. and certain of its affiliates (Philips); and certain other private investors. On September 5, 1994, its shares were listed on the Taiwan Stock Exchange (TSE). On October 8, 1997, TSMC listed some of its shares of stock on the New York Stock Exchange (NYSE) in the form of American Depositary Shares (ADSs).

The Company is engaged mainly in the manufacturing, selling, packaging, testing and computer-aided designing of integrated circuits and other semiconductor devices and the manufacturing of masks.

As of December 31, 2006 and 2005, the Company had 20,202 and 19,460 employees, respectively.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements are presented in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, Business Accounting Law, Guideline Governing Business Accounting, and accounting principles generally accepted in the R.O.C.

For the convenience of readers, the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the R.O.C. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail.

Significant accounting policies are summarized as follows:

Use of Estimates

The preparation of financial statements in conformity with the aforementioned guidelines, law and principles requires management to make reasonable assumptions and estimates of matters that are inherently uncertain. The actual results may differ from management s estimates.

Classification of Current and Noncurrent Assets and Liabilities

Current assets are assets held for trading purposes and assets expected to be converted to cash, sold or consumed within one year from the balance sheet date. Current liabilities are obligations incurred for trading purposes and obligations expected to be settled within one year from the balance sheet date. Assets and liabilities that are not classified as current are noncurrent assets and liabilities, respectively.

Cash Equivalents

Repurchase agreements collateralized by government bonds and corporate notes acquired with maturities of less than three months from the date of purchase are classified as cash equivalents. The carrying amount approximates fair value.

Table of Contents

Financial Assets/Liabilities at Fair Value Through Profit or Loss

Derivatives that do not meet the criteria for hedge accounting are initially recognized at fair value, with transaction costs expensed as incurred. The derivatives are remeasured at fair value subsequently with the changes in fair value recognized in earnings. A regular way purchase or sale of financial assets is accounted for using settlement date accounting.

Fair value is estimated using valuation techniques incorporating estimates and assumptions that are consistent with prevailing market conditions. When the fair value is positive, the derivative is recognized as a financial asset; when the fair value is negative, the derivative is recognized as a financial liability.

Available-for-sale Financial Assets

Investments designated as available-for-sale financial assets include debt securities and equity securities. Available-for-sale financial assets are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition. Changes in fair value from subsequent remeasurement are reported as a separate component of shareholders equity. The corresponding accumulated gains or losses are recognized in earnings when the financial asset is derecognized from the balance sheet. A regular way purchase or sale of financial assets is accounted for using settlement date accounting.

Except structured time deposits whose fair value is estimated using valuation techniques, fair values of open-end mutual funds and publicly traded stocks are determined using the net assets value and the closing-price at the end of the year, respectively. For debt securities, fair value is determined using the average of bid and asked prices at the end of the year.

Cash dividends are recognized as investment income upon resolution of shareholders of an investee but are accounted for as reductions to the original cost of investments if such dividends are declared on the earnings of the investees attributable to periods prior to the purchase of the investments. Stock dividends are recorded as an increase in the number of shares held and do not affect investment income. The cost per share is recalculated based on the new total number of shares. Any difference between the initial carrying amount of a debt security and the amount due at maturity is amortized using the effective interest method, with the amortization recognized in earnings.

If there is objective evidence which indicates that a financial asset is impaired, a loss is recognized. If, in a subsequent period, the amount of the impairment loss decreases, for equity securities, the previously recognized impairment loss is reversed to the extent of the decrease and recorded as an adjustment to shareholders equity; for debt securities, the amount of the decrease is recognized in earnings, provided that the decrease is clearly attributable to an event which occurred after the impairment loss was recognized.

Held-to-maturity Financial Assets

Debt securities for which the Company has a positive intention and ability to hold to maturity are categorized as held-to-maturity financial assets and are carried at amortized cost under the effective interest method. Those financial assets are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition. Gains or losses are recognized at the time of derecognition, impairment or amortization. A regular way purchase or sale of financial assets is accounted for using settlement date accounting.

If there is objective evidence which indicates that a financial asset is impaired, a loss is recognized. If, in a subsequent period, the amount of the impairment loss decreases and the decrease is clearly attributable to an event which occurred after the impairment loss was recognized, the previously recognized impairment loss is reversed to the extent of the decrease. The reversal may not result in a carrying amount that exceeds the amortized cost that would have been determined as if no impairment loss had been recognized.

Table of Contents

Allowance for Doubtful Receivables

An allowance for doubtful receivables is provided based on a review of the collectibility of accounts receivable. The Company determines the amount of allowance for doubtful receivables by examining the aging analysis of outstanding accounts receivable and current trends in the credit quality of its customers as well as its internal credit policies.

Revenue Recognition and Allowance for Sales Returns and Others

The Company recognizes revenue when evidence of an arrangement exists, shipment is made, price is fixed or determinable, and collectibility is reasonably assured. Revenues from the design and manufacture of photo masks, which are used as manufacturing tools in the fabrication process, are recognized when the photo masks are qualified by customers. Provisions for estimated sales returns and others are generally recorded in the period the related revenue is recognized based on historical experience, management s judgment, and any known factors that would significantly affect the allowance.

Sales prices are determined using fair value taking into account related sales discounts agreed to by the Company and its customers. Sales agreements typically provide that payment is due 30 days from invoice date for a majority of the customers and 30 to 45 days after the end of the month in which sales occur for some customers. Since the receivables from sales are collectible within one year and such transactions are frequent, fair value of the receivables is equivalent to the nominal amount of the cash to be received.

Inventories

Inventories are stated at the lower of cost or market value. Inventories are recorded at standard cost and adjusted to the approximate weighted-average cost at the balance sheet date. Market value represents replacement cost for raw materials, supplies and spare parts and net realizable value for work in process and finished goods. The Company assesses the impact of changing technology on its inventories on hand and writes off inventories that are considered obsolete. Year-end inventories are evaluated for estimated excess quantities and obsolescence based on a demand forecast within a specific time horizon, which is generally 180 days or less. Estimated losses on scrap and slow-moving items are recognized and included in the allowance for losses.

Investments Accounted for Using Equity Method

Investments in companies wherein the Company exercises significant influence over the operating and financial policy decisions are accounted for using the equity method. The Company s share of the net income or net loss of an investee is recognized in the equity in earnings/losses of equity method investees, net account. Prior to January 1, 2006, the difference, if any, between the cost of investment and the Company s proportionate share of the investee s equity was amortized by the straight-line method over five years, with the amortization recorded in the equity in earnings/losses of equity method investees, net account. Effective January 1, 2006, pursuant to the revised Statement of Financial Accounting Standards No. 5, Long-term Investments in Equity Securities (SFAS No. 5), the cost of an investment shall be analyzed and the difference between the cost of investment and the fair value of identifiable net assets acquired, representing goodwill, shall not be amortized and instead shall be tested for impairment annually. The accounting treatment for the investment premiums acquired before January 1, 2006 is the same as that for goodwill which is no longer being amortized; while investment discounts continue to be amortized over the remaining periods. When an indication of impairment is identified, the carrying amount of the investment is reduced, with the related impairment loss recognized in earnings.

When the Company subscribes for additional investee s shares at a percentage different from its existing ownership percentage, the resulting carrying amount of the investment in the investee differs from the amount of the Company s share of the investee s equity. The Company records such a difference as an adjustment to long-term investments with the corresponding amount charged or credited to capital surplus.

Gains or losses on sales from the Company to equity method investees are deferred in proportion to the Company s ownership percentage in the investees until such gains or losses are realized through transactions with third parties. The entire amount of the gains or losses on sales to investees over which the Company has a controlling interest is deferred until such gains or losses are realized through subsequent sales of the related products to third parties. Gains or losses on sales from equity method investees to the Company are deferred in proportion to the Company s ownership percentages in the investees until they are realized through transactions with third parties.

Gains or losses on sales between equity method investees are deferred in proportion to the Company s weighted-average ownership percentages in the investees that record such gains or losses until they are realized through transactions with third parties.

If an investee s functional currency is a foreign currency, translation adjustments will result from the translation of the investee s financial statements into the reporting currency of the Company. Such adjustments are accumulated and reported as a separate component of shareholders equity.

Financial Assets Carried at Cost

Investments in which the Company does not exercise significant influence and that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are carried at their original cost, such as non-publicly traded stocks and mutual funds. The costs of mutual funds and non-publicly traded stocks are determined using the weighted-average method. If there is objective evidence which indicates that a financial asset is impaired, a loss is recognized. A subsequent reversal of such impairment loss is not allowed.

The accounting treatment for cash dividends and stock dividends arising from financial assets carried at cost is the same as that for cash and stock dividends arising from available-for-sale financial assets.

Property, Plant and Equipment and Assets Leased to Others

Property, plant, and equipment and assets leased to others are stated at cost less accumulated depreciation. When an indication of impairment is identified, any excess of the carrying amount of an asset over its recoverable amount is recognized as a loss. If the recoverable amount increases in a subsequent period, the amount previously recognized as impairment would be reversed and recognized as a gain. However, the adjusted amount may not exceed the carrying amount that would have been determined, net of depreciation, as if no impairment loss had been recognized.

Significant additions, renewals and betterments incurred during the construction period are capitalized. Maintenance and repairs are expensed as incurred.

Depreciation is computed using the straight-line method over the following estimated service lives: buildings - 10 to 20 years; machinery and equipment - 5 years; and office equipment - 3 to 5 years.

Upon sale or disposal of property, plant and equipment, the related cost and accumulated depreciation are deducted from the corresponding accounts, with any gain or loss recorded as to non-operating gains or losses in the period of sale or disposal.

Goodwill

Goodwill represents the excess of the consideration paid for acquisition over the fair value of identifiable net assets acquired. Prior to January 1, 2006, goodwill was amortized using the straight-line method over the estimated life of 10 years. Effective January 1, 2006, pursuant to the newly revised SFAS No. 25, Business Combinations - Accounting Treatment under Purchase Method (SFAS No. 25), goodwill is no longer amortized and instead is tested for impairment annually. If an event occurs or circumstances change which indicated that the fair value of goodwill is more likely than not below its carrying amount, an impairment loss is recognized. A subsequent recovery in fair value of goodwill is not allowed.

Table of Contents

Deferred Charges

Deferred charges consist of technology license fees, software and system design costs and other charges. The amounts are amortized over the following periods: Technology license fees - the shorter of the estimated life of the technology or the term of the technology transfer contract; software and system design costs and other charges - 3 years. When an indication of impairment is identified, any excess of the carrying amount of an asset over its recoverable amount is recognized as a loss. If the recoverable amount increases in a subsequent period, the previously recognized impairment loss would be reversed and recognized as a gain. However, the adjusted amount may not exceed the carrying amount that would have been determined, net of amortization, as if no impairment loss had been recognized.

Pension Costs

For employees under defined contribution pension plans, pension costs are recorded based on the actual contributions made to employees individual pension accounts during their service periods. For employees under defined benefit pension plans, pension costs are recorded based on actuarial calculations.

Income Tax

The Company applies intra-period and inter-period allocations for its income tax, whereby (1) a portion of current income tax expense is allocated to the cumulative effect of changes in accounting principles; and (2) deferred income tax assets and liabilities are recognized for the tax effects of temporary differences and unused tax credits. Valuation allowances are provided to the extent, if any, that it is more likely than not that deferred income tax assets will not be realized. A deferred tax asset or liability is classified as current or noncurrent in accordance with the classification of its related asset or liability. However, if a deferred tax asset or liability does not relate to an asset or liability in the financial statements, then it is classified as either current or noncurrent based on the expected length of time before it is realized or settled.

Any tax credits arising from purchases of machinery, equipment and technology, research and development expenditures, personnel training, and investments in important technology-based enterprises are recognized using the flow-through method.

Adjustments of prior years tax liabilities are added to or deducted from the current year s tax provision.

Income tax on unappropriated earnings at a rate of 10% is expensed in the year of shareholder approval which is the year subsequent to the year the earnings are generated.

The R.O.C. government enacted the Alternative Minimum Tax Act (the AMT Act), which became effective on January 1, 2006. The alternative minimum tax (AMT) imposed under the AMT Act is a supplemental tax levied at a rate of 10% which is payable if the income tax payable determined pursuant to the Income Tax Law is below the minimum amount prescribed under the AMT Act. The taxable income for calculating the AMT includes most of the income that is exempted from income tax under various laws and statutes. The Company has considered the impact of the AMT Act in the determination of its tax liabilities.

Stock-based Compensation

Employee stock option plans that are amended or have options granted on or after January 1, 2004 are accounted for by the interpretations issued by the Accounting Research and Development Foundation. The Company adopted the intrinsic value method and any compensation cost determined using this method is recognized in earnings over the employee vesting period.

Table of Contents

Treasury Stock

The Company s stock held by subsidiaries is treated as treasury stock and reclassified from investments accounted for using equity method to treasury stock. The gains resulted from disposal of the treasury stock held by subsidiaries and cash dividends received by subsidiaries from the Company are recorded under capital surplus - treasury stock transactions.

Foreign-currency Transactions

Foreign-currency transactions are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Exchange gains or losses derived from foreign-currency transactions or monetary assets and liabilities denominated in foreign currencies are recognized in earnings. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are revalued at prevailing exchange rates with the resulting gains or losses recognized in earnings.

3. ACCOUNTING CHANGES

On January 1, 2006, the Company adopted the newly released Statements of Financial Accounting Standards No. 34, Financial Instruments: Recognition and Measurement (SFAS No. 34) and No. 36, Financial Instruments: Disclosure and Presentation and related revisions of previously released SFASs.

a. Effect of adopting the newly released SFASs and related revisions of previously released SFASs

   The Company had categorized its financial assets and liabilities upon initial adoption of the newly released SFASs. The adjustments made to the carrying amounts of the financial instruments categorized as financial assets or financial liabilities at fair value through profit or loss were included in the cumulative effect of chang