Phison Electronics Corp. and Subsidiaries

**Consolidated Financial Statements for the
Years Ended December 31, 2006 and 2005 and
Independent Auditors' Report**

REPRESENTATION LETTER

The affiliates of Phison Electronics Corp. (the “Corporation”), which should have been included in the combined financial statements of the Corporation and its affiliates as of and for the year ended December 31, 2006 based on the “Regulations Governing The Preparation of Combined Financial Statements of Public Companies and Their Affiliates” in the Republic of China (ROC), are the same as those included in the consolidated financial statements of the Corporation and its subsidiaries as of and for the year ended December 31, 2006, prepared under the Statement of Financial Accounting Standards No. 7, “Consolidated Financial Statements,” in the ROC. The information required to be disclosed in the combined financial statements has already been disclosed in the above consolidated financial statements. Consequently, there is no need to prepare separate combined financial statements of the Corporation and its affiliates.

Very truly yours,

PHISON ELECTRONICS CORP.

By

____

EN MIN JOW
Chairman

January 26, 2007

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
Phison Electronics Corp.

We have audited the accompanying consolidated balance sheets of Phison Electronics Corp. (the "Corporation') and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the Rules Governing the Auditing and Certification 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Phison Electronics Corp. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their 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 relevant to financial accounting standards, and accounting principles generally accepted in the Republic of China.

As disclosed in Note 3 to the consolidated financial statements, the Corporation and subsidiaries adopted on January 1, 2006 the newly issued Statements of Financial Accounting Standards ("Statements" or SFAS) No. 34 - "Accounting for Financial Instruments" and No. 36 - "Disclosure and Presentation of Financial Instruments" and the revisions of previously released Statements, which were revised to harmonize with SFAS No. 34 and No. 36.

January 26, 2007

Notice to Readers

The accompanying consolidated 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 jurisdictions. 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 consolidated 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 consolidated financial statements shall prevail.

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Par Value)

ASSETS	2006 Amount	%	2005 Amount	%
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 4)	$ 1,306,098	23	$ 779,908	27
Financial assets at fair value through profit or loss - current (Notes 2 and 5)	150,129	3	-	-
Notes and accounts receivable				
Third parties, net (Notes 2 and 6)	2,119,915	36	1,037,556	36
Related parties (Note 18)	44,348	1	68,312	2
Inventories, net (Notes 2 and 7)	1,498,852	26	637,783	22
Deferred income tax assets (Notes 2 and 13)	132,760	2	52,051	2
Restricted assets (Note 19)	29,017	-	14,959	1
Other	225,259	4	118,742	4
Total current assets	5,506,378	95	2,709,311	94
LONG-TERM INVESTMENTS				
Investments accounted for by the equity method (Notes 2, 3 and 9)	85,580	2	-	-
Financial assets carried at cost - noncurrent (Notes 2, 3 and 8)	20,000	-	24,650	1
Total long-term investments	105,580	2	24,650	1
PROPERTIES (Notes 2 and 10)				
Cost				
Testing equipment	37,311	1	23,224	1
Office equipment	7,496	-	4,842	-
Leasehold improvements	17,636	-	12,056	1
Other equipment	2,902	-	4,499	-
Total cost	65,345	1	44,621	2
Less: Accumulated depreciation	28,737	1	17,017	1
	36,608	-	27,604	1
Prepayment for land	40,500	1	-	-
Prepayment for equipment	509	-	1,780	-
Net properties	77,617	1	29,384	1
INTANGIBLE ASSETS (Notes 2, 11 and 20)	37,065	1	43,016	2
OTHER ASSETS				
Guarantee deposits paid (Notes 19 and 20)	4,988	-	41,970	1
Deferred charges, net (Note 2)	54,370	1	22,844	1
Deferred income tax assets, net (Notes 2 and 13)	242	-	423	-
Miscellaneous (Notes 2 and 12)	2,441	-	375	-
Total other assets	62,041	1	65,612	2
TOTAL	$ 5,788,681	100	$ 2,871,973	100

LIABILITIES AND STOCKHOLDERS' EQUITY	2006 Amount	%	2005 Amount	%
CURRENT LIABILITIES				
Notes and accounts payable				
Third parties	$ 2,283,497	40	$ 628,011	22
Related parties (Note 18)	365,741	6	228,249	8
Income tax payable (Notes 2 and 13)	86,455	2	19,554	-
Accrued expenses (Note 18)	182,699	3	146,359	5
Other	23,164	-	78,837	3
Total current liabilities	2,941,556	51	1,101,010	38
OTHER LIABILITIES				
Accrued pension cost (Notes 2 and 12)	-	-	1,385	-
Total liabilities	2,941,556	51	1,102,395	38
SHAREHOLDERS' EQUITY (Note 15)				
Capital stock - NT$10.00 par value				
Authorized - 100,000 thousand shares in 2006 and 60,000 thousand shares in 2005				
Issued and outstanding - 72,577 thousand shares in 2006 and 52,212 thousand shares in 2005	725,771	13	522,121	18
Capital surplus				
Additional paid-in capital	722,962	12	501,962	18
From long term investment	562	-	-	-
Total capital surplus	723,524	12	501,962	18
Retained earnings				
Legal reserve	128,122	2	69,113	2
Unappropriated retained earnings	1,269,708	22	676,382	24
Total retained earnings	1,397,830	24	745,495	26
Total shareholders' equity	2,847,125	49	1,769,578	62
TOTAL	$ 5,788,681	100	$ 2,871,973	100

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

(With Deloitte & Touche audit report dated January 26, 2007)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2006		2005	
	Amount	**%**	**Amount**	**%**
OPERATING REVENUE (Notes 2 and 18)				
Gross sales	$12,533,007	101	$ 6,352,540	101
Less: Sales returns and allowances	134,322	1	48,021	1
Net sales	12,398,685	100	6,304,519	100
Service revenue	53,289	-	3,770	-
Total operating revenue	12,451,974	100	6,308,289	100
OPERATING COSTS (Notes 14 and 18)	10,746,618	86	5,319,062	84
GROSS PROFIT	1,705,356	14	989,227	16
OPERATING EXPENSES (Notes 14 and 18)				
Marketing	140,249	1	91,044	1
General and administrative	72,715	1	48,255	1
Research and development	339,965	3	240,478	4
Total operating expenses	552,929	5	379,777	6
OPERATING INCOME	1,152,427	9	609,450	10
NONOPERATING INCOME AND GAINS				
Interest income	12,458	-	6,486	-
Foreign exchange gains, net (Note 2)	7,115	-	16,397	-
Equity in net gain of investees (Notes 2 and 9)	5,698	-	-	-
Gains on disposal of investments, net (Note 2)	3,517	-	3,369	-
Other (Notes 2 and 20)	47,047	1	4,859	-
Total nonoperating income and gains	75,835	1	31,111	-
NONOPERATING EXPENSES AND LOSSES				
Losses on inventory valuation and obsolescence (Notes 2 and 7)	120,590	1	60,000	1
Interest expense	642	-	545	-
Other (Note 2)	3,508	-	103	-
Total nonoperating expenses and losses	124,740	1	60,648	1

(Continued)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2006		2005	
	Amount	**%**	**Amount**	**%**
CONSOLIDATED INCOME BEFORE INCOME TAX	$ 1,103,522	9	$ 579,913	9
INCOME TAX EXPENSE (BENEFIT) (Notes 2 and 13)	32,310	-	(10,173)	-
CONSOLIDATED NET INCOME	$ 1,071,212	9	$ 590,086	9
ATTRIBUTED TO SHAREHOLDERS OF THE PARENT	$ 1,071,212		$ 590,086	

	2006		2005	
	Before Income Tax	**After Income Tax**	**Before Income Tax**	**After Income Tax**
EARNINGS PER SHARE (Note 16)				
Basic	$ 15.60	$ 15.15	$ 9.27	$ 9.43
Diluted	$ 15.46	$ 15.01	$ 9.08	$ 9.24

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

(With Deloitte & Touche audit report dated January 26, 2007) (Concluded)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Earnings Per Share Data)

	Capital Stocks Issued and Outstanding		Capital Surplus			Retained Earnings			Total Shareholders' Equity (Note 15)
	Shares (Thousands)	Amount	Paid-in Capital in Excess of Par Value	Long-term Investment	Total	Legal Reserve	Unappropriated	Total	
BALANCE, JANUARY 1, 2005	36,232	$ 362,321	$ 51,962	$ -	$ 51,962	$ 34,280	$ 379,692	$ 413,972	$ 828,255
Appropriation of the 2004 earnings									
Legal reserve	-	-	-	-	-	34,833	(34,833)	-	-
Bonus to employees - stock	1,800	18,000	-	-	-	-	(18,000)	(18,000)	-
Bonus to employees - cash	-	-	-	-	-	-	(18,000)	(18,000)	(18,000)
Stock dividends - NT$2.49380 per share	9,058	90,580	-	-	-	-	(90,580)	(90,580)	-
Cash dividends - NT$3.49130 per share	-	-	-	-	-	-	(126,812)	(126,812)	(126,812)
Remuneration to directors and supervisors	-	-	-	-	-	-	(5,171)	(5,171)	(5,171)
Balance after appropriation	47,090	470,901	51,962	-	51,962	69,113	86,296	155,409	678,272
Issuance of stock due to exercise of stock options	622	6,220	-	-	-	-	-	-	6,220
Issuance of capital stock as of October 17, 2005 - NT$110 per share	4,500	45,000	450,000	-	450,000	-	-	-	495,000
Consolidated net income in 2005	-	-	-	-	-	-	590,086	590,086	590,086
BALANCE, DECEMBER 31, 2005	52,212	522,121	501,962	-	501,962	69,113	676,382	745,495	1,769,578
Appropriation of the 2005 earnings									
Legal reserve	-	-	-	-	-	59,009	(59,009)	-	-
Bonus to employees - stock	1,950	19,500	-	-	-	-	(19,500)	(19,500)	-
Bonus to employees - cash	-	-	-	-	-	-	(23,000)	(23,000)	(23,000)
Stock dividends - NT$2.99088 per share	15,800	158,000	-	-	-	-	(158,000)	(158,000)	-
Cash dividends - NT$3.97523 per share	-	-	-	-	-	-	(210,000)	(210,000)	(210,000)
Remuneration to directors and supervisors	-	-	-	-	-	-	(8,377)	(8,377)	(8,377)
Balance after appropriation	69,962	699,621	501,962	-	501,962	128,122	198,496	326,618	1,528,201
Issuance of stock due to exercise of stock options	615	6,150	-	-	-	-	-	-	6,150
Effect of change in equity in an investee due to the Corporation's subscription for additional shares issued by an investee at a rate not equal to its current equity	-	-	-	562	562	-	-	-	562
Issuance of capital stock as of December 15, 2006 - NT$120.5 per share	2,000	20,000	221,000	-	221,000	-	-	-	241,000
Consolidated net income in 2006	-	-	-	-	-	-	1,071,212	1,071,212	1,071,212
BALANCE, DECEMBER 31, 2006	72,577	$ 725,771	$ 722,962	$ 562	$ 723,524	$ 128,122	$ 1,269,708	$ 1,397,830	$ 2,847,125

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

(With Deloitte & Touche audit report dated January 26, 2007)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income	$ 1,071,212	$ 590,086
Adjustments to reconcile net income to net cash provided by operating activities:		
Losses on inventory valuation and obsolescence	120,590	60,000
Deferred income tax	(80,528)	(38,698)
Amortization	26,633	20,134
Depreciation	13,456	8,619
(Reversal of) allowance for doubtful accounts	13,308	(4,611)
Equity in net loss (gain) of investees	(5,698)	-
Gain on disposal of financial assets carried at cost - noncurrent	(2,139)	-
Gain on disposal of properties	(3)	-
Net changes in operating assets and liabilities		
Financial assets at fair value through profit or loss - current	(150,129)	97,499
Notes and accounts receivable	(1,071,703)	(443,763)
Inventories	(981,659)	(467,477)
Other current assets	(107,047)	(53,548)
Notes and accounts payable	1,792,978	225,308
Income tax payable	66,901	14,412
Accrued expenses	34,955	63,616
Other current liabilities	(50,897)	20,773
Accrued pension cost	(2,066)	292
Net cash provided by operating activities	688,164	92,642
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in investments accounted for by the equity method	(79,320)	-
Acquisition of properties	(66,486)	(11,317)
Increase in deferred charges	(48,168)	(22,283)
Decrease in guarantee deposits paid	36,982	39,401
Decrease (increase) in restricted assets	(14,058)	2,138
Proceeds from disposal of financial assets carried at cost - noncurrent	6,789	-
Increase in intangible assets	(3,510)	(22,104)
Proceeds from disposal of properties	24	-
Increase in financial assets carried at cost - noncurrent	-	(15,300)
Cash dividends received from financial assets carried at cost - noncurrent	-	150
Net cash used in investing activities	(167,747)	(29,315)

(Continued)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars)

	2006	2005
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds of the issuance of capital stock	$ 241,000	$ 495,000
Cash dividends paid	(210,000)	(126,812)
Bonus to employees and remuneration to directors and supervisors	(31,377)	(23,171)
Proceeds from exercise of stock options	6,150	6,220
Decrease in guarantee deposits received	-	(168)
Net cash provided by financing activities	5,773	351,069
NET INCREASE IN CASH AND CASH EQUIVALENTS	526,190	414,396
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	779,908	365,512
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 1,306,098	$ 779,908
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 642	$ 545
Income tax paid	$ 52,084	$ 14,113
INVESTING ACTIVITIES AFFECTING BOTH CASH AND NONCASH ITEMS		
Increase in properties	$ 61,710	$ 18,261
Decrease (increase) in payables to contractors and equipment suppliers (included in other current liabilities)	4,776	(6,944)
Cash paid	$ 66,486	$ 11,317
Increase in intangible assets	$ 3,510	$ 48,384
Increase in accrued expense	-	(26,280)
Cash paid	$ 3,510	$ 22,104

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

(With Deloitte & Touche audit report dated January 26, 2007) (Concluded)

1. ORGANIZATION AND OPERATIONS

Phison Electronics Corp. (the "Corporation") was incorporated on November 8, 2000 under the Company Law of the Republic of China (ROC). The Corporation mainly designs and sells flash memory controllers and peripheral system applications as well as designs the TI DSP (Texas Instruments' digital signal processor) system.

The Corporation's shares have been traded on the Gre-Tai Securities Market (the over-the-counter securities exchange of the ROC) since December 6, 2004.

As of December 31, 2006 and 2005, the Corporation and subsidiaries had 273 and 210 employees, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements have been presented in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, Business Accounting Law, Guidelines Governing Business Accounting, and accounting principles generally accepted in the Republic of China. In preparing consolidated financial statements in conformity with these guidelines and principles, the Corporation is required to make certain estimates and assumptions that could affect the amounts of allowance for sales returns and discounts; allowance for doubtful accounts, allowance for inventory valuation and obsolescence losses, pension, probable litigation loss, depreciation of properties, amortization of intangible assets and deferred charges, etc. Actual results could differ from these estimates.

For the convenience of readers, the accompanying consolidated financial statements have been translated into English from the original Chinese version prepared and used in the ROC. 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 consolidated financial statements shall prevail.

Significant accounting policies are summarized as follows:

Basis of Consolidation

a. Basis of consolidation

The consolidated financial statements as of and for the year ended December 31, 2006 have been prepared in accordance with the revised Statement of Financial Accounting Standards (SFAS) No. 7 - "Consolidated Financial Statements" and included the financial statements of the Corporation, its direct and indirect subsidiaries and other investees controlled by the Corporation and its subsidiaries.

b. The consolidated subsidiaries included the following:

Investor	Subsidiary	Nature of Business	Percentage of Ownership as of December 31, 2006	Percentage of Ownership as of December 31, 2005	Description
The Corporation	Lian Xu Dong Investment Corp.	Investment	100%	100%	The Corporation invested in Lian Xu Dong Investment Corp. in July 2005.

c. No subsidiaries were excluded from the consolidated financial statements.

d. There were no significant transactions between the Corporation and subsidiaries.

Current and Noncurrent Assets and Liabilities

Current assets include cash and cash equivalents, assets held for trading and those to be converted to cash, sold or consumed within 12 months from the balance sheet date. Current liabilities are obligations held for trading and those expected to be due within 12 months from the balance sheet date. All other assets and liabilities are classified as noncurrent.

Cash Equivalents

Short-term bills and bonds acquired under repurchase agreements that require them to be sold within three months are classified as cash equivalents.

Financial Instruments at Fair Value through Profit or Loss

Financial instruments at fair value through profit or loss include financial assets or liabilities held for trading and those designated on initial recognition to be measured at fair value with fair value changes recognized in profit or loss. On initial recognition, the financial instruments are recognized at fair value, transaction costs are recognized as expense and are subsequently measured at fair value with fair value changes recognized in profit or loss. The purchase or sale of the financial instruments is recognized and de-recognized using trade date accounting.

Derivative financial instruments that do not meet the criteria for hedge accounting are classified as financial assets or liabilities held for trading. When the fair value is a positive amount, the derivative is recognized as a financial asset, when the fair value is a negative amount, the derivative is recognized as a financial liability.

The fair value of open-end funds is based on their net asset value on the balance sheet date.

Sales Recognition and Allowance for Doubtful Accounts

Sales are recognized when titles to products and risk of ownerships are transferred to customers, primarily upon shipment, since the earnings process is completed or virtually completed and earnings are realized or realizable. For products shipped for further processing, sales are not recognized because there is no transfer of titles and risks. Provisions for sales discounts and returns are estimated on the basis of historical experience and relevant factors.

Sales are determined at fair value under price negotiation between the Corporation and buyers, taking into account related sales discounts. If the terms of sale receivables are within one year, the amounts of receivables are not significantly different from fair value, and the transactions are frequent, then the sale revenues are not discounted to fair value.

Allowance for doubtful accounts is provided on the basis of a periodic review of the collectibility of receivables, including the analysis of the aging of all receivables as well as the economic environment.

Inventories

Inventories are stated at the lower of weighted-average cost or market value. Market value is based on replacement cost or net realizable value. An allowance for slow-moving items is provided on the basis of the Corporation's policy to an appropriate percentage of the allowance for losses.

Financial Assets Carried at Cost

If there is no active market for an equity instrument and the fair value of the equity instrument cannot be reliably estimated, the equity instrument, including unlisted stocks, emerging stocks, etc., is measured at original cost. Cash dividends are recognized as dividend income on the ex-dividend date, but are accounted for as reductions of the original cost of investments if these dividends are declared from investees' earnings attributable to periods before the purchase of investments. Stock dividends are not recognized as current income but are accounted for only as increase in the number of shares held. Impairment losses are recognized if a decrease in the fair value of the instruments can be objectively related to an event. The reversal of impairment loss is not allowed.

Investments Accounted for by the Equity Method

Long-term investments in which the Corporation owns 20% or more of an investee's outstanding voting shares or exercises significant influence on an investee are accounted for by the equity method.

Under the equity method, the investment is stated at cost on the acquisition date and subsequently adjusted for the Corporation's proportionate share in the investee's net income or net loss and in other changes in shareholders' equity of the investees and in the same accounting period. If the Corporation subscribes for additional shares issued by an investee at a rate not equal to its current equity, the increase in the Corporation's equity in the investee's net assets is credited to capital surplus. Any decrease in the Corporation's equity in the investee's net assets is debited to capital surplus. If capital surplus is not enough for debiting purposes, the debit is made against unappropriated earnings.

Cash dividends received are accounted for as reductions of the carrying values of the long-term investments. Stock dividends received are recorded as an increase in the number of shares held.

If an investee becomes impaired, as defined in Statement of Financial Accounting Standards No. 35 - "Accounting for Asset Impairment," the recoverable amount of the investment is calculated and compared with carrying value. If the recoverable amount is less than the carrying amount, an impairment loss is recognized and charged to current income, and the recoverable amount becomes the new investment carrying value.

Costs of long-term investments sold are determined using the weighted-average method.

Properties

Properties are stated at cost less accumulated depreciation. Significant additions renewals and betterments are capitalized, while maintenance and repairs are expensed currently.

Depreciation is calculated using the straight-line method over the following estimated service lives: testing equipment, 3 years; office equipment, 3 years; leasehold improvements, 2 to 3 years; and other equipment, 2 to 5 years. If an asset is still in use beyond its initially estimated service life, its residual value is written off over its newly estimated service life.

When properties are retired or disposed of, the related cost and accumulated depreciation are removed from the accounts, and the resulting gain or loss is credited or charged to nonoperating income in the current period.

Intangible Assets

Intangible assets, consisting of costs to acquire royalty, patents and trademarks, are amortized using the straight-line method over three to six years.

Deferred Charges

Deferred charges, mainly the costs of acquiring computer software, are amortized using the straight-line method over three to five years.

Asset Impairment

If the carrying value of assets (including properties, intangible assets, deferred charges and investments accounted for by the equity method) is less than their recoverable amount, which indicates that an impairment exists, an impairment loss should be recognized. Any subsequent reversal of the impairment loss for the increase in recoverable amount is recognized as income. However, the increase in carrying amount should not exceed the carrying amount that would have been determined, net of amortization or depreciation, had no impairment loss been recognized. The reversal of impairment loss on goodwill is not allowed.

Pension Costs

The Corporation has two types of pension plans: Defined benefit and defined contribution.

Pension costs under the defined benefit pension plan are recognized on the basis of actuarial calculations. Pension costs under the defined contribution pension plan are recognized as current expenses during the employees' service periods.

Income Tax

The Corporation uses inter-period tax allocation, in which deferred income tax assets and liabilities are recognized for the tax effects of temporary differences and unused investment tax credits. Valuation allowance is provided for deferred income tax assets that are not certain to be realized. A deferred tax asset or liability should be classified as current or noncurrent according to the classification of the related asset or liability for financial reporting. However, if a deferred asset or liability cannot be related to an asset or liability in the financial statements, it should be classified as current or noncurrent on the basis of the expected realization date of the temporary difference.

Tax credits for certain purchases of equipment and technology, research and development expenditures and personnel training expenditures are accounted for by the flow-through method.

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

Income taxes (10%) on undistributed earnings generated annually since 1998 are recorded as expense in the year when the shareholders resolve to retain these earnings.

Foreign-currency Transactions

Assets, liabilities, revenues or expenses denominated in foreign currencies as a result of foreign-currency transactions on nonderivative financial instruments are recorded in New Taiwan dollars at the exchange rates prevailing on the dates of the transactions.

On the balance sheet date, monetary assets or liabilities denominated in foreign currencies are translated at the prevailing exchange rates, and the resulting exchange differences are included in gain or loss for the current period.

The above prevailing exchange rates are based on the average of the bid and ask rates of major banks.

Reclassification

Certain accounts in the consolidated financial statements as of and for the year ended December 31, 2005 have been reclassified to be consistent with the presentation of consolidated financial statements as of and for the year ended December 31, 2006.

3. ACCOUNTING CHANGES

Effective January 1, 2006, the Corporation adopted the newly issued Statements of Financial Accounting Standards ("Statements" or SFAS) No. 34 - "Accounting for Financial Instruments" and No. 36 - "Disclosure and Presentation of Financial Instruments" and the related revisions of previously released Statements.

The effects of the accounting changes are summarized as follows:

a. Effect on financial statements

   The accounting changes had no material impact on the Corporation's financial statements as of and for the year ended December 31, 2006.

b. Reclassification of financial statement accounts

   As a result of the accounting changes, effective January 1, 2006, certain accounts in the consolidated financial statement as of and for year ended December 31, 2005 were reclassified to be consistent with the presentation of the consolidated financial statements as of and for the year ended December 31, 2006. However, the restatement of the consolidated financial statements as of and for the year ended December 31, 2005 is not required. In addition, the Corporation had to state in the notes to the consolidated financial statements the different valuation methods for certain account items. However, disclosure of the related pro forma information of prior years is not needed.

   Certain accounting policies used before the adoption of SFAS Nos. 34 and 36 are summarized as follows:

   1) Short-term investments

      Short-term investments are carried at the lower of aggregate costs or market value. An allowance for losses is provided when the aggregate carrying value of the investments exceeds the total market value. Any recovery of the market value to the extent of the original carrying value is recognized as income.

      Costs of investments sold are determined using the weighted-average method.

2) Long-term investments

Long-term investments in which the Corporation does not exercise significant influence on the investees are accounted for by the cost method. Cash dividends received within one year of investment acquisition are accounted for as reductions of the carrying value of the long-term investments, and cash dividends received in subsequent years are recognized as dividend income.

Stock dividends received are recorded as an increase in the number of shares held and do not affect investment income or the carrying value of the investments. If the decline in the carrying value of investments in unlisted stocks is considered irrecoverable, the related reduction is charged to current income.

Costs of investments sold are determined using the weighted-average method.

3) Derivative financial instruments

Forward exchange contracts are used for hedging and are recorded at the spot rates on the starting date of the contracts. The difference between the rate on the contract starting date and the forward rate is amortized over the term of the contract and credited or charged to income. Any resulting gain or loss on the balance sheet date or settlement date is credited or charged to income. In addition, receivables and payables on forward exchange contracts that are open on the balance sheet date are netted out, and the difference is listed as an asset or a liability.

Due to the adoption of new and amended Statements starting on January 1, 2006, certain accounts in the consolidated financial statements as of and for the year ended December 31, 2005 have been reclassified as follows to conform to the presentation of the consolidated financial statements as of and for the year ended December 31, 2006.

	Before Reclassification	After Reclassification
Balance sheet		
Long-term investments	$ 24,650	$ -
Financial assets carried at cost - noncurrent	-	24,650

Starting on January 1, 2006, the Corporation adopted the newly revised SFAS No. 1 - “Conceptual Framework of Financial Accounting and Preparation of Financial Statements,” SFAS No. 5 - “Long-term Investments in Equity Securities,” and SFAS No. 25 - “Business Combinations - Accounting Treatment under Purchase Method.” These accounting changes had no effect on the consolidated income in 2006.

4. CASH AND CASH EQUIVALENTS

	December 31	
	2006	**2005**
Cash on hand	$ 176	$ 50
Savings accounts	563,627	358,044
Certificates of deposits	90,063	118,669
Foreign accounts	542,753	32,709
Checking accounts	173	31
Short-term bills and bonds acquired under repurchase agreements	109,306	270,405
	$ 1,306,098	$ 779,908

5. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS - CURRENT

Financial instruments held for trading are summarized as follows:

	December 31	
	2006	**2005**
Financial assets held for trading		
Beneficiary certificates - open-end funds	$ 150,129	$ -

The Corporation entered into forward exchange contracts to hedge exposures due to exchange rate fluctuations. The purpose of the hedge strategy was to reduce most of the risks arising from changes in market prices and cash flows. All of the outstanding forward exchange contracts of as of December 31, 2006 and 2005 had matured.

Net gains on financial assets held for trading in 2006 and 2005 were $1,593 thousand and $3,369 thousand, respectively. Net losses on financial liabilities held for trading in 2006 and 2005 were $214 thousand and $3,261 thousand, respectively.

6. NOTES AND ACCOUNTS RECEIVABLE - THIRD PARTIES, NET

	December 31	
	2006	**2005**
Notes receivable	$ 26,431	$ 51,509
Accounts receivable	2,115,612	1,009,120
	2,142,043	1,060,629
Less: Allowance for sales returns and allowances	-	1,652
Allowance for doubtful accounts	22,128	21,421
	$ 2,119,915	$ 1,037,556

The factored accounts receivable in the year ended December 31, 2006 were as follows:

Buyer	Factoring Amount	Settle Amount	Prepayment	Discounting Charge Rate (%)	Individual Buyer's Limit
Standard Chartered Bank	$68,040	$63,106	$4,934	6.0201-6.1469	US$5,000 thousand

The limit above is used in revolving bases.

The factor is Standard Chartered Bank (SCB). This sale is without recourse.

7. INVENTORY, NET

	December 31	
	2006	2005
Finished goods	$ 20,682	$ 32,100
Semifinished goods	223,015	84,244
Work in process	438,334	135,510
Raw materials	1,010,012	458,531
	1,692,043	710,385
Less: Allowance for inventory valuation and obsolescence losses	193,191	72,602
	$ 1,498,852	$ 637,783

On February 27, 2006, Quan Yi Technology, the Corporation's outsourcing partner, was robbed, and the stolen products included those of the Corporation. Thus, the Corporation lost approximately $48,533 thousand in inventory. For its loss, the Corporation received from the insurance company a compensation of $46,076 thousand in October 2006.

8. FINANCIAL ASSETS CARRIED AT COST - NONCURRENT

	December 31	
	2006	2005
Common stock - unlisted stocks	$ 20,000	$ 24,650

The above investments in stocks were measured at cost because the related instruments had no active market and their fair value could not be reliably measured.

9. INVESTMENTS ACCOUNTED FOR BY THE EQUITY METHOD

	December 31			
	2006		2005	
	Carrying Amount	% of Owner-ship	Carrying Amount	% of Owner-ship
Unlisted stocks				
Aptos Technology	$ 85,580	18	$ -	-

In June 2006, the Corporation invested in Aptos Technology, which assembles and tests memory cards to stabilize the production of the Corporation's memory cards.

In September 2006, the Corporation had been authorized to invest Dong Ke Hong Technology (Shenzhen) by Investment Commission, MOEA. As of December 31, 2006, the Corporation has no outflow amount of the Investment.

The carrying value of the equity-method investment was $5,698 thousand gain in 2006, which determined on the basis of audited financial statements.

10. PROPERTIES

	December 31	
	2006	2005
Accumulated depreciation		
Testing equipment	$ 15,909	$ 9,467
Office equipment	3,360	2,183
Leasehold improvements	8,134	2,915
Other equipment	1,334	2,452
	$ 28,737	$ 17,017

11. INTANGIBLE ASSETS

	December 31	
	2006	2005
Royalty	$ 33,505	$ 39,107
Patents	1,845	1,545
Technology license fees	1,659	2,281
Trademarks	56	83
	$ 37,065	$ 43,016

12. PENSION PLAN

The Labor Pension Act (the "Act") took effect on July 1, 2005. The Corporation employees subject to the Labor Standards Law (the "Law") as of June 30, 2005 were allowed to choose to continue to be subject to the pension plan under the Law or to be subject instead to the new pension plan under the Act, with their service years accumulated as of June 30, 2005 to be retained. Those hired on or after July 1, 2005 automatically become subject to the pension plan under the Act.

The Act provides for a defined contribution pension plan. Based on this plan, the rate of the Corporation's required monthly contributions, starting on July 1, 2005, to the employees' individual pension accounts is at 6% of monthly salaries and wages. The Corporation recognized defined contribution pension cost of $6,589 thousand and $2,542 thousand in the years ended December 31, 2006 and 2005, respectively.

The Law provides for a defined benefit pension plan. This pension plan provides benefits based on the employee's length of service and average salary or wage before retirement. The Corporation contributes an amount equal to 2% of monthly salaries and wages to a pension fund. The fund is administered by the employees' pension fund committee and deposited in the committee's name in the Central Trust of China. As of December 31, 2006 and 2005, the pension fund balances were $8,179 thousand and $5,786 thousand, respectively.

Defined benefit pension information is summarized as follows:

a. Pension cost

	2006	2005
Service cost	$ 187	$ 1,057
Interest cost	196	161
Expected return on plan assets	(159)	(97)
Amortization	1	29
Net pension cost	$ 225	$ 1,150

b. Reconciliation of the fund status of the plan and prepaid pension cost

	December 31	
	2006	2005
Benefit obligation		
Vested	$ -	$ -
Non-vested	(3,013)	(2,743)
Accumulated	(3,013)	(2,743)
Additional benefits based on future salaries	(2,701)	(2,484)
Projected benefit obligation	(5,714)	(5,227)
Fair value of plan assets	8,179	5,786
Funded status	2,465	559
Unrecognized net transitional obligation	671	700
Unrecognized net gain	(695)	(884)
Prepaid pension cost	$ 2,441	$ 375
Vested benefits	$ -	$ -

c. Actuarial assumptions

	2006	2005
Discount rate used in determining present values	3.75%	3.75%
Future salary increase rate	3.00%	3.00%
Expected rate of return on plan assets	2.75%	2.75%

13. INCOME TAX

The Basic Income Tax Act (BITA) has took effect on January 1, 2006. Based on the BITA, basic income is the sum of the taxable income as calculated in accordance with the Income Tax Act, plus deductions claimed in regard to investment tax credit granted under other laws. Basic tax is the basic income multiplied by a 10% tax rate. The tax payable of the current year is the higher of the basic income tax and income tax payable calculated in accordance with the Income Tax Act.

a. A reconciliation of income tax on pretax income at statutory rate and current income tax expense payable was as follows:

	2006	2005
Income tax on pretax income at statutory rate (25%)	$ 275,871	$ 144,959
Add (deduct) tax effects of		
Permanent difference	(2,414)	(833)
Temporary difference	30,593	10,801
Tax-exempt income	(158,060)	(105,404)
Additional 10% tax on unappropriated earnings	11,220	7,881
Investment tax credits	(78,605)	(28,702)
Current income tax payable	$ 78,605	$ 28,702

b. Income tax expense (benefit) consisted of:

	2006	2005
Current income tax expense payable	$ 78,605	$ 28,702
Net change in deferred income tax for the period	(80,528)	(38,698)
Adjustments to prior year's taxes	34,233	(177)
Income tax expense (benefit)	$ 32,310	$ (10,173)

c. Deferred income tax assets and liabilities consisted of:

	December 31	
	2006	2005
Current, net		
Investment tax credits	$ 78,605	$ 28,702
Allowance for inventory valuation and obsolescence losses	48,298	18,150
Foreign exchange loss	3,352	2,071
Allowance for doubtful accounts	2,319	2,533
Other	186	595
	132,760	52,051
Less: Valuation allowance	-	-
	$ 132,760	$ 52,051
Noncurrent, net		
Investment tax credits	$ 42,356	$ 78,601
Other	242	432
	42,598	79,033
Less: Valuation allowance	42,356	78,610
	$ 242	$ 423

The effective tax rate used for computing deferred income tax assets on December 31, 2006 and 2005 was 25%.

d. As of December 31, 2006, investment tax credits were as follows:

Regulatory Basis of Tax Credits	Items	Total Creditable Amounts	Remaining Creditable Amounts	Expiry Year
Statute for Upgrading Industries	Research and development expenditures	$ 83,259	$ 9,685	2009
		111,276	111,276	2010
		$ 194,535	$ 120,961	

e. The Corporation's net operating income generated from the following expansion projects is exempt from income taxes:

	Tax-exemption Period
First expansion and construction of the Corporation's factories	September 15, 2002 to September 14, 2007
Second expansion and construction of the Corporation's factories	August 1, 2004 to July 31, 2009

f. Integrated income tax information was as follows:

	December 31	
	2006	2005
Balance of imputation credit account (ICA):		
The Corporation	$ 36,060	$ 12,121
Subsidiary - Lian Xu Dong Investment Corp.	$ -	$ -

The actual ratios of imputation tax credits to the 2005 and 2004 earnings were 5.67% and 3.81%, respectively.

The tax credits allocable to the shareholders are based on the balance of ICA on the dividend distribution date.

g. As of December 31, 2006, there were no unappropriated earnings generated before January 1, 1998.

h. Income tax returns through 2003 had been examined by the tax authorities. However, the Corporation disputed the tax-exemption income by the tax authorities on the 2002 return. The Corporation will file an appeal for tax authorities to reexamine the 2002 return. Nevertheless, the Corporation believes that the effect of possible tax liabilities would not be material.

14. LABOR COST, DEPRECIATION AND AMORTIZATION EXPENSES

	2006			2005		
	Classified as Operating Cost	Classified as Operating Expense	Total	Classified as Operating Cost	Classified as Operating Expense	Total
Labor cost						
Salary	$ 30,018	$160,954	$190,972	$ 28,678	$115,365	$144,043
Labor and health insurance	2,416	8,204	10,620	1,506	5,723	7,229
Pension cost	1,732	5,082	6,814	949	2,743	3,692
Other	6,618	18,274	24,892	3,196	12,759	15,955
	$ 40,784	$192,514	$233,298	$ 34,329	$136,590	$170,919
Depreciation	$ 2,587	$ 10,869	$ 13,456	$ 2,727	$ 5,892	$ 8,619
Amortization	-	26,633	26,633	-	20,134	20,134

15. SHAREHOLDERS' EQUITY

a. Capital

In their meeting on November 1, 2006, the Corporation's shareholders decided to issue upper limit 13,500 thousand common shares by private equity raising. On November 2, 2006, the board of directors resolved to issue 2,000 thousand common shares by private equity raising, the share issuance at a NT$10.00 par value and set December 15, 2006 as the fund raising deadline, with NT$120.5 as the offering price. This common share issuance was approved by and registered with the government authorities on January 12, 2007. The difference in price between par value and offering price was $221,000 thousand, recognized as additional paid-in capital. As of December 31, 2006, leave 11,500 thousand common shares not be issued by private equity raising.

b. Capital surplus

Under the Company Law, capital surplus may only be used to offset a deficit. However, capital surplus generated from the issue price in excess of the par value of capital stock, including the stock issued for new capital and the buyback of treasury stock, may be transferred to capital as stock dividends, and this transfer is restricted to a certain percentage of the capital surplus and may be made only within prescribed limits each time. Capital surplus generated from adjustments due to investee's equity is restricted to be used.

c. Appropriation of earnings and dividend policy

The Corporation's Articles of Incorporation provide that, under the board of directors' resolution, annual net income (less any deficit and 10% as legal reserve) less special reserve based on relevant laws and regulations and any portion decided to be retained plus unappropriated earnings of prior years should be distributed as follows:

1) 2%, as remuneration to directors and supervisors;
2) 10% to 20%, as bonus to employees; and
3) The remainder, as dividends.

The Corporation's dividend appropriation is based on its profitability. In addition, since the Corporation is expanding fast, dividends will be appropriated considering the current and future investment environment, capital requirements, domestic and international competition, capital budget plans, shareholders' interests, balance between cash and stock dividends, and the Corporation's long-term financial plans. The board of directors prepares the proposal on annual earnings distribution for the shareholders' approval. Profits may be distributed as cash or stock dividend; however, cash dividends should be at least 10% of total distribution. The Corporation's operating results should also be considered in dividend appropriation.

Legal reserve should be appropriated until the reserve equals the Corporation's paid-in capital. The reserve can only be used to offset an accumulated deficit. When the reserve exceeds 50% of the Corporation's paid-in capital, the excess may be distributed as follows: (a) if the Corporation has no earnings, the excess may be declared as dividends or bonus; and (b) if the Corporation has no deficit, only the excess portion that is over 25% of the Corporation's paid-in capital may be declared as stock dividends.

The appropriation of earnings should be resolved by the shareholders in, and given effect to in the financial statements of, the year following the year of earnings generation.

Under the Imputed Income Tax System, ROC-resident shareholders are allowed tax credits for the income tax paid by the Corporation. Tax credits allocated to shareholders are based on the balance of the imputation credit account (ICA) on the dividend distribution date.

On June 14, 2006 and June 16, 2005, the shareholders approved the Board of Directors' proposal on the appropriation and dividends per share of the 2005 and 2004 earnings, respectively, as follows:

	Appropriation of Earnings		**Dividends Per Share (NT$)**	
	For Fiscal Year 2005	**For Fiscal Year 2004**	**For Fiscal Year 2005**	**For Fiscal Year 2004**
Legal reserve	$ 59,009	$ 34,833	$ -	$ -
Bonus to employees - stock	19,500	18,000	-	-
Bonus to employees - cash	23,000	18,000	-	-
Stock dividends	158,000	90,580	2.99088	2.49380
Cash dividends	210,000	126,812	3.97523	3.49130
Remuneration to directors and supervisors	8,377	5,171	-	-
	$ 477,886	$ 293,396		

Had the above employee bonus and remuneration to directors and supervisors been expensed, the basic EPS after income tax in 2005 and 2004 would have decreased from NT$12.25 to NT$11.20 in 2005 and from NT$9.72 to NT$8.57 in 2004. The shares distributed as bonus to employees were 1,950 thousand and 1,800 thousand as of December 31, 2005 and 2004, respectively. There were 3.73% and 4.97% of the Corporation's total outstanding common shares as of December 31, 2005 and 2004, respectively.

As of January 26, 2007, the date of the accompanying independent auditors' report, the Board of Directors had not resolved the appropriation of the 2006 earnings. Information on earnings appropriation can be assessed through the Market Observation Post System on the Web site of the Taiwan Stock Exchange.

d. Stock options

On May 16, 2003 and October 21, 2003, the Securities and Futures Commission approved the Corporation's Employee Stock Option Plans (the "Plans"), which provided qualified employees with 640 thousand and 1,200 thousand units of option rights, respectively, with each unit representing one common share. The option rights on both plans are valid for three years from the date of issuance and exercisable at certain percentages after the second year of issuance.

Under the Plans, the options are granted at an exercise price equal to the closing price of the Corporation's common shares as shown on the OTC exchange on the grant date. Based on the Plans, the number of outstanding options and exercise prices have been adjusted to reflect the appropriation of dividends.

The changes in outstanding stock options in 2006 and 2005 were as follows:

	2006		2005	
	Outstanding Option Rights (in Thousands)	**Exercise Price (NT$)**	**Outstanding Option Rights (in Thousands)**	**Exercise Price (NT$)**
Beginning balance	615	$10	1,359	$10-15.41
Options granted	(615)	10	(622)	10
Options canceled	-	-	(122)	10
Ending balance	-		615	

As of December 31, 2006, all of the outstanding options had been converted to common stock.

In 2006, stock options consisting of 615 thousand units had been converted to 615 thousand common shares. As a result, there were increases of $6,150 thousand in capital stock.

16. EARNINGS PER SHARE

The numerators and denominators used in computing earnings per share (EPS) were as follows:

	Amounts (Numerator)		Number of Shares (Denominator) (in Thousands)	EPS (NT$)	
	Before Income Tax	**After Income Tax**		**Before Income Tax**	**After Income Tax**
2006					
Basic EPS					
Consolidated income available to common shareholders	$ 1,103,522	$ 1,071,212	70,727	$ 15.60	$ 15.15
Effect of dilutive potential common stock - stock options	-	-	656		
Diluted EPS					
Consolidated income available to common shareholders (including effect of dilutive potential common stock)	$ 1,103,522	$ 1,071,212	71,383	$ 15.46	$ 15.01
2005					
Basic EPS					
Consolidated income available to common shareholders	$ 579,913	$ 590,086	62,568	$ 9.27	$ 9.43
Effect of dilutive potential common stock - stock options	-	-	1,267		
Diluted EPS					
Consolidated income available to common shareholders (including effect of dilutive potential common stock)	$ 579,913	$ 590,086	63,835	$ 9.08	$ 9.24

The average number of shares outstanding for EPS calculation had been adjusted retroactively for the distribution of stock dividends and stock bonuses (see Note 15). The retroactive adjustment caused the basic EPS before income tax and after income tax in 2005 to decrease from NT$12.04 to NT$9.27 and from NT$12.25 to NT$9.43, respectively. The diluted of EPS before income tax and after income tax in 2005 from NT$11.08 to NT$9.08 and from NT$12.01 to NT$9.24, respectively.

17. FINANCIAL INSTRUMENTS

a. Fair value

	December 31			
	2006		2005	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Nonderivative financial instruments				
Assets				
Cash and cash equivalents	$ 1,306,098	$ 1,306,098	$ 779,908	$ 779,908
Financial assets at fair value through profit or loss - current	150,129	150,129	-	-
Notes and accounts receivable	2,164,263	2,164,263	1,105,868	1,105,868
Restricted assets	29,017	29,017	14,959	14,959
Financial assets carried at cost - noncurrent	20,000		24,650	
Guarantee deposits paid	4,988	4,988	41,970	41,970
Liabilities				
Notes and accounts payable	2,649,238	2,649,238	856,260	856,260

Effective January 1, 2006, the Corporation adopted newly issued SFAS No.34 - "Accounting for Financial Instruments"; thus, the derivative financial instruments were not recognized in the 2005 financial statements. Please refer to Note 3 for the description of the cumulative effect of changes in accounting principle and the adjustments in equity as a result of the adoption of SFAS No. 34.

b. The methods and assumptions applied in determining fair values of financial instruments were as follows:

1) Short-term financial instruments - the carrying value reported in the balance sheets is a reasonable basis for estimating fair value because these instruments have short maturities. These instruments included cash and cash equivalents, notes and accounts receivables, restricted assets, notes and accounts payable.

2) Fair values of financial assets at fair value through profit or loss- current were based on their quoted market price.

3) Fair values of financial assets carried at cost- noncurrent have no active market and their fair value cannot be reliably estimated. Thus, the fair values of these financial assets cannot be estimated.

4) For guarantee deposits paid, fair values are estimated at their carrying amount because these deposits do not have specific due dates.

c. The fair values of financial assets and liabilities were not simultaneously determined by quoted prices in active markets and by estimations using valuation methods.

d. The gain was recognized $129 thousand for fair value changes based on of using valuation methods in 2006.

e. The financial assets exposed to fair value interest rate risk amounted to $228,387 thousand and $444,033 thousand as of December 31, 2006 and 2005, respectively. The financial assets exposed to cash flow interest rate risk amounted to $1,106,379 thousand and $390,753 thousand as of December 31, 2006 and 2005, respectively.

f. The interest income on financial assets were not carried at fair value and financial assets at fair value through profit or loss was $12,458 thousand and $6,486 thousand in 2006 and 2005, respectively. The interest expense for financial liabilities was not carried at fair value and financial liabilities at fair value through profit or loss was $642 thousand and $545 thousand in 2006 and 2005, respectively.

g. Financial risks:

1) Market risk

All derivative transactions are used to hedge exchange rate fluctuations of net foreign currency-denominated assets or liabilities. Gains or losses on these hedging instruments are likely to offset the gains or losses on the hedged items. Thus, the market risk is immaterial.

2) Credit risk

Credit risk represents the potential impact on financial assets that the Corporation might encounter if counter-parties or third parties breach the contracts. Other factors that affect financial assets include credit risk concentration, components of financial instruments, contract amount and other receivables. The maximum credit risk exposure of each financial instrument is the same as its carrying value.

3) Liquidity risk

The Corporation has no cash flow risks because it has sufficient operating capital to meet cash needs, and had no forward exchange contracts outstanding as of December 31, 2006. However, as of December 31, 2006, the Corporation had equity instruments without any active market; thus, it expects to have significant liquidity risk.

4) Cash flow interest rate risk.

Due to market interest rate fluctuations, assets and liabilities with floating interest rate will affect cash flows. However, the Corporation had no liabilities with floating interest rate; thus, it expects to have no significant cash flow interest rate risks.

18. RELATED-PARTY TRANSACTIONS

In addition to those disclosed in other notes to the consolidated financial statements, the Corporation and subsidiaries' related-party transactions were as follows:

a. The Corporation's related parties were as follows:

Related Party	Relationship with the Corporation and Subsidiaries
Toshiba Corporation, Japan ("Toshiba")	Board director
Toshiba Europe Gmbh	Subsidiary of Toshiba
Toshiba International Procurement Hong Kong Ltd.	Subsidiary of Toshiba
Toshiba Of Canada Limited	Subsidiary of Toshiba
Toshiba America Information	Subsidiary of Toshiba
Toshiba Digital Media Network Taiwan Corporation	Subsidiary of Toshiba
Toshiba Electronics Taiwan Corp.	Subsidiary of Toshiba
M-Systems B.V.	Board director
M-Systems Flash Disk Pioneers ("M-Systems")	Parent company of M-Systems B.V.
M-Systems Asia Ltd.	Subsidiary of M-Systems B.V.
TwinSys Data Storage Limited Partnership ("TwinSys")	Subsidiary of M-Systems
Aptos Technology	Investment by the equity method

b. The significant transactions with the related parties are summarized as follows:

The transaction terms and prices for related and third parties were similar.

	2006		2005	
	Amount	%	Amount	%
1) Net sales				
M-Systems	$ 408,790	3	$ 440,204	7
Toshiba Europe Gmbh	146,072	1	101	-
Toshiba International Procurement Hong Kong Ltd.	70,297	1	-	-
M-Systems Asia Ltd.	8,527	-	42,490	1
Other	5,770	-	81,366	1
	$ 639,456	5	$ 564,161	9
2) Purchase				
Toshiba Electronics Taiwan Corp.	$ 2,531,337	24	$ 2,251,734	42
Other	7,071	-	35,449	1
	$ 2,538,408	24	$ 2,287,183	43
3) Royalty expenses (included in sales expenses)				
M-Systems	$ 33,011	23	$ 25,552	28
4) Processing expenses (included in manufacture expenses)				
Aptos Technology	$ 64,287	5	$ -	-

	December 31			
	2006		2005	
	Amount	%	Amount	%
5) Notes and accounts receivable				
M-Systems	$ 36,165	2	$ 65,979	6
Other	8,183	-	2,333	-
	$ 44,348	2	$ 68,312	6
6) Notes and accounts payable				
Toshiba Electronics Taiwan Corp.	$ 342,178	13	$ 223,638	26
Other	23,563	1	4,611	1
	$ 365,741	14	$ 228,249	27
7) Accrued expenses - royalty				
M-Systems	$ 17,350	9	$ 34,225	23

19. PLEDGED ASSETS

The following assets had been pledged or mortgaged as collaterals for bank loans and for the issuance of letters of credit for purchasing materials and as refundable deposits for the Customs Duty Bureau and the court as follows:

	December 31	
	2006	2005
Guarantee deposits paid - certificates of deposits	$ -	$ 40,000
The issuance of L/C for purchasing materials - certificates of deposits	14,000	5,000
Refundable deposits for the Customs Duty Bureau - certificates of deposits	15,017	5,058
Compensating balance - saving accounts	-	4,901
	$ 29,017	$ 54,959

20. SIGNIFICANT COMMITMENTS AND CONTINGENCIES

The Corporation's significant commitments and contingencies as of December 31, 2006 were as follows:

a. The Corporation rents its office under operating lease agreements expiring in April 2008.

As of December 31, 2006, future remaining lease payments were as follows:

Period/Year	Amount
2007	$ 9,482
2008	407
	$ 9,889

b. Unused letters of credit amounted to US$500 thousand and $598,750 thousand.

c. On August 15, 2002, Feiya Technology Corp. ("Feiya," which was renamed Silicon Motion, Inc.) filed a case with the Hsinchu District Court against the Corporation and the Corporation's president, Mr. Pua Khein Seng, and vice president, Mr. Aw Yong Chee Kong, who were former employees of Feiya. Feiya claimed damages of $45,000 thousand for the alleged theft of trade secrets. The Hsinchu District Court rejected this claim because Feiya could not provide evidences for its charge. However, Feiya disagreed with this decision and filed an appeal with the Taiwan High Court on April 26, 2004. On September 22, 2006, the Corporation and Feiya settled this case and agreed to waive the rights on each other. Thus, the Corporation would reverse the litigation loss of $45,000 thousand and recognized this amount as other income. Meanwhile, the Corporation deposited $40,000 thousand as litigation guarantee were returned by the court.

d. In November 2004, the Corporation signed a license agreement on pen drive products with M-Systems. Under this agreement, the Corporation should pay M-Systems royalties and commissions at a percentage of net sales over six years.

e. On February 21, 2006, the Corporation received a formal complaint from Carry Computer Eng Co., Ltd. ("Carry") on its product, a UFD with display which can show the density and related data. Carry claimed that the Corporation, the Corporation's president and engineers infringed Carry's copyright, reneged, and accessed Carry's trade secrets.

   The Corporation believes that Carry's charges are groundless because of the following reasons:

   1) There is no evidence that the information in question is Carry's copyrighted or trade secret.

   2) The product concept in question was presented by Carry during the 2005 Cebit Show held in Germany.

   3) Carry is not an inventor of the product in question. In addition, many inventions are posted on the patent database, which the public, including the Corporation, can research and use as basis for making its own products.

   4) The Corporation has the same kind of product, but this product is based on a different technology.

   In addition, the Corporation's shipped less than 10 thousand units of the product; thus, the Corporation believes the complaint would not have material effect on the Corporation's financial statements.

f. In 2005, Fineart Technology Co., Ltd. ("Fineart") alleged that Pen Mail, a USB (universal serial bus)-enhancing software developed by the Corporation for a client, infringed the patent on Fineart's product, Flash Mail. Fineart filed a lawsuit and claimed $20,000 thousand as damages. The case was settled and Fineart and the Corporation agreed to waive the rights to each other on January 25, 2007. The result have no material effect on the Corporation's financial statements and operations.

21. ADDITIONAL DISCLOSURES

Following are the additional disclosures required by the Securities and Futures Bureau for the Corporation and its investees:

a. Financing provided: None

b. Endorsement/guarantee provided: None

c. Marketable securities held: Table 1 (attached)

d. Marketable securities acquired and disposed of at costs or prices of at least $100 million or 20% of the paid-in capital: Table 2 (attached)

e. Acquisition of individual real estate at costs of at least $100 million or 20% of the paid-in capital: None

f. Disposal of individual real estate at prices of at least $100 million or 20% of the paid-in capital: None

g. Total purchases from or sales to related parties amounting to at least $100 million or 20% of the paid-in capital: Table 3 (attached)

h. Receivables from related parties amounting to at least $100 million or 20% of the paid-in capital: None

i. Names, locations, and related information of investees on which the Corporation exercised significant influence: Table 4 (attached)

j. Derivative transactions: Notes 5 and 17 to the financial statements

k. Investment in Mainland China: None

22. SEGMENT INFORMATION

a. Industry information

The Operates Inside and Outside the ROC	2006 Electronics Department	Investment Department	Adjustments and Elimination	Consolidated
Segment revenue from unaffiliated customers	$ 12,451,974	$ -	$ -	$ 12,451,974
Segment operating income	$ 1,152,451	$ (24)	$ -	$ 1,152,427
Nonoperating income and gains				75,835
Nonoperating expenses and losses				124,740
Income before income tax				$ 1,103,522
Identifiable assets	$ 5,662,912	$ 20,189	$ -	$ 5,683,101
Long-term investments				105,580
Total assets				$ 5,788,681
Depreciation and amortization				$ 40,089
Capital expenditure				$ 66,486

b. Geographic information

As of December 31, 2006, the Corporation and subsidiaries had no revenue-generating operating unit outside the Republic of China.

c. Export sales

Geographic Area	2006	2005
Asia	$ 2,757,240	$ 1,488,276
Europe	2,589,224	1,326,697
United States	1,970,553	1,060,916
Australia	13,018	2,641
Africa	7,115	-

d. Major customer

Sales to a customer accounting for at least 10% of the Corporation and subsidiaries' total sales were as follows:

	2006		2005	
Customer	**Amount**	**%**	**Amount**	**%**
A	$ 1,842,669	15	$ 682,418	11

TABLE 1

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

MARKETABLE SECURITIES HELD
DECEMBER 31, 2006
(In Thousands of New Taiwan Dollars)

Holding Company Name	Marketable Securities Type and Issuer	Relationship with the Holding Company	Financial Statement Account	December 31, 2006				Note
				Shares or Units (Thousands)	Carrying Value	Percentage of Ownership	Market value or Net Asset Value	
Phison Electronics Corp.	Beneficiary certificate							
	ABN AMRO Bond Fund	-	Financial assets at fair value through profit or loss	1,328	$ 20,017	-	$ 20, 017	Note 2
	ABN AMRO Select Bond Fund	-	Financial assets at fair value through profit or loss	3,532	40,032	-	40,032	Note 2
	Fuh-Hwa Bond Fund	-	Financial assets at fair value through profit or loss	2,253	30,029	-	30,029	Note 2
	Kirin Bond Fund	-	Financial assets at fair value through profit or loss	1,808	20,018	-	20,018	Note 2
	HSBC Fuh-Tai Bond Fund	-	Financial assets at fair value through profit or loss	1,348	20,017	-	20,017	Note 2
	Maga Diamond Bond Fund	-	Financial assets at fair value through profit or loss	1,740	20,016	-	20,016	Note 2
	Common stock							
	Lian Xu Dong Investment Corp.	Subsidiary	Investments accounted for by the equity method	2,000	20,189	100.00	20,189	Note 3
	Aptos Technology	Investment by the equity method	Investments accounted for by the equity method	7,597	85,580	18.09	85,580	Note 4
	Trison Technology Corporation	-	Financial assets carried at cost - noncurrent	2,000	20,000	11.76	18,602	Note 3

Note 1: The Corporation held marketable securities that had not been guaranteed, pledged or mortgaged as collaterals or restricted by other commitments.

Note 2: The calculation of market value of beneficiary certificate was based on the net asset value of the fund as of December 31, 2006.

Note 3: The calculation of the net asset value was based on the investee's most recent financial statements, which had not been audited.

Note 4: The calculation of the net asset value was based on the investee's most recent financial statements, which had been audited.

TABLE 2

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

MARKETABLE SECURITIES ACQUIRED AND DISPOSED OF AT COSTS OR PRICES OF AT LEAST NT$100 MILLION OR 20% OF THE PAID-IN CAPITAL
YEAR ENDED DECEMBER 31, 2006
(In Thousands of New Taiwan Dollars)

Company Name	Marketable Securities Type and Issuer	Financial Statement Account	Counter-party	Nature of Relationship	Beginning Balance		Acquisition		Disposal				Ending Balance	
					Units (Thousands)	Amount	Units (Thousands)	Amount	Units (Thousands)	Amount	Carrying Value	Gain on Disposal	Units (Thousands)	Amount
Phison Electronics Corp.	Beneficiary certificate													
	ABN AMRO Bond Fund	Financial assets at fair value through profit or loss	-	-	-	$ -	10,024	$ 150,000	8,696	$ 130,140	$ 130,000	$ 140	1,328	$ 20,017 (Note)
	Ta Chong Bond Fund	Financial assets at fair value through profit or loss	-	-	-	-	7,771	100,000	7,771	100,298	100,000	298	-	-
	NITC Bond Fund	Financial assets at fair value through profit or loss	-	-	-	-	737	120,000	737	120,278	120,000	278	-	-
	Fuh-Hwa Bond Fund	Financial assets at fair value through profit or loss	-	-	-	-	9,074	120,000	6,821	90,182	90,000	182	2,253	30,029 (Note)

Note: The amount included the revaluation gain or loss on financial assets.

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

TOTAL PURCHASE FROM OR SALE TO RELATED PARTIES AMOUNTING TO AT LEAST NT$100 MILLION OR 20% OF THE PAID-IN CAPITAL
YEAR ENDED DECEMBER 31, 2006
(In Thousands of New Taiwan Dollars)

Company Name	Related Party	Nature of Relationship	Transaction Details				Abnormal Transaction		Notes/Accounts Payable or Receivable		Note
			Purchase (Sale)	Amount	% to Total	Payment Terms	Unit Price	Payment Terms	Ending Balance	% to Total	
Phison Electronics Corp.	Toshiba Electronics Taiwan Corp.	Subsidiary of a corporate member of the Corporation's board of directors	Purchase	$ 2,531,337	24	Net 30 days after monthly closing	None	None	$ (342,178)	(13)	-
	M-Systems Flash Disk Pioneers Ltd.	Parent company of a corporate member of the Corporation's board of directors	Sales	(408,790)	3	Net 30 days after monthly closing	None	None	36,165	2	-
	Toshiba Europe Gmbh	Subsidiary of a corporate member of the Corporation's board of directors	Sales	(146,072)	1	Net 30 days after monthly closing	None	None	3,261	-	-

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

NAMES, LOCATIONS, AND OTHER INFORMATION OF INVESTEES ON WHICH THE COMPANY EXERCISES SIGNIFICANT INFLUENCE
YEAR ENDED DECEMBER 31, 2006
(In Thousands of New Taiwan Dollars)

Investor	Investee	Location	Main Businesses and Products	Investment Amount		Balance as of December 31, 2006			Net Income of the Investee	Investment Income	Note
				December 31, 2006	December 31, 2005	Shares (Thousands)	Percentage of Ownership	Carrying Value			
Phison Electronics Corp.	Lian Xu Dong Investment Corp.	Hsinchu, Taiwan	Investment	$ 20,000	$ 20,000	2,000	100.00	$ 20,189	$ 218	$ 226 (Note 1)	Subsidiary
	Aptos Technology	Miaoli, Taiwan	Memory card assembly and test flash application	79,320	-	7,597	18.09	85,580	32,883	5,698 (Note 2)	Investment by the equity method

Note 1: The calculated of Lian Xu Dong's carrying value was based on the investee's most recent financial statements, which had not been audited.

Note 2: The calculated of Apto's carrying value was based on the investee's most recent financial statements, which had been audited.