Phison Electronics Corp. and Subsidiaries

Consolidated Financial Statements for the Years Ended December 31, 2007 and 2006 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, 2007 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, 2007, 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

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EN MIN JOW
Chairman

February 15, 2008

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, 2007 and 2006, 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 consolidated 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, 2007 and 2006, 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 stated 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.

February 15, 2008

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, 2007 AND 2006
(In Thousands of New Taiwan Dollars, Except Par Value)

ASSETS	2007 Amount	2007 %	2006 Amount	2006 %
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 4)	$ 2,767,961	36	$ 1,306,098	23
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)	1,790,740	23	2,119,915	36
Related parties (Note 18)	47,401	1	44,348	1
Inventories, net (Notes 2 and 7)	1,783,098	23	1,498,852	26
Deferred income tax assets - current (Notes 2 and 13)	169,999	2	132,760	2
Restricted assets (Note 19)	10,253	-	29,017	-
Other	269,460	3	225,259	4
Total current assets	6,838,912	88	5,506,378	95
LONG-TERM INVESTMENTS				
Investments accounted for by the equity method (Notes 2 and 9)	246,870	3	85,580	2
Financial assets carried at cost - noncurrent (Notes 2 and 8)	49,300	1	20,000	-
Total long-term investments	296,170	4	105,580	2
PROPERTIES (Notes 2 and 10)				
Cost				
Land	180,000	3	-	-
Testing equipment	85,355	1	37,311	1
Office equipment	8,737	-	7,496	-
Leasehold improvements	2,588	-	17,636	-
Other equipment	2,024	-	2,902	-
Total cost	278,704	4	65,345	1
Less: Accumulated depreciation	35,772	1	28,737	1
	242,932	3	36,608	-
Construction in progress	287,243	4	-	-
Prepayment for land and equipment	4,972	-	41,009	1
Net properties	535,147	7	77,617	1
INTANGIBLE ASSETS (Notes 2, 11 and 20)	75,577	1	91,435	2
OTHER ASSETS				
Guarantee deposits paid	6,712	-	4,988	-
Deferred income tax assets - noncurrent (Notes 2 and 13)	121	-	242	-
Miscellaneous (Notes 2 and 12)	3,703	-	2,441	-
Total other assets	10,536	-	7,671	-
TOTAL	$ 7,756,342	100	$ 5,788,681	100

LIABILITIES AND SHAREHOLDERS' EQUITY	2007 Amount	2007 %	2006 Amount	2006 %
CURRENT LIABILITIES				
Notes and accounts payable				
Third parties	$ 1,041,550	13	$ 2,283,497	40
Related parties (Note 18)	1,369,446	18	365,741	6
Income tax payable (Notes 2 and 13)	111,670	2	86,455	2
Accrued expenses (Note 18)	208,020	3	182,699	3
Other	29,059	-	23,164	-
Total current liabilities	2,759,745	36	2,941,556	51
Total liabilities	2,759,745	36	2,941,556	51
SHAREHOLDERS' EQUITY (Note 15)				
Capital stock - NT$10.00 par value				
Authorized - 130,000 thousand shares in 2007 and 100,000 thousand shares in 2006				
Issued and outstanding - 101,180 thousand shares in 2007 and 72,577 thousand shares in 2006	1,011,802	13	725,771	13
Capital surplus				
Additional paid-in capital	1,767,962	23	722,962	12
From long-term investment	4,517	-	562	-
Total capital surplus	1,772,479	23	723,524	12
Retained earnings				
Legal reserve	235,243	3	128,122	2
Unappropriated retained earnings	1,977,073	25	1,269,708	22
Total retained earnings	2,212,316	28	1,397,830	24
Total shareholders' equity	4,996,597	64	2,847,125	49
TOTAL	$ 7,756,342	100	$ 5,788,681	100

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

(With Deloitte & Touche audit report dated February 15, 2008)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

NONCONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2007 AND 2006
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2007		2006	
	Amount	**%**	**Amount**	**%**
OPERATING REVENUE (Notes 2 and 18)				
Gross sales	$20,322,964	101	$12,533,007	101
Less: Sales returns and allowances	138,745	1	134,322	1
Net sales	20,184,219	100	12,398,685	100
Service revenue	73,972	-	53,289	-
Total operating revenue	20,258,191	100	12,451,974	100
OPERATING COSTS (Notes 14 and 18)	17,956,828	89	10,746,618	86
GROSS PROFIT	2,301,363	11	1,705,356	14
OPERATING EXPENSES (Notes 14 and 18)				
Marketing	191,255	1	140,249	1
General and administrative	135,194	-	72,715	1
Research and development	390,276	2	339,965	3
Total operating expenses	716,725	3	552,929	5
OPERATING INCOME	1,584,638	8	1,152,427	9
NONOPERATING INCOME AND GAINS				
Equity in net gain of investees (Notes 2 and 9)	45,376	1	5,698	-
Interest income	24,519	-	12,458	-
Foreign exchange gains, net (Note 2)	8,673	-	7,115	-
Gains on disposal of investments, net (Notes 2 and 5)	3,140	-	3,517	-
Other	16,716	-	47,047	1
Total nonoperating income and gains	98,424	1	75,835	1
NONOPERATING EXPENSES AND LOSSES				
Losses on inventory valuation and obsolescence (Notes 2 and 7)	145,583	1	120,590	1
Other	6,940	-	4,150	-
Total nonoperating expenses and losses	152,523	1	124,740	1

(Continued)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

NONCONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2007 AND 2006
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2007		2006	
	Amount	**%**	**Amount**	**%**
CONSOLIDATED INCOME BEFORE INCOME TAX	$ 1,530,539	8	$ 1,103,522	9
INCOME TAX EXPENSE (Notes 2 and 13)	135,986	1	32,310	-
CONSOLIDATED NET INCOME	$ 1,394,553	7	$ 1,071,212	9
ATTRIBUTED TO SHAREHOLDERS OF THE PARENT	$ 1,394,553	7	$ 1,071,212	9

	2007		2006	
	Before Income Tax	**After Income Tax**	**Before Income Tax**	**After Income Tax**
EARNINGS PER SHARE (Note 16)				
Basic	$ 15.53	$ 14.15	$ 11.91	$ 11.56
Diluted	$ 15.50	$ 14.12	$ 11.80	$ 11.46

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

(With Deloitte & Touche audit report dated February 15, 2008) (Concluded)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2007 AND 2006
(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, 2006	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
Appropriation of the 2006 earnings									
Legal reserve	-	-	-	-	-	107,121	(107,121)	-	-
Bonus to employees - stock	1,830	18,300	-	-	-	-	(18,300)	(18,300)	-
Bonus to employees - cash	-	-	-	-	-	-	(40,000)	(40,000)	(40,000)
Stock dividends - NT$2.84329 per share	21,773	217,731	-	-	-	-	(217,731)	(217,731)	-
Cash dividends - NT$3.79106 per share	-	-	-	-	-	-	(290,309)	(290,309)	(290,309)
Remuneration to directors and supervisors	-	-	-	-	-	-	(11,558)	(11,558)	(11,558)
Balance after appropriation	96,180	961,802	722,962	562	723,524	235,243	584,689	819,932	2,505,258
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	-	-	-	3,955	3,955	-	(2,169)	(2,169)	1,786
Issuance of capital stock as of June 14, 2007 - NT$214 per share	4,000	40,000	816,000	-	816,000	-	-	-	856,000
Issuance of capital stock as of October 31, 2007 - NT$239 per share	1,000	10,000	229,000	-	229,000	-	-	-	239,000
Consolidated net income in 2007	-	-	-	-	-	-	1,394,553	1,394,553	1,394,553
BALANCE, DECEMBER 31, 2007	101,180	$1,011,802	$1,767,962	$4,517	$1,772,479	$235,243	$1,977,073	$2,212,316	$4,996,597

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

(With Deloitte & Touche audit report dated February 15, 2008)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2007 AND 2006
(In Thousands of New Taiwan Dollars)

	2007	**2006**
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income	$ 1,394,553	$ 1,071,212
Adjustments to reconcile net income to net cash provided by operating activities:		
Losses on inventory valuation and obsolescence	145,583	120,590
Amortization	45,953	26,633
Equity in net gain of investees	(45,376)	(5,698)
Depreciation	22,091	13,456
Deferred income tax	(37,118)	(80,528)
Allowance for doubtful accounts	5,391	13,308
Loss (gain) on disposal of properties, net	4,073	(3)
Donation of shares of an equity-method investee	372	-
Gain on disposal of intangible assets	(197)	-
Gain on disposal of financial assets carried at cost - noncurrent	-	(2,139)
Net changes in operating assets and liabilities		
Financial assets at fair value through profit or loss - current	150,129	(150,129)
Notes and accounts receivable	320,731	(1,071,703)
Inventories	(429,829)	(981,659)
Other current assets	(46,176)	(107,047)
Notes and accounts payable	(238,242)	1,792,978
Income tax payable	25,215	66,901
Accrued expenses	25,321	34,955
Other current liabilities	4,344	(50,897)
Accrued pension cost	(1,262)	(2,066)
Net cash provided by operating activities	1,345,556	688,164
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of properties	(482,143)	(66,486)
Increase in investments accounted for by the equity method	(114,500)	(79,320)
Increase in financial assets carried at cost - noncurrent	(29,300)	-
Increase in intangible assets	(28,123)	(51,678)
Decrease (increase) in restricted assets	18,764	(14,058)
(Increase) decrease in refundable deposits	(1,724)	36,982
Proceeds from disposal of intangible assets	200	-
Proceeds from disposal of financial assets carried at cost - noncurrent	-	6,789
Proceeds from disposal of properties	-	24
Net cash used in investing activities	(636,826)	(167,747)

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PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2007 AND 2006
(In Thousands of New Taiwan Dollars)

	2007	2006
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds of the issuance of capital stock	$ 1,095,000	$ 241,000
Cash dividends	(290,309)	(210,000)
Cash remuneration to directors and supervisors and bonus to employees	(51,558)	(31,377)
Proceeds from exercise of stock options	-	6,150
Net cash provided by financing activities	753,133	5,773
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,461,863	526,190
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,306,098	779,908
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 2,767,961	$ 1,306,098
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 174	$ 642
Income tax paid	$ 141,744	$ 52,084
CASH INVESTING AND FINANCING ACTIVITIES		
Increase in properties	$ 483,694	$ 61,710
Decrease (increase) in payables to contractors and equipment suppliers (included in other current liabilities)	(1,551)	4,776
Acquisition of properties	$ 482,143	$ 66,486

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

(With Deloitte & Touche audit report dated February 15, 2008) (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, 2007 and 2006, the Corporation and subsidiaries had 355 and 273 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, impairment loss on assets and amortization of intangible assets, 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, 2007 have been prepared in accordance with the 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		Description
			2007	2006	
The Corporation	Lian Xu Dong Investment Corp.	Investment	100%	100%	-

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, and those assets held primarily for trading purposes or to be realized, sold or consumed within one year from the balance sheet date. All other assets such as property, plant and equipment and intangible assets are classified as noncurrent. Current liabilities are obligations incurred for trading purposes or to be settled within one year from the balance sheet date. All other 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 are financial assets or liabilities held for trading and those designated on initial recognition to be measured at fair value, with fair value changes recognized as profit or loss. On initial recognition, the financial instruments are recognized at fair value, and transaction costs are recognized as expense. When the instruments are remeasured at fair value, the fair value changes are recognized as profit or loss. On financial instrument disposal, the difference between the purchase or selling price and book value of the financial instrument is recognized as profit or loss. A regular 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. If the fair value of the derivative is a positive amount, the derivative is recognized as a financial asset; otherwise, 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, taking into account sales discounts agreed on by the Corporation and its customers. 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 - unlisted stocks, emerging-market stock, 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 on investees' earnings attributable to periods before the purchase of the 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 in the same accounting period as that of the Corporation. 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 and betterments are capitalized, while maintenance and repairs are expensed currently.

Depreciation is calculated using the straight-line method over service lives estimated as follows: testing equipment, 3 to 6 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, trademarks, technology license fee and the costs of acquiring computer software, are amortized using the straight-line method over 1 to 6 years.

Asset Impairment

If the carrying value of assets (including properties, intangible assets 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. Investments in which the Corporation has significant influence over investees are tested for impairment separately at their carrying amounts. Any subsequent reversal of the impairment loss due to the increase in recoverable amount is recognized as income. However, the increased carrying amount should not exceed the carrying amount that would have been determined, net of amortization or depreciation, had no impairment loss been recognized.

Stock-based Compensation

Employee stock option plans with a grant or amendment date on or after January 1, 2004 is accounted for under the interpretations issued by the Accounting Research and Development Foundation (“ARDF”). The Company adopted the intrinsic value method, under which compensation cost is recognized on a straight-line basis over the vesting year.

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 nonderivative foreign-currency transactions 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 exchange rates used in currency translation are based on the average of the buying and selling rates of major banks.

Reclassification

Certain accounts in the consolidated financial statements as of and for the year ended December 31, 2006 have been reclassified to be consistent with the presentation of consolidated financial statements as of and for the year ended December 31, 2007.

3. ACCOUNTING CHANGES

Effective January 1, 2006, the Corporation and subsidiaries 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. These accounting changes had no effect on the consolidated income for the year ended December 31, 2006.

Starting on January 1, 2006, the Corporation and subsidiaries 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 for the year ended December 31, 2006.

4. CASH AND CASH EQUIVALENTS

	December 31	
	2007	**2006**
Cash on hand	$ 185	$ 176
Savings accounts	567,243	563,627
Certificates of deposits	384,034	90,063
Foreign savings accounts	1,335,603	542,753
Checking accounts	685	173
Short-term bills and bonds acquired under repurchase agreements	480,211	109,306
	$ 2,767,961	$ 1,306,098

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

Financial instruments held for trading are summarized as follows:

	December 31, 2006
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 forward exchange contracts had matured as of December 31, 2007 and 2006.

On the financial instruments held for trading in the years ended December 31, 2007 and 2006, net gains on financial assets were $3,247 thousand and $1,593 thousand, respectively, and net losses on financial liabilities were $107 thousand and $214 thousand, respectively.

6. NOTES AND ACCOUNTS RECEIVABLE - THIRD PARTIES

	December 31	
	2007	2006
Notes receivable	$ 1,609	$ 26,431
Accounts receivable	1,816,529	2,115,612
	1,818,138	2,142,043
Less: Allowance for doubtful accounts	27,398	22,128
	$ 1,790,740	$ 2,119,915

The factored accounts receivable in the year ended December 31, 2007 and 2006 were as follows:

Factor	Factored Amount	Settle Amount	Prepayment	Discounting Rate (%)	Factor's Limit
2007					
Standard Chartered Bank	$ 14,725	$ 11,228	$ 3,497	5.3858-6.3583	US$2,000 thousand
2006					
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	
	2007	2006
Finished goods	$ 16,917	$ 20,682
Semifinished goods	452,072	223,015
Work in process	171,562	438,334
Raw materials	1,465,959	1,010,012
	2,106,510	1,692,043
Less: Allowance for inventory valuation and obsolescence losses	323,412	193,191
	$ 1,783,098	$ 1,498,852

8. FINANCIAL ASSETS CARRIED AT COST - NONCURRENT

	December 31	
	2007	2006
Common stock - unlisted stocks	$ 42,700	$ 20,000
Foreign beneficiary certificate	6,600	-
	$ 49,300	$ 20,000

These stocks and beneficiary certificate were measured at cost because they had no active market and their fair value could not be reliably measured.

9. INVESTMENTS ACCOUNTED FOR BY THE EQUITY METHOD

	December 31			
	2007		2006	
	Carrying Amount	% of Owner-ship	Carrying Amount	% of Owner-ship
Unlisted stocks				
Aptos Technology	$ 186,912	19.89	$ 85,580	18.09
Flexmedia Electronics Corporation	59,958	30.00	-	-
	$ 246,870		$ 85,580	

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 November 2007, the Corporation and Wintek Corp., a TFT-LCD panel manufacturer, jointly established Flexmedia Electronics Corporation, which researches, develops, produces and sells high-tech multimedia products.

In September 2006, the Investment Commission of the Ministry of Economic Affairs (MOEA) authorized the Corporation to invest in Dong Ke Hong Technology (Shenzhen). As of December 31, 2007, the Corporation had not remitted out any capital. Under MOEA regulations, if the Corporation does not remit out any capital within one year from the authorization date, the authorization loses its validity.

The investment gain and loss recognized by the equity-method in the year ended December 31, 2007 and 2006 were summarized as follows:

	2007	2006
Aptos Technology	$ 45,418	$ 5,698
Flexmedia Electronics Corporation	(42)	-
	$ 45,376	$ 5,698

As of December 31, 2007 and 2006, the carrying value of the above equity-method investment was determined on the basis of the investees' audited financial statement.

10. PROPERTIES

	December 31	
	2007	2006
Accumulated depreciation		
Testing equipment	$ 27,976	$ 15,909
Office equipment	4,681	3,360
Leasehold improvements	2,161	8,134
Other equipment	954	1,334
	$ 35,772	$ 28,737

11. INTANGIBLE ASSETS

	December 31	
	2007	2006
Computer softwares	$ 45,804	$ 54,370
Royalty	25,943	33,505
Patents	2,793	1,845
Technology license fee	1,037	1,659
Trademarks	-	56
	$ 75,577	$ 91,435

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 $9,074 thousand and $6,589 thousand in the years ended December 31, 2007 and 2006, 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 basic salary or wage of the year 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 Bank of Taiwan (the Central Trust of China merged with the Bank of Taiwan in July 2007, with the Bank of Taiwan as the survivor entity) in the committee's name. As of December 31, 2007 and 2006, the pension fund balances were $9,892 thousand and $8,179 thousand, respectively.

Defined benefit pension information is summarized as follows:

a. Pension cost

	2007	2006
Service cost	$ 249	$ 187
Interest cost	214	196
Expected return on plan assets	(225)	(159)
Amortization	29	1
Net pension cost	$ 267	$ 225

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

	December 31	
	2007	2006
Benefit obligation		
Vested	$ -	$ -
Non-vested	(5,226)	(3,013)
Accumulated	(5,226)	(3,013)
Additional benefits based on future salaries	(6,753)	(2,701)
Projected benefit obligation	(11,979)	(5,714)
Fair value of plan assets	9,892	8,179
Funded status	(2,087)	2,465
Unrecognized net transitional obligation	642	671
Unrecognized net loss (gain)	5,148	(695)
Prepaid pension cost	$ 3,703	$ 2,441
Vested benefits	$ -	$ -

c. Actuarial assumptions

	2007	2006
Discount rate used in determining present values	3.50%	3.75%
Future salary increase rate	4.00%	3.00%
Expected rate of return on plan assets	2.75%	2.75%

13. INCOME TAX

The Basic Income Tax Act (BITA) took effect on January 1, 2006. Based on the BITA, basic income is the sum of the taxable income under the Income Tax Law, plus tax-exempt income 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 or the income tax payable the Income Tax Law. BITA had no effect on the tax liabilities in the years ended December 31, 2007 and 2006.

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

	2007	2006
Income tax on pretax income at statutory rate (25%)	$ 382,641	$ 275,871
Add (deduct) tax effects of		
Permanent difference	(11,803)	(2,414)
Temporary difference	31,450	30,593
Tax-exempt income	(97,707)	(158,060)
Additional 10% tax on unappropriated earnings	38,619	11,220
Investment tax credits	(171,589)	(78,605)
Current income tax payable	$ 171,611	$ 78,605

b. Income tax expense consisted of:

Current income tax payable	$ 171,611	$ 78,605
Deferred income tax	(37,118)	(80,528)
Adjustments to prior year's taxes	1,493	34,233
Income tax expense	$ 135,986	$ 32,310

c. Deferred income tax assets consisted of:

	December 31	
	2007	2006
Current		
Investment tax credits	$ 86,559	$ 78,605
Allowance for inventory valuation and obsolescence losses	80,852	48,298
Allowance for doubtful accounts	2,186	2,319
Foreign exchange loss, net	271	3,352
Other	131	186
	169,999	132,760
Less: Valuation allowance	-	-
	$ 169,999	$ 132,760
Noncurrent		
Investment tax credits	$ -	$ 42,356
Other	121	242
	121	42,598
Less: Valuation allowance	-	42,356
	$ 121	$ 242

The effective tax rate used for computing deferred income tax assets on December 31, 2007 and 2006 was 25%.

d. As of December 31, 2007, investment tax credits were as follows:

Regulatory Basis of Tax Credits	Items	Total Creditable Amount	Remaining Creditable Amount	Expiry Year
Statute for Upgrading Industries	Research and development expenditures	$ 100,551	$ 86,559	2011

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
Third expansion and construction of the Corporation's factories	February 28, 2006 to February 27, 2011
Fourth expansion and construction of the Corporation's factories	August 10, 2007 to August 9, 2012

f. Integrated income tax information was as follows:

	December 31	
	2007	2006
Balance of imputation credit account (ICA):		
The Corporation	$ 119,695	$ 36,066
Subsidiary - Lian Xu Dong Investment Corp.	$ -	$ -

The creditable ratio for distribution of earnings of 2007 and 2006 was 10.86% (estimate) and 8.33%, respectively.

For distribution of earnings generated after January 1, 1998, the ratio for the imputation credits allocated to shareholders of the Corporation is based on the balance of the ICA as of the date of dividend distribution. The expected creditable ratio for the 2007 earnings may be adjusted, depending on the ICA balance on the date of dividend distribution.

g. As of December 31, 2007, there were no unappropriated earnings generated before January 1, 1998.

h. Income tax returns through 2005 had been examined by the tax authorities. However, the Corporation disagreed with the tax authorities' rejection of the Corporation's claim of a tax-exempt income in its 2005 return. The Corporation will file an appeal for tax authorities to reexamine the 2005 return. In September 2007, the tax authorities modified its assessment of the Corporation's 2002 return. However, the Corporation still disagreed with the modified assessment and filed an appeal for the tax authorities to reexamine the 2002 return. The Corporation believed that any tax liabilities would not be material.

14. LABOR COST, DEPRECIATION AND AMORTIZATION EXPENSES

	2007			2006		
	Classified as Operating Cost	Classified as Operating Expense	Total	Classified as Operating Cost	Classified as Operating Expense	Total
Labor cost						
Salary	$ 51,800	$243,727	$295,527	$ 30,018	$160,954	$190,972
Labor and health insurance	3,187	11,254	14,441	2,416	8,204	10,620
Pension cost	2,122	7,219	9,341	1,732	5,082	6,814
Other	10,509	27,099	37,608	6,618	18,274	24,892
	$ 67,618	$289,299	$356,917	$ 40,784	$192,514	$233,298
Depreciation	$ 6,553	$ 15,538	$ 22,091	$ 2,587	$ 10,869	$ 13,456
Amortization	662	45,291	45,953	-	26,633	26,633

15. SHAREHOLDERS' EQUITY

a. Capital

In their meeting on November 1, 2006, the Corporation's shareholders decided to issue up to 13,500 thousand common shares by private place, as follows: (1) on November 2, 2006, the board of directors resolved to issue 2,000 thousand common shares at 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 NT$221,000 thousand, recognized as additional paid-in capital. (2) on April 26, 2007, the board of directors resolved to issue 4,000 thousand common shares at NT$10.00 par value and set June 14, 2007 as the fund raising deadline, with NT$214 as the offering price. This common share issuance was approved by and registered with the government authorities on July 4, 2007. The difference in price between par value and offering price was $816,000 thousand, recognized as additional paid-in capital. (3) on October 12, 2007, the board of directors resolved to issue 1,000 thousand common shares at NT$10.00 par value and set October 31, 2007 as the fund raising deadline, with NT$239 as the offering price. This common share issuance was approved by and registered with the government authorities on November 16, 2007. The difference in price between par value and offering price was $229,000 thousand, recognized as additional paid-in capital.

As of December 31, 2007, the Corporation had 7,000 thousand common shares issued and outstanding. Because the Corporation had no plan to raise capital soon, the Corporation decided to cancel the remain 6,500 thousand authorized common shares, in accordance with the Securities and Exchange Act of the Republic of China.

On January 30, 2008, the board of directors decided to issue upper limit 5,000 thousand common shares by private place. However, this plan had not been resolved by the shareholders meeting.

b. Capital surplus

Under the Company Law, capital surplus may only be used to offset a deficit. However, capital surplus generated from the issue of shares in excess of par value, 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 on long-term equity investments should not be used for any purpose.

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) 1.5%, as remuneration to directors and supervisors;
2) 9% to 14%, as bonus to employees; and
3) The remainder, as dividends.

If the bonus to employees is distributed as stock dividend, the employees of the Corporation must be matched certain specific terms, when the stock dividend be distributed.

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.

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 50% 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 13, 2007 and June 14, 2006, the shareholders approved the Board of Directors' proposal on the appropriation and dividends per share of the 2006 and 2005 earnings, as follows:

	Appropriation of Earnings		**Dividends Per Share (NT$)**	
	For Fiscal Year 2006	**For Fiscal Year 2005**	**For Fiscal Year 2006**	**For Fiscal Year 2005**
Legal reserve	$ 107,121	$ 59,009	$ -	$ -
Bonus to employees - stock	18,300	19,500	-	-
Bonus to employees - cash	40,000	23,000	-	-
Stock dividends	217,731	158,000	2.84329	2.99088
Cash dividends	290,309	210,000	3.79106	3.97523
Remuneration to directors and supervisors	11,558	8,377	-	-
	$ 685,019	$ 477,886		

Had the above employee bonus and remuneration to directors and supervisors been expensed, the basic EPS after income tax in 2006 and 2005 would have decreased from NT$15.15 to NT$14.16 in 2006 and from NT$12.25 to NT$11.20 in 2005. The shares distributed as bonus to employees were 1,830 thousand and 1,950 thousand as of December 31, 2006 and 2005, respectively. There were 2.52% and 3.73% of the Corporation's total outstanding common shares as of December 31, 2006 and 2005, respectively.

As of February 15, 2008, the date of the accompanying independent auditors' report, the Board of Directors had not resolved the appropriation of the 2007 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, consisting of the "first plan" and the "second plan," under which qualified employees obtained 640 thousand units and 1,200 thousand units, respectively, of option rights. On May 23, 2007, the Financial Supervisory Commission, Executive Yuan also approved the Corporation's Employee Stock Option Plan ("the third plan"), under which qualified employees obtained 1,000 thousand units of option rights. For all the plans, each unit represents one commons share, and the option rights 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 2007 and 2006 were as follows:

	2007		2006	
	Number of Option (in Thousands)	**Exercise Price (NT$)**	**Number of Option (in Thousands)**	**Exercise Price (NT$)**
Balance, beginning of year	-	$ -	615	$ 10
Options granted	1,000	176	-	-
Options exercised	-	-	(615)	10
Balance, end of year	1,000		-	

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

The outstanding and exercisable options as of December 31, 2007 were as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Price (NT$)	**Number of Options (in Thousands)**	**Weighted-average Remaining Life (Years)**	**Weighted-average Exercise Price (NT$)**	**Number of Options (in Thousands)**	**Weighted-average Exercise Price (NT$)**
$176	1,000	2.50	$176	-	$ -

No compensation cost was recognized under the intrinsic value method for the years ended December 31, 2007. Had the Company recognized compensation cost based on the fair value method using the Black-Scholes pricing model, the assumptions and pro forma results of the Company would have been as follows:

	Year Ended December 31, 2007
Assumptions	
Risk-free interest rate	2.2%
Expected life	2.50 year
Expected volatility	53.12%
Expected dividend yield	0%
Net income	
As reported	$ 1,394,553
Pro forma	1,393,640
Basic after income tax earnings per share (NT$)	
As reported	$14.15
Pro forma	$14.14
Diluted after income tax earnings per share (NT$)	
As reported	$14.12
Pro forma	$14.11

On November 22, 2007, the board of directors approved the Corporation's Employee Stock Option Plan, under which qualified employees received 500 thousand units of option rights, with each unit representing one common share. This option right is valid for three years from the issuance date, and its exercise price is decided under procedures stated in the plan. On January 3, 2008, the plan was approved by the Financial Supervisory Commission, Executive Yuan. As of February 15, 2008, the date of the accompanying auditors' report, the Corporation's president had not determined the unit issuance date.

e. Treasury stock

On December 25, 2007, the board of directors approved a proposal for the Corporation to buy back 1,500 thousand common shares in the open market for issuance to employees between NT$135 and NT$250 per unit during from December 26, 2007 to February 25, 2008. As of December 31, 2007, however, the Corporation had not made the buyback.

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
2007					
Basic EPS					
Consolidated income available to common shareholders	$ 1,530,539	$ 1,394,553	98,550	$ 15.53	$ 14.15
Effect of dilutive potential common stock - stock options	-	-	200		
Diluted EPS					
Consolidated income available to common shareholders (including effect of dilutive potential common stock)	$ 1,530,539	$ 1,394,553	98,750	$ 15.50	$ 14.12

2006	Amounts (Numerator) Before Income Tax	After Income Tax	Number of Shares (Denominator) (in Thousands)	EPS (NT$) Before Income Tax	After Income Tax
Basic EPS					
Consolidated income available to common shareholders	$ 1,103,522	$ 1,071,212	92,667	$ 11.91	$ 11.56
Effect of dilutive potential common stock - stock options	-	-	842		
Diluted EPS					
Consolidated income available to common shareholders (including effect of dilutive potential common stock)	$ 1,103,522	$ 1,071,212	93,509	$ 11.80	$ 11.46

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 consolidated income tax and after consolidated income tax in the year ended December 31, 2006 to decrease from NT$15.60 to NT$11.91 and from NT$15.15 to NT$11.56, respectively. The diluted EPS before consolidated income tax and after consolidated income tax in the year ended December 31, 2006 decreased from NT$15.46 to NT$11.80 and from NT$15.01 to NT$11.46, respectively.

17. FINANCIAL INSTRUMENTS

a. Fair value

	December 31			
	2007		2006	
Nonderivative financial instruments	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Cash and cash equivalents	$ 2,767,961	$ 2,767,961	$ 1,306,098	$ 1,306,098
Financial assets at fair value through profit or loss - current	-	-	150,129	150,129
Notes and accounts receivable	1,838,141	1,838,141	2,164,263	2,164,263
Restricted assets	10,253	10,253	29,017	29,017
Financial assets carried at cost - noncurrent	49,300		20,000	
Guarantee deposits paid	6,712	6,712	4,988	4,988
Liabilities				
Notes and accounts payable	2,410,996	2,410,996	2,649,238	2,649,238
Accrued expenses	208,020	208,020	182,699	182,699

Effective January 1, 2006, the Corporation and subsidiaries 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, and accrued expenses.

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

   3) Financial assets carried at cost-noncurrent have no active market; thus their fair value cannot be reliably 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 $0 and $129 thousand for fair value changes based on of using valuation methods in 2007 and 2006, respectively.

e. The financial assets exposed to fair value interest rate risk amounted to $874,498 thousand and $228,387 thousand as of December 31, 2007 and 2006, respectively. The financial assets exposed to cash flow interest rate risk amounted to $1,902,846 thousand and $1,106,379 thousand as of December 31, 2007 and 2006, respectively.

f. 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 and subsidiaries 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 and subsidiaries 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, 2007. However, as of December 31, 2007, the Corporation and subsidiaries 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 and subsidiaries had no liabilities with floating interest rate; thus, it expects to have no significant cash flow interest rate risks.

18. RELATED-PARTY TRANSACTIONS

The Corporation and subsidiaries' related-party transactions were as follows:

a. The Corporation's and subsidiaries' 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 Singapore Pte. Ltd., Computer System Division	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 (merged with Sandisk on March 15, 2007)
M-Systems Flash Disk Pioneers ("M-Systems")	Parent company of M-Systems B.V. (merged with Sandisk on March 15, 2007)
M-Systems Asia Ltd.	Subsidiary of M-Systems B.V. (merged with Sandisk on March 15, 2007)
TwinSys Data Storage Limited Partnership ("TwinSys")	Subsidiary of M-Systems (merged with Sandisk on March 15, 2007)
Aptos Technology	Equity method investee (since August 31, 2006)
Flexmedia Electronics Corp.	Equity method investee (since November 20, 2007)

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

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

	2007		2006	
	Amount	%	Amount	%
1) Net sales				
Toshiba Corporation, Japan	$ 161,508	1	$ 140	-
M-Systems	-	-	408,790	3
Other	159,379	1	230,526	2
	$ 320,887	2	$ 639,456	5
2) Purchase				
Toshiba Electronics Taiwan Corp.	$ 5,023,465	30	$ 2,531,337	24
Other	3,156	-	7,071	-
	$ 5,026,621	30	$ 2,538,408	24

	2007		2006	
	Amount	%	Amount	%
3) Royalty expenses (included in sales expenses)				
M-Systems	$ 7,803	4	$ 33,011	23
4) Processing expenses (included in manufacture expenses)				
Aptos Technology	$ 255,343	14	$ 64,287	5

	December 31			
	2007		2006	
	Amount	%	Amount	%
5) Notes and accounts receivable				
Toshiba Corporation, Japan	$ 22,038	1	$ -	-
M-Systems	-	-	36,165	2
Other	25,363	2	8,183	-
	$ 47,401	3	$ 44,348	2
6) Notes and accounts payable				
Toshiba Electronics Taiwan Corp.	$ 1,324,803	55	$ 342,178	13
Aptos Technology	44,643	2	23,563	1
	$ 1,369,446	57	$ 365,741	14
7) Accrued expenses - royalty				
M-Systems	$ -	-	$ 17,350	9

19. PLEDGED ASSETS

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

	December 31	
	2007	2006
Refundable deposits for the Customs Duty Bureau - certificates of deposits	$ 10,253	$ 15,017
The issuance of L/C for purchasing materials - certificates of deposits	-	14,000
	$ 10,253	$ 29,017

20. SIGNIFICANT COMMITMENTS AND CONTINGENCIES

Significant commitments and contingencies as of December 31, 2007 were as follows:

a. The Corporation rents its office under operating lease agreements expiring in February 2010.

   As of December 31, 2007, future remaining lease payments were as follows:

Period/Year	Amount
2008	$ 3,510
2009	2,302
2010	228
	$ 6,040

b. Unused letters of credit amounted to US$3,003 thousand and $1,013,870 thousand.

c. 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.

d. 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.

e. In October 2007, SanDisk Corporation ("Sandisk") filed three complaints of patent infringement in the United States District Court of the Western District of Wisconsin and in the United States International Trade Commission (ITC) against the Corporation.

   1) In the ITC lawsuit filed on October 24, 2007, SanDisk is suing the Corporation for infringement of four SanDisk patents. The ITC will make an investigation.

   2) In the first United States District Court of the Western District of Wisconsin case filed on October 24, 2007, SanDisk is suing the Corporation for infringement of two patents.

   3) In the second United States District Court of the Western District of Wisconsin case filed on October 25, 2007, SanDisk is suing the Corporation for infringement of the same four patents at issue in the ITC complaint.

The Corporation has authorized the U.S. law firm Fish & Richardson P.C. and Whyte Hirschboeck Dudek S.C. to handle these lawsuits. As of February 15, 2008, the date of the accompanying auditors' report, both of the Wisconsin cases are presently stayed, pending the outcome of the ITC investigation. Up to currently, the Corporation believes this case would not have a material effect on the Corporation's financial statements.

f. On January 25, 2008, Uniquestar Electronics Inc. filed a complaint, demanding that the Corporation pay $3,525 thousand, because the Corporation's processing factory went out of business. The district court will investigate this case soon. The Corporation believes this case would not have a material effect on the Corporation's financial statements.

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: None

e. Acquisition of individual real estate at costs of at least $100 million or 20% of the paid-in capital: Table 2 (attached)

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

l. Business relationship between the Corporation and subsidiaries, and significant intercompany transactions: None

22. SEGMENT INFORMATION

a. Industry information

The Operates Inside and Outside the ROC	2007 Electronics Department	2007 Investment Department	2007 Adjustments and Elimination	2007 Consolidated
Segment revenue from unaffiliated customers	$ 20,258,191	$ -	$ -	$ 20,258,191
Segment operating income	$ 1,584,666	$ (28)	$ -	$ 1,584,638
Nonoperating income and gains				98,424
Nonoperating expenses and losses				152,523
Income before income tax				$ 1,530,539
Identifiable assets	$ 7,449,840	$ 10,332	$ -	$ 7,460,172
Long-term investments				296,170
Total assets				$ 7,756,342
Depreciation and amortization				$ 68,044
Capital expenditure				$ 482,143

The Operates Inside and Outside the ROC	2006 Electronics Department	2006 Investment Department	2006 Adjustments and Elimination	2006 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, 2007, the Corporation and subsidiaries had no revenue-generating operating unit outside the Republic of China.

c. Export sales

Geographic Area	2007	2006
Asia	$ 2,942,180	$ 2,757,240
Europe	5,057,139	2,589,224
United States	4,768,585	1,970,553
Australia	110,210	13,018
Other	22,068	7,115

d. Major customer

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

	2007		2006	
Customer	**Amount**	**%**	**Amount**	**%**
A	$ 2,020,968	10	$ 1,842,669	15

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

MARKETABLE SECURITIES HELD
DECEMBER 31, 2007
(In Thousands of New Taiwan Dollars)

Holding Company Name	Marketable Securities Type and Issuer	Relationship with the Holding Company	Financial Statement Account	December 31, 2007				Note
				Shares or Units (Thousands)	Carrying Value	Percentage of Ownership	Market value or Net Asset Value	
Phison Electronics Corp.	Common stock							
	Lian Xu Dong Investment Corp.	Subsidiary	Investments accounted for by the equity method	2,000	$ 20,332	100.00	$ 20,332	Note 2
	Aptos Technology	Investment by the equity method	Investments accounted for by the equity method	12,121	186,912	19.89	186,912	Note 3
	Flexmedia Electronics Corp.	Investment by the equity method	Investments accounted for by the equity method	6,000	59,958	30.00	59,958	Note 3
	Trison Technology Corporation	-	Financial assets carried at cost - noncurrent	2,000	20,000	11.76	20,707	Note 2
	Metison Technologies Corporation	-	Financial assets carried at cost - noncurrent	570	5,700	19.00	5,187	Note 2
	Hycon Technologies Corporation	-	Financial assets carried at cost - noncurrent	700	7,000	7.95	6,387	Note 3
	Foreign beneficiary certificate							
	Jafco Asia Technology Fund IV L.P.	-	Financial assets carried at cost - noncurrent	-	6,600	0.50	6,166	Note 4
Lian Xu Dong Investment Corp.	Common stock							
	Jim-Dandy Technologies Corporation	-	Financial assets carried at cost - noncurrent	1,000	10,000	19.23	10,000	Note 2

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 the net asset value was based on the investee’s financial statements, which had not been audited.

Note 3: The calculation of the net asset value was based on the investee’s financial statements, which had been audited.

Note 4: The calculation of the market value was based on their net assets value as of December 31, 2007.

TABLE 2

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

ACQUISITION OF INDIVIDUAL REAL ESTATE AT COSTS OF AT LEAST NT$100 MILLION OR 20% OF THE PAID-IN CAPITAL
YEAR ENDED DECEMBER 31, 2007
(In Thousands of New Taiwan Dollars)

Company Name	Type of Property	Transaction Date	Transaction Amount	Payment Status	Counter-party	Nature of Relationships	Prior Transaction of Related Counter-party				Price Reference	Purpose of Acquisition	Other Terms
							Owner	Relationship	Transfer Date	Amount			
Phison Electronics Corp.	Land	January 18, 2007	$ 135,000	Full payment	Kuan Yuan Paper MAG. Co., Ltd. and Ms. June Shu Hsieh	-	-	-	-	$ -	Valuation report	For constructing a building	-
	Land	August 20, 2007	45,000	Full payment	Kuan Yuan Paper MAG. Co., Ltd.	-	-	-	-	-	-	For constructing a building	-

TABLE 3

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, 2007
(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	$ 5,023,465	30	Net 30 days after monthly closing	None	None	$ (1,324,803)	(55)	-
	TOSHIBA Corporation, Japan	The Corporation's board of directors	Sale	(161,508)	(1)	Net 30 days after monthly closing	None	None	22,038	1	-

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

NAMES, LOCATIONS, AND OTHER INFORMATION OF INVESTEES ON WHICH THE COMPANY EXERCISES SIGNIFICANT INFLUENCE
YEAR ENDED DECEMBER 31, 2007
(In Thousands of New Taiwan Dollars)

Investor	Investee	Location	Main Businesses and Products	Investment Amount		Balance as of December 31, 2007			Net (Loss) Income of the Investee	Investment (Loss) Income (Note)	Note
				December 31, 2007	December 31, 2006	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	$ 20,332	$ 143	$ 143 (Note 1)	Subsidiary
	Aptos Technology	Miaoli, Taiwan	Memory card assembly and test flash application	133,447	79,320	12,121	19.89	186,912	211,979	45,418 (Note 2)	Investment by the equity method
	Flexmedia Electronics Corp.	Hsinchu, Taiwan	Hihg-tech Multi-Media production R&D, sales and product	60,000	-	6,000	30.00	59,958	(139)	(42) (Note 2)	Investment by the equity method

Note 1: The calculation of the investee carrying value was based on the investee's financial statements, which had not been audited.

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