

Phison Electronics Corp.

Financial Statements as of December 31, 2002 and 2001

Together with Independent Auditors' Report

Readers are advised that the original version of these financial statements is in Chinese. If there is any conflict between these financial statements and the Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail.

English Translation of a Report Originally Issued in Chinese

Independent Auditors' Report

The Board of Directors and Shareholders
Phison Electronics Corp.

We have audited the accompanying balance sheets of Phison Electronics Corp. as of December 31, 2002 and 2001 and the related statements of income, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Phison Electronics Corp. as of December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the Republic of China.

T N Soong & Co
An Associate Member Firm of Deloitte Touche Tohmatsu
Taipei, Taiwan
The Republic of China

February 22, 2003

Notice to Readers

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

English Translation of Financial Statements Originally Issued in Chinese

PHISON ELECTRONICS CORP.

BALANCE SHEETS

December 31, 2002 and 2001

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

<u>A S S E T S</u>	<u>2002</u>		<u>2001</u>		<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>	<u>2002</u>		<u>2001</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>		<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
CURRENT ASSETS					CURRENT LIABILITIES				
Cash and cash equivalents (Notes 2 and 3)	\$ 105,968	23	\$ 6,493	5	Short-term loans	\$ -	-	\$ 10,000	9
Short-term investments (Notes 2 and 4)	10,000	2	14,006	12	Notes payable	3,088	1	17,222	15
Notes receivable	54,613	12	8,958	8	Accounts payable	178,457	39	38,019	32
Accounts receivable - net (Notes 2 and 5)	119,939	26	59,827	51	Income tax payable (Notes 2 and 10)	9,929	2	1,193	1
Inventories - net (Notes 2 and 6)	83,530	18	8,729	7	Accrued expenses and other current liabilities	<u>29,417</u>	<u>6</u>	<u>8,320</u>	<u>7</u>
Pledged certificates of deposits (Note 14)	20,026	4	12,200	11	Total Current Liabilities	<u>220,891</u>	<u>48</u>	<u>74,754</u>	<u>64</u>
Deferred income tax assets (Notes 2 and 10)	2,284	1	2,735	2	SHAREHOLDERS' EQUITY (Note 11)				
Prepaid expenses and other current assets	<u>11,249</u>	<u>3</u>	<u>2,609</u>	<u>2</u>	Capital stock, \$10 par value				
Total Current Assets	<u>407,609</u>	<u>89</u>	<u>115,557</u>	<u>98</u>	Authorized - 12,000 thousand shares				
PROPERTIES (Notes 2 and 7)					Issued - 7,908 thousand and 3,000 thousand shares				
Cost					as of December 31, 2002 and 2001, respectively	79,080	17	30,000	25
Testing equipment	2,582	1	1,050	1	Capital surplus - paid-in capital	73,052	16	-	-
Furniture and fixtures	981	-	550	1	Retained earnings				
Transportation equipment	200	-	200	-	Legal reserve	1,288	-	-	-
Leasehold improvements	750	-	-	-	Unappropriate	<u>85,979</u>	<u>19</u>	<u>12,885</u>	<u>11</u>
Other equipment	<u>3,553</u>	<u>1</u>	<u>212</u>	<u>-</u>	Total retained earnings	<u>87,267</u>	<u>19</u>	<u>12,885</u>	<u>11</u>
Total cost	8,066	2	2,012	2	Total Shareholders' Equity	<u>239,399</u>	<u>52</u>	<u>42,885</u>	<u>36</u>
Accumulated depreciation	<u>1,449</u>	<u>1</u>	<u>363</u>	<u>-</u>					
Net Properties	<u>6,617</u>	<u>1</u>	<u>1,649</u>	<u>2</u>					
OTHER ASSETS									
Refundable deposits (Note 15)	40,818	9	186	-					
Deferred charges - net (Note 2)	<u>5,246</u>	<u>1</u>	<u>247</u>	<u>-</u>					
Total Other Assets	<u>46,064</u>	<u>10</u>	<u>433</u>	<u>-</u>					
TOTAL ASSETS	<u>\$460,290</u>	<u>100</u>	<u>\$117,639</u>	<u>100</u>	TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$460,290</u>	<u>100</u>	<u>\$117,639</u>	<u>100</u>

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

(With T N Soong & Co report dated February 22, 2003)

English Translation of Financial Statements Originally Issued in Chinese

PHISON ELECTRONICS CORP.

STATEMENTS OF INCOME

For the Years Ended December 31, 2002 and 2001

(January 1 to April 30, 2001 - Development Stage)

(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	<u>2002</u>		<u>2001</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
REVENUE				
Gross sales of products (Note 2)	\$ 834,840	100	\$ 139,123	96
Sale returns and allowances (Note 2)	<u>6,575</u>	<u>1</u>	<u>878</u>	<u>1</u>
Net sales	828,265	99	138,245	95
Service revenue	<u>6,737</u>	<u>1</u>	<u>6,964</u>	<u>5</u>
Total Revenue	835,002	100	145,209	100
 COST OF SALES	 <u>686,058</u>	 <u>82</u>	 <u>105,631</u>	 <u>73</u>
GROSS PROFIT	<u>148,944</u>	<u>18</u>	<u>39,578</u>	<u>27</u>
OPERATING EXPENSES				
Selling	8,186	1	2,703	2
General and administrative	16,415	2	8,466	6
Research and development	<u>31,255</u>	<u>4</u>	<u>17,635</u>	<u>12</u>
Total Operating Expenses	<u>55,856</u>	<u>7</u>	<u>28,804</u>	<u>20</u>
OPERATING INCOME	<u>93,088</u>	<u>11</u>	<u>10,774</u>	<u>7</u>
NONOPERATING INCOME				
Interest	1,091	-	127	-
Gain on sales of short-term investments	669	-	1,064	1
Subsidy income (Note 2)	571	-	1,287	1
Gain identified during physical inventory	-	-	431	-
Foreign exchange gain - net (Note 2)	-	-	1,271	1
Other income	<u>913</u>	-	<u>797</u>	<u>1</u>
Total Nonoperating Income	<u>3,244</u>	-	<u>4,977</u>	<u>4</u>
NONOPERATING EXPENSES				
Interest expense	592	-	-	-
Foreign exchange loss - net (Note 2)	2,084	-	-	-
Loss identified during physical inventory	1,636	-	-	-
Losses on decline in value of inventory (Notes 2 and 6)	183	-	233	-
Other expense	<u>2</u>	-	<u>-</u>	<u>-</u>
Total Nonoperating Expenses	<u>4,497</u>	-	<u>233</u>	<u>-</u>

(Forward)

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	<u>2002</u>		<u>2001</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
INCOME BEFORE INCOME TAX	\$ 91,835	11	\$ 15,518	11
INCOME TAX (EXPENSE) BENEFIT (Notes 2 and 10)	(<u>10,481</u>)	(<u>1</u>)	<u>1,530</u>	<u>1</u>
NET INCOME	<u>\$ 81,354</u>	<u>10</u>	<u>\$ 17,048</u>	<u>12</u>
	<u>Before</u>	<u>After</u>	<u>Before</u>	<u>After</u>
	<u>Income</u>	<u>Income</u>	<u>Income</u>	<u>Income</u>
	<u>Tax</u>	<u>Tax</u>	<u>Tax</u>	<u>Tax</u>
EARNINGS PER SHARE (Note 12)				
Basic earnings per share	<u>\$15.78</u>	<u>\$13.98</u>	<u>\$ 4.56</u>	<u>\$ 5.01</u>
Diluted earnings per share	<u>\$15.55</u>	<u>\$13.77</u>	<u>\$ 4.56</u>	<u>\$ 5.01</u>

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

(With T N Soong & Co report dated February 22, 2003)

English Translation of Financial Statements Originally Issued in Chinese

PHISON ELECTRONICS CORP.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2002 and 2001
(January 1 to April 30, 2001 - Development Stage)
(In Thousands of New Taiwan Dollars, Except Per Share Data)

	CAPITAL STOCK ISSUED		DEFICIT IN DEVELOPMENT - STAGE (Note 1)	CAPITAL SURPLUS - PAID-IN CAPITAL	RETAINED EARNINGS			TOTAL SHAREHOLDERS' EQUITY
	Shares (Thousands)	Amount			Legal Reserve	Unappropriated	Total	
BALANCE, JANUARY 1, 2001	3,000	\$30,000	(\$ 4,163)	\$ -	\$ -	\$ -	\$ -	\$ 25,837
Transfer of deficit in development stage	-	-	4,163	-	-	(4,163)	(4,163)	-
Net income in 2001	-	-	-	-	-	17,048	17,048	17,048
BALANCE, JANUARY 1, 2002	3,000	30,000	-	-	-	12,885	12,885	42,885
Issuance of capital stock, March 1, 2002	2,000	20,000	-	-	-	-	-	20,000
Appropriations of prior year's earnings								
Legal reserve	-	-	-	-	1,288	(1,288)	-	-
Stock dividend - 10%	500	5,000	-	-	-	(5,000)	(5,000)	-
Bonus to employees - stock	174	1,740	-	-	-	(1,740)	(1,740)	-
Remuneration to directors and supervisors	-	-	-	-	-	(232)	(232)	(232)
Issuance of capital stock, April 30, 2002	734	7,340	-	20,552	-	-	-	27,892
Issuance of capital stock, December 27, 2002	1,500	15,000	-	52,500	-	-	-	67,500
Net income in 2002	-	-	-	-	-	81,354	81,354	81,354
BALANCE, DECEMBER 31, 2002	<u>7,908</u>	<u>\$79,080</u>	<u>\$ -</u>	<u>\$73,052</u>	<u>\$1,288</u>	<u>\$85,979</u>	<u>\$87,267</u>	<u>\$239,399</u>

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

(With T N Soong & Co report dated February 22, 2003)

English Translation of Financial Statements Originally Issued in Chinese

PHISON ELECTRONICS CORP.

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2002 and 2001

(January 1 to April 30, 2001 - Development Stage)

(In Thousands of New Taiwan Dollars)

	<u>2002</u>	<u>2001</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 81,354	\$ 17,048
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,595	406
Gain on sales of short-term investments	(669)	(1,064)
Loss of decline in value of inventory	183	233
Deferred income tax assets	451	(2,735)
Allowance for doubtful receivables	505	869
Allowance for sales returns and discounts	565	261
Changes in operating assets and liabilities:		
Notes receivable	(45,655)	(8,958)
Accounts receivable	(61,182)	(60,957)
Inventories	(74,984)	(8,962)
Prepaid expenses and other current assets	(8,640)	(2,319)
Notes payable	(14,134)	17,222
Accounts payable	140,438	38,019
Income tax payable	8,736	1,193
Accrued expenses and other current liabilities	<u>20,347</u>	<u>5,677</u>
Net Cash Provided by (Used in) Operating Activities	<u>48,910</u>	<u>(4,067)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in short-term investments	(338,948)	(59,957)
Proceeds from sales of short-term investments	343,623	71,015
Increase in pledged certificates of deposits	(7,826)	(12,200)
Acquisition of properties	(5,304)	(1,433)
Increase in refundable deposits	(40,632)	(66)
Increase in deferred charges	<u>(5,508)</u>	<u>(104)</u>
Net Cash Used in Investing Activities	<u>(54,595)</u>	<u>(2,745)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in short-term loans	(10,000)	10,000
Proceeds from issuance of capital stock	115,392	-
Remuneration to directors and supervisors	<u>(232)</u>	<u>-</u>
Net Cash Provided by Financing Activities	<u>105,160</u>	<u>10,000</u>
NET INCREASE IN CASH	99,475	3,188
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>6,493</u>	<u>3,305</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 105,968</u>	<u>\$ 6,493</u>

(Forward)

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	<u>2002</u>	<u>2001</u>
SUPPLEMENTAL INFORMATION		
Interest paid	<u>\$ 592</u>	<u>\$ -</u>
Income tax paid	<u>\$ 1,294</u>	<u>\$ 13</u>
Noncash investing activities:		
Net cash payments acquisitions of properties	\$ 6,054	\$ 1,433
Increase in payables to contractors and equipment supplies	(750)	-
	<u>\$ 5,304</u>	<u>\$ 1,433</u>

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

(With T N Soong & Co report dated February 22, 2003)

PHISON ELECTRONICS CORP.

NOTES TO FINANCIAL STATEMENTS
(Amounts in Thousands of New Taiwan Dollars,
Unless Specified of Otherwise)

1. GENERAL

The Corporation was incorporated on November 8, 2000 under the Company Law of the Republic of China. The Corporation was in the development stage until April 30, 2001 and started its operations and earning of significant revenue from May 1, 2001.

The Corporation mainly designs and sells flash memory controllers and peripheral system applications as well as designs TI DSP system.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation's significant accounting policies, which conform to generally accepted accounting principles in the Republic of China, are summarized as follows:

Cash and cash equivalents

Corporate bonds acquired under agreements that provide for repurchase for up to three months from date of purchase are classified as cash equivalents.

Short-term investments

Short-term investments are carried at the lower of cost or market value. The costs of investments sold are determined by weighted-average method.

Allowance for doubtful receivables

Allowance for doubtful receivables is provided on the basis of a review of the collectibility of receivables.

Inventories

Inventories are carried at the lower of weighted-average cost or market value. The basis of market value is net realizable value for finished goods, semifinished goods and work in process; and replacement cost for raw materials.

Properties

Properties are stated at cost less accumulated depreciation. Major additions, renewals and betterment are capitalized; maintenance and repairs are expensed currently.

Depreciation is calculated by the straight-line method over property service lives initially estimated as follows: Testing equipment - 3 years; furniture and fixtures - 3 years; transportation equipment - 5 years; leasehold improvement - 3 years; and other equipment - 2-5 years.

If an asset is still in use beyond its estimated service life, its residual value is written off over its newly estimated service life.

Upon sale or disposal of property and equipment, the related cost and accumulated depreciation are removed from the accounts, and any resulting gain or loss is credited or charged to income in the period of disposal.

Deferred charges

Deferred charges, consisting of costs in acquiring computer software and patents, are amortized using the straight-line method over 3 to 5 years.

Sales and sales returns and allowances

Sales are recognized when titles of products and risk of ownerships are transferred to customers, primarily upon shipment. Allowance and related provisions for sales returns and others are estimated on the basis of past experience. These provisions are deducted from sales in the year the products are sold and estimated related costs are deducted from cost of sales.

Subsidy income

The Corporation receives a subsidy from the government for developing certain products. The Corporation recognizes the subsidy as income upon receiving the funds based on a disbursement schedule agreed to by the Corporation and the government.

Pension costs

Effective December 31, 2002, the Corporation adopted Financial Accounting Standards No. 18, "Accounting for Pensions," which requires: (a) actuarial determination of assets and obligations as of December 31, 2002; (b) recognition of additional liability as both asset and liability; (c) disclosure of certain pension information; and (d) recognition of pension costs as actuarially determined starting 2003. The adoption had no significant impact on the Corporation's 2002 financial statements.

The Corporation recognizes pension expense for the amount contributed to a pension fund. Pension benefits paid in excess of the fund are also charged to expense.

Income tax

The Corporation uses an inter-period tax allocation method for income tax. Deferred income tax assets and liabilities are recognized for the tax effects of temporary differences, unused tax credits, and operating loss carry forwards. Valuation allowances are provided to the extent, if any, that it is more likely than not that deferred income tax assets will not be realized. A deferred tax asset or liability is, according to the classification of its related asset or liability, classified as current or noncurrent. However, if a deferred tax asset or liability does not relate to an asset or liability in the financial statements, it is classified as current or noncurrent on the basis of the expected length of the realization period.

Any tax credit arising from the purchase of machinery, equipment and technology, research and development expenditures, personnel training investments are recognized currently.

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

Income tax (10%) on unappropriated earnings is expensed in the year the shareholders approve for retain earnings.

Foreign-currency transactions

Foreign-currency transactions are recorded in New Taiwan dollars at spot rates. Gains or losses resulting from the application of different foreign exchange rates when cash in foreign currency is converted into New Taiwan dollars or when foreign-currency receivables and payables are settled, are credited or charged to income in the year of conversion or settlement. At period-end, the balances of foreign-currency assets and liabilities are restated at prevailing exchange rates, and the resulting differences are recorded as exchange gain or loss in current income.

Reclassifications

Certain accounts in 2001 had been reclassified to conform to the 2002 presentation.

3. CASH AND CASH EQUIVALENTS

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Cash on hand	\$ 37	\$ 21
Checking and saving accounts	99,278	-
Corporate bonds acquired under repurchase agreements	6,653	-
Time deposits	-	6,472
	<u>\$105,968</u>	<u>\$ 6,493</u>

4. SHORT-TERM INVESTMENTS

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Bond funds	<u>\$ 10,000</u>	<u>\$ 14,006</u>
Market value	<u>\$ 10,000</u>	<u>\$ 14,012</u>

5. ACCOUNTS RECEIVABLES

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Accounts receivables	\$ 121,270	\$ 60,957
Less: Allowance for doubtful accounts	505	869
Allowance for sales returns and discounts	<u>826</u>	<u>261</u>
	<u>\$ 119,939</u>	<u>\$ 59,827</u>

6. INVENTORY

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Finished goods	\$ 5,675	\$ 1,585
Semifinished goods	27,801	894
Work in process	388	74
Raw materials	<u>50,082</u>	<u>6,409</u>
	83,946	8,962
Less: Allowance for decline in value of inventory	<u>416</u>	<u>233</u>
	<u>\$ 83,530</u>	<u>\$ 8,729</u>

7. PROPERTIES

Accumulated depreciation consisted of the following:

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Testing equipment	\$ 675	\$ 242
Furniture and fixtures	252	66
Transportation equipment	53	20
Leasehold improvement	-	-
Other equipment	<u>469</u>	<u>35</u>
	<u>\$ 1,449</u>	<u>\$ 363</u>

8. PENSION PLAN

The Corporation has a pension plan for all regular employees, which provides benefits based on length of service and average basic salaries or wages before retirement.

Starting in February 2001, the Corporation made monthly contributions at amounts equal to 3% of salaries to a pension fund administered by the employees pension fund monitoring committee and deposited in the committee's name in the Central Trust of China.

Pension information is summarized as follows:

a. Reconciliation of the fund status of the plan and accrual pension cost

	<u>2002</u>
Benefit obligation	
Vested benefit obligation	\$ -
Non-vested benefit obligation	<u>758</u>
Accumulated benefit obligation	758
Additional benefits based on future salaries	<u>905</u>
Projected benefit obligation	1,663
Fair value of plan assets	(<u>876</u>)
Fund status	787
Unrecognized net transitional obligation	(787)
Unrecognized net gain or loss	<u>-</u>
 Accrued pension cost	 <u>\$ -</u>
 Vested benefits	 <u>\$ -</u>

b. Actuarial assumptions

Discount rate used in determining present values	3%
Future salary increase rate	3%
Expected rate of return on plan assets	3%

c. Summary of changes in the pension fund

Contributions	<u>\$ 532</u>
Payment of benefits	<u>\$ -</u>

9. SHORT-TERM LOANS

	<u>2001</u>
Mortgaged loan: 2001 - due January 2002, interest at 3.2%	<u>\$ 10,000</u>

As of December 31, 2002, the Corporation had an unused credit line of approximately \$89,865.

10. INCOME TAX

- a. A reconciliation of income tax expense - current before tax credits and income tax expense on income before income tax at statutory rate is shown below:

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Income tax expense on income before income tax at statutory rate (25%)	\$ 22,959	\$ 3,879
Tax - exempt income	(3,470)	-
Permanent difference	(198)	(266)
Temporary difference	<u>565</u>	<u>(188)</u>
Income tax expense - current before tax credits	<u>\$ 19,856</u>	<u>\$ 3,425</u>

- b. Income tax (expense) benefit consisted of:

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Income tax expense - current before tax credits	(\$ 19,856)	(\$ 3,425)
Additional 10% tax on unappropriated earnings	(148)	-
Income tax credits	<u>10,002</u>	<u>2,220</u>
Income tax payable - current	(10,002)	(1,205)
Net change in deferred income tax assets for the period	(451)	1,025
Prior year adjustment	(28)	-
Valuation allowance	<u>-</u>	<u>1,710</u>
Income tax (expense) benefit	<u>(\$ 10,481)</u>	<u>\$ 1,530</u>

- c. Deferred income tax assets (liabilities) as of December 31, 2002 and 2001 consisted of:

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Current:		
Temporary difference	\$ 442	(\$ 288)
Investment tax credits	<u>1,842</u>	<u>3,023</u>
	<u>\$ 2,284</u>	<u>\$ 2,735</u>

The effective tax rate used for deferred income tax assets calculation were 25%.

- d. Integrated income tax information:

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Imputation credit account (ICA)	<u>\$ 1,299</u>	<u>\$ 13</u>

The expected and actual creditable tax ratios for 2002 and 2001 were 1.52% and 0.01%, respectively.

The imputation credit allocated to each shareholder is based on the ICA balance on the date of dividend distribution; In addition, the expected creditable tax ratio for 2002 may be adjusted depending on the amount of dividends actually paid or distributed.

- e. As of December 31, 2002, investment tax credits consisted of the following:

<u>Regulation</u>	<u>Items</u>	<u>Total Creditable Amounts</u>	<u>Remaining Creditable Amounts</u>	<u>Expiry Year</u>
Statute for Upgrading Upgrading Industries	Purchase of machinery	\$ 37	\$ 37	2005
	and equipment	<u>44</u>	<u>44</u>	2006
		<u>\$ 81</u>	<u>\$ 81</u>	
	Research and development expenditures	\$ 697 2,290 <u>8,776</u>	\$ - 1,761 <u>-</u>	2004 2005 2006
		<u>\$ 11,763</u>	<u>\$ 1,761</u>	

- f. Income from the following expansion and construction project base on the Corporation's investment plan is exempt from income tax:

Tax-exempt Period

High level IC design and pen drive production September 2002 to September 2007

Income tax returns through 2000 had been examined and cleared by the tax authorities.

11. SHAREHOLDERS' EQUITY

Capital surplus can only be used to offset a deficit under the ROC Company Law. However, the components of capital surplus generated from donations and the excess of the issue price over the par value of capital stock can be transferred to capital as stock dividends.

The Corporation's Articles of Incorporation provide that, under the board of directors' resolution, a certain percentage of annual net income (less tax, any deficit and 10% as legal reserve) plus accumulated unappropriated prior year's retained earnings, should be appropriated as follows:

- a. 2%, as remuneration to directors and supervisors;
- b. 15% to 20%, as bonus to employees; and

c. The remainder, as dividends to shareholders.

These appropriations and the disposition of the remaining net income should be approved by the shareholders in the following year and given effect to in the financial statements of that year.

The bonus to employees and the remuneration to directors and supervisors appropriated from the earnings in 2001 were approved in the shareholders' meeting on April 9, 2002:

	<u>Amounts</u>	<u>Shares</u> <u>(Thousands)</u>
Bonus to employees - in stock	\$ 1,740	174
Remuneration to directors and supervisors - in cash	<u>232</u>	-
	<u>\$ 1,972</u>	

The shares distributed as bonus to employees were 5.80% of the Corporation's total outstanding common shares as of December 31, 2001.

The above earnings appropriation was consistent with the resolution passed in the board of directors' meeting on March 5, 2002. Had the appropriations been both paid in cash and charged against the 2001 income, the basic EPS after income tax for the year ended December 31, 2001 would have decreased from NT\$5.01 to NT\$4.57.

As of February 22, 2003, the appropriation of the earnings of 2002 had not been yet resolved by the board of directors.

The appropriation for legal reserve should be made until the reserve equals the aggregate par value of the Corporation's outstanding capital stock. The reserve can only be used to offset a deficit or when the balance of the reserve reaches 50% of the aggregate par value of the Corporation's outstanding Capital Stock, up to 50% thereof can be distributed as stock dividend.

Under the integrated income tax system, ROC-resident shareholders are allowed a tax credit for the income tax paid by the Corporation on earnings generated. The Corporation maintains an imputation credit account (ICA) for this income tax. The tax credit allocated to each shareholder will be based on the ratio of the ICA balance and the undistributed earnings. This ratio will be computed on the date of dividend distribution.

On September 5, 2002, the meeting of board of directors approved the Corporation's Employee Stock Option Plan. The Plan provides qualified employees with 640 thousand units of option rights, with each unit representing 1 common share of stock. The option rights are valid for three years and exercisable subsequent to the second anniversary of issuance. As of September 6, 2002, there were 582 thousand shares granted at approximately NT\$13.

12. EARNINGS PER SHARE

Earnings per share (EPS) were computed as follows:

	Amounts (Numerator)		Share (Denominator) (Thousand)	EPS (Dollars)	
	Before Income Tax	After Income Tax		Before Income Tax	After Income Tax
<u>For the year ended December 31, 2002</u>					
Basic EPS					
Income available to common shareholders	\$91,835	\$81,354	5,820	<u>\$15.78</u>	<u>\$13.98</u>
Employee stock option Diluted effect of potential common shares	<u>-</u>	<u>-</u>	<u>87</u>		
Diluted EPS					
Income available to common shareholders plus diluted effect of potential common shares	<u>\$91,835</u>	<u>\$81,354</u>	<u>5,907</u>	<u>\$15.55</u>	<u>\$13.77</u>
<u>For the year ended December 31, 2001</u>					
Basic EPS					
Income available to common shareholders	<u>\$15,518</u>	<u>\$17,048</u>	<u>3,404</u>	<u>\$ 4.56</u>	<u>\$ 5.01</u>
Diluted EPS					
Income available to common shareholders	<u>\$15,518</u>	<u>\$17,048</u>	<u>3,404</u>	<u>\$ 4.56</u>	<u>\$ 5.01</u>

Based on the treasury Stock method under the Statement of Financial Accounting Standards No. 24, "Earnings Per Share," the potential common shares from the employee Stock option plan (See Note 11) were included in the denominator of the diluted EPS computation because these shares are considered dilutive.

The average number of shares outstanding for EPS calculation had been adjusted retroactively for the issuance of stock dividends and stock bonuses. The retroactive adjustment caused the basic EPS before income tax and after income tax for the year ended December 31, 2001 to decrease from NT\$5.17 and NT\$5.68 to NT\$4.56 and NT\$5.01, respectively.

13. RELATED-PARTY TRANSACTIONS

- a. The Corporation had business transactions with the following related party:

<u>Related Party</u>	<u>Nature of Relationship</u>
M-Systems Flash Disk Pioneers	M-Systems Flash Disk Pioneers is the parent company of the Board of directors of the Corporation

- b. The significant transaction with the above related party is summarized as follows:

<u>For the years</u>	<u>2002</u>		<u>2001</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Sales				
M-Systems Flash Disk Pioneers	<u>\$ 25,668</u>	<u>3</u>	<u>\$ -</u>	<u>-</u>

The selling terms and price for related and third parties are similar.

14. ASSETS PLEDGED

The Corporation had pledged certificates of deposits as collateral for the issuance of letters of credit for purchasing materials.

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Pledged certificates of deposits	<u>\$ 20,026</u>	<u>\$ 12,200</u>

15. COMMITMENTS AND CONTINGENT LIABILITY AS OF DECEMBER 31, 2002

- a. The Corporation leases its office under agreements that will expire in December 2004. The current rent amounts to \$1,722 each year. As of December 31, 2002, the estimated future annual minimum rents under lease agreements are as follows:

<u>Year of Payment</u>	<u>Amount</u>
2003	\$ 3,288
2004	<u>2,761</u>
	<u>\$ 6,049</u>

- b. Unused letters of credit amounted to \$110,135.

- c. In March 2001, the Corporation entered into a product development agreement with the Industrial Technology Research Institute. The Corporation should pay the Institute development expenses of \$1,000 in four installments. When products are sold, the Corporation should pay the Institute royalty at 1% of product sales quarterly until April 2011.
- d. On August 15, 2002, Feiya Technology Corp. ("Feiya", which was later 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 damage of \$45,000 for alleged theft of trade secrets. According to the legal counsel of the Corporation, Feiya could not provide evidences for its charge. Therefore, no accruals had been provided because the Corporation believed the litigation would not have significant impact on the Corporation's financial conditions and operations. Nevertheless, the Corporation placed \$40,000 with the Hsinchu District Court as guarantee deposit for the litigation.

16. FINANCIAL INSTRUMENTS

- a. The Company did not enter into any derivative financial instruments transactions in 2002.
- b. The fair values of the Company's financial instruments were:

	December 31			
	2002		2001	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<u>Assets</u>				
Cash	\$ 105,968	\$ 105,968	\$ 6,493	\$ 6,493
Short-term investments	10,000	10,000	14,006	14,012
Notes receivable	54,613	54,613	8,958	8,958
Accounts receivable	119,939	119,939	59,827	59,827
Pledged certificate of deposits	20,026	20,026	12,200	12,200
Refundable deposits	40,818	40,818	186	186
<u>Liabilities</u>				
Short-term borrowings	-	-	10,000	10,000
Notes payable	3,088	3,088	17,222	17,222
Accounts payable	178,457	178,457	38,019	38,019

The following bases were used to estimate the fair values of financial instruments:

- 1) Short-term financial instruments - the carrying amounts reported in the balance sheet;
- 2) Short-term investments - market values;
- 3) Refundable deposits and guarantee deposits - carrying values.

The fair values of nonfinancial instruments were not included in the fair values disclosed above. Thus, the sum of the fair values of the financial instruments listed above do are represent the fair value of the Corporation.

17. ADDITIONAL DISCLOSURES

Except for those shown in Tables 1 to 3, the Corporation had no significant transactions as well as investments in other companies and Mainland China that should be disclosed.

18. SEGMENT INFORMATION

- a. Industry information: The Corporation mainly designs and sells flash memory controllers and peripheral system applications, as well as designs TI DSP system, which all pertain to one segment.
- b. Geographic information: As of December 31, 2002, the Corporation had no revenue - generating operating unit outside the Republic of China.
- c. Foreign sales information:

<u>Foreign Area</u>	<u>2002</u>	<u>2001</u>
Europe	\$ 101,225	\$ 30,980
United States	92,438	13,402
Asia	71,151	5,632

- d. Customers with sales exceeding 10% of the total sales:

<u>Customers</u>	<u>2002</u>		<u>2001</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
A	\$ 100,270	12	\$ 265	-
B	91,036	11	4,343	3
C	90,477	11	30,936	21
D	83,580	10	8,079	6
E	59,170	7	17,629	12

PHISON ELECTRONICS CORP.
 MARKETABLE SECURITIES HELD
 December 31, 2002
 (Amounts in Thousands of New Taiwan Dollars, Unless Otherwise Specified)

Marketable Securities Type	Marketable Securities Name	Relationship with the Corporation	Financial Statement Account	December 31, 2002				Note
				Shares/Units (Thousands)	Carrying Value	Percentage of Ownership	Market Value	
Certificate	Fubon Ju-I Fund	-	Short-term investment	667	\$10,000	-	\$10,000	-

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

PHISON ELECTRONICS CORP. LTD.

MARKETABLE SECURITIES ACQUIRED AND DISPOSED OF AT COSTS OR PRICES OF AT LEAST NT\$100 MILLION OR 20% OF THE PAID-IN CAPITAL

For the Year Ended December 31, 2002

(Amounts in Thousands of New Taiwan Dollars, Unless Otherwise Specified)

Company Name	Marketable Securities Type and Name	Financial Statement Account	Counter-Party	Nature of Relationship	Beginning Balance		Acquisition		Disposal				Ending Balance	
					Shares (Thousands)	Amount	Shares/Units (Thousands)	Amount	Shares/Units (Thousands)	Amount	Carrying Value	Gain (Loss) on Disposal	Shares/Units (Thousand)	Amount
Phison Electronics Corp.	<u>Certificate</u>													
	Sheng Hua 1699 Bond Fund	Short-term investment	-	-	354	\$ 4,000	2,426	\$ 28,013	2,780	\$ 32,078	\$ 32,013	\$ 65	-	\$ -
	Phoenix Fund	Short-term investment	-	-	-	-	1,154	16,032	1,154	16,062	16,032	30	-	-
	Polaris De-Li Fund	Short-term investment	-	-	-	-	1,423	20,000	1,423	20,022	20,000	22	-	-
	Fuh-Hwa Albatross Fund	Short-term investment	-	-	-	-	2,138	22,055	2,138	22,096	22,055	41	-	-
	Citic Safe Income Fund	Short-term investment	-	-	-	-	5,243	71,979	5,243	72,110	71,979	131	-	-
	Cash Reserves Fund	Short-term investment	-	-	376	4,003	9,644	104,345	10,020	108,574	108,348	226	-	-
	Sheng Hua 5599 Bond Fund	Short-term investment	-	-	-	-	2,374	24,521	2,374	24,579	24,521	58	-	-

PHISON ELECTRONICS CORP. LTD.

TOTAL PURCHASE FROM OR SALE TO RELATED PARTIES AMOUNTING TO AT LEAST NT\$100 MILLION OR 20% OF THE PAID-IN CAPITAL
 For the Year Ended December 31, 2002
 (Amounts in Thousands of New Taiwan Dollars, Unless Otherwise Specified)

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	
M-Systems Flash Disk Pioneers	M-Systems Flash Disk Pioneers is the parent company of the Board of directors of the Corporation	Sales	\$25,668	3	30 days from monthly closing date	None	None	\$7	-	-