TAIWAN SEMICONDUCTOR MANUFACTURING CO LTD
Form 6-K
September 01, 2006

1934 Act Registration No. 1-14700

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 6-K
REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16 OF
THE SECURITIES EXCHANGE ACT OF 1934
For the month of August 2006
Taiwan Semiconductor Manufacturing Company Ltd.
(Translation of Registrant s Name Into English)
No. 8, Li-Hsin Rd. 6,
Hsinchu Science Park,
Taiwan
(Address of Principal Executive Offices)

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

Form 20-F þ Form 40-F o

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

Yes o No þ

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

Taiwan Semiconductor Manufacturing Company Limited
Financial Statements for the
Six Months Ended June 30, 2006 and 2005 and
Independent Auditors Report

INDEPENDENT AUDITORS REPORT

The Board of Directors and Shareholders
Taiwan Semiconductor Manufacturing Company Limited

We have audited the accompanying balance sheets of Taiwan Semiconductor Manufacturing Company Limited as of June 30, 2006 and 2005, and the related statements of income, changes in shareholders equity and cash flows for the six months then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Taiwan Semiconductor Manufacturing Company Limited as of June 30, 2006 and 2005, and the results of its operations and its cash flows for the six months then ended in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China.

We have also audited, in accordance with the Rules Governing the Audit of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China, the consolidated financial statements of Taiwan Semiconductor Manufacturing Company Limited and subsidiaries as of and for the six months ended June 30, 2006 and 2005, and have expressed an unqualified opinion on the consolidated financial statements.

July 12, 2006

<u>*Notice to Readers*</u>

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.

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

Taiwan Semiconductor Manufacturing Company Limited
BALANCE SHEETS
JUNE 30, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Par Value)

	2006 Amount	%	2005 Amount	%
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 4)	$ 127,713,018	22	$ 78,597,384	16
Financial assets at fair value through profit or loss (Notes 2, 3 and 5)	322,456		121,841	
Available-for-sale financial assets (Notes 2, 3 and 6)	62,102,387	11	48,298,762	10
Held-to-maturity financial assets (Notes 2, 3 and 7)	5,738,737	1	1,109,846	
Notes and accounts receivable	19,713,819	4	20,040,283	4
Receivables from related parties (Note 23)	22,909,889	4	14,999,678	3
Allowance for doubtful receivables (Note 2)	(975,704)		(978,577)	
Allowance for sales returns and others (Note 2)	(5,571,076)	(1)	(3,945,057)	
Other receivables from related parties (Note 23)	1,659,482		1,565,784	
Other financial assets (Note 3)	872,627		1,603,340	
Inventories, net (Notes 2 and 8)	18,375,580	3	14,113,615	3
Deferred income tax assets (Notes 2 and 16)	6,084,277	1	5,330,000	1
Prepaid expenses and other current assets (Note 3)	954,026		969,974	
Total current assets	259,899,518	45	181,826,873	37
LONG-TERM INVESTMENTS (Notes 2, 3, 6, 7, 9 and 10)				
Available-for-sale financial assets	4,873,970	1		
Held-to-maturity financial assets	23,524,067	4	27,297,965	5
Financial assets carried at cost	818,969		784,939	
Investments accounted for using equity method	54,000,233	9	48,351,666	10
Total long-term investments	83,217,239	14	76,434,570	15
PROPERTY, PLANT, AND EQUIPMENT (Notes 2, 11 and 23)				
Cost				
Buildings	91,815,148	16	88,695,499	18
Machinery and equipment	484,487,876	84	441,034,330	88
Office equipment	8,090,185	1	7,586,253	1
	584,393,209	101	537,316,082	107
Accumulated depreciation	(388,228,761)	(67)	(330,854,258)	(66)
Advance payments and construction in progress	27,054,673	5	18,601,286	4

Net property, plant, and equipment	223,219,121	39	225,063,110	45
GOODWILL (Note 2)	1,567,756		1,741,951	
OTHER ASSETS				
Deferred income tax assets (Notes 2 and 16)	7,394,956	1	6,313,825	1
Deferred charges, net (Notes 2 and 12)	6,163,992	1	7,874,553	2
Refundable deposits	83,655		87,542	
Assets leased to others, net (Note 2)	70,012		75,746	
Idle assets	6,789		13,995	
Total other assets	13,719,404	2	14,365,661	3
TOTAL	$ 581,623,038	100	$ 499,432,165	100
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Financial liabilities at fair value through profit or loss (Notes 2, 3 and 5)	$ 599,909		$ 836,704	
Accounts payable	6,772,076	1	5,680,946	1
Payables to related parties (Note 23)	3,281,423		2,146,317	
Income tax payable (Notes 2 and 16)	4,486,901	1	252,800	
Cash dividends and bonus payable (Note 18)	65,257,190	11	49,590,312	10
Payables to contractors and equipment suppliers	16,952,057	3	10,004,328	2
Accrued expenses and other current liabilities (Notes 3 and 14)	7,385,228	1	7,712,787	2
Current portion of bonds payable (Note 13)	2,500,000	1	10,500,000	2
Total current liabilities	107,234,784	18	86,724,194	17
LONG-TERM LIABILITIES				
Bonds payable (Note 13)	17,000,000	3	19,500,000	4
Other long-term payables (Note 14)	1,458,603		1,644,136	
Other payables to related parties (Notes 23 and 26)	1,085,366		1,727,133	1
Total long-term liabilities	19,543,969	3	22,871,269	5
OTHER LIABILITIES				
Accrued pension cost (Notes 2 and 15)	3,484,350	1	3,410,250	1
Guarantee deposits (Note 26)	3,354,046	1	1,517,584	
Deferred credits (Notes 2 and 23)	1,173,542		708,941	

Total other liabilities	8,011,938	2	5,636,775	1
Total liabilities	134,790,691	23	115,232,238	23
CAPITAL STOCK $10 PAR VALUE				
Authorized: 27,050,000 thousand shares, Issued: 25,823,357 thousand shares in 2006, 24,726,129 thousand shares in 2005	258,233,569	44	247,261,288	50
CAPITAL SURPLUS (Notes 2 and 18)	53,822,486	9	56,720,875	11
RETAINED EARNINGS (Note 18)				
Appropriated as legal capital reserve	43,705,711	8	34,348,208	7
Appropriated as special capital reserve	640,742		2,226,427	
Unappropriated earnings	92,376,976	16	47,808,698	10
	136,723,429	24	84,383,333	17
OTHERS (Notes 2 and 3)				
Cumulative translation adjustments	(1,145,616)		(2,612,996)	(1)
Unrealized gains on financial instruments	116,554			
	(1,029,062)		(2,612,996)	(1)
TREASURY STOCK (AT COST, Notes 2 and 20) 33,926 thousand shares in 2006 and 46,862 thousand shares in 2005	(918,075)		(1,552,573)	
Total shareholders equity	446,832,347	77	384,199,927	77
TOTAL	$ 581,623,038	100	$ 499,432,165	100

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

Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF INCOME
FOR THE SIX MONTHS ENDED JUNE 30, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2006		2005	
	Amount	%	Amount	%
GROSS SALES (Notes 2 and 23)	$ 161,789,754		$ 116,819,058	
SALES RETURNS AND ALLOWANCES (Note 2)	3,269,063		2,649,624	
NET SALES	158,520,691	100	114,169,434	100
COST OF SALES (Notes 17 and 23)	80,991,942	51	69,315,398	61
GROSS PROFIT	77,528,749	49	44,854,036	39
OPERATING EXPENSES (Notes 17 and 23)				
Research and development	7,255,721	4	6,632,293	6
General and administrative	3,379,438	2	3,743,998	3
Marketing	1,053,473	1	617,811	
Total operating expenses	11,688,632	7	10,994,102	9
INCOME FROM OPERATIONS	65,840,117	42	33,859,934	30
NON-OPERATING INCOME AND GAINS				
Equity in earnings of equity method investees, net (Notes 2 and 10)	3,404,382	2		
Interest income (Notes 2 and 3)	1,910,958	1	1,175,969	1
Settlement income (Note 25)	483,734	1	711,324	1
Gain on disposal of financial instruments, net (Notes 2, 3, 5 and 22)	468,482		1,394,620	1
Technical service income (Notes 23 and 26)	344,601		186,962	
Gain on disposal of property, plant and equipment and other assets (Notes 2 and 23)	257,239		107,395	
Others (Note 23)	172,551		221,233	
Total non-operating income and gains	7,041,947	4	3,797,503	3
NON-OPERATING EXPENSES AND LOSSES				

Foreign exchange loss, net (Note 2)	1,250,047	1	2,035,490	2
Interest expense (Notes 3 and 13)	330,600		606,225	
Valuation loss on financial instruments, net (Notes 2, 3, 5 and 22)	277,453		41,467	
Loss on idle assets	37,283		106,972	

(Continued)

	2006 Amount	%	2005 Amount	%
Loss on disposal of property, plant, and equipment (Note 2)	$ 8,996		$ 53,599	
Equity in losses of equity method investees, net (Notes 2 and 10)			786,018	1
Others	71,630		29,942	
Total non-operating expenses and losses	1,976,009	1	3,659,713	3
INCOME BEFORE INCOME TAX	70,906,055	45	33,997,724	30
INCOME TAX BENEFIT (EXPENSE) (Notes 2 and 16)	(4,051,241)	(3)	1,189,610	1
NET INCOME BEFORE CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	66,854,814	42	35,187,334	31
CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES, NET OF TAX BENEFIT OF NT$82,062 THOUSAND (Note 3)	(246,186)			
NET INCOME	$ 66,608,628	42	$ 35,187,334	31

	2006		2005	
	Before Income Tax	After Income Tax	Before Income Tax	After Income Tax
EARNINGS PER SHARE (NT$, Note 21)				
Basic earnings per share	$ 2.74	$ 2.58	$ 1.32	$ 1.37
Diluted earnings per share	$ 2.73	$ 2.58	$ 1.32	$ 1.37

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

	2006	2005
NET INCOME BEFORE CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	$ 66,937,134	$ 35,278,370
NET INCOME	$ 66,690,948	$ 35,278,370

EARNINGS PER SHARE (NT$)				
Basic earnings per share	$	2.58	$	1.37
Diluted earnings per share	$	2.58	$	1.37

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

Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Dividend Per Share)

pital Stock			Retained Earnings				Others		
n s)	Amount	Capital Surplus	Legal Capital Reserve	Special Capital Reserve	Unappropriated Earnings	Total	Cumulative Translation Adjustments	Unrealized Gain on Financial Instruments	Total
25	$ 247,300,246	$ 57,117,886	$ 34,348,208	$ 2,226,427	$ 106,196,399	$ 142,771,034	$ (640,742)	$	$ (640,742
			9,357,503		(9,357,503)				
				(1,585,685)	1,585,685				
					(3,432,129)	(3,432,129)			
13	3,432,129				(3,432,129)	(3,432,129)			
					(61,825,061)	(61,825,061)			
50	3,709,504				(3,709,504)	(3,709,504)			
					(257,410)	(257,410)			
50	3,709,504	(3,709,504)							
19	82,186	243,864							
		87,920							

	82,320								
					66,608,628	66,608,628			
							(504,874)		(504,874
								(191,469)	(191,469
								308,023	308,023
57	$ 258,233,569	$ 53,822,486	$ 43,705,711	$ 640,742	$ 92,376,976	$ 136,723,429	$ (1,145,616)	$ 116,554	$ (1,029,062

(Continued)

apital Stock			Retained Earnings				Others			
(in nds)	Amount	Capital Surplus	Legal Capital Reserve	Special Capital Reserve	Unappropriated Earnings	Total	Cumulative Translation Adjustments	Unrealized Gain on Financial Instruments	Total	Trea St
,964	$ 232,519,637	$ 56,537,259	$ 25,528,007	$	$ 88,202,009	$ 113,730,016	$ (2,226,427)	$	$ (2,226,427)	$ (1,5
			8,820,201		(8,820,201)					
				2,226,427	(2,226,427)					
					(3,086,215)	(3,086,215)				
,622	3,086,215				(3,086,215)	(3,086,215)				
					(46,504,097)	(46,504,097)				
,602	11,626,024				(11,626,024)	(11,626,024)				
					(231,466)	(231,466)				
,941	29,412	87,806								
		4,774								

		84,285								
					35,187,334	35,187,334				
							(386,569)		(386,569)	
		6,751								
,129	$ 247,261,288	$ 56,720,875	$ 34,348,208	$ 2,226,427	$ 47,808,698	$ 84,383,333	$ (2,612,996)	$	$ (2,612,996)	$ (1,5

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

(Concluded)

Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2006 AND 2005
(In Thousands of New Taiwan Dollars)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 66,608,628	$ 35,187,334
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	32,154,504	34,330,028
Amortization of premium/ discount of financial assets	43,781	58,771
Loss (gain) on disposal of available-for-sale financial assets, net	(1,116)	111,808
Gain on disposal of financial assets carried at cost, net		(94)
Gain on disposal of property, plant, and equipment, net	(248,243)	(53,796)
Equity in losses (earnings) of equity method investees, net	(3,404,382)	786,018
Loss on idle assets	37,283	106,972
Deferred income taxes	293,722	(1,149,822)
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Financial assets and liabilities at fair value through profit or loss	1,424,079	1,872,228
Notes and accounts receivable	877,999	(4,713,402)
Receivables from related parties	(1,859,285)	1,136,361
Allowance for doubtful receivables	(640)	(1,884)
Allowance for sales returns and others	1,301,107	617,143
Other receivables from related parties	473,280	(1,095,494)
Other financial assets	233,403	(768,010)
Inventories, net	(2,117,625)	58,330
Prepaid expenses and other current assets	217,747	785,308
Increase (decrease) in:		
Accounts payable	(1,280,030)	(807,671)
Payables to related parties	24,117	(1,619,155)
Income tax payable	671,013	(127,103)
Accrued expenses and other current liabilities	(645,267)	(1,235,137)
Accrued pension cost	22,958	309,054
Deferred credits	(47,872)	
Net cash provided by operating activities	94,779,161	63,787,787
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of:		
Available-for-sale financial assets	(64,826,510)	(42,911,838)
Held-to-maturity financial assets	(7,754,790)	(3,485,821)
Financial assets carried at cost	(11,479)	(14,207)
Investments accounted for using equity method	(274,687)	(3,225,972)
Property, plant, and equipment	(32,170,773)	(51,194,392)
Proceeds from disposal of:		

Available-for-sale financial assets	44,101,660	43,277,329
Financial assets carried at cost		1,996
Property, plant, and equipment and other assets	710,702	1,430,769

(Continued)

	2006	2005
Redemption of held-to-maturity financial assets upon maturity	$ 7,837,000	$ 4,914,180
Increase in deferred charges	(693,239)	(503,079)
Increase in refundable deposits	(13)	(2,129)
Proceeds from return of capital by investee	102,662	
Net cash used in investing activities	(52,979,467)	(51,713,164)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in guarantee deposits	461,101	1,105,191
Proceeds from exercise of employee stock options	326,050	117,218
Bonus to directors and supervisors	(257,410)	(231,466)
Net cash provided by financing activities	529,741	990,943
NET INCREASE IN CASH AND CASH EQUIVALENTS	42,329,435	13,065,566
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	85,383,583	65,531,818
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 127,713,018	$ 78,597,384
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 420,000	$ 420,000
Income tax paid	$ 2,994,232	$ 87,315
INVESTING ACTIVITIES AFFECTING BOTH CASH AND NON-CASH ITEMS		
Acquisition of property, plant, and equipment	$ 40,263,600	$ 30,044,411
Decrease (increase) in payables to contractors and equipment suppliers	(8,092,827)	21,149,981
Cash paid	$ 32,170,773	$ 51,194,392
NON-CASH FINANCING ACTIVITIES		
Current portion of bonds payable	$ 2,500,000	$ 10,500,000
Current portion of other long-term payables (under accrued expenses and other current liabilities)	$ 940,123	$ 1,417,437

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

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Taiwan Semiconductor Manufacturing Company Limited
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005
(Amounts in Thousands of New Taiwan Dollars, Unless Specified Otherwise)

1. GENERAL

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

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

As of June 30, 2006 and 2005, the Company had 20,357 and 18,734 employees, respectively.

2. SIGNIFICANT ACCOUNTING POLICIES

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

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

Significant accounting policies are summarized as follows:

Use of Estimates

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

Classification of Current and Noncurrent Assets and Liabilities

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

Cash Equivalents

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

Financial Assets/Liabilities at Fair Value Through Profit or Loss

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

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

Available-for-Sale Financial Assets

Investments designated as available-for-sale financial assets include debt securities and equity securities.

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

Fair values for beneficiary certificates of open-end funds and publicly traded stocks are determined using the net assets value and the closing-price at the balance sheet date, respectively. For other debt securities, fair value is determined using the average of bid and asked prices at the balance sheet date.

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

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

Held-to-Maturity Financial Assets

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

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

Allowance for Doubtful Receivables

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

Revenue Recognition and Allowance for Sales Returns and Others

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

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

Inventories

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

Financial Assets Carried at Cost

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

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

Investments Accounted for Using Equity Method

Investments in companies wherein the Company exercises significant influence over the operating and financial policy decisions are accounted for using the equity method. The Company s share of the net income or net loss of an investee is recognized in the equity in earnings/losses of equity method investees, net account. The difference, if any, between the cost of investment and the Company s proportionate share of the investee s equity was previously amortized by the straight-line method over five years and was also recorded in the equity in earnings/losses of equity method investees, net account. Effective January 1, 2006, pursuant to the revised Statement of Financial Accounting Standards No. 5, Long-term Investments in Equity Securities (SFAS No. 5), investment premiums, representing goodwill, are no longer being amortized; while investment discounts continue to be amortized over the remaining periods. When an indication of impairment is identified, the carrying amount of the investment is reduced, with the related impairment loss charged to current income.

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

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

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

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

Property, Plant, and Equipment and Assets Leased to Others

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

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

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

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

Goodwill

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

Deferred Charges

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

Pension Costs

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

Income Tax

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

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

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

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

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

Stock-based Compensation

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

Treasury Stock

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

Foreign-currency Transactions

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

3. ACCOUNTING CHANGES

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

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

The Company had properly categorized its financial assets and liabilities upon the initial adoption of the newly released SFASs. The adjustments made to the carrying amounts of the financial instruments categorized as financial assets or financial liabilities at fair value through profit or loss were included in the cumulative effect of changes in accounting principles; on the other hand, the adjustments made to the carrying amounts of those categorized as available-for-sale financial assets were recognized as adjustments to shareholders equity.

The effect of adopting the newly released SFASs is summarized as follows:

	Recognized as Cumulative Effect of Changes in Accounting Principles (Net of Tax)	Recognized as a Separate Component of Shareholders Equity
Financial assets or liabilities at fair value through profit or loss	$ (246,186)	$
Available-for-sale financial assets		
	$ (246,186)	$

The adoption of the newly released SFASs resulted in a decrease in net income before cumulative effect of changes in accounting principles of NT$31,267 thousand, a decrease in net income of NT$277,453 thousand, and a decrease in basic earnings per share (after income tax) of NT$0.01, for the six months ended June 30, 2006.

Effective January 1, 2006, the Company adopted the newly revised SFAS No. 5 and SFAS No. 25, which prescribe that investment premiums, representing goodwill, be assessed for impairment at least on an annual basis instead of being amortized. Such a change in accounting principle did not have a material effect on the Company s financial statements as of and for the six months ended June 30, 2006.

b. Reclassifications

Upon the adoption of SFAS No. 34, certain accounts in the financial statements as of and for the six months ended June 30, 2005 were reclassified to conform with the financial statements as of and for the six months ended June 30, 2006. The previous issued financial statements as of and for the six months ended June 30, 2005 need not be restated.

Certain accounting policies prior to the adoption of the newly released SFASs are summarized as follows:

1) Short-term investments

Short-term investments that were publicly-traded, easily converted to cash, and not acquired for the purpose of controlling the investees or establishing close business relationship with the investees were carried at the lower of cost or market value at the balance sheet date, with any temporary decline in value charged to current income. The market value of publicly-traded stocks was determined using the average-closing prices for the last month of the period.

2) Derivative financial instruments

The Company entered into forward exchange contracts to manage foreign exchange exposures on foreign-currency-denominated assets and liabilities. The contracts were recorded in New Taiwan dollars at the current rate of exchange at the contract date. The differences in the New Taiwan dollar amounts translated using the current rates and the amounts translated using the contracted forward rates were amortized over the terms of the forward contracts using the straight-line method. At the end of each period, the receivables or payables arising from forward contracts were restated using the prevailing exchange rates with the resulting differences credited or charged to income. In addition, the receivables and payables related to the same forward contracts were netted with the resulting amount presented as either an asset or a liability. Any resulting gain or loss upon settlement was credited or charged to income in the period of settlement.

The Company entered into cross currency swap contracts to manage currency exposures on foreign-currency-denominated assets and liabilities. The principal amount was recorded using the current rates at the contract date. The differences in the New Taiwan dollar amounts translated using the current rates and the amounts translated using the contracted rates were amortized over the terms of the contracts using the straight-line method. At the end of each period, the receivables or payables arising from cross-currency swap contracts were restated using the prevailing exchange rate with the resulting differences credited or charged to income. In addition, the receivables and payables related to the contracts of the same counter party were netted with the resulting amount presented as either an asset or a liability. The difference in interest computed pursuant to the contracts on each settlement date or the balance sheet date was recorded as an adjustment to the interest income or expense associated with the hedged items. Any resulting gain or loss upon settlement was credited or charged to income in the period of settlement.

The Company entered into interest rate swap contracts to manage exposures to changes in interest rates on existing assets or liabilities. These transactions were accounted for on an accrual basis, in which the cash settlement receivable or payable was recorded as an adjustment to interest income or expense associated with the hedged items.

Certain accounts in the financial statements as of and for the six months ended June 30, 2005 have been reclassified to conform to the classifications prescribed by the newly released SFASs. The reclassifications of the whole or a part of the account balances of certain accounts are summarized as follows:

	Before Reclassification	**After Reclassification**
Balance sheet		
Short-term investments	$ 49,408,608	$
Other financial assets	78,900	
Prepaid expenses and other current assets	42,941	
Long-term investments accounted for using cost method	784,939	
Long-term bonds investment	16,342,005	
Other long-term investments	10,955,960	
Accrued expenses and other current liabilities	(836,704)	
Financial assets at fair value through profit or loss		121,841
Financial liabilities at fair value through profit or loss		(836,704)
Available-for-sale financial assets		48,298,762
Held-to-maturity financial assets		28,407,811
Financial assets carried at cost		784,939
	$ 76,776,649	$ 76,776,649
Statement of income		
Interest income	$ 449,756	$
Foreign exchange gain, net	1,837,806	
Interest expense	(781,134)	
Unrealized valuation loss on short-term investments	(41,467)	
Loss on disposal of investment, net	(111,808)	
Valuation loss on financial instruments, net		(41,467)
Gain on disposal of financial instruments, net		1,394,620
	$ 1,353,153	$ 1,353,153

4. CASH AND CASH EQUIVALENTS

	June 30	
	2006	**2005**
Cash and deposits in banks	$ 67,694,314	$ 48,158,582
Repurchase agreements collaterized by government bonds	59,351,764	29,804,199

Corporate notes	666,940	172,291
Treasury bills		349,892
Agency notes		112,420
	$ 127,713,018	$ 78,597,384

5. FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	June 30	
	2006	2005
Derivatives financial assets		
Forward exchange contracts	$	$ 1,123
Cross currency swap contracts	322,456	120,718
	$ 322,456	$ 121,841
Derivatives financial liabilities		
Forward exchange contracts	$ 8,265	$ 41,092
Cross currency swap contracts	591,644	795,612
	$ 599,909	$ 836,704

The Company entered into derivative contracts for the six months ended June 30, 2006 and 2005 to manage exposures due to the fluctuations of foreign exchange rates. The derivative contracts entered into by the Company did not meet the criteria for hedge accounting prescribed by SFAS No. 34. Therefore, effective from January 1, 2006, the Company discontinued applying hedge accounting treatment for its derivative financial instruments.

Outstanding forward contracts as of June 30, 2006 and 2005:

	Currency	Maturity Date	Contract Amount (in Thousands)
June 30, 2006			
Sell	US$/NT$	July 2006	US$ 10,000
	EUR/US$	July 2006	EUR 10,000
June 30, 2005			
Sell	US$/NT$	July 2005 to August 2005	US$ 103,000

Outstanding cross currency swap contracts as of June 30, 2006 and 2005:

Maturity Date	Contract Amount (in Thousands)	Range of Interest Rates Paid	Range of Interest Rates Received
June 30, 2006			
July 2006 to September 2006	US$ 2,266,000	2.40%-5.57%	0.60%-2.78%

June 30, 2005

July 2005 to August 2005	US$2,045,000	3.10%-3.40%	1.03%-1.22%

The Company did not enter into any interest rate swap contracts during the six months ended June 30, 2006. The Company rescinded all interest rate swap contracts in the first quarter of 2005 before their original maturities. The rescission loss of NT$28,295 thousand has been reclassified and included in the losses on disposal of financial instrument account.

Net gains arising from derivative financial instruments for the six months ended June 30, 2006 were NT$189,913 thousand (including realized settlement gains of NT$467,366 thousand and valuation losses of NT$277,453 thousand).

6. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	June 30	
	2006	2005
Beneficiary certificates of open-end funds	$ 22,157,124	$ 10,300,638
Corporate bonds	14,297,001	11,555,183
Agency bonds	13,787,394	11,511,740
Corporate issued asset-backed securities	10,921,185	11,419,169
Government bonds	4,831,843	2,741,122
Structured time deposits	498,190	
Money market funds	385,937	491,465
Corporate notes	97,683	158,052
Commercial papers		94,770
Publicly-traded stocks		26,623
	66,976,357	48,298,762
Current portion	(62,102,387)	(48,298,762)
	$ 4,873,970	$

The Company entered into investment management agreements with three well-known financial institutions (fund managers) to manage its investment portfolios. In accordance with the investment guidelines and terms specified in these agreements, the securities invested by the fund managers cannot be below a pre-defined credit rating. As of June 30, 2006, the Company s investment portfolios managed by these fund managers aggregated to an original amount of US$1,200,000 thousand. The investment portfolios included securities such as corporate bonds, agency bonds, asset-backed securities, government bonds and others. Securities acquired with maturities of less than three months from the date of purchase were classified as cash equivalents.

As of June 30, 2006, structured time deposits categorized as available-for-sale financial assets consisted of the following:

	Principal Amount	Carrying Amount	Range of Interest Rates	Maturity Date
Step-up callable deposits				
Domestic deposits	$ 500,000	$ 498,190	1.76%	March 2008

The interest rate of the step-up callable deposits is pre-determined by the Company and the banks.

7. HELD-TO-MATURITY FINANCIAL ASSETS

	June 30	
	2006	2005
Government bonds	$ 5,239,892	$ 11,817,146
Corporate bonds	12,895,132	5,634,705
Structured time deposits	11,127,780	10,955,960
	29,262,804	28,407,811
Current portion	(5,738,737)	(1,109,846)
	$ 23,524,067	$ 27,297,965

Structured time deposits categorized as held-to-maturity financial assets consisted of the following:

	Principal Amount	Interest Receivable	Range of Interest Rates	Maturity Date
June 30, 2006				
Step-up callable deposits				
Domestic deposits	$ 4,000,000	$ 27,016	1.40%-2.01%	June 2007 to March 2009
Callable range accrual deposits				
Domestic deposits	3,887,880	4,725	(See below)	September 2009 to December 2009
Foreign deposits	3,239,900	4,914	(See below)	October 2009 to January 2010
	$ 11,127,780	$ 36,655		
June 30, 2005				
Step-up callable deposits				
Domestic deposits	$ 4,000,000	$ 18,027	1.40%-2.44%	July 2006 to August 2007
Callable range accrual deposits				
Domestic deposits	3,794,160	8,266	(See below)	September 2009 to December 2009
Foreign deposits	3,161,800	11,971	(See below)	October 2009 to January 2010
	$ 10,955,960	$ 38,264		

The amount of interest earned by the Company for the callable range accrual deposits is based on a pre-defined range as determined by the 3-month or 6-month LIBOR plus an agreed upon rate ranging between 2.10% and 3.45%. Based on the terms of the deposits, if the 3-month or 6-month LIBOR moves outside of the pre-defined range, the interest paid to the Company is at a fixed rate between zero and 1.5%. Under the terms of the contracts, the bank has the right to cancel the contracts prior to the maturity date.

As of June 30, 2006 and 2005, the principal of the deposits that resided in banks located in Hong Kong amounted to US$80,000 thousand; those resided in banks located in Singapore amounted to US$20,000 thousand.

8. INVENTORIES, NET

	June 30 2006	June 30 2005
Finished goods	$ 4,163,346	$ 2,600,225
Work in process	13,243,014	11,380,115
Raw materials	1,236,095	937,820
Supplies and spare parts	537,546	658,803
	19,180,001	15,576,963
Allowance for losses	(804,421)	(1,463,348)
	$ 18,375,580	$ 14,113,615

9. FINANCIAL ASSETS CARRIED AT COST

	June 30 2006	June 30 2005
Non-publicly traded stocks	$ 472,500	$ 482,500
Funds	346,469	302,439
	$ 818,969	$ 784,939

10. INVESTMENTS ACCOUNTED FOR USING EQUITY METHOD

	June 30 2006		June 30 2005	
	Carrying Amount	% of Owner-ship	Carrying Amount	% of Owner-ship
TSMC International Investment Ltd. (TSMC International)	$ 25,984,419	100	$ 23,057,382	100
TSMC (Shanghai) Company Limited (TSMC-Shanghai)	9,093,788	100	9,967,851	100
Systems on Silicon Manufacturing Company Pte Ltd. (SSMC)	5,094,733	32	3,514,280	32
Vanguard International Semiconductor Corporation (VIS)	5,087,101	27	5,115,164	27
TSMC Partners, Ltd. (TSMC Partners)	4,225,071	100	3,873,176	100
TSMC North America (TSMC-North America)	1,790,365	100	794,692	100
Emerging Alliance Fund, L.P. (Emerging Alliance)	1,050,087	99	820,765	99
VentureTech Alliance Fund II, L.P. (VTAF II)	707,835	98	469,749	98
Global UniChip Corporation (GUC)	447,762	45	403,208	46
VentureTech Alliance Fund III, L.P. (VTAF III)	145,055	98		
Chi Cherng Investment Co., Ltd. (Chi Cherng)	113,574	36	77,971	36
Hsin Ruey Investment Co., Ltd. (Hsin Ruey)	113,246	36	77,256	36
TSMC Japan K. K. (TSMC-Japan)	96,536	100	95,013	100

Taiwan Semiconductor Manufacturing Company Europe B.V. (TSMC-Europe)	36,909	100	22,491	100

(Continued)

	June 30			
	2006		2005	
	Carrying Amount	% of Owner-ship	Carrying Amount	% of Owner-ship
Taiwan Semiconductor Manufacturing Company Korea (TSMC-Korea)	$ 13,752	100	$	
VisEra Technologies Company, Ltd. (VisEra)			62,668	25
	$ 54,000,233		$ 48,351,666	

For the six months ended June 30, 2006 and 2005, net equity in earnings of NT$3,404,382 thousand and net equity in losses of NT$786,018 thousand were recognized, respectively. The carrying amounts of the investments accounted for using the equity method and the related equity in earnings or losses of equity method investees were determined based on the audited financial statements of the investees as of and for the same periods ended as the Company.

In November 2005, the Company transferred all of its shares in VisEra to VisEra Holding Company, an investee of TSMC Partners accounted for using the equity method, due to changes in investment structure.

11. PROPERTY, PLANT AND EQUIPMENT

Accumulated depreciation consisted of the following:

	June 30	
	2006	2005
Buildings	$ 46,538,174	$ 39,229,473
Machinery and equipment	335,618,032	286,453,058
Office equipment	6,072,555	5,171,727
	$ 388,228,761	$ 330,854,258

No interest was capitalized during the six months ended June 30, 2006 and 2005.

12. DEFERRED CHARGES, NET

	June 30	
	2006	2005
Technology license fees	$ 4,708,484	$ 5,836,060
Software and system design costs	1,401,428	1,942,091
Others	54,080	96,402
	$ 6,163,992	$ 7,874,553

13. BONDS PAYABLE

	June 30 2006	June 30 2005
Domestic unsecured bonds:		
Issued in December 2000 and repayable in December 2005 and 2007 in two installments, 5.25% and 5.36% interest payable annually, respectively	$ 4,500,000	$ 15,000,000
Issued in January 2002 and repayable in January 2007, 2009 and 2012 in three installments, 2.60%, 2.75% and 3.00% interest payable annually, respectively	15,000,000	15,000,000
	19,500,000	30,000,000
Current portion	(2,500,000)	(10,500,000)
	$ 17,000,000	$ 19,500,000

As of June 30, 2006, future principal repayments for the Company s bonds were as follows:

Year of Repayment	Amount
2007	$ 7,000,000
2009	8,000,000
2010 and thereafter	4,500,000
	$ 19,500,000

14. OTHER LONG-TERM PAYABLES

Most of the payables resulted from license agreements for certain semiconductor-related patents. As of June 30, 2006, future payments for other long-term payables were as follows:

Year of Payment	Amount
2006 (3rd to 4th quarter)	$ 493,300
2007	641,216
2008	335,006
2009	335,006
2010	335,006
2011 and thereafter	259,192
	2,398,726
Current portion (classified under accrued expenses and other current liabilities)	(940,123)
	$ 1,458,603

15. PENSION PLANS

The Labor Pension Act (the Act) became effective on July 1, 2005. The employees who were subject to the Labor Standards Law prior to July 1, 2005 were allowed to choose to be subject to the pension mechanism under the Act with their seniority as of July 1, 2005 retained or continue to be subject to the pension mechanism under the Labor Standards Law. Employees who joined the Company after July 1, 2005 can only be subject to the pension mechanism under the Act.

The pension mechanism under the Act is deemed a defined contribution plan. Pursuant to the Act, the Company has made monthly contributions equal to 6% of each employee s monthly salary to employees pension accounts starting from July 1, 2005, and recognized pension costs of NT$309,709 thousand for the six months ended June 30, 2006.

The Company has a defined benefit plan under the Labor Standards Law that provides benefits based on an employee s length of service and average monthly salary for the six-month period prior to retirement. The Company contributes an amount equal to 2% of salaries paid each month to a pension fund (the Fund). The Fund is administered by the pension fund monitoring committee (the Committee) and deposited in the Committee s name in the Central Trust of China.

Changes in the Fund and accrued pension cost under the defined benefit plan are summarized as follows:

	Six Months Ended June 30	
	2006	**2005**
The Fund		
Balance, beginning of period	$ 1,658,864	$ 1,428,001
Contributions	131,250	122,103
Interest	34,384	15,629
Payment	(4,677)	(8,419)
Balance, end of period	$ 1,819,821	$ 1,557,314
Accrued pension cost		
Balance, beginning of period	$ 3,461,392	$ 3,101,196
Accruals	22,958	309,054
Balance, end of period	$ 3,484,350	$ 3,410,250

16. INCOME TAX

a. A reconciliation of income tax expense based on income before income tax at statutory rate and income tax currently payable was as follows:

	Six Months Ended June 30	
	2006	**2005**
Income tax expense based on income before income tax at statutory rate (25%)	$ (17,726,514)	$ (8,499,431)
Tax effect of the following:		
Tax-exempt income	6,411,975	4,734,183
Temporary and permanent differences	721,070	(635,273)
Additional tax at 10% on unappropriated earnings	(1,156,130)	(1,489,709)
Cumulative effect of changes in accounting principles	82,062	
Income tax credits	7,462,975	5,890,230
Income tax currently payable	$ (4,204,562)	$

(Continued)

b. Income tax benefit (expense) consisted of the following:

	Six Months Ended June 30	
	2006	2005
Income tax currently payable	$ (4,204,562)	$
Other income tax adjustments	447,043	39,788
Net change in deferred income tax assets		
Investment tax credits	(2,756,331)	2,512,133
Temporary differences	1,423,579	1,708,642
Adjustment in valuation allowance	1,039,030	(3,070,953)
Income tax benefit (expense)	$ (4,051,241)	$ 1,189,610

c. Net deferred income tax assets consisted of the following:

	June 30	
	2006	2005
Current deferred income tax assets		
Investment tax credits	$ 6,084,277	$ 5,330,000
Noncurrent deferred income tax assets, net		
Investment tax credits	$ 15,025,163	$ 23,066,717
Temporary differences	741,309	(741,893)
Valuation allowance	(8,371,516)	(16,010,999)
	$ 7,394,956	$ 6,313,825

d. Integrated income tax information:

The balance of the imputation credit account as of June 30, 2006 and 2005 was NT$743,590 thousand and NT$15,569 thousand, respectively.

The expected and actual creditable ratios for distribution of earnings of 2005 and 2004 were 2.88% and 0.11%, respectively.

The imputation credit allocated to the shareholders is based on its balance as of the date of dividend distribution. The expected creditable ratio may change when the actual distribution of imputation credits is made.

e. All earnings generated prior to December 31, 1997 have been appropriated.

f. As of June 30, 2006, investment tax credits consisted of the following:

Regulation	Item	Total Creditable Amount	Remaining Creditable Amount	Expiry Year
Statute for Upgrading Industries	Purchase of machinery and equipment	$ 2,685,805	$	2006
		4,113,449	1,144,070	2007
		6,809,054	6,809,054	2008
		6,049,452	6,049,452	2009
		1,722,682	1,722,682	2010
		$ 21,380,442	$ 15,725,258	
Statute for Upgrading Industries	Research and development expenditures	$ 1,780,480	$	2006
		1,243,821	1,243,821	2007
		1,627,535	1,627,535	2008
		1,534,670	1,534,670	2009
		797,450	797,450	2010
		$ 6,983,956	$ 5,203,476	
Statute for Upgrading Industries	Personnel training	$ 27,311	$	2006
		26,780	26,780	2007
		37,207	37,207	2008
		36,915	36,915	2009
		$ 128,213	$ 100,902	
Statute for Upgrading Industries	Investments in important technology-based enterprises	$ 79,804	$ 79,804	2010

g. The profits generated from the following expansion and construction projects are exempt from income tax:

	Tax-Exemption Period
Construction of Fab 8 - modules B	2002 to 2005
Expansion of Fab 2 - modules A and B, Fab 3, Fab 4, Fab 5 and Fab 6	2003 to 2006
Construction of Fab 12	2004 to 2007

h. The tax authorities have examined income tax returns of the Company through 2002.

17. LABOR COST, DEPRECIATION AND AMORTIZATION

	Six Months Ended June 30, 2006		
	Classified as Cost of Sales	Classified as Operating Expenses	Total
Labor cost			
Salary	$ 5,183,360	$ 2,144,658	$ 7,328,018
Labor and health insurance	340,274	167,998	508,272
Pension	309,451	152,942	462,393
Meal	225,304	76,220	301,524
Welfare	94,186	48,784	142,970
Others	103,858	12,901	116,759
	$ 6,256,433	$ 2,603,503	$ 8,859,936
Depreciation	$ 29,319,569	$ 1,617,095	$ 30,936,664
Amortization	$ 722,358	$ 479,323	$ 1,201,681

	Six Months Ended June 30, 2005		
	Classified as Cost of Sales	Classified as Operating Expenses	Total
Labor cost			
Salary	$ 4,091,113	$ 1,678,438	$ 5,769,551
Labor and health insurance	303,436	144,065	447,501
Pension	295,506	140,296	435,802
Meal	208,186	67,904	276,090
Welfare	72,159	40,344	112,503
Others	51,139	45,032	96,171
	$ 5,021,539	$ 2,116,079	$ 7,137,618
Depreciation	$ 31,158,607	$ 1,489,769	$ 32,648,376
Amortization	$ 814,069	$ 859,118	$ 1,673,187

18. SHAREHOLDERS EQUITY

The Company has issued a total of 863,834 thousand ADSs which are traded on the NYSE as of June 30, 2006. The number of common shares represented by the ADSs is 4,319,169 thousand (one ADS represents five common shares).

Capital surplus can only be used to offset a deficit under the Company Law. However, the capital surplus generated from donations and the excess of the issuance price over the par value of capital stock (including the stock issued for new capital, mergers, convertible bonds and the surplus from treasury stock transactions) may be appropriated as stock dividends, which is limited to a certain percentage of the Company s paid-in capital.

Capital surplus consisted of the following:

	June 30	
	2006	**2005**
From merger	$ 24,003,546	$ 24,003,546
Additional paid-in capital	19,788,594	23,139,481
From convertible bonds	9,360,424	9,360,424
From treasury stock transactions	389,188	91,241
From long-term investments	280,679	126,128
Donations	55	55
	$ 53,822,486	$ 56,720,875

The Company s Articles of Incorporation as revised on May 10, 2005 provide that, when allocating the net profits for each fiscal year, the Company shall first offset its losses in previous years and then set aside the following items accordingly:

a. Legal capital reserve at 10% of the profits left over, until the accumulated legal capital reserve has equaled the Company s paid-in capital;

b. Special capital reserve in accordance with relevant laws or regulations or as requested by the authorities in charge;

c. Bonus to directors and supervisors and bonus to employees of the Company of not more than 0.3% and not less than 1% of the remainder, respectively. Directors who also serve as executive officers of the Company are not entitled to receive the bonus to directors and supervisors. The Company may issue stock bonuses to employees of an affiliated company meeting the conditions set by the Board of Directors or, by the person duly authorized by the Board of Directors;

d. Any balance left over shall be allocated according to the resolution of the shareholders meeting.

The Company s Articles of Incorporation also stipulate that profits of the Company may be distributed by way of cash dividend and/or stock dividend. However, distribution of profits shall be made preferably by way of cash dividend. Distribution of profits may also be made by way of stock dividend; provided that the ratio for stock dividend shall not exceed 50% of the total distribution.

Any appropriations of the profits are recorded in the year of shareholder approval and given effect to in the financial statements of that year.

The appropriation for legal capital reserve shall be made until the reserve equals the Company s paid-in capital. The reserve may be used to offset a deficit, or be distributed as dividends and bonuses for the portion in excess of 50% of the paid-in capital if the Company has no unappropriated earnings and the reserve balance has exceeded 50% of the Company s paid-in capital. The Company Law also prescribes that, when the reserve has reached 50% of the Company s paid-in capital, up to 50% of the reserve may be transferred to capital.

A special capital reserve equivalent to the net debit balance of the other components of shareholders equity (for example, cumulative translation adjustments and unrealized loss on financial assets, but excluding treasury stock) shall be made from unappropriated earnings pursuant to existing regulations promulgated by the Securities and Futures Bureau (SFB). Any special reserve appropriated may be reversed to the extent that the net debit balance reverses.

The appropriations of earnings for 2005 and 2004 had been approved in the shareholders meetings held on May 16, 2006 and May 10, 2005, respectively. The appropriations and dividends per share were as follows:

	Appropriation of Earnings		Dividends Per Share (NT$)	
	For Fiscal Year 2005	For Fiscal Year 2004	For Fiscal Year 2005	For Fiscal Year 2004
Legal capital reserve	$ 9,357,503	$ 8,820,201		
Special capital reserve	(1,585,685)	2,226,427		
Employees profit sharing in cash	3,432,129	3,086,215		
Employees profit sharing in stock	3,432,129	3,086,215		
Cash dividends to shareholders	61,825,061	46,504,097	$ 2.50	$ 2.00
Stock dividends to shareholders	3,709,504	11,626,024	0.15	0.50
Bonus to directors and supervisors	257,410	231,466		
	$ 80,428,051	$ 75,580,645		

The amounts of the above appropriations of earnings for 2005 and 2004 are consistent with the resolutions of the meetings of the Board of Directors held on February 14, 2006 and February 22, 2005, respectively. If the above bonus to employees, directors and supervisors had been paid entirely in cash and charged to earnings of 2005 and 2004, the basic earnings per share (after income tax) for the years ended December 31, 2005 and 2004 would have decreased from NT$3.79 to NT$3.50 and NT$3.97 to NT$3.70, respectively.

The shares distributed as a bonus to employees represented 1.39% and 1.33% of the Company s total outstanding common shares as of December 31, 2005 and 2004, respectively.

The above information about the appropriations of bonus to employees, directors and supervisors is available at Market Observation Post System website.

Under the Integrated Income Tax System that became effective on January 1, 1998, the R.O.C. resident shareholders are allowed a tax credit for their proportionate share of the income tax paid by the Company on earnings generated since January 1, 1998.

19. STOCK-BASED COMPENSATION PLANS

The Company s Employee Stock Option Plans under the 2005 Plan, 2003 Plan and 2002 Plan were approved by the SFB on January 6, 2005, October 29, 2003 and June 25, 2002, respectively. The maximum number of options authorized to be granted under the 2005 Plan, the 2003 Plan and the 2002 Plan was 11,000 thousand, 120,000 thousand and 100,000 thousand, respectively, with each option eligible to subscribe for one common share when exercisable. The options may be granted to qualified employees of the Company or any of its domestic or foreign subsidiaries, in which the Company s shareholding with voting rights, directly or indirectly, is more than fifty percent (50%). The options of all the plans are valid for ten years and exercisable at certain percentages subsequent to the second anniversary of the grant date. Under the terms of the plans, the options are granted at an exercise price equal to the closing price of the Company s common shares listed on the TSE on the grant date.

Options of the aforementioned Plans that had never been granted or had been granted but subsequently canceled had expired as of June 30, 2006.

Information about outstanding stock options for the six months ended June 30, 2006 and 2005 was as follows:

	Number of Options (in Thousands)	Weighted-Average Exercise Price (NT$)
Six months ended June 30, 2006		
Balance, beginning of period	67,758	$39.4
Options granted	2,517	39.7
Options exercised	(8,219)	39.7
Options canceled	(2,304)	44.5
Balance, end of period	59,752	39.6
Six months ended June 30, 2005		
Balance, beginning of period	64,367	40.5
Options granted	14,864	48.4
Options exercised	(2,941)	39.9
Options canceled	(2,931)	42.7
Balance, end of period	73,359	42.1

The number of outstanding options and exercise prices have been adjusted to reflect the appropriations of dividends in accordance with the plans.

As of June 30, 2006, information about outstanding and exercisable options was as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Price (NT$)	Number of Options (in Thousands)	Weighted-average Remaining Contractual Life (Years)	Weighted-average Exercise Price (NT$)	Number of Options (in Thousands)	Weighted-average Exercise Price (NT$)
$27.6-$39.7	39,415	5.64	$35.6	29,458	$35.6
$45.1-$52.3	20,337	7.34	47.3	312	45.5
	59,752			29,770	

No compensation cost was recognized under the intrinsic value method for the six months ended June 30, 2006 and 2005. Had the Company used the fair value based method (based on the Black-Scholes model) to evaluate the options granted after January 1, 2004, the assumptions and pro forma results of the Company for the six months ended June 30, 2006 and 2005 would have been as follows:

	Six Months Ended June 30	
	2006	**2005**
Assumptions:		
Expected dividend yield	1.00%-3.44%	1.00%-3.44%
Expected volatility	43.77%-46.15%	43.77%-46.15%
Risk free interest rate	3.07%-3.85%	3.07%-3.85%
Expected life	5 years	5 years
Net income:		
Net income as reported	$ 66,608,628	$ 35,187,334
Pro forma net income	66,552,140	35,140,859
Earnings per share (EPS) after income tax (NT$):		
Basic EPS as reported	$ 2.58	$ 1.37
Pro forma basic EPS	2.58	1.36
Diluted EPS as reported	2.58	