China Steel Corporation

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

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
China Steel Corporation

We have audited the accompanying balance sheets of China Steel Corporation (the "Corporation") as of December 31, 2006 and 2005, and the related statements of income, changes in stockholders' 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 Rules Governing the Audit of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China (ROC). 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 in the first paragraph present fairly, in all material respects, the financial position of the Corporation as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, requirements of the Business Accounting Law and Guidelines Governing Business Accounting relevant to financial accounting standards, and accounting principles generally accepted in the ROC.

Effective 2006, as stated in Note 3 to the accompanying financial statements, the Corporation adopted the newly issued Statement of Financial Accounting Standards (SFAS) No. 34 "Accounting for Financial Instruments," SFAS No. 36 "Disclosure and Presentation of Financial Instruments" and the related revisions to other SFASs.

February 7, 2007

<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. Also, as stated in Note 2 to the financial statements, the additional footnote disclosures that are not required under generally accepted accounting principles were not translated into English.

CHINA STEEL CORPORATION

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

ASSETS	**2006 Amount**	**%**	**2005 Amount**	**%**
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 4)	$ 16,196,611	6	$ 17,739,481	7
Financial assets at fair value through profit or loss - current (Notes 2 and 5)	12,315,988	5	10,975,710	4
Available-for-sale financial assets - current (Notes 2 and 6)	4,935,322	2	1,218,156	1
Notes receivable (Note 7)	1,336,278	1	1,641,032	1
Accounts receivable (Notes 2 and 7)	2,737,167	1	2,034,629	1
Other receivables	272,550	-	546,006	-
Inventories (Notes 2 and 8)	32,410,868	12	35,792,031	14
Deferred income tax assets (Note 21)	172,190	-	143,975	-
Pledged time deposits (Note 25)	3,650,000	1	4,600,000	2
Other	1,019,180	-	1,160,737	-
Total current assets	75,046,154	28	75,851,757	30
LONG-TERM INVESTMENTS				
Available-for-sale financial assets - noncurrent (Notes 2 and 6)	2,851,977	1	1,001,210	-
Financial assets carried at cost - noncurrent (Notes 2 and 9)	5,766,315	2	6,173,510	3
Investment in bonds without quoted price - noncurrent (Notes 2 and 10)	5,482,324	2	5,881,374	2
Long-term stock investment - equity method (Notes 2 and 11)	60,630,662	23	52,825,719	21
Total long-term investments	74,731,278	28	65,881,813	26
PROPERTIES (Notes 2, 12, 24 and 25)				
Land	8,322,881	3	7,994,055	3
Land improvements	4,212,123	2	4,216,794	2
Buildings and improvements	37,423,461	14	36,016,863	14
Machinery and equipment	219,788,073	83	212,821,181	85
Transportation equipment	1,473,130	-	1,452,514	1
Miscellaneous equipment	3,096,559	1	3,013,382	1
Total cost	274,316,227	103	265,514,789	106
Appreciation	17,249,891	7	17,668,482	7
Total cost and appreciation	291,566,118	110	283,183,271	113
Less: Accumulated depreciation	203,035,577	76	197,384,284	79
	88,530,541	34	85,798,987	34
Constructions in progress	21,922,773	8	19,768,057	8
Net properties	110,453,314	42	105,567,044	42
OTHER ASSETS				
Rental assets - net (Notes 2 and 13)	3,039,354	1	3,066,346	2
Refundable deposits	55,833	-	346,830	-
Restricted assets - pledged time deposits (Note 25)	31,694	-	31,694	-
Unamortized repair costs and others (Note 2)	2,269,068	1	16,856	-
Total other assets	5,395,949	2	3,461,726	2
TOTAL	$ 265,626,695	100	$ 250,762,340	100

LIABILITIES AND STOCKHOLDERS' EQUITY	**2006 Amount**	**%**	**2005 Amount**	**%**
CURRENT LIABILITIES				
Short-term loans and overdraft (Note 14)	$ 16,609,989	6	$ 11,473,383	4
Commercial paper payable (Note 15)	-	-	1,499,376	1
Notes and accounts payable (Notes 7 and 24)	3,610,786	2	2,336,407	1
Income tax payable (Note 21)	5,682,534	2	7,578,477	3
Accrued expenses (Notes 2 and 18)	7,929,764	3	7,159,512	3
Other payables	3,237,957	1	2,890,008	1
Bonds payable - current portion (Note 16)	-	-	10,000,000	4
Long-term bank loans - current portion (Note 17)	-	-	727,220	-
Other	1,857,490	1	1,444,863	1
Total current liabilities	38,928,520	15	45,109,246	18
LONG-TERM LIABILITIES				
Bonds payable, net of current portion (Note 16)	13,700,000	5	-	-
Bank loans, net of current portion (Notes 17 and 25)	3,426,250	1	2,769,030	1
Total long-term liabilities	17,126,250	6	2,769,030	1
RESERVE FOR LAND VALUE INCREMENT TAX (Note 12)	2,171,124	1	2,171,124	1
OTHER LIABILITIES				
Deferred income tax liabilities (Note 21)	2,716,689	1	2,944,097	1
Deferred credits - gain on intercompany transactions (Note 19)	1,150,940	-	1,142,352	1
Total other liabilities	3,867,629	1	4,086,449	2
Total liabilities	62,093,523	23	54,135,849	22
CAPITAL STOCK - authorized 12,000,000 thousand shares at NT$10 par value (Notes 2 and 20)				
Common shares - issued 11,053,758 thousand shares and 10,545,974 thousand shares as of December 31, 2006 and 2005, respectively	110,537,576	42	105,459,736	42
Preferred shares - issued 40,694 thousand shares and 40,698 thousand shares as of December 31, 2006 and 2005, respectively	406,940	-	406,980	-
Total capital stock	110,944,516	42	105,866,716	42
CAPITAL SURPLUS (Notes 2 and 20)	1,548,370	1	1,209,378	-
RETAINED EARNINGS (Notes 2 and 20)	83,429,463	31	90,107,602	36
OTHER EQUITY ITEMS				
Cumulative translation adjustments (Note 2)	(62,787)	-	(335,992)	-
Investees' unrecognized net loss on pension cost	(37,358)	-	(36,872)	-
Unrealized gain (loss) on financial instruments (Notes 3, 6 and 11)	7,533,737	3	(446,483)	-
Revaluation increment on assets (Notes 3, 12, 19 and 20)	1,512,123	-	1,535,363	-
Total other equity items	8,945,715	3	716,016	-
TREASURY STOCK– 82,780 thousand shares and 79,199 thousand shares as of December 31, 2006 and 2005, respectively	(1,334,892)	-	(1,273,221)	-
Total stockholders' equity	203,533,172	77	196,626,491	78
TOTAL	$ 265,626,695	100	$ 250,762,340	100

The accompanying notes are an integral part of the financial statements.
(With Deloitte & Touche audit report dated February 7, 2007)

CHINA STEEL CORPORATION

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

	2006		2005	
	Amount	**%**	**Amount**	**%**
REVENUES (Notes 2, 24 and 29)	$ 177,658,233	100	$ 186,317,669	100
COST OF REVENUES (Notes 22 and 24)	134,216,258	76	118,991,792	64
GROSS PROFIT	43,441,975	24	67,325,877	36
UNREALIZED (REALIZED) GAIN ON INTERCOMPANY TRANSACTIONS	(26,208)	-	376,905	-
REALIZED GROSS PROFIT	43,468,183	24	66,948,972	36
OPERATING EXPENSES (Notes 22 and 24)				
Selling	2,324,447	1	2,248,551	1
General and administrative	2,281,730	1	2,682,343	1
Research and development	1,117,278	1	1,114,714	1
Total operating expenses	5,723,455	3	6,045,608	3
OPERATING INCOME	37,744,728	21	60,903,364	33
NONOPERATING INCOME AND GAINS				
Interest	343,746	-	540,381	-
Investment income under the equity method (Note 11)	9,631,087	6	4,442,401	3
Gain on appraisal of financial assets (Note 5)	148,954	-	412,496	-
Other	1,299,162	1	1,574,407	1
Total nonoperating income and gains	11,422,949	7	6,969,685	4
NONOPERATING EXPENSES AND LOSSES				
Interest (Note 12)	541,823	-	734,335	-
Impairment loss on financial assets carried at cost (Note 9)	272,000	-	906,000	1
Other	675,101	1	1,120,285	1
Total nonoperating expenses and losses	1,488,924	1	2,760,620	2
INCOME BEFORE INCOME TAX	47,678,753	27	65,112,429	35
INCOME TAX (Notes 2 and 21)	8,482,347	5	14,465,790	8

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CHINA STEEL CORPORATION

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

	2006		2005	
	Amount	**%**	**Amount**	**%**
INCOME BEFORE CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	$ 39,196,406	22	$ 50,646,639	27
CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES (Note 3) (Net of $64,547 thousand income tax benefit in 2006)	(37,822)	-	-	-
NET INCOME	$ 39,158,584	22	$ 50,646,639	27

	2006		2005	
	Before Tax	**After Tax**	**Before Tax**	**After Tax**
EARNINGS PER SHARE (Note 23)				
Basic	$ 4.33	$ 3.56	$ 5.93	$ 4.61
Diluted	$ 4.32	$ 3.56	$ 5.91	$ 4.60

PRO FORMA INFORMATION **-** if the Corporation's shares held by subsidiaries had been accounted for as investments rather than treasury stock

	2006	**2005**
Income before cumulative effect of changes in accounting principles	$ 39,535,300	$ 50,966,883
Net income	39,497,478	50,966,883
Basic earnings per share based on weighted-average number of outstanding common shares 11,052,158 thousand and 11,053,729 thousand as of December 31, 2006 and 2005, respectively	$ 3.57	$ 4.61
Diluted earnings per share based on weighted-average number of outstanding common shares 11,092,852 thousand and 11,094,427 thousand as of December 31, 2006 and 2005, respectively	$ 3.56	$ 4.59

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

(With Deloitte & Touche audit report dated February 7, 2007)

CHINA STEEL CORPORATION

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Cash Dividends Per Share)

	Capital Stock			Retained Earnings									
	Common Stock	Preferred Stock	Capital Surplus	Legal Reserve	Special Reserve	Unappropriated	Total	Revaluation Increment on Assets	Unrealized Gain (Loss) on Financial Instruments	Cumulative Translation Adjustments	Investees' Unrecognized Net Loss on Pension Cost	Treasury Stock	Total Stockholders' Equity
BALANCES, JANUARY 1, 2005	$ 98,889,368	$ 421,770	$ 833,146	$ 25,452,594	$ 8,030,816	$ 52,159,008	$ 85,642,418	$ 339,174	$ (454,039)	$ (365,599)	$ (32,003)	$ (1,113,121)	$ 184,161,114
Conversion of preferred stock to common shares	14,790	(14,790)	-	-	-	-	-	-	-	-	-	-	-
Adjustment of reserve for land value increment tax (Note 12)	-	-	-	-	-	-	-	1,196,189	-	-	-	-	1,196,189
Appropriation of 2004 earnings (Note 20)													
Legal reserve	-	-	-	5,161,667	-	(5,161,667)	-	-	-	-	-	-	-
Special reserve	-	-	-	-	436,524	(436,524)	-	-	-	-	-	-	-
Bonus to employees	1,590,021	-	-	-	-	(2,304,056)	(2,304,056)	-	-	-	-	-	(714,035)
Remuneration to directors and supervisors	-	-	-	-	-	(138,243)	(138,243)	-	-	-	-	-	(138,243)
Cash dividends to preferred shareholders - $3.9 per share	-	-	-	-	-	(158,785)	(158,785)	-	-	-	-	-	(158,785)
Cash dividends to common shareholders - $3.9 per share	-	-	-	-	-	(38,572,559)	(38,572,559)	-	-	-	-	-	(38,572,559)
Stock dividends to preferred shareholders - 5%	20,357	-	-	-	-	(20,357)	(20,357)	-	-	-	-	-	-
Stock dividends to common shareholders - 5%	4,945,200	-	-	-	-	(4,945,200)	(4,945,200)	-	-	-	-	-	-
Net income in 2005	-	-	-	-	-	50,646,639	50,646,639	-	-	-	-	-	50,646,639
Adjustment of equity in investees due to change in percentage of ownership	-	-	55,853	-	-	(42,255)	(42,255)	-	-	-	-	(213,620)	(200,022)
Reversal of unrealized loss on investees' long-term investments	-	-	-	-	-	-	-	-	7,556	-	-	-	7,556
Cumulative translation adjustments on long-term investments	-	-	-	-	-	-	-	-	-	29,607	-	-	29,607
Investees' unrecognized net loss on pension cost	-	-	-	-	-	-	-	-	-	-	(4,869)	-	(4,869)
Disposal of the Corporation's shares held by subsidiaries	-	-	34,425	-	-	-	-	-	-	-	-	60,955	95,380
Cash dividends declared by the Corporation and received by subsidiaries	-	-	285,954	-	-	-	-	-	-	-	-	-	285,954
Reacquired the Corporation's issued shares	-	-	-	-	-	-	-	-	-	-	-	(7,435)	(7,435)
BALANCES, DECEMBER 31, 2005	105,459,736	406,980	1,209,378	30,614,261	8,467,340	51,026,001	90,107,602	1,535,363	(446,483)	(335,992)	(36,872)	(1,273,221)	196,626,491
Adjustment upon adoption of the newly issued Statement of Financial Accounting Standard No. 34 (Note 3)	-	-	-	-	-	-	-	-	3,936,398	261,188	-	-	4,197,586
Conversion of preferred stock to common shares	40	(40)	-	-	-	-	-	-	-	-	-	-	-
Appropriation of 2005 earnings (Note 20)													
Legal reserve	-	-	-	5,060,439	-	(5,060,439)	-	-	-	-	-	-	-
Special reserve	-	-	-	-	(22,347)	22,347	-	-	-	-	-	-	-
Bonus to employees	1,373,025	-	-	-	-	(2,288,375)	(2,288,375)	-	-	-	-	-	(915,350)
Remuneration to directors and supervisors	-	-	-	-	-	(137,302)	(137,302)	-	-	-	-	-	(137,302)
Cash dividends to preferred shareholders - $3.75 per share	-	-	-	-	-	(152,618)	(152,618)	-	-	-	-	-	(152,618)
Cash dividends to common shareholders - $3.75 per share	-	-	-	-	-	(39,541,401)	(39,541,401)	-	-	-	-	-	(39,541,401)
Stock dividends to preferred shareholders - 3.5%	14,244	-	-	-	-	(14,244)	(14,244)	-	-	-	-	-	-
Stock dividends to common shareholders - 3.5%	3,690,531	-	-	-	-	(3,690,531)	(3,690,531)	-	-	-	-	-	-
Net income in 2006	-	-	-	-	-	39,158,584	39,158,584	-	-	-	-	-	39,158,584
Unrealized gain (loss) on available-for-sale financial assets	-	-	-	-	-	-	-	-	1,646,395	-	-	-	1,646,395
Reclassify to nonoperating income due to disposal of appreciated properties	-	-	-	-	-	-	-	(23,240)	-	-	-	-	(23,240)
Adjustment of equity in investees due to change in percentage of ownership	-	-	(78)	-	-	(12,252)	(12,252)	-	2,397,427	-	-	(71,556)	2,313,541
Cumulative translation adjustments on long-term investments	-	-	-	-	-	-	-	-	-	12,017	-	-	12,017
Investees' unrecognized net loss on pension cost	-	-	-	-	-	-	-	-	-	-	(486)	-	(486)
Reacquired the Corporation's issued shares	-	-	-	-	-	-	-	-	-	-	-	(32,096)	(32,096)
Disposal of the Corporation's shares held by subsidiaries	-	-	38,071	-	-	-	-	-	-	-	-	41,981	80,052
Cash dividends declared by the Corporation and received by subsidiaries	-	-	300,999	-	-	-	-	-	-	-	-	-	300,999
BALANCES, DECEMBER 31, 2006	$ 110,537,576	$ 406,940	$ 1,548,370	$ 35,674,700	$ 8,444,993	$ 39,309,770	$ 83,429,463	$ 1,512,123	$ 7,533,737	$ (62,787)	$ (37,358)	$ (1,334,892)	$ 203,533,172

The accompanying notes are an integral part of the financial statements. Additional explanations for stockholder's equity accounts are in Appendix.
(With Deloitte & Touche audit report dated February 7, 2007)

CHINA STEEL CORPORATION

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

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 39,158,584	$ 50,646,639
Cumulative effect of changes in accounting principles	37,822	-
Adjustments		
Depreciation	9,357,647	9,418,781
Amortization	505,859	87,520
Deferred income tax	(191,076)	(17,548)
Cash dividends from long-term investments under the equity method	4,956,820	5,282,274
Investment income under the equity method	(9,631,087)	(4,442,401)
Constructive dividends from investment in bonds without quoted price	399,050	102,951
Impairment loss on financial assets carried at cost	272,000	906,000
Gain on appraisal of financial assets	(148,954)	(412,496)
Unrealized loss (gain) on intercompany transactions	(26,208)	376,905
Effect of exchange rate changes on foreign-currency long-term debts	619	(287,960)
Reversal of allowance for loss on inventories	-	(164,689)
Others	(81,069)	244,684
Net changes in operating assets and liabilities		
Notes receivable	304,754	70,303
Accounts receivable	(702,538)	27,534
Inventories	3,419,504	(9,715,611)
Other receivable	273,456	(319,826)
Other current assets	141,557	(1,012,252)
Notes and accounts payable	1,274,379	(749,933)
Income tax payable	(1,895,943)	(1,826,588)
Accrued expenses	817,054	60,499
Other payables	(1,038,867)	1,806,051
Other current liabilities	447,422	(815,799)
Net cash provided by operating activities	47,650,785	49,265,038
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of financial assets at fair value through profit or loss	(17,900,161)	(19,550,886)
Proceeds from disposal of financial assets at fair value through profit of loss	16,864,655	31,624,551
Purchase of financial assets carried at cost	(75,760)	(1,058,554)
Proceeds from disposal of financial assets carried at cost	4,955	83,103
Purchase of investment in bonds without quoted price	-	(3,349,944)
Increase in long-term stock investments under equity method	(289,554)	(13,250,926)
Proceeds from reduced capital on long-term investments under equity method	-	597,639
Acquisition of properties	(12,911,588)	(16,028,779)
Proceeds from disposal of properties	1,836	96,234
Decrease (increase) in refundable deposits	290,997	(273,038)
Proceeds from reduced capital on financial assets carried at cost	18,000	-

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CHINA STEEL CORPORATION

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

	2006	2005
Decrease in pledged time deposits	$ 950,000	$ 100,000
Decrease (increase) in other assets	(2,757,586)	3,464
Net cash used in investing activities	(15,804,206)	(21,007,136)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in short-term bank loans and overdraft	5,136,606	7,007,423
Decrease in commercial paper payable	(1,499,376)	(299,676)
Repayments of bonds payable	(10,000,000)	(5,000,000)
Increase in bonds payable	13,700,000	-
Increase in long-term loans	-	923,010
Purchase of treasury stocks	(32,096)	(7,435)
Cash dividends	(39,641,931)	(38,692,230)
Remuneration to directors and supervisors and bonus to employees	(1,052,652)	(852,278)
Net cash used in financing activities	(33,389,449)	(36,921,186)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,542,870)	(8,663,284)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	17,739,481	26,402,765
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 16,196,611	$ 17,739,481
SUPPLEMENTAL INFORMATION		
Interest paid (exclusive of capitalized interest)	$ 573,342	$ 742,881
Income tax paid	10,569,366	16,309,926
PURCHASE OF PROPERTIES		
Acquisition of properties	$ 14,246,316	$ 16,054,622
Increase in payable on properties purchased	(1,334,728)	(25,843)
	$ 12,911,588	$ 16,028,779
PAYMENTS OF CASH DIVIDENDS		
Total cash dividends payable to stockholders	$ 39,694,019	$ 38,731,344
Increase in dividends payable	(52,088)	(39,114)
	$ 39,641,931	$ 38,692,230
NONCASH FINANCING ACTIVITIES		
Current portion of long-term liabilities	$ -	$ 10,727,220

The accompanying notes are an integral part of the financial statements. (Concluded)
(With Deloitte & Touche audit report dated February 7, 2007)

CHINA STEEL CORPORATION

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Amounts Stated Otherwise, Earnings and Dividends Per Share)

1. ORGANIZATION AND OPERATIONS

China Steel Corporation (the "Corporation") was incorporated on December 3, 1971. It manufactures and sells steel products and engages in machinery and communications engineering and construction.

The Corporation's stock is listed on the Taiwan Stock Exchange. As of December 31, 2006, the Ministry of Economic Affairs (previously the Ministry of Finance), Republic of China owned 22.7% of the Corporation's outstanding common stock.

As of December 31, 2006 and 2005, the Corporation had about 9,000 and 8,700 employees, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements have been prepared in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, requirements of the Business Accounting Law and Guidelines Governing Business Accounting and accounting principles generally accepted in the Republic of China (ROC). Under these guidelines and principles, the Corporation is required to make certain estimates and assumptions on recorded assets, liabilities, revenues and expenses, including those related to doubtful accounts, inventory loss, depreciation of properties, impairment loss on assets, pension and loss on lawsuits. Actual results could differ from these estimates.

For the convenience of readers, the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the ROC. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail. However, the accompanying financial statements do not include the English translation of additional disclosures that are not required under generally accepted accounting principles but are required by the Securities and Futures Bureau (SFB, formerly the Securities and Futures Commission before July 1, 2004) for their oversight purposes.

The Corporation's significant accounting policies are summarized as follows:

Current and Noncurrent Assets and Liabilities

Current assets include unrestricted cash, cash equivalents, assets held mainly for operating purposes, and other assets to be realized in cash or to be consumed within 12 months from the balance sheet date. Properties and other assets which do not belong to current assets are classified as non-current. Liabilities to be settled within 12 months from the balance sheet date are classified as current. Liabilities which do not belong to current liabilities are classified as noncurrent.

Cash Equivalents

Cash equivalents are short-term notes and bills with maturities of three months or less. The carrying value of cash equivalents approximates fair value.

Financial Assets at Fair Value Through Profit or Loss

Financial instruments (mainly open-end funds) are recognized as financial assets at fair value through profit or loss to remove significant accounting inconsistency. These financial instruments are initially recognized at fair value and its transaction costs are expensed currently. When subsequently measured at fair value, the changes in fair value are recognized in current income. A regular way purchase or sale of financial assets is recorded using trade date accounting.

Fair value is based on net asset value of open-end funds on balance sheet date.

Available-for-sale Financial Assets

Available-for-sale financial assets are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition. When subsequently measured at fair value, the changes in fair value are excluded from earnings and reported as a separate component of stockholders' equity. The 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 recorded using trade date accounting.

Cash dividends received from and after the year of investment acquisition are recognized as income in the period received. Stock dividends are recognized only as an increase in the number of shares of stock held on the ex-dividend date. Costs of investments sold are determined by the weighted-average method. Any difference between the initial carrying amounts of a debt security and the amount due at maturity is amortized using the straight – line method and the amortization is credited or charged to income.

If there is objective evidence that a financial asset is impaired, an impairment 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 stockholders' 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.

Fair value is based on the closing price on balance sheet date for listed stocks and determined by using valuation technique for financial instruments without quoted price.

Factoring of Accounts Receivable

The following three conditions must be met to recognize factoring of accounts receivable:

a. The accounts receivable have been legally isolated from the Corporation.

b. The transferees have obtained the right to pledge or exchange the accounts receivable, which are either the transferred accounts receivable or beneficial interest in the transferred assets.

c. The transferor does not maintain effective control, through an agreement to repurchase or redeem the transferred accounts receivable before their maturity, over the transferred accounts receivable.

If the three conditions are met, the difference between the proceeds and the face value of the accounts receivable is recognized as a loss and recorded as nonoperating expenses.

Inventories

Inventories are raw materials, supplies, fuel, finished products, work in process and by-products. Inventories are stated at the lower of total moving average cost or market value. Market value is the net realizable value for finished products, work in process and by-products, and replacement costs for raw materials, supplies and fuel.

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 original cost, such as non-publicly traded stocks and mutual funds. If there is objective evidence that a financial asset is impaired, an impairment loss is recognized. No recording of a subsequent recovery in fair value is allowed.

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

Investment in Bonds Without Quoted Price

Investment that does not have a quoted market price in an active market and the receipt upon maturity is fixed or definite is carried at the amortized cost. Those financial assets are initially recognized at fair value plus transaction cost that are directly attributable to the acquisition. Earnings or losses are recognized at the time of derecognition, impairment or amortization.

If there is objective evidence that a financial asset is impaired, an impairment 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 should not result in a carrying amount of the financial asset that exceeds the amortized cost that would have been determined if no impairment loss had been recognized.

Long-term Stock Investment - Equity Method

Long-term stock investments in which the Corporation owns 20% or more of the outstanding voting shares or where the Corporation has significant influence on the investees are accounted for by the equity method. When the equity method is first applied or when a stock is acquired, the difference between the carrying value of an investment and the proportionate equity in the investee is amortized over five years.

Effective January 1, 2006, pursuant to the revised Statement of Financial Accounting Standards (SFAS) No.5 "Long-term Investment under Equity Method," investment premiums, representing goodwill, are no longer being amortized, but annual impairment test is required. The investment discounts, representing the fair value of identifiable net assets acquired over investment costs, are allocated proportionately based on the fair values of noncurrent asset amounts and any remaining unallocated balance is recorded as extraordinary income. The investment discounts that existed prior to January 1, 2006 will continue to be amortized over five years.

If an investee issues additional shares and the Corporation acquires shares at a percentage different from its current equity in the investee, capital surplus is adjusted for the difference between the carrying values of the investments and the Corporation's equity in the investee's net assets. If the carrying value is less than equity in net assets, the difference is added to capital surplus. If the carrying value is more than equity in net assets, the difference is deducted from capital surplus, or from unappropriated earnings when capital surplus is not enough for debiting purposes.

If the market prices of investees - equity securities significantly decline below carrying value and the decline is permanent, the investment loss should be recognized as realized loss in the same year of the decline. This investment will be revalued if an investee's market value becomes higher than book value per share. The difference between the new cost of the investment and the proportionate equity in the investee is amortized over five years.

Properties

Properties are stated at cost or cost plus appreciation, less accumulated depreciation. Interest expense for the purchase or construction of properties is capitalized as property cost. Major additions, renewals and betterments are capitalized, while maintenance and repairs are expensed currently.

Depreciation is calculated by the straight-line method over service lives estimated as follows: land improvements, 10 to 40 years; buildings and improvements, 5 to 60 years; machinery and equipment, 3 to 25 years; transportation equipment, 3 to 25 years; and miscellaneous equipment, 3 to 10 years. Depreciation on appreciation is calculated by the straight-line method over the remaining service lives of the revalued assets. When a property reaches its residual value but is still in use, its residual value is depreciated over its reestimated service life.

Upon sale or other disposal of properties, the related cost, appreciation and accumulated depreciation are removed from the accounts. Gains or losses are credited or charged to current income.

Rental Assets

Rental assets (included in other assets) are stated at the lower of carrying value or recoverable value.

Asset Impairment

Assets (primarily properties, rental assets and long-term investments under the equity method) are evaluated on the basis of their recoverable value. If the recoverable value is less than the carrying value of the assets, the decline is charged to impairment loss and accumulated impairment loss is established. If the value of the impaired assets recovers, the accumulated impairment loss will be reversed. However, the loss reversal is only to the extent that the increased carrying amount of an asset does not exceed the asset carrying amount (net of depreciation) that would have been determined had no impairment loss been recognized in prior years.

Unamortized Repair Costs

Unamortized repair costs refer to the major repairs of blast furnaces and are amortized over five years.

Treasury Stock

The Corporation reacquired its issued shares in accordance with government regulations and recorded this reacquisition as treasury stock at cost, which is presented as a deduction to stockholders' equity.

Effective 2002, the Corporation's shares acquired and held by subsidiaries are reclassified to treasury stock from long-term investments and accounted for at the carrying value recorded by subsidiaries for short-term or long-term investments as of January 1, 2002.

Effective 2005, the revised SFAS No. 7, "Consolidated Financial Statements," requires that equity-method investees that are not majority-owned but over which the Corporation has controlling capability in substance are deemed as subsidiaries. Thus, the Corporation's shares held by these investees are recorded as treasury stock.

Revenue Recognition and Allowance for Doubtful Accounts

Revenues are recognized when titles to products and risks of ownership are transferred to customers as follows: domestic sales - when products are delivered out of the Corporation's premises to customers; exports - when products are loaded onto vessels.

Sales are measured at fair value, the price (net of trade discounts and sales discounts) agreed to by the Corporation and customers. But if the related receivable is due within one year, the difference between its present value and receivable amount is immaterial, and sales transactions are frequent, the fair value of receivables is equivalent to the nominal amount of cash to be received.

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

Capitalization and Expense

Expenditure which amount is significant and has future economic benefits is classified as asset; otherwise is classified as expense or loss.

Pension

Pension costs under defined benefit pension plan are recognized on the basis of actuarial calculations. The difference between the actuarial pension cost and the amount appropriated to a special fund (Note 18) is recognized as accrued pension liability (included in accrued expenses). Unamortized net transition assets and actuarial gain or loss are amortized over 11 years and the average remaining service life of employees, respectively.

Pension costs under defined contribution plan are recognized based on the amount of actual contributions made by the Corporation to the employees' individual pension accounts.

Income Tax

Income tax is provided based on inter-period allocation basis. Tax effects of deductible temporary differences are recognized as deferred income tax assets. Valuation allowance is provided for deferred tax assets with uncertain realizability. Tax effects of taxable temporary differences are recognized as deferred tax liabilities. A deferred tax asset or liability is classified as current or noncurrent depending on the classification of the related asset or liability for financial reporting. But if the deferred income tax asset or liability cannot be related to an asset or liability for financial reporting, the classification is based on the expected reversal or realization date of the temporary difference.

Tax credits arising from expenditures for purchases of equipment, research and development, employees' training, and investment in newly emerging, important and strategic industries are recognized when those credits are granted.

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

Annual earnings are appropriated under a resolution adopted in the stockholders' meeting in the year following the year of earnings generation. Under tax regulations, unappropriated earnings generated from January 1, 1998 are subject to 10% income tax. This tax is recorded as expense in the year when the stockholders resolve to retain the earnings.

Foreign-currency Transactions

Foreign-currency transactions, except derivative transactions, are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Gains or losses resulting from the application of prevailing exchange rates when foreign-currency assets and liabilities are settled or converted, are credited or charged to income in the year of settlement or conversion. On the balance sheet date, foreign-currency assets and liabilities are restated at the prevailing exchange rates, and resulting differences are accounted for as follows:

(a) Equity-method stock investments - as cumulative translation adjustments under stockholders' equity;

(b) Other assets and liabilities - as credits or charges to current income.

Foreign – currency financial assets carried at cost are stated at the historical rate.

The spot exchange rates use the middle price of the Taipei Foreign Exchange Trading Centre.

Hedge Accounting

The Corporation uses financial instruments to hedge the currency change of a net investment in a foreign operation. The hedge is attributable to fair value hedge and using the non-derivative financial instruments to be the hedge tools.

For the fair value hedge, both the fair value change of the investments and financial instruments are recorded as gain or loss in the current period.

The Corporation uses the hedge activities to control the net investment currency exchange and fair value risk.

Reclassification

As stated in Note 3, certain accounts for the year ended December 31, 2005 had been reclassified to conform to the classifications in 2006.

3. ACCOUNTING CHANGES

Effective 2006, the Corporation adopted the newly issued SFAS No.34 "Accounting for Financial Instruments" No.36 "Disclosure and Presentation of Financial Instruments" and the related revisions of previously released SFASs.

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

   The Corporation had properly categorized its financial assets and liabilities upon initial adoption of the newly released SFASs and related revisions of previously 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 financial assets carried at cost and available-for-sale financial assets were recognized as adjustments to shareholders' equity.

   In addition, the foreign-currency investment under cost method is reclassified as financial assets carried at cost which were revalued based on the historical exchange rate at initial investment date and adjustment was made to cumulative translation adjustment recorded in shareholders' equity and related financial assets.

   The Corporation also reassessed the hedge effectiveness for the equity investment in East Asia United Steel Corporation and adjusted the exchange loss of $193,641 thousand previously recorded to cumulative effect of changes in accounting principles.

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 Stockholders' Equity (Net of Tax)
Financial assets at fair value through profit or loss	$ 155,819	$ -
Available-for-sale financial assets	-	3,936,398
Financial assets carried at cost	(193,641)	261,188
	$ (37,822)	$ 4,197,586

The net effect of the change in accounting principles is not significant to the Corporation's net income and basic earnings per share for the year ended December 31, 2006.

b. Reclassifications

Upon the adoption of SFAS No.34, certain accounts in the financial statements as of and for the year ended December 31, 2005 were reclassified to conform with the financial statements as of and for the year ended December 31, 2006. The previously issued financial statements as of and for the year ended December 31, 2005 were not required to 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) Long-term stock investment

Long-term stock investments in which the Corporation owns less than 20% of the outstanding voting shares or where the Corporation has no significant influence on the investees are accounted for by the cost method. The investments listed on the Taiwan Stock Exchange are stated at the lower of total cost or market value and unrealized loss on long-term investment is classified as a deduction item of the stockholders' equity.

On the balance sheet date, foreign-currency assets and liabilities are restated at the prevailing exchange rates, and resulting differences are accounted for as cumulative translation adjustments under stockholders' equity if restated balances are lower than their costs; otherwise, no adjustment is made.

Certain accounts in the financial statements as of and for the year ended December 31, 2005 have been reclassified to conform to the classifications prescribed by the newly released and revised SFASs. The reclassifications of certain accounts are summarized as follows:

	Before Reclassification	After Reclassification
Balance sheet		
Short-term investments	$ 16,693,866	$ -
Long-term investments	13,056,094	-
Unrealized loss on long-term investments	(446,483)	-
Financial assets at fair value through profit or loss	-	10,975,710
Available-for-sale financial assets - current	-	1,218,156
Available-for-sale financial assets - noncurrent	-	1,001,210
Investment in bonds without quoted price- noncurrent	-	5,881,374
Financial assets carried at cost - noncurrent	-	6,173,510
Unrealized loss on financial instrument	-	(446,483)
Cash and cash equivalents	-	4,500,000
Income statement		
Gain on disposal of investments	412,496	-
Impairment loss on long-term investment	906,000	-
Gain on appraisal of financial assets	-	412,496
Impairment loss on financial assets carried at cost	-	906,000

Effective January 1, 2006, the Corporation adopted the amended SFAS No.1 "Conceptual Framework for Financial Accounting and Preparation of Financial Statements," No.5 "Long-Term Investment under Equity Method" and No.25 "Business Combinations." The amendments of the SFASs mainly provided that the carrying value of investment and the proportionate equity shall be analyzed, and goodwill should be tested for impairment annually and is no longer being amortized. Such change did not have significant impact on the Corporation's financial statements as of and for the year ended December 31, 2006.

c. Revision of the Business Accounting Law

Certain accounts in the financial statements as of and for the year ended December 31, 2005 have been reclassified to conform to the revision of the Business Accounting Law. The reclassification of the account balances was as follows:

	Before Reclassification	After Reclassification
Capital surplus	$ 1,535,363	$ -
Revaluation increment on assets – stockholders' equity	-	1,535,363

4. CASH AND CASH EQUIVALENTS

	2006	2005
Cash on hand	$ 18,704	$ 20,273
Checking accounts and demand deposits	872,368	2,320,639
Time deposits	2,700,000	3,700,000
Negotiable certificate of time deposits	3,000,000	4,500,000
Cash equivalents - short-term notes and bills	9,605,539	7,198,569
	$ 16,196,611	$ 17,739,481

As of December 31, 2006, the Corporation had foreign bank deposits of ￥8,685 thousand in Japan-Osaka Bank and ￥27,904 thousand in Singapore - Daiwa Securities SMBC with the total of $10,057 thousand.

5. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

This mainly represents open-end funds. As of December 31, 2006 and 2005, the balances of financial assets at fair value through profit or loss were $12,315,988 thousand and $10,975,710 thousand, respectively. The purpose of classifying open-end funds to this account is to remove the accounting inconsistency between investment income and interest expense.

Net gain arising from the financial assets at fair value through profit or loss for the year ended December 31, 2006 was $148,954 thousand (including gain on appraisal and disposal of financial assets).

6. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2006		2005	
	Current	Noncurrent	Current	Noncurrent
Listed stock				
Maruichi Steel Tube Ltd.	$ -	$ 757,920	$ -	$ 757,920
Advanced Material Technology Corporation (AMTC)	-	243,290	-	243,290
Tang Eng Iron Works Corporation (TEIWC)	-	-	-	-
Taiwan Semiconductor Manufacturing Company (TSMC)	967,456	-	967,456	-
Bank debentures - Taiwan Cooperative Bank	250,460	-	250,700	-
Allowance for appraisal	3,717,406	1,850,767	-	-
	$ 4,935,322	$ 2,851,977	$ 1,218,156	$ 1,001,210

In July 2006, Tang Eng Iron Works Corporation’s stock was listed on the Gre Tai Securities Market. Accordingly, this financial asset carried at cost was classified as available-for-sale financial asset. The Corporation recognized an unrealized gain on appraisal of $895,821 thousand on this financial asset.

The unrealized gain on the above mentioned financial assets determined at fair value as at December 31, 2006 was $1,646,395 thousand.

The Corporation borrowed foreign-currency bank loans in the same amounts with the hedged investment to hedge exchange rate fluctuation risks on the investments in Maruichi Steel Tube Ltd. (Notes 17 and 27)

7. NOTES AND ACCOUNTS RECEIVABLE

The Corporation entered into three factoring accounts receivable contracts (without recourse) with Mega International Commercial Bank (formerly The International Commercial Bank of China merged with the Bank of Communications to form Mega International Commercial Bank), Bank of Taiwan and Taipei Fubon Bank for the facilities of $5.84 billion, $2.5 billion and $0.8 billion, respectively. Under the contracts, the Corporation is empowered to sell accounts receivable to the banks upon the delivery of products to customers and is required to complete related formalities at the next banking day.

The Corporation entered into a commercial paper purchasing contract, which was due on October 31, 2005, with Mega Bills Finance Corporation (formerly Chung Hsing Bills Finance Corporation) for the facility of $2.5 billion. Customers will issue commercial papers to the Corporation upon the delivery of products. The commercial papers will be sold to Mega Bills Finance Corporation (without recourse) upon the Corporation’s endorsements.

As of December 31, 2006, there was no outstanding endorsed commercial paper.

The related information for the Corporation's sale of its notes and accounts receivable for the year ended December 31, 2006 and 2005 is as follows:

Transaction Counter - party	Total Factoring Amounts	Related Expenses	Proceeds Received	Interest Rate (%)
2006				
Accounts Receivable				
Mega International Commercial Bank	$ 9,088,245	$ 73,956	$ 9,014,289	1.57 ~ 1.95
Bank of Taiwan	1,069,512	6,494	1,063,018	1.57 ~ 1.95
Taipei Fubon Bank	45,040	284	44,756	2.02 ~ 2.15
	$ 10,202,797	$ 80,734	$ 10,122,063	
2005				
Notes Receivable				
Mega Bills Finance Corporation	$ 3,368,849	$ 20,531	$ 3,348,318	1.70 ~ 2.10
Accounts Receivable				
Mega International Commercial Bank	5,898,506	43,579	5,854,927	1.64 ~ 2.10
Bank of Taiwan	3,208,548	21,386	3,187,162	1.64 ~ 4.16
	9,107,054	64,965	9,042,089	
	$ 12,475,903	$ 85,496	$ 12,390,407	

8. INVENTORIES

	2006	2005
Finished products	$ 6,555,804	$ 6,776,286
Work in process	9,947,583	9,293,601
Raw materials	6,730,833	12,320,916
Supplies	5,471,366	5,210,244
Materials in transit and others	2,667,036	1,733,764
Fuel	151,547	89,186
Others	886,699	368,034
	$ 32,410,868	$ 35,792,031

9. FINANCIAL ASSETS CARRIED AT COST

	2006	2005
Common stocks without quoted market prices		
Industrial Bank of Taiwan	$ 1,000,000	$ 1,000,000
CDIB & Partners Investment Holding Corporation	500,000	500,000
CDIB BioScience Ventures I, Inc. (CBVI)	102,000	120,000
Hsun Hsin Cement Enterprise Corp.	75,760	-
Phalanx Biotech Group Corporation (PBG)	73,370	105,370

(Continued)

	2006	2005
Overseas Investment & Development Corporation	$ 50,000	$ 50,000
CTB I Venture Capital Co., Ltd.	50,000	50,000
Asia Pacific Broadband Telecom Co., Ltd. (APBT)	-	240,000
Kaohsiung Arena Development Corp. (KADC) (Note 11)	-	135,000
Tang Eng Iron Works Corporation (TEIWC) (Note 6)	-	-
Preferred stocks without quoted market prices		
East Asia United Steel Corporation (EAUS)	2,741,000	2,794,000
Dragon Steel Corporation	999,877	999,877
Fund - Sino-Canada Biotechnology Development Fund, LP (SCBDF)	174,308	179,263
	$ 5,766,315	$ 6,173,510

The stocks which do not have quoted prices and their fair value cannot be measured reliably were classified as financial assets carried at cost.

In June 2006, CBVI reduced its capital and returned $18,000 thousand to the Corporation.

In August 2006, the Corporation invested $75,760 thousand for limestones supply to acquire 8,609 thousand shares of Hsun Hsin Cement Enterprise Corp. ($8.8 per share), representing 9% equity, which manufactures and sells cement products.

In May 2003, the Corporation signed a slab production joint-venture contract with Sumitomo Metal Industries, Ltd. and Sumitomo Corporation. In July 2003, the joint venture company of East Asia United Steel Corporation (EAUS) was established. As of December 31, 2006, the Corporation had invested in EAUS the amount of ￥10 billion (Notes 17 and 27). The Corporation thus enjoys a stable supply of good quality slab from this joint venture. The Corporation also signed a contract with Chung Hung Steel Corporation (CHSC) to transfer the purchasing right of slabs from EAUS, and the Corporation receives premiums on this contract based on the volume purchased by CHSC.

The Corporation promised to invest 100 units ($10,000 thousand Canadian dollars) in the SCBDF fund. As of December 31, 2006, the Corporation had invested $219,025 thousand (CAD$9,435 thousand) in SCBDF fund. The difference between the above cumulative investment and the carrying value was cash dividends received by the Corporation.

In September 2006, PBG reduced its capital to offset a deficit. Accordingly, the Corporation recognized an impairment loss of $32,000 thousand.

In 2006 and 2005, the Corporation recognized an impairment loss of $240,000 thousand and $906,000 thousand (recorded as nonoperating loss) on its investment in APBT, respectively.

10. INVESTMENT IN BONDS WITHOUT QUOTED PRICE

	2006	2005
Taiwan High Speed Rail Corporation (THSRC)		
Preferred C	$ 4,297,940	$ 4,646,990
Preferred B	884,384	934,384
Taigen Biotechnology Co., Ltd. (TBC)	300,000	300,000
	$ 5,482,324	$ 5,881,374

In September 2003, the Corporation acquired 100,000 thousand Preferred B shares (representing 4% of ownership) of THSRC for $1,000,000 thousand. Dividend on these shares is at 5%, payable on a nonparticipating and cumulative basis. These shares with six years of durations could be extended for 13 months prior to 3 months of the due date. In April 2005 and August 2004, the Corporation acquired additional 505,370 thousand Preferred C shares of THSRC for $3,199,944 thousand and $1,499,996 thousand, respectively. These shares, representing 19% of ownership, which may be converted to common shares within four years from the acquisition date, have a 9.5% dividend in the first two years and 0% in the next two years. At the end of four years, i.e., in 2009 and 2008, if the Corporation does not convert the Preferred C shares into common shares and THSRC cannot redeem the shares, the unredeemed shares will have 4.71% dividends. THSRC mainly builds and operates public transportation systems.

In November 2005 and March 2004, the Corporation acquired a total of 20,000 thousand preferred shares of TBC for $300,000 thousand. Preferred shareholders are entitled to 8% participating and noncumulative dividends as well as 9% voting and election rights. TBC mainly researches and develops drugs. The Corporation can request TBC to redeem all or part of preferred shares by issuing new stock or its own retained earnings after July of 2007.

11. LONG-TERM STOCK INVESTMENTS UNDER EQUITY METHOD

	2006		2005	
	Amount	% of Ownership	Amount	% of Ownership
Stocks listed on the Taiwan Stock Exchange				
Chung Hung Steel Corporation (CHSC)	$ 2,759,685	24	$ 1,138,751	24
China Steel Chemical Corporation (CSCC)	1,226,692	30	1,099,876	30
China Hi-ment Corporation (CHC)	656,151	20	619,815	20
China Steel Structure Corporation (CSSC)	499,023	18	471,177	18
China Ecotek Corporation (CEC)	373,658	36	407,238	36
	5,515,209		3,736,857	
Less: Shares held by subsidiaries accounted for as treasury stock	332,196		333,214	
	5,183,013		3,403,643	
Stocks without quoted market prices				
Dragon Steel Corporation (DSC)	15,731,795	47	15,122,411	47
Gains Investment Corporation (GIC)	8,788,400	100	6,341,240	100
China Steel Express Corporation (CSE)	8,631,926	100	7,870,266	100
C. S. Aluminum Corporation (CAC)	7,387,741	100	7,031,956	100
China Prosperity Development Corporation (CPDC)	4,680,646	100	4,721,157	100
Kaohsiung Rapid Transit Corporation (KRTC)	3,035,260	31	3,112,060	31
China Steel Asia Pacific Holdings Pte Ltd (CSAPH)	2,683,091	100	2,408,502	100
Goang Yaw Investment Corporation (Goang Yaw) and other two investment companies	1,877,523	99	817,541	99
China Steel Global Trading Corporation (CSGT)	1,193,585	100	1,135,359	100
China Steel Machinery Corporation (CSMC)	861,088	100	826,656	100
Info-Champ Systems Corporation (ICSC)	644,834	100	554,411	100
Kaohsiung Arena Development Corporation (KADC)	260,606	18	-	-
China Steel Security Corporation (CSS)	250,071	100	236,689	100
Taiwan Rolling Stock Co., Ltd. (TRSC)	226,194	22	164,447	27

(Continued)

	2006 Amount	2006 % of Owner-ship	2005 Amount	2005 % of Owner-ship
Hi-mag Magnetic Corporation (HMC)	$ 94,324	50	$ -	50
Baolai Greeting Development Co., Ltd. (BGDC)	50,136	45	-	-
China Steel Management Consulting Corporation (CSMCC)	9,458	38	8,533	38
TaiAn Technologies Corporation (TTC)	4,136	17	3,420	17
	56,410,814		50,354,648	
Less: Shares held by subsidiaries accounted for as treasury stock	963,165		932,572	
	55,447,649		49,422,076	
	$ 60,630,662		$ 52,825,719	

As of December 31, 2006 and 2005, the Corporation's total equity in CHSC was 39%, including directly owned - 24% and indirectly owned - 15%. The Corporation's total equity in TTC was 22%, including directly owned - 17% and indirectly owned through CSCC - 5%. In March 2005 and November 2004, the Corporation had totally invested $135,000 thousand in KADC and invested additional $135,000 thousand in June and September 2006. The Corporation's subsidiary also invested in KADC in 2006, thus, the Corporation and subsidiary's total equity in KADC was 33%, including directly owned - 18% and indirectly owned - 15%. Accordingly, the investment in KADC carried at cost was changed to be accounted for by equity method.

In 2005, DSC issued additional shares and declared stock dividends for its preferred stock. The Corporation further increased its investment in DSC by 980,032 thousand shares for $13,230,426 thousand ($13.5 per share) and common stock dividends appropriated from DSC received by the Corporation. The Corporation's equity in DSC increased from 37% to 47%.

In August 2005, CSAPH reduced its capital and returned US$18,000 thousand (29,455 thousand shares) to the Corporation.

In May 2006, the Corporation invested $54,000 thousand to acquire 5,400 thousand shares of BGDC, representing 45% equity. The Corporation plans to invest in BGDC a total of $216,000 thousand. BGDC will engage in hotel business and is currently in the development stage.

The market value of above listed stocks was $11,527,090 thousand and $6,625,280 thousand based on the closing prices on December 31, 2006 and average closing prices in December 2005, respectively.

The Corporation's Board of Directors approved plans for additional investments in China Shipbuilding Corp., DSC, TRSC, etc. The related subscription schedule depends on the investees' capital increase requirements. As of December 31, 2006, the Corporation's future infused capital in these investees aggregated $6,722,831 thousand.

Investment income (loss) under the equity method was as follows:

	2006	2005
CSE	$ 3,452,173	$ 2,722,709
CHSC, Goang Yaw and other two subsidiaries	2,623,804	(1,174,216)
GIC	886,902	692,336
CAC	689,395	483,448

(Continued)

	2006	2005
DSC	$ 642,517	$ 366,086
CSCC	362,817	304,511
CSGT	357,284	355,539
CSAPH	285,331	185,550
CHC	135,591	136,701
ICSC	83,440	83,685
CSMC	34,173	135,794
CSSC	17,733	184,297
CEC	(8,829)	40,771
Others	68,756	(74,810)
	$ 9,631,087	$ 4,442,401

Above investment income (loss) was recognized based on the investees' audited financial statements.

The Corporation has prepared the consolidated financial statements including all majority-owned and controlled-in-substance subsidiaries in accordance with the related regulations.

12. PROPERTIES

	Cost	Appreciation	Total
December 31, 2006			
Cost and appreciation			
Land	$ 8,322,881	$ 5,840,732	$ 14,163,613
Land improvements	4,212,123	492,990	4,705,113
Buildings and improvements	37,423,461	2,423,546	39,847,007
Machinery and equipment	219,788,073	8,433,643	228,221,716
Transportation equipment	1,473,130	27,233	1,500,363
Miscellaneous equipment	3,096,559	31,747	3,128,306
	274,316,227	17,249,891	291,566,118
Accumulated depreciation			
Land improvements	3,221,503	432,626	3,654,129
Buildings and improvements	16,343,315	1,678,984	18,022,299
Machinery and equipment	169,297,383	8,431,852	177,729,235
Transportation equipment	1,151,393	27,222	1,178,615
Miscellaneous equipment	2,419,566	31,733	2,451,299
	192,433,160	10,602,417	203,035,577
Constructions in progress	21,922,773	-	21,922,773
	$ 103,805,840	$ 6,647,474	$ 110,453,314

(Continued)

	Cost	Appreciation	Total
December 31, 2005			
Cost and appreciation			
Land	$ 7,994,055	$ 5,840,732	$ 13,834,787
Land improvements	4,216,794	492,990	4,709,784
Buildings and improvements	36,016,863	2,424,236	38,441,099
Machinery and equipment	212,821,181	8,844,981	221,666,162
Transportation equipment	1,452,514	33,748	1,486,262
Miscellaneous equipment	3,013,382	31,795	3,045,177
	265,514,789	17,668,482	283,183,271
Accumulated depreciation			
Land improvements	3,097,184	421,746	3,518,930
Buildings and improvements	15,356,709	1,623,030	16,979,739
Machinery and equipment	164,474,811	8,841,645	173,316,456
Transportation equipment	1,170,916	33,728	1,204,644
Miscellaneous equipment	2,332,735	31,780	2,364,515
	186,432,355	10,951,929	197,384,284
Constructions in progress	19,768,057	-	19,768,057
	$ 98,850,491	$ 6,716,553	$ 105,567,044

In the purchase of properties in 2006, the capitalized interest information is disclosed as follows:

Interest expense before capitalization	$ 636,177
Capitalized interest – construction in progress	(94,354)
Interest expense through income statement	$ 541,823
Interest rates of interest expenses capitalized (annual rate)	1.64%-2.23%

In 1981 and 1994, the Corporation revalued its properties and patents in accordance with government regulations, resulting in an increment of $17,662,343 thousand. After the deduction of the reserve for land value increment tax of $3,370,813 thousand, an increment of $14,291,530 thousand was credited to capital surplus. As of December 31, 2006, capital surplus from revaluation of assets totaling $13,952,356 thousand had been transferred to capital stock, reducing the balance of capital surplus from revaluation of assets to $339,174 thousand. In January 2005, the government revised the land increment tax law to reduce the tax rate. Thus, the reserve for land value increment tax decreased and the capital surplus from revaluation increment increased each by $1,196,189 thousand. Accordingly, the balance of capital surplus from revaluation increment increased to $1,535,363 thousand. In 2006, upon retirement or sale of appreciated properties, the capital surplus from revaluation increment decreased by $23,240 thousand. Such decrease was reclassified to nonoperating revenue.

In 2005, the Corporation decreased the reserve for land value increment tax by $3,500 thousand resulting from sale of its land, building and equipment situated in Taipei with a gain on disposal of $68,026 thousand. As of December 31, 2006, the balance of reserve for land value increment tax amounted to $2,171,124 thousand.

In January 2005, the Corporation repurchased land from CPDC for $834,673 thousand, and after offsetting unrealized gain on intercompany transaction of $268,876 thousand which occurred in 1999, the actual purchase cost was $565,797 thousand.

13. RENTAL ASSETS - NET

	2006	2005
Land - at cost	$ 2,966,632	$ 2,966,398
Machinery and equipment - at cost	2,000,000	2,000,000
Less: Accumulated depreciation	1,333,278	1,306,052
Accumulated impairment loss	594,000	594,000
	72,722	99,948
	$ 3,039,254	$ 3,066,346

The Corporation has leased some of its plant property and machinery to its subsidiaries (Note 24).

14. SHORT-TERM BANK LOANS AND OVERDRAFT

	2006	2005
Credit loans - interest at 1.658%-1.73% p.a. and 1.387%-1.479% p.a. as of December 31, 2006 and 2005, respectively	$ 13,900,000	$ 7,500,000
Letters of credit - due within 180 days; interest at 0.7%-5.7833% p.a. and 0.26%-5.38% p.a. as of December 31, 2006 and 2005, respectively	489,422	674,869
Overdraft - interest at 1.49%-1.701% p.a. and 1.1%-2.72% p.a. as of December 31, 2006 and 2005, respectively	2,220,567	3,298,514
	$ 16,609,989	$ 11,473,383

15. COMMERCIAL PAPER PAYABLE

	2005
Commercial paper - interest rates at 1.15%-1.34% p.a. as of December 31, 2005	$ 1,500,000
Unamortized discounts	(624)
	$ 1,499,376

16. LONG-TERM BONDS PAYABLE

	2006	2005
5-year unsecured bonds - issued at par in:		
November 2006; repayable in November 2011; 2.07% interest p.a., payable annually	$ 5,600,000	$ -
June 2006; repayable in June 2011; 2.32% interest p.a., payable annually	8,100,000	-
November 2001; repayable in November 2006; 3.1% interest p.a., payable annually	-	3,500,000
November 2001; repayable in November 2006; 3.0763% interest p.a., compounded semiannually and payable annually	-	1,500,000

(Continued)

	2006	2005
June 2001; repayable in June 2006; 4.27% interest p.a., payable annually	$ -	$ 5,000,000
	13,700,000	10,000,000
Current portion	-	10,000,000
	$ 13,700,000	$ -

17. LONG-TERM DEBTS

	2006	2005
Repayable in July 2010 (¥4.4 billion); floating rates at 0.69% and 0.2288% p.a. as of December 31, 2006 and 2005, respectively	$ 1,206,040	$ 1,230,680
Repayable in December 2009 (¥2.6 billion); floating rates at 0.8563% and 0.2310% p.a. as of December 31, 2006 and 2005, respectively	712,660	727,220
Repayable in July 2010 (¥2.2 billion); floating rates at 0.8034% and 0.2750% p.a. as of December 31, 2006 and 2005, respectively	603,020	615,340
Repayable in July 2010 (¥3.3 billion); floating rates at 0.7719% and 0.3625% p.a. as of December 31, 2006 and 2005, respectively	904,530	923,010
	3,426,250	3,496,250
Current portion	-	727,220
	$ 3,426,250	$ 2,769,030

As of December 31, 2006, the Corporation borrowed long-term bank loans in yen to hedge the exchange rate fluctuations on the investments in yen in East Asia United Steel Corporation and Maruichi Steel Tube Ltd (Note 6).

18. PENSION PLAN

The Labor Pension Act (the "Act") became effective on July 1, 2005. The Corporation's regular employees hired before June 30, 2005, have chosen to continue their pension plan under the Labor Standards Law (those employees may change their choice to the "Act" before July 1, 2010), or have chosen the pension plan under the Act, but retained their employment seniority earned until June 30, 2005. Employees hired after July 1, 2005 can only adopt the pension plan under the Act.

Under the Act, a defined contribution plan, the Corporation makes monthly contribution to employees' personal retirement account at amounts equal to 6% of the salaries and wages of employees.

The pension costs are as follows:

	2006	2005
Under Labor Standards Law	$ 1,422,843	$ 1,369,536
Under Labor Pension Act	10,283	1,773
	$ 1,433,126	$ 1,371,309

The Corporation has a retirement plan in accordance with the Labor Standards Law. Retirement benefits are based on employee's length of service and his/her average salaries and wages of the last six months before retirement.

The Corporation makes contributions, equal to a certain percentage of salaries, to a pension fund, which is deposited in the Central Trust of China in the name of, and administered by the employees' pension fund administration committee. The changes in the fund are summarized as follows:

	2006	2005
Balance, beginning of year	$ 11,759,018	$ 10,503,035
Contributions	1,473,971	1,289,951
Gains	248,241	117,438
Payment of benefits	(294,130)	(151,406)
Balance, end of year	$ 13,187,100	$ 11,759,018

Since August 1999, the Corporation also made contributions, equal to a certain percentage of salaries of management personnel (vice presidents and above), to another pension fund, which is deposited in The Mega International Commercial Bank in the name of, and administered by an officers' pension fund management committee. The changes in the fund are summarized as follows:

	2006	2005
Balance, beginning of year	$ 14,478	$ 9,982
Contributions	3,316	4,343
Interest income	270	153
Payment of benefits	(1,290)	-
Balance, end of year	$ 16,774	$ 14,478

Under SFAS No. 18, pension information based on actuarial calculation is as follows:

	2006	2005
a. Net pension cost		
Service cost	$ 1,313,716	$ 1,254,577
Interest cost	486,928	431,026
Expected return on plan assets	(425,333)	(335,227)
Amortization	47,532	19,160
	$ 1,422,843	$ 1,369,536
b. Reconciliation of the funded status of the plan and accrued pension liability		
Benefit obligation		
Vested	$ 304,305	$ 263,749
Non-vested	12,173,110	10,603,429
Accumulated	12,477,415	10,867,178
Additional benefits based on future salaries	3,270,173	3,181,579
Projected	15,747,588	14,048,757
Fair value of plan assets	(13,403,529)	(11,936,196)
Funded status	2,344,059	2,112,561

(Continued)

	2006	2005
Unrecognized net asset at transition	$ 71,519	$ 81,055
Unamortized net actuarial loss	(2,303,011)	(2,032,626)
Accrued pension liabilities (included in accrued expense)	$ 112,567	$ 160,990

The difference between the pension fund and the fair value of plan assets as of December 31, 2006 and 2005 represented the accrued interest income of the fund.

	2006	2005
c. Vested benefits	$ 328,828	$ 284,753
d. Actuarial assumptions		
Discount rate used in determining present values	3.5%	3.5%
Future salary increase rate	3.0%	3.0%
Expected rate of return on plan assets	2.5%	3.5%

19. DEFERRED CREDITS - GAIN ON INTERCOMPANY TRANSACTION

	2006	2005
Gain on disposal of land	$ 1,136,164	$ 1,136,164
Gain on contracted projects	14,776	6,188
	$ 1,150,940	$ 1,142,352

A deferred income of $1,405,040 thousand was the unrealized gain from the sale of land to CPDC in February 1999. The Corporation repurchased some of the land in the first half of 2005 for construction of office building and thus the deferred credits decreased by $268,876 thousand. The remaining deferred credit will be recognized as income when CPDC sells the rest of the land to third parties.

The Corporation obtained building construction projects from KRTC, resulting in deferred revenue. The accumulated credits will be recognized as income over the service lives of the buildings after completion of the construction, expected in 2007 to 2009.

20. STOCKHOLDERS' EQUITY

a. Capital stock

In 2006 and August 2005, the Corporation, through capitalization of retained earnings, issued new common shares of 507,780 thousand and 655,558 thousand, respectively.

In 2006 and 2005, 4 thousand shares and 1,479 thousand shares of preferred stock were converted into common stock. As of December 31,2006, 3 thousand shares of which were not yet registered with the government.

b. Treasury stock

Purpose	Thousand Shares: Beginning of Year	Increase	Decrease	End of Year: Thousand Shares	Book Value
2006					
1) Shares acquired and held by subsidiaries	78,899	4,955	2,674	81,180	$ 1,295,361
2) Shares acquired by the Corporation for transfer to employees	300	1,300	-	1,600	39,531
	79,199	6,255	2,674	82,780	$ 1,334,892
2005					
1) Shares acquired and held by subsidiaries	106,652	6,891	34,644	78,899	$ 1,265,786
2) Shares acquired by the Corporation for transfer to employees	-	300	-	300	7,435
	106,652	7,191	34,644	79,199	$ 1,273,221

1) Shares acquired and held by subsidiaries

The Corporation's shares acquired and held by subsidiaries (with 50% or more shareholdings) were accounted for as treasury stock (recorded as long-term or financial assets - current by investees). As mentioned in Note 2, effective 2005, the Corporation's shares acquired and held by other equity-method investees substantially controlled by the Corporation were also reclassified as treasury stock. This accounting change resulted in an increase of 22,189 thousand treasury shares in treasury stock, with a carrying value of $539,707 thousand as of January 1, 2005. In 2006 and 2005, treasury stock increased by 4,955 thousand shares and 6,891 thousand shares, due to subsidiaries' purchase and the Corporation's capitalization of retained earnings; treasury stock decreased by 2,674 thousand shares and 34,644 thousand shares due to subsidiaries' sales of their holdings of the Corporation's shares and due to change in percentage of ownership. The difference between the sale prices ($80,052 thousand in 2006 and $95,380 thousand in 2005) and carrying values of $38,071 thousand and $34,425 thousand were credited to capital surplus.

As of December 31, 2006 and 2005, the market values of those treasury shares are $2,808,816 thousand and $1,922,771 thousand, respectively.

Although these shares (the Corporation held with 50% or more shareholdings) are treated as treasury stock in the financial statements, the stockholders are entitled to exercise their rights on these stocks, except participation in the Corporation's capital increase by cash. However, effective June 2005, the revised Company Law restricts the treasury stockholders from exercise of voting rights. The shares held by the equity-method investees substantially controlled by the Corporation can still have the same rights with other common stockholders.

2) Shares acquired for transfer to employees

The Corporation under relevant regulations reacquired its issued common shares from the public market at a total of 1,600 thousand shares during December 2005 to February 2006.

Under the Securities Transaction Law, the Corporation's share repurchase is restricted to up to 10% of total issued shares, and the total purchase amount should not exceed the sum of retained earnings, paid-in capital in excess of par value and realized capital surplus. In addition, the Corporation should transfer those shares to employees within three years. Otherwise these shares are deemed unissued and the Corporation should then register with the government for capital decrease. Further, the Corporation should not pledge these stocks as collateral and should not collect dividends or exercise voting rights on these stocks.

c. Overseas depositary receipts

In May 1992, February 1997 and October 2003, the ROC's Ministry of Economic Affairs (MOEA) (the shares were transferred to the Ministry of Finance in 2005 and re-transferred to the Ministry of Economic Affairs in October 2006) sold its shares in the Corporation through issuances of 88,329,150 units of Global Depositary Receipts (international GDR), with each unit representing 20 shares of the Corporation's common stock, or equivalent to the Corporation's common shares totalling 1,879,517,614 shares. The depositary shares then increased by 5,646,722 resulting from the capitalization of retained earnings. Under relevant regulations, the GDR holders may also request the conversion to the shares represented by the International GDR. The foreign investors may also request the reissuance of such depositary receipts within the originally approved units. As of December 31, 2006, the outstanding depositary receipts were 8,562,913 units, equivalent to 171,258,414 common shares, which represented 1.55% of the outstanding common shares.

d. Preferred stock

Preferred stockholders have the following entitlements or rights:

1) 14% annual dividends, with dividend payments ahead of those to common stockholders;

2) Preference over common stock in future payment of dividends in arrears;

3) Redemption of stock, at the Corporation's option out of its retained earnings or the proceeds from issuance of new shares;

4) The same rights as common stockholders, except the right to vote for directors and supervisors; and

5) Conversion of shares into common stock.

e. Capital surplus

Following are the capital surplus sources:

	2006	**2005**
Treasury stock transaction	$1,305,851	$ 960,872
Long-term stock investments under the equity method	234,420	240,407
Others	8,099	8,099
	$1,548,370	$1,209,378

Under relevant regulations, capital surplus from treasury stock transaction may be used to offset a deficit or transferred to capital. Capital surplus from long-term stocks investments accounted for under the equity method is prohibited from any use.

f. Other items

Revaluation increment on assets may only be used to offset a deficit. In the future, the Corporation, except the appropriations in accordance with the Company Law, shall return the revaluation increment on assets from retained earnings before any appropriations are made.

As of December 31, 2006, the Corporation's revaluation increment on assets was not used to offset a deficit.

g. Appropriation of retained earnings

The Corporation's Articles of Incorporation provides that the annual net income, less any deficit, should be appropriated in the following order of presentation:

1) 10% as legal reserve, until its balance equals the issued capital stock;

2) Preferred stock dividends at 14% of paid-in capital;

3) Of the remainder, 0.3% as compensation to directors and supervisors and 3% to 5% as bonus to employees;

4) Common stock dividends at 14% of paid-in capital; and

5) The remainder, if any, as additional dividends divided equally between the holders of preferred and common stocks.

The Board of Directors should propose the appropriation of annual income. If necessary, it may, after appropriating preferred stock dividends at 14% of paid-in capital, propose to retain certain earnings as a special reserve. These proposals should be submitted to the stockholders' meeting for approval.

The Corporation is required to appropriate a special reserve from annual earnings for any net debit balance resulting from adjustments to the stockholders' equity, excluding treasury stock. Effective 2002, if the market price is lower than the carrying value of the Corporation's shares held by subsidiaries, the Corporation should appropriate a special reserve equal to the difference between market price and carrying value. The Corporation may release a portion of this special reserve when debit balances are partially or fully reversed.

The Corporation's steel business is in a phase of stable growth; thus, more than 75% of the appropriation of dividends and bonus should be in cash and less than 25% in stock.

Under the Company Law, legal reserve should be appropriated from retained earnings until its balance equals the issued capital stock. Legal 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 Corporation has no unappropriated earnings and the reserve balance has exceeded 50% of the Corporation's capital stock. The Company Law also prescribes that, when the reserve has reached 50% of the Corporation's capital stock, up to 50% of the reserve may be transferred to capital.

The Corporation's stockholders in their June 2006 and 2005 meetings approved the following appropriations of the 2005 and 2004 earnings, which were proposed by the Board of Directors in March 2006 and 2005, respectively.

	Amount		Dividends Per Share	
	2005	2004	2005	2004
Legal reserve	$ 5,060,439	$ 5,161,667		
Special reserve	(22,347)	436,524		
Preferred Stocks				
Cash dividends	152,618	158,785	$ 3.75	$ 3.90
Stock dividends	14,244	20,357	0.35	0.50
			$ 4.10	$ 4.40
Common Stocks				
Cash dividends	39,541,401	38,572,559	$ 3.75	$ 3.90
Stock dividends	3,690,531	4,945,200	0.35	0.50
			$ 4.10	$ 4.40
Remuneration to directors and supervisors	137,302	138,243		
Bonus to employees				
Cash dividends	915,350	714,035		
Stock dividends	1,373,025	1,590,021		
	$ 50,862,563	$ 51,737,391		

As of February 7, 2007, the auditors' report date, the appropriation of 2006 earnings had not been proposed by the Board of Directors.

Information on the Board of Directors' proposed appropriation of earnings and related stockholders' meeting may be accessed through the Web site of the Taiwan Stock Exchange Corporation.

h. Effect of bonus to employees and remuneration to directors and supervisors if charged to expense

The aforementioned appropriation of bonus to employees and remuneration to directors and supervisors was as follows:

	Amount	Shares (Thousands)	Percentage to Common Shares Outstanding as of each year-end (%)
2005			
Bonus to employees			
Stock dividends	$ 1,373,025	137,303	1.30
Cash dividends	915,350	-	-
Remuneration to directors and supervisors - cash	137,302	-	-
	$ 2,425,677		
2004			
Bonus to employees			
Stock dividends	$ 1,590,021	159,002	1.61
Cash dividends	714,035	-	-
Remuneration to directors and supervisors - cash	138,243	-	-
	$ 2,442,299		

Had the bonus to employees and remuneration to directors and supervisors been charged to expense (stock bonus calculation was based on par value) in 2005 and 2004, the basic earnings per share (after tax) for 2005 and 2004 would have decreased (the capitalization of retained earnings in 2006 and 2005 were already reflected as retroactive adjustment of the shares for 2005 and 2004) from $4.61 to $4.39 for 2005 and from $4.93 to $4.70 for 2004.

21. INCOME TAX

The ROC 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.

a. Reconciliation between the income tax expense and the income tax calculated on pre-tax financial statement income based on the statutory tax rate:

	2006	2005
Tax on pretax income at statutory rate (25%)	$ 11,919,688	$ 16,278,107
Add (deduct) tax effects of differences of:		
Permanent		
Investment income under equity method - domestic	(2,336,439)	(1,064,213)
Unrealized gain on appraisal of financial assets and disposal of Investment	(37,239)	(103,227)
Cash dividends - domestic	(68,001)	(59,201)
Others	(9,137)	(14,806)
	(2,450,816)	(1,241,447)
Temporary		
Impairment loss on financial assets carried at cost	68,000	226,500
Depreciation	158,549	177,765
Reversal of allowance for loss on inventory	-	(41,172)
Unrealized (realized) gain on intercompany transactions	(6,552)	94,226
Investment income under equity method - foreign	(71,333)	(46,387)
Unrealized (realized) foreign exchange gain	22,483	(89,399)
Investment loss resulting from investees' capital return	(10,939)	(102,180)
Accrued Electrostatic Precipitator dust disposal expense	31,934	-
Cash dividends - foreign	-	164,897
Others	3,383	(54,203)
	195,525	330,047
Income tax payable based on taxable income	9,664,397	15,366,707
Tax credits	(1,070,145)	(884,544)
Prior periods' adjustments	47,253	(48,692)
Separate income tax on interest income	31,918	49,867
Tax payable	8,673,423	14,483,338
Deferred tax adjustments	(191,076)	(17,548)
	$ 8,482,347	$ 14,465,790

(Continued)

	2006	2005
b. Change in income tax payable		
Balance, beginning of year	$ 7,578,477	$ 9,405,065
Current income tax	8,673,423	14,483,338
Payment in the current year	(10,569,366)	(16,309,926)
Balance, end of year	$ 5,682,534	$ 7,578,477
c. Deferred income tax assets and liabilities		
Current		
Deferred income tax assets		
Unrealized gain on intercompany transactions	$ 85,659	$ 94,358
Severance pay	65,249	57,657
Accrued Electrostatic Precipitator dust disposal expense	31,934	-
Others	10,121	16,971
	192,963	168,986
Deferred income tax liabilities		
Temporary difference between tax reporting and financial reporting - inventory	(20,773)	(25,011)
	172,190	143,975
Noncurrent		
Deferred income tax assets		
Impairment loss on financial assets carried at cost	300,000	240,000
Impairment loss on rental assets	83,165	107,927
Cumulative effect of changes in accounting principles	64,547	-
Unrealized gain on intercompany transactions	3,694	1,547
Unrealized foreign exchange gain	(66,554)	(89,037)
Others	3,292	12,277
	388,144	272,714
Deferred income tax liabilities		
Foreign investment income	(394,568)	(323,235)
Temporary difference between tax reporting and financial reporting – depreciation methods	(2,710,265)	(2,893,576)
	(3,104,833)	(3,216,811)
	(2,716,689)	(2,944,097)
Total deferred income tax liabilities - net	$ (2,544,499)	$ (2,800,122)

(Concluded)

Under related regulations, the above tax credits resulted from certain purchases of machinery and equipment, research and development, employees' training, and investment in newly emerging, important and strategic industries.

Temporary difference for depreciation between tax reporting and financial reporting resulted from the adoption of accelerated depreciation method in the filing of income tax returns.

The Corporation's income tax returns through 2002 had been examined by the tax authorities.

d. Imputation tax system

Under the Imputation Tax System, domestic stockholders are allowed a tax credit for the income tax paid by the Corporation on earnings generated since 1998. Nonresident stockholders, including holders of overseas depository receipts, are allowed only a tax credit from the 10% income tax on undistributed earnings, which can be used to offset withholding income tax on dividends paid.

As of December 31, 2006, the balance of the imputation credit account (ICA) aggregated $2,985,419 thousand. The estimated creditable tax ratio for the 2006 earnings was 22.07%, and the actual ratio for the 2005 earnings was 29.84%.

As of December 31, 2006, undistributed earnings generated up to 1997 amounted to $35,440 thousand, which is not subject to the Imputation Tax System.

22. PERSONNEL EXPENDITURE, DEPRECIATION AND AMORTIZATION

	2006				2005			
	Cost of Revenues	Operating Expense	Others	Total	Cost of Revenues	Operating Expense	Others	Total
Personnel Expenditure								
Salary	$ 13,696,813	$ 2,295,958	$ 65,947	$ 16,058,718	$ 14,425,508	$ 2,504,219	$ 150,488	$ 17,080,215
Labor and health insurance	586,130	94,286	-	680,416	521,086	88,829	1,495	611,410
Pension and consolation costs	1,232,785	244,335	166,438	1,643,558	1,167,221	227,063	123,377	1,517,661
Others	461,656	76,018	61,251	598,925	497,379	81,214	40,973	619,566
	$ 15,977,384	$ 2,710,597	$ 293,636	$ 18,981,617	$ 16,611,194	$ 2,901,325	$ 316,333	$ 19,828,852
Depreciation	$ 9,113,997	$ 217,104	$ 26,546	$ 9,357,647	$ 9,086,337	$ 303,379	$ 29,065	$ 9,418,781
Amortization	500,561	1,137	4,161	505,859	79,712	1,260	6,548	87,520

23. EARNINGS PER SHARE

	2006		2005	
	Before Tax	After Tax	Before Tax	After Tax
Basic EPS				
Net income before cumulative effect of changes in accounting principles	$ 4.34	$ 3.57	$ 5.93	$ 4.61
Cumulative effect of changes in accounting principles	(0.01)	(0.01)	-	-
Net income	$ 4.33	$ 3.56	$ 5.93	$ 4.61
Diluted EPS				
Net income before cumulative effect of changes in accounting principles	$ 4.33	$ 3.56	$ 5.91	$ 4.60
Cumulative effect of changes in accounting principles	(0.01)	-	-	-
Net income	$ 4.32	$ 3.56	$ 5.91	$ 4.60

	Amount (Numerator)		Shares	Earnings Per Share (Dollars)	
	Before Tax	After Tax	(Denominator) (Thousand)	Before Tax	After Tax
Year ended December 31, 2006					
Net income (Net of cumulative effect of changes in accounting principles, before and after income tax of $102,369 thousand and $37,822 thousand, respectively	$ 47,576,384	$ 39,158,584			
Less: Preferred dividends	(69,301)	(56,972)			
Basic EPS					
Net income of common Stockholders	47,507,083	39,101,612	10,970,978	$ 4.33	$ 3.56
Effect of potentially dilutive shares:					
Add: Preferred dividends	69,301	56,972	40,694		
Diluted EPS					
Net income of common stockholders and effect of potentially dilutive shares	$ 47,576,384	$ 39,158,584	11,011,672	4.32	3.56
Year ended December 31, 2005					
Net income	$ 65,112,429	$ 50,646,639			
Less: Preferred dividends	(73,251)	(56,977)			
Basic EPS					
Net income of common Stockholders	65,039,178	50,589,662	10,972,069	5.93	4.61
Effect of potentially dilutive shares:					
Add: Preferred dividends	73,251	56,977	40,698		
Diluted EPS					
Net income of common stockholders and effect of potentially dilutive shares	$ 65,112,429	$ 50,646,639	11,012,767	5.91	4.60

In EPS calculation for the year ended December 31, 2005, the number of outstanding shares was retroactively adjusted for the effect of capitalization of 2005 retained earnings. Thus EPS before tax and after tax decreased from NT$6.21 to NT$4.83 and from NT$5.93 to NT$4.61, respectively.

24. RELATED-PARTY TRANSACTIONS

a. Related parties

Related Parties	Relationship with the Corporation
C. S. Aluminum Corporation (CAC)	Subsidiary
China Steel Express Corporation (CSE)	Subsidiary
China Steel Chemical Corporation (CSCC)	Subsidiary
China Steel Global Trading Corporation (CSGT)	Subsidiary
China Hi-ment Corporation (CHC)	Subsidiary
China Ecotek Corporation (CEC)	Subsidiary
China Steel Structure Corporation (CSSC)	Subsidiary
Chung Hung Steel Corporation (CHSC)	Subsidiary
China Steel Machinery Corporation (CSMC)	Subsidiary
Gains Investment Corporation (GIC)	Subsidiary
China Steel Security Corporation (CSS)	Subsidiary
China Prosperity Development Corporation (CPDC)	Subsidiary
Info-Champ Systems Corporation (ICSC)	Subsidiary
China Steel Management Consulting Corporation (CSMCC)	Subsidiary
Hi-mag Magnetic Corporation	Subsidiary
Long-Yuan-Fa Investment Corporation	Subsidiary
Horng-Yih Investment Corporation	Subsidiary
Goang-Yaw Investment Corporation	Subsidiary
Dragon Steel Corporation (DSC)	Subsidiary
China Steel Asia Pacific Holdings Pte Ltd. (CSAPH)	Subsidiary
Chung Mao Trading (BVI) Corp.	Indirect investee under Corporation's substantial control
Chung Mao Trading (SAMOA) Co.	Indirect investee under Corporation's substantial control
CSGT (Singapore) Pte. Ltd.	Indirect investee under Corporation's substantial control
Mentor Consulting Corporation	Indirect investee under Corporation's substantial control
Steel Castle Technology Corp.	Indirect investee under Corporation's substantial control
Union Steel Development Corp.	Indirect investee under Corporation's substantial control
Betacera Inc.	Indirect investee under Corporation's substantial control
Wabo Globe Trading Corporation	Indirect investee under Corporation's substantial control
Universal Exchange Inc.	Indirect investee under Corporation's substantial control
United Steel Engineering and Construction Corporation (USECC)	Indirect investee under Corporation's substantial control
Thintech Materials Technology Co., Ltd.	Indirect investee under Corporation's substantial control
Pao Good Industrial Co., Ltd.	Indirect investee under Corporation's substantial control
Ornasteel Enterprise Corp. (M) Sdn. Bhd.	Indirect investee under Corporation's substantial control
Group Steel Enterprise Corp. (M) Sdn. Bhd	Indirect investee under Corporation's substantial control
CSGT (JAPAN) Co., Ltd.	Indirect investee under Corporation's substantial control

(Continued)

Related Parties	Relationship with the Corporation
CSGT Hong Kong Limited	Indirect investee under Corporation's substantial control
CSGT (SHANGHAI) Co., Ltd.	Indirect investee under Corporation's substantial control
Ningbo Huayang Aluminum – Tech Co., Ltd	Indirect investee under Corporation's substantial control
Taiwan Rolling Stock Co., Ltd. (TRSC)	Investee
Kaohsiung Rapid Transit Corporation (KRTC)	Investee
TaiAn Technologies Corporation (TTC)	Investee
Kaohsiung Labor Assemble & Disassemble Co., Ltd.	Indirect investee under Corporation's substantial control
CSC Educational Foundation	Foundation established with Corporation's donation

b. Significant related-party transactions:

	2006		2005	
	Amount	**%**	**Amount**	**%**
Sales				
CHSC	$ 4,240,417	2	$ 1,140,929	1
CSSC	2,969,530	2	3,243,159	2
OEC	2,147,388	1	2,513,078	1
CSCC	1,801,268	1	1,754,811	1
Others	2,256,675	2	2,774,069	1
	$ 13,415,278	8	$ 11,426,046	6
Purchases				
CSE	$ 13,604,954	17	$ 13,220,944	16
CAC	3,112,947	4	1,784,766	2
CSGT	481,638	1	1,161,914	1
Others	589,724	1	946,407	2
	$ 17,789,263	23	$ 17,114,031	21

Sales to and purchases from related parties are made under normal terms, except those with OEC, CAC, CSCC, CHC, and CSE, for which there were no similar transactions in the market for comparison.

Assets lease

The Corporation leases its land and office to CAC, CSSC, CHC, CSCC and CSMC, etc. Rentals are calculated at 4% to 10% p.a. of land assessed value as published by the government or under normal terms. Rentals are collected semiannually, except for rentals from CAC and that from CSCC on the storage tank and pipelines, which are collected monthly. Lease information is as follows:

	Expiry Date	Rental Income 2006	2005
CAC	February 2016	$ 47,385	$ 47,353
CSMC	November 2011	24,597	22,959
CSCC	December 2010	18,864	19,939
CSSC	May 2018	15,717	16,054
CHC	April 2012	4,912	4,927
Others	April 2009	7,526	3,606
		$ 119,001	$ 114,838

Property transaction

In January 2005, the Corporation bought land from CPDC for office construction at the price of $834,673 thousand, which was determined by reference to appraisal report.

Other expenditures

Other expenditures paid to related parties pertained to furnace slag and clearance services, property maintenance or construction, export shipping charges, commissions for export and import services, etc., were recognized on manufacturing expenses, operating expenses and nonoperating expenses as follow:

	2006	2005
CEC	$ 2,377,107	$ 2,040,106
CSMC	1,785,416	1,260,775
CSSC	1,084,371	1,017,263
USECC	688,442	544,868
CHC	664,591	522,038
Others	1,412,643	1,346,208
	$ 8,012,570	$ 6,731,258

Donation expenditures

In 2006, the Corporation donated $200,000 thousand to CSC Educational Foundation. This foundation is established for promotion of education and personnel training in steel and related fields.

Other revenues

Other revenues pertained to labor services, processing of products, utilities, construction, and other services to related parties. These were recognized in other operating revenues and nonoperating revenues.

	2006	2005
KRTC	$ 1,561,709	$ 1,225,521
CHSC	357,625	238,711
CAC	256,862	156,169
DSC	233,972	239,535
CSCC	85,962	106,010
Others	273,235	325,852
	$ 2,769,365	$ 2,291,798

Short–term loans payable to related parties

In January 2005, the Corporation borrowed $1,238,738 thousand (USD$38,500 thousand) from CSAPH at no interest and repaid in September 2005.

c. Balances at year-end

	2006		2005	
	Amount	%	Amount	%
Receivables				
CSCC	$ 170,630	6	$ 115,473	6
CHSC	165,261	6	27,589	1
KRTC	107,675	4	22,029	1
DSC	63,741	2	166,031	8
Others	117,827	5	74,828	4
	$ 625,134	23	$ 405,950	20
Payables				
CSE	$ 1,923,696	53	$ 761,699	33
CAC	354,993	10	86,247	4
Others	46,661	1	22,561	-
	$ 2,325,350	64	$ 870,507	37

25. PLEDGED ASSETS

a. Time deposits of $3,681,694 thousand and $4,631,694 thousand as of December 31, 2006 and 2005, respectively, have been pledged mainly as collateral for bank overdraft, etc.

b. The Corporation provided machinery and equipment with carrying values of $2,431,310 thousand and $2,723,469 thousand as of December 31, 2006 and 2005, respectively, as collaterals for long-term credit lines with banks.

26. COMMITMENTS AS OF DECEMBER 31, 2006

a. The Corporation engaged in several construction contracts, under guarantees of $1,214,995 thousand granted by The Mega International Commercial Bank and Taipei Fubon Bank.

b. Unused letters of credit for purchase of raw materials and supplies amounted to $8.1 billion.

c. The Corporation entered into raw material purchase contracts with suppliers in Australia, India, Brazil, Canada, Indonesia, North Korea, Japan, Philippines, Russia and domestic companies with contract terms of 1 to 10 years. Contracted annual purchases of 8,200,000 metric tons of coal, 17,120,000 metric tons of iron ore, and 2,800,000 metric tons of limestones are at prices negotiable every year. Unpaid purchase amounts as of December 31, 2006 were US$9.7 billion (including 16,920,000 metric tons of coal; 163,150,000 metric tons of iron ore; and 220,000 metric tons of limstones).

d. CHSC entered into a syndicated credit facility agreement with The Mega International Commercial Bank and 23 other banks and another syndicated agreement with The Mega International Commercial Bank and 21 other banks. Under these agreements, the Corporation and its related parties should collectively hold at least 30% of CHSC's issued shares and have over half of CHSC's board seats as well as significant influence on its operations. As of December 31, 2006, the Corporation had total direct and indirect shareholdings in CHSC of 39% and total seats in the Board of Directors and significant influence on its operations.

e. KRTC entered into a syndicated credit facility agreement with the Taiwan Bank and 23 other banks. Under this agreement, the Corporation and its subsidiaries should collectively hold at least 30% of KRTC's capital stock during the construction period. As of December 31, 2006, the Corporation's total equity in KRTC was 31%.

27. FINANCIAL INSTRUMENTS

The Corporation had no derivative transactions for the years ended December 31, 2006 and 2005.

a. As of December 31, 2006 and 2005, the information of fair values was as follows:

	2006		2005	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Assets				
Financial assets at fair value through profit or loss	$ 12,315,988	$ 12,315,988	$ 10,975,710	$ 11,131,531
Available-for-sale financial assets	7,787,299	7,787,299	2,219,366	6,097,129
Financial assets carried at cost	5,766,315	-	6,173,510	-
Investment in bonds without quoted price	5,482,324	5,482,324	5,881,374	5,881,374
Refundable deposits	55,833	55,833	346,830	346,830
Liabilities				
Long-term bonds	13,700,000	13,865,449	10,000,000	10,034,101
Long-term bank debts	3,426,250	3,426,250	3,496,250	3,496,250

Effective 2006, the Corporation adopted the newly issued SFAS No. 34 "Accounting for Financial Instruments." Thus, some changes of fair value in financial assets were not recognized in 2005.

The cumulative effect of changes in accounting principles and the adjustment of stockholders' equity were stated in Note 3.

b. The assumptions and methods used to estimate the fair values of financial instruments are as follows:

1) The carrying values of cash and cash equivalents, notes and accounts receivable, other receivables, pledged time deposits, short-term bank loans and overdraft, notes and accounts payable and accrued expenses, approximate fair value because of the short maturities of these instruments.

2) The fair values of financial assets at fair value through profit of loss and available-for-sale financial assets are determined at their market value. If there is no market value available for reference, the fair values are determined by using valuation technique. The information used as basis for determining the Corporation's assumptions in applying valuation technique is consistent with that used by market participants. The information is obtained by the Corporation from financial institutions.

3) The fair values of long-term liabilities (including bonds payable) are determined by the present values of future cash flows, with the values discounted at the interest rates of similar long-term debts available for the Corporation.

4) The fair values of refundable deposits are determined at their carrying values.

5) The fair value of investment in bonds without quoted price is determined at their carrying values.

6) Financial assets carried at cost are financial instruments held by non-public corporation which do not have quoted market price in an active market and whose verifiable fair value cannot be determined at a reasonable cost.

c. The fair values of the Corporation's financial assets determined by either using quoted market price in an active market or valuation technique were as follows:

	Amount determined by quoted market price		**Amount determined by using valuation technique**	
	2006	**2005**	**2006**	**2005**
Assets				
Financial assets at fair value through profit or loss	$ 12,315,988	$ 10,975,710	$ -	$ -
Available-for-sale financial assets	7,536,549	1,968,666	250,750	250,700

d. There is no gain or loss for the estimated change in fair value by using valuation technique for the year ended December 31, 2006.

e. As of December 31, 2006, the financial assets and liabilities with the cash flow risk of the interest rate change were $250,750 thousand and $20,036,239 thousand, respectively. The financial liabilities with fair value risk of the interest rate change were $13,700,000 thousand.

f. The Corporation's total interest revenues and expenses (exclusive of capitalized interest) which were incurred from other than financial assets and liabilities at fair value through profit or loss were $343,746 thousand and $541,823 thousand, respectively, for the year ended December 31, 2006.

g. Financial risk information

1) Market risk

This includes fair value risk of interest rate change, exchange rate risk, and market price risk. The Corporation had long-term loans in yen to hedge the exchange rate fluctuations on its investment in yen, thus, the exchange rate risk can be hedged naturally. The Corporation issues the bonds payable with the fixed interest rate, and the fair value will be influenced by the market interest rate change. If market interest rate changes at 1% each time, the fair value of bonds payable will increase or decrease by $604,447 thousand.

The Corporation's investments in the bond funds and stocks of Taiwan Semiconductor Manufacturing Company Ltd., Advanced Material Technology Corporation, Maruichi Steel Tube Ltd, and Tang Eng Iron Works Corporation invlove market risk. Except the minor fluctuation of the bond fund's market price, if the share price of the stocks increases or decreases by $1 each time, the fair value will increase or decrease by $124,735 thousand.

2) Credit risk

Credit risk represents the potential loss that would be incurred by the Corporation if the counter-parties or third-parties breached the contracts. The Corporation's financial instruments are affected by its credit risk concentration, component, contract amounts and other receivables.

As of December 31, 2006, the Corporation's credit risks amounted to $1,334,059 thousand (including net notes and accounts receivable, other receivables and refundable deposits, net notes and accounts receivable after deducted with factoring and L/C transaction of $3,067,769 thousand) and the maximum credit risk and carrying value are the same. The credit risks of the cash and bank deposits of the Corporation were considered to be immaterial.

3) Liquidity risk

The Corporation has sufficient operating capital to meet future cash needs. Therefore, the cash flow risk is low.

Financial assets at fair value through profit or loss and available-for-sale financial assets could be sold rapidly at prices approximating fair value because those financial assets could be sold in secondary financial market at market value.

There are liquidity risks for the financial assets carried at cost and investment in bonds without quoted price because no market values are available.

4) Cash flow risk of interest rate change

Market interest rate change will influence the effective interest rate of the financial instruments (including short-term loans and overdraft) which have cash flow risk of the interest rate change, and make future cash flow fluctuate. If the market interest rate increases 1%, the Corporation's cash outflow will increase $197,855 thousand.

h. Fair value hedge

The Corporation borrowed long-term bank loans in yen to effectively hedge the exchange rate fluctuations on the investments in East Asia United Steel Corporation and Maruichi Steel Tube Ltd in yen.

	Appointed hedging instrument	
Hedged item	**Financial instrument**	**Changes of fair value**
Stock investments in Maruichi Steel Tube Ltd.	Long-term bank loans in yen	$ 14,560
Stock investments in East Asia United Steel Corporation	Long-term bank loans in yen	55,440

CHINA STEEL CORPORATION

ADDITIONAL EXPLANATION FOR ACCOUNTS IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2006 AND 2005

1. ADJUSTMENT OF EQUITY IN INVESTEES DUE TO CHANGE IN PERCENTAGE OF OWNERSHIP

a. Long-term investment adjustment

When an investee's capital surplus changed, the investor should adjust its long-term stock investment account and capital surplus account based on its stockholding percentage.

b. Adjustment of equity in investee due to change in percentage of ownership

If an investee issues new shares and original stockholders do not subscribe the new shares proportionately, then the investment percentage, e.g. the equity in the investee's net assets, will change. This change shall be reflected as an adjustment of the additional paid-in capital (capital surplus) and the long-term stock investments accounts. If this adjustment is to reduce the additional paid-in capital resulting from long-term stock investments and its balance is insufficient, the difference should be adjusted to the unappropriated retained earnings.

2. UNREALIZED GAIN (LOSS) ON FINANCIAL INSTRUMENTS

Available-for-sale financial asset is measured at fair value and its value change is recorded as a reconciliation item in the stockholders' equity.

3. INVESTEES' UNRECOGNIZED NET LOSS ON PENSION COST

a. Unrecognized net loss on pension cost is the minimum pension liability exceeding the sum of unrecognized prior service cost and unrecognized transitional net benefit obligation. It is classified as a reduction of stockholders' equity.

b. Minimum pension liability, which is calculated actuarially, is the minimum amount of pension liability that is required to be recognized on the balance sheet.

c. Prior service cost is the increase in projected benefit obligation due to an employee's accumulation of service years at the initial introduction of pension data or the subsequent pension data amendment.

d. Unrecognized transitional net assets or benefit obligation means the amount resulting from a change from a method specified in Statement of Financial Accounting Standards No. 18, "Accounting for Pensions." This amount is the difference between (a) the fair market value of plan assets plus accrued pension liability or less prepaid pension cost recognized previously in the books and (b) the projected benefit obligation. If the difference is positive, it is treated as unrecognized transition net assets; if the difference is negative, it is treated as unrecognized transition net benefit obligations.

4. TRANSFER OF TREASURY STOCK TO EMPLOYEES.

Treasury stock is transferred at the price which is determined at the purchase cost plus the Corporation financial cost up to the time that the transfer is made.

When treasury stocks are transferred, if the transfer price is higher than the book value, the difference should be credited to capital surplus. If the transfer price is lower than book value, the difference should first be offset against capital surplus from the same class of treasury stock transactions, and the remainder, if any, should be debited to unappropriated retained earnings.

5. DISPOSAL OF THE CORPORATION'S SHARES HELD BY SUBSIDIARIES

A parent company should account for its outstanding stocks held by its subsidiary as treasury stocks when it recognizes investment income and prepares financial statements, and the accounting treatment is the same as that stated in item 4 above.

6. CASH DIVIDENDS DECLARED BY THE CORPORATION AND RECEIVED BY SUBSIDIARIES

When an investor receives cash dividends from available-for-sale financial assets or financial assets carried at cost or from a year after investment acquisition, it records these dividends as investment income. But if the cash dividend is from the parent company, the accounting for these dividends is the same as that for treasury stock, i.e., the investment income should be credited to capital surplus when the parent company prepares financial statements.