# China Steel Corporation

**Financial Statements for the**
**Years Ended December 31, 2011 and 2010 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, 2011 and 2010, 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. 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, 2011 and 2010, 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 Republic of China.

We have also audited the consolidated financial statements of the Corporation and its subsidiaries as of and for the years ended December 31, 2011 and 2010 on which we expressed an unqualified opinion.

March 21, 2012

<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, 2011 AND 2010**
**(In Thousands of New Taiwan Dollars, Except Par Value)**

| | 2011 | | 2010 | |
|---|---|---|---|---|
| **ASSETS** | **Amount** | **%** | **Amount** | **%** |
| CURRENT ASSETS | | | | |
| Cash (Note 4) | $ 683,607 | - | $ 2,170,616 | 1 |
| Available-for-sale financial assets - current (Notes 2, 6 and 28) | 2,207,870 | 1 | 2,068,057 | 1 |
| Hedging derivative assets - current (Notes 2, 7 and 28) | 22,630 | - | - | - |
| Notes receivable | 866,772 | - | 706,075 | - |
| Notes receivable - related parties (Note 29) | 468,399 | - | 537,208 | - |
| Accounts receivable (Notes 2, 3 and 8) | 2,764,299 | 1 | 1,897,408 | 1 |
| Accounts receivable - related parties (Notes 2, 3 and 29) | 553,216 | - | 589,531 | - |
| Other receivables (Notes 11 and 25) | 1,162,430 | - | 1,122,103 | - |
| Other financial assets - current (Notes 2, 13 and 28) | 2,399,287 | 1 | 1,093,993 | - |
| Inventories (Notes 2 and 9) | 67,340,540 | 16 | 46,957,509 | 12 |
| Deferred income tax assets - current (Notes 2 and 25) | 1,379,334 | - | 593,502 | - |
| Restricted assets - current (Notes 4 and 30) | 5,678,750 | 1 | 4,651,000 | 1 |
| Others | 1,712,543 | 1 | 1,497,530 | 1 |
| Total current assets | 87,239,677 | 21 | 63,884,532 | 17 |
| INVESTMENTS | | | | |
| Available-for-sale financial assets - noncurrent (Notes 2, 6 and 28) | 3,260,406 | 1 | 3,135,657 | 1 |
| Hedging derivative assets - noncurrent (Notes 2, 7 and 28) | 89,387 | - | - | - |
| Financial assets carried at cost - noncurrent (Notes 2,10, 28 and 29) | 7,421,220 | 2 | 3,247,228 | 1 |
| Bond investments with no active market - noncurrent (Notes 2, 11 and 28) | 3,906,000 | 1 | 3,685,500 | 1 |
| Investments accounted for by the equity method (Notes 2, 12 and 28) | 127,252,843 | 30 | 123,129,399 | 32 |
| Other financial assets - noncurrent (Notes 2, 13 and 28) | 2,119,688 | - | 753,328 | - |
| Total investments | 144,049,544 | 34 | 133,951,112 | 35 |
| PROPERTY, PLANT AND EQUIPMENT (Notes 2, 7, 13, 14, 29 and 30) | | | | |
| Land | 11,024,276 | 2 | 10,877,244 | 3 |
| Land improvements | 4,223,646 | 1 | 4,223,646 | 1 |
| Buildings | 44,939,092 | 11 | 44,640,508 | 12 |
| Machinery and equipment | 278,296,503 | 66 | 278,377,356 | 73 |
| Transportation equipment | 1,804,682 | - | 1,773,975 | - |
| Other equipment | 5,118,133 | 1 | 5,011,842 | 1 |
| Spare parts | 6,918,272 | 2 | 6,780,271 | 2 |
| Total cost | 352,324,604 | 83 | 351,684,842 | 92 |
| Revaluation increment | 48,885,858 | 12 | 43,431,952 | 11 |
| Cost and revaluation increment | 401,210,462 | 95 | 395,116,794 | 103 |
| Less: Accumulated depreciation | 260,114,511 | 62 | 250,045,464 | 65 |
| | 141,095,951 | 33 | 145,071,330 | 38 |
| Construction in progress and prepayments for equipment | 46,045,195 | 11 | 35,888,973 | 9 |
| Net property, plant and equipment | 187,141,146 | 44 | 180,960,303 | 47 |
| INTANGIBLE ASSETS (Note 2) | 184,081 | - | 226,445 | - |
| OTHER ASSETS | | | | |
| Assets leased to others, net (Notes 2 and 15) | 3,063,360 | 1 | 3,218,045 | 1 |
| Refundable deposits (Note 28) | 223,215 | - | 116,518 | - |
| Restricted assets - noncurrent (Notes 4 and 30) | 33,817 | - | 30,467 | - |
| Total other assets | 3,320,392 | 1 | 3,365,030 | 1 |
| TOTAL | $ 421,934,840 | 100 | $ 382,387,422 | 100 |

| | 2011 | | 2010 | |
|---|---|---|---|---|
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | **Amount** | **%** | **Amount** | **%** |
| CURRENT LIABILITIES | | | | |
| Short-term loans and overdraft (Notes 16 and 30) | $ 6,467,626 | 1 | $ 1,341,764 | - |
| Commercial paper payable (Note 17) | 3,595,877 | 1 | 3,699,639 | 1 |
| Hedging derivative liabilities - current (Notes 2, 7 and 28) | 7,620 | - | 3,537 | - |
| Notes payable - related parties (Note 29) | - | - | 23,163 | - |
| Accounts payable | 4,665,602 | 1 | 4,630,800 | 1 |
| Accounts payable - related parties (Note 29) | 851,314 | - | 1,309,664 | - |
| Income tax payable (Notes 2 and 25) | 2,520,677 | 1 | 4,834,790 | 1 |
| Accrued expenses (Notes 18 and 22) | 8,306,109 | 2 | 10,732,630 | 3 |
| Other payables (Note 2) | 4,976,046 | 1 | 3,839,231 | 1 |
| Bonds payable - current portion (Notes 19 and 28) | 11,295,086 | 3 | 13,697,919 | 4 |
| Long-term debt - current portion (Notes 20, 28 and 30) | 3,682,227 | 1 | - | - |
| Others | 3,086,241 | 1 | 3,856,966 | 1 |
| Total current liabilities | 49,454,425 | 12 | 47,970,103 | 12 |
| LONG-TERM LIABILITIES | | | | |
| Hedging derivative liabilities - noncurrent (Notes 2, 7 and 28) | 421 | - | 2,877 | - |
| Bonds payable (Notes 19 and 28) | 37,969,340 | 9 | 29,580,147 | 8 |
| Long-term debt (Notes 20, 28 and 30) | 21,284,765 | 5 | 23,181,624 | 6 |
| Long-term notes payable (Notes 21 and 28) | 11,989,008 | 3 | 4,496,973 | 1 |
| Total long-term liabilities | 71,243,534 | 17 | 57,261,621 | 15 |
| RESERVE FOR LAND VALUE INCREMENT TAX (Note 14) | 10,011,916 | 2 | 8,673,466 | 2 |
| OTHER LIABILITIES | | | | |
| Accrued pension cost (Note 22) | 51,491 | - | - | - |
| Deferred income tax liabilities - noncurrent (Notes 2 and 25) | 446,254 | - | 524,317 | - |
| Deferred credits - gain from affiliates (Notes 10 and 23) | 2,140,211 | 1 | 2,007,550 | 1 |
| Total other liabilities | 2,637,956 | 1 | 2,531,867 | 1 |
| Total liabilities | 133,347,831 | 32 | 116,437,057 | 30 |
| CAPITAL STOCK - NT$10 par value, authorized 17,000,000 thousand shares (Note 24) | | | | |
| Common shares - issued 15,046,209 thousand shares and 13,527,901 thousand shares as of December 31, 2011 and 2010, respectively | 150,462,093 | 36 | 135,279,009 | 36 |
| Preferred shares - issued 38,268 thousand shares | 382,680 | - | 382,680 | - |
| Total capital stock | 150,844,773 | 36 | 135,661,689 | 36 |
| CAPITAL SURPLUS (Notes 2 and 24) | 36,247,705 | 8 | 20,072,476 | 5 |
| RETAINED EARNINGS (Notes 2 and 24) | 80,051,881 | 19 | 94,337,962 | 25 |
| OTHER EQUITY | | | | |
| Unrealized revaluation increment (Note 24) | 26,757,590 | 6 | 21,873,940 | 6 |
| Unrealized gain on financial instruments (Notes 7, 13 and 24) | 3,020,919 | 1 | 2,374,377 | - |
| Cumulative translation adjustments (Notes 2 and 24) | 17,192 | - | (101,443) | - |
| Net loss not recognized as pension cost | (230,590) | - | (117,015) | - |
| Treasury stock - 295,065 thousand shares and 284,762 thousand shares as of December 31, 2011 and 2010, respectively (Notes 2 and 24) | (8,122,461) | (2) | (8,151,621) | (2) |
| Total other equity | 21,442,650 | 5 | 15,878,238 | 4 |
| Total stockholders' equity | 288,587,009 | 68 | 265,950,365 | 70 |
| TOTAL | $ 421,934,840 | 100 | $ 382,387,422 | 100 |

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

# CHINA STEEL CORPORATION

## STATEMENTS OF INCOME
## YEARS ENDED DECEMBER 31, 2011 AND 2010
## (In Thousands of New Taiwan Dollars, Except Earnings Per Share)

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| OPERATING REVENUES (Notes 2 and 29) | $ 240,376,019 | 100 | $ 239,186,921 | 100 |
| OPERATING COSTS (Notes 2, 9, 26 and 29) | 218,781,975 | 91 | 196,235,742 | 82 |
| GROSS PROFIT | 21,594,044 | 9 | 42,951,179 | 18 |
| REALIZED GAIN FROM AFFILIATES, NET | 61,894 | - | 47,610 | - |
| REALIZED GROSS PROFIT | 21,655,938 | 9 | 42,998,789 | 18 |
| OPERATING EXPENSES (Notes 26 and 29) | | | | |
| Research and development | 1,437,899 | 1 | 1,380,490 | 1 |
| Selling | 2,414,478 | 1 | 2,615,206 | 1 |
| General and administrative | 3,204,580 | 1 | 2,954,465 | 1 |
| Total operating expenses | 7,056,957 | 3 | 6,950,161 | 3 |
| OPERATING INCOME | 14,598,981 | 6 | 36,048,628 | 15 |
| NONOPERATING INCOME AND GAINS | | | | |
| Interest income (Note 28) | 121,480 | - | 91,999 | - |
| Valuation gain on financial assets (Notes 2 and 5) | 2,828 | - | 12,571 | - |
| Investment income recognized under equity method, net (Notes 2 and 12) | 5,151,451 | 2 | 8,247,775 | 4 |
| Gain on sale of investments (Note 2) | 1,101 | - | 8,892 | - |
| Exchange gain (Note 2) | 403,480 | - | 273,127 | - |
| Others (Notes 2, 11, 14 and 29) | 1,194,643 | 1 | 892,324 | - |
| Total nonoperating income and gains | 6,874,983 | 3 | 9,526,688 | 4 |
| NONOPERATING EXPENSES AND LOSSES | | | | |
| Interest expense (Notes 14 and 28) | 769,406 | 1 | 659,814 | - |
| Others (Notes 2, 26 and 29) | 419,865 | - | 821,231 | - |
| Total nonoperating expenses and losses | 1,189,271 | 1 | 1,481,045 | - |
| INCOME BEFORE INCOME TAX | 20,284,693 | 8 | 44,094,271 | 19 |
| INCOME TAX (Notes 2 and 25) | 791,014 | - | 6,507,445 | 3 |
| NET INCOME | $ 19,493,679 | 8 | $ 37,586,826 | 16 |

(Continued)

# CHINA STEEL CORPORATION

**STATEMENTS OF INCOME**
**YEARS ENDED DECEMBER 31, 2011 AND 2010**
**(In Thousands of New Taiwan Dollars, Except Earnings Per Share)**

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | **Before Income Tax** | **After Income Tax** | **Before Income Tax** | **After Income Tax** |
| EARNINGS PER SHARE (Note 27) | | | | |
| Basic | $ 1.42 | $ 1.36 | $ 3.17 | $ 2.70 |
| Diluted | $ 1.41 | $ 1.35 | $ 3.14 | $ 2.67 |

Pro forma information (after income tax) assuming the Corporation's shares held by its subsidiaries were accounted for as investments instead of treasury stock is as follows:

| | 2011 | 2010 |
|---|---|---|
| Net income | $ 20,153,180 | $ 37,977,668 |
| Basic earnings per share based on weighted-average number of outstanding common shares aggregating 14,556,209 thousand shares and 14,206,209 thousand shares for the years ended December 31, 2011 and 2010, respectively | $ 1.38 | $ 2.67 |
| Diluted earnings per share based on weighted-average number of outstanding common shares aggregating 14,686,578 thousand shares and 14,359,712 thousand shares for the years ended December 31, 2011 and 2010, respectively | $ 1.37 | $ 2.64 |

(Concluded)

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

## CHINA STEEL CORPORATION

**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**
**YEARS ENDED DECEMBER 31, 2011 AND 2010**
**(In Thousands of New Taiwan Dollars, Except Dividends Per Share)**

| | Issued | | | Retained Earnings | | | | Other Equity | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Common Shares | Preferred Shares | Capital Surplus | Legal Reserve | Special Reserve | Unappropriated Earnings | Total | Unrealized Revaluation Increment | Unrealized Gain on Financial Instruments | Cumulative Translation Adjustments | Net Loss not Recognized as Pension Cost | Treasury Stock | Total Stockholders' Equity |
| BALANCE, JANUARY 1, 2010 | $ 130,945,189 | $ 382,680 | $ 19,598,511 | $ 47,117,709 | $ 7,615,701 | $ 19,617,957 | $ 74,351,367 | $ 21,913,148 | $ 4,216,431 | $ 183,001 | $ (42,133) | $ (8,189,031) | $ 243,359,163 |
| Appropriation of 2009 earnings (Note 24) | | | | | | | | | | | | | |
| Legal reserve | - | - | - | 1,952,817 | - | (1,952,817) | - | - | - | - | - | - | - |
| Cash dividends to preferred stockholders - NT$1.07 per share | - | - | - | - | - | (40,947) | (40,947) | - | - | - | - | - | (40,947) |
| Cash dividends to common stockholders - NT$1.01 per share | - | - | - | - | - | (13,225,464) | (13,225,464) | - | - | - | - | - | (13,225,464) |
| Stock dividends to preferred stockholders - NT$0.33 per share | 12,628 | - | - | - | - | (12,628) | (12,628) | - | - | - | - | - | - |
| Stock dividends to common stockholders - NT$0.33 per share | 4,321,192 | - | - | - | - | (4,321,192) | (4,321,192) | - | - | - | - | - | - |
| Net income in 2010 | - | - | - | - | - | 37,586,826 | 37,586,826 | - | - | - | - | - | 37,586,826 |
| Change in unrealized gain on available-for-sale financial assets | - | - | - | - | - | - | - | - | (185,756) | - | - | - | (185,756) |
| Change in unrealized revaluation increment (Note 14) | - | - | - | - | - | - | - | (41,393) | - | - | - | - | (41,393) |
| Adjustment from changes in equity recognized under equity method | - | - | 83,123 | - | - | - | - | 2,185 | (1,055,295) | - | (74,882) | (46,313) | (1,091,182) |
| Foreign exchange loss on translation of foreign-currency financial statements | - | - | - | - | - | - | - | - | - | (364,769) | - | - | (364,769) |
| Foreign exchange gain on hedge of a net investment in a foreign operation | - | - | - | - | - | - | - | - | - | 80,325 | - | - | 80,325 |
| Change in unrealized gain on financial instruments for cash flow hedging | - | - | - | - | - | - | - | - | (601,003) | - | - | - | (601,003) |
| Disposal of the Corporation's shares held by subsidiaries (Note 24) | - | - | 102,280 | - | - | - | - | - | - | - | - | 298,725 | 401,005 |
| Cash dividends paid by the Corporation to its subsidiaries | - | - | 288,562 | - | - | - | - | - | - | - | - | - | 288,562 |
| Purchase of the Corporation's shares by subsidiaries | - | - | - | - | - | - | - | - | - | - | - | (215,002) | (215,002) |
| BALANCE, DECEMBER 31, 2010 | 135,279,009 | 382,680 | 20,072,476 | 49,070,526 | 7,615,701 | 37,651,735 | 94,337,962 | 21,873,940 | 2,374,377 | (101,443) | (117,015) | (8,151,621) | 265,950,365 |
| Appropriation of 2010 earnings (Note 24) | | | | | | | | | | | | | |
| Legal reserve | - | - | - | 3,758,683 | - | (3,758,683) | - | - | - | - | - | - | - |
| Cash dividends to preferred stockholders - NT $1.99 per share | - | - | - | - | - | (76,153) | (76,153) | - | - | - | - | - | (76,153) |
| Cash dividends to common stockholders - NT $1.99 per share | - | - | - | - | - | (26,920,523) | (26,920,523) | - | - | - | - | - | (26,920,523) |
| Stock dividends to preferred stockholders - NT$0.5 per share | 19,134 | - | - | - | - | (19,134) | (19,134) | - | - | - | - | - | - |
| Stock dividends to common stockholders - NT$0.5 per share | 6,763,950 | - | - | - | - | (6,763,950) | (6,763,950) | - | - | - | - | - | - |
| Issuance of common stock for cash (Note 24) | 8,400,000 | - | 15,338,755 | - | - | - | - | - | - | - | - | - | 23,738,755 |
| Compensation cost of share-based payment | - | - | 98,826 | - | - | - | - | - | - | - | - | - | 98,826 |
| Net income in 2011 | - | - | - | - | - | 19,493,679 | 19,493,679 | - | - | - | - | - | 19,493,679 |
| Change in unrealized gain on available-for-sale financial assets | - | - | - | - | - | - | - | - | 141,223 | - | - | - | 141,223 |
| Change in unrealized revaluation increment (Note 14) | - | - | - | - | - | - | - | 4,739,111 | - | - | - | - | 4,739,111 |
| Adjustment from changes in equity recognized under equity method | - | - | 78,147 | - | - | - | - | 144,539 | 251,529 | - | (113,575) | 83 | 360,723 |
| Foreign exchange gain on translation of foreign-currency financial statements | - | - | - | - | - | - | - | - | - | 180,788 | - | - | 180,788 |
| Foreign exchange loss on hedge of a net investment in a foreign operation | - | - | - | - | - | - | - | - | - | (62,153) | - | - | (62,153) |
| Change in unrealized gain on financial instruments for cash flow hedging | - | - | - | - | - | - | - | - | 253,790 | - | - | - | 253,790 |
| Disposal of the Corporation's shares held by subsidiaries (Note 24) | - | - | 106,638 | - | - | - | - | - | - | - | - | 404,810 | 511,448 |
| Cash dividends paid by the Corporation to its subsidiaries | - | - | 552,863 | - | - | - | - | - | - | - | - | - | 552,863 |
| Purchase of the Corporation's shares by subsidiaries | - | - | - | - | - | - | - | - | - | - | - | (375,733) | (375,733) |
| BALANCE, DECEMBER 31, 2011 | $ 150,462,093 | $ 382,680 | $ 36,247,705 | $ 52,829,209 | $ 7,615,701 | $ 19,606,971 | $ 80,051,881 | $ 26,757,590 | $ 3,020,919 | $ 17,192 | $ (230,590) | $ (8,122,461) | $ 288,587,009 |

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

# CHINA STEEL CORPORATION

**STATEMENTS OF CASH FLOWS**
**YEARS ENDED DECEMBER 31, 2011 AND 2010**
**(In Thousands of New Taiwan Dollars)**

| | 2011 | 2010 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 19,493,679 | $ 37,586,826 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation | 16,064,667 | 15,804,272 |
| Amortization | 42,364 | 75,010 |
| Pension cost | 51,491 | - |
| Deferred income tax | (913,703) | 1,640,135 |
| Provision for loss on inventories | 3,060,921 | 149,012 |
| Gain on sale of investments | (1,101) | (8,892) |
| Investment income under equity method, net | (5,151,451) | (8,247,775) |
| Realized gain from affiliates, net | (61,894) | (47,610) |
| Cash dividends received from equity method investees | 5,582,492 | 6,842,767 |
| Valuation gain on financial assets | (2,828) | (12,571) |
| Compensation cost of share-based payment | 98,826 | - |
| Others | (104,227) | (190,447) |
| Net changes in operating assets and liabilities | | |
| Notes receivable | (160,697) | (278,006) |
| Notes receivable - related parties | 68,809 | (314,777) |
| Accounts receivable | (866,891) | 4,790 |
| Accounts receivable - related parties | 36,315 | 340,371 |
| Other receivables | 124,373 | (306,253) |
| Inventories | (23,289,268) | (12,220,801) |
| Other current assets | (215,013) | (587,140) |
| Notes payable - related parties | (23,163) | 23,163 |
| Accounts payable | 34,802 | 2,626,633 |
| Accounts payable - related parties | (458,350) | (1,798,298) |
| Income tax payable | (2,478,813) | 4,834,790 |
| Accrued expenses | (2,426,521) | 2,238,492 |
| Other payables | 2,223,410 | (164,523) |
| Other current liabilities | (576,170) | 1,485,125 |
| Net cash provided by operating activities | 10,152,059 | 49,474,293 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Acquisition of financial assets designated as at fair value through profit or loss | (8,000,000) | (12,240,059) |
| Proceeds from disposal of financial assets designated as at fair value through profit or loss | 8,002,828 | 16,315,474 |
| Acquisition of available-for-sale financial assets | - | (251,988) |
| Acquisition of financial assets carried at cost | (4,085,903) | (1,283,289) |
| Proceeds from disposal of financial assets carried at cost | 1,101 | 159,724 |
| Proceeds from the capital reduction on financial assets carried at cost | 14,911 | 25,721 |
| Acquisition of investments accounted for by equity method | (3,324,396) | (20,713,569) |
| Acquisition of property, plant and equipment | (17,189,295) | (31,281,536) |
| Proceeds from disposal of property, plant and equipment | 1,267 | 404 |
| Proceeds from disposal of assets leased to others | 5,000 | - |
| Decrease (increase) in other financial assets | (2,476,273) | 2,604,292 |

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## CHINA STEEL CORPORATION

**STATEMENTS OF CASH FLOWS**
**YEARS ENDED DECEMBER 31, 2011 AND 2010**
**(In Thousands of New Taiwan Dollars)**

| | 2011 | 2010 |
|---|---|---|
| Decrease (increase) in refundable deposits | $ (106,697) | $ 21,806 |
| Increase in restricted assets | (1,031,100) | (517,164) |
| Increase in intangible assets | - | (90) |
| Net cash used in investing activities | (28,188,557) | (47,160,274) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Increase (decrease) in short-term loans and overdraft | 5,125,862 | (4,915,999) |
| Decrease in commercial paper payable | (103,762) | (4,300,138) |
| Issuance of bonds payable | 19,700,000 | - |
| Repayments of bonds payable | (13,700,000) | - |
| Proceeds from long-term debt | 1,279,567 | 20,945,295 |
| Repayments of long-term debt | - | (3,025,330) |
| Increase (decrease) in long-term notes payable | 7,500,000 | (750,000) |
| Cash dividends | (26,990,933) | (13,285,712) |
| Issuance of common stock for cash | 23,738,755 | - |
| Net cash provided by (used in) financing activities | 16,549,489 | (5,331,884) |
| NET DECREASE IN CASH | (1,487,009) | (3,017,865) |
| CASH, BEGININING OF YEAR | 2,170,616 | 5,188,481 |
| CASH, END OF YEAR | $ 683,607 | $ 2,170,616 |
| SUPPLEMENTAL CASH FLOW INFORMATION | | |
| Interest paid | $ 1,439,066 | $ 1,254,676 |
| Capitalized interest | (644,909) | (610,630) |
| Interest paid (excluding capitalized interest) | $ 794,157 | $ 644,046 |
| Income tax paid | $ 4,183,530 | $ 32,520 |
| INVESTING AND FINANCING ACTIVITIES AFFECTING BOTH CASH AND NON-CASH ITEMS | | |
| Cash paid for acquisition of property, plant and equipment | | |
| Acquisition of property, plant and equipment | $ 16,081,479 | $ 31,765,694 |
| Decrease (increase) in payable for equipment purchased | 1,107,816 | (484,158) |
| | $ 17,189,295 | $ 31,281,536 |
| Cash dividends paid to stockholders | | |
| Total cash dividends payable to stockholders | $ 26,996,676 | $ 13,266,411 |
| Decrease (increase) in dividends payable | (5,743) | 19,301 |
| | $ 26,990,933 | $ 13,285,712 |
| NON-CASH FINANCING ACTIVITIES | | |
| Current portion of long-term liabilities | $ 14,977,313 | $ 13,697,919 |

(Concluded)

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

## 1. ORGANIZATION AND OPERATIONS

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

The Corporation's shares have been listed on the Taiwan Stock Exchange since December 1974. As of December 31, 2011 and 2010, the Ministry of Economic Affairs, Republic of China owned 20.05% and 21.24% of the Corporation's issued common stock, respectively.

As of December 31, 2011 and 2010, the Corporation had about 9,500 and 9,200 employees, respectively.

## 2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, Business Accounting Law, Guidelines Governing Business Accounting, and accounting principles generally accepted in the Republic of China ("ROC GAAP").

For readers' convenience, the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the ROC. If inconsistencies arise between the English version and the Chinese version or if differences arise in the interpretations between the two versions, the Chinese version of the financial statements shall prevail. However, the accompanying financial statements do not include English translation of the additional footnote disclosures that are not required under generally accepted accounting principles but are required by the Securities and Futures Bureau ("SFB") for their oversight purposes.

Significant accounting policies are summarized as follows:

**Foreign-currency Transactions**

Non-derivative foreign-currency transactions are recorded in functional currency at the rates of exchange in effect when the transactions occur. Exchange differences arising from settlement of foreign-currency assets and liabilities are recognized in profit or loss.

At the balance sheet date, foreign-currency monetary assets and liabilities are revalued using prevailing exchange rates and the exchange differences are recognized in profit or loss.

At the balance sheet date, foreign-currency nonmonetary assets and liabilities that are measured at fair value are revalued using prevailing exchange rates, with the exchange differences treated as follows:

a. Recognized in stockholders' equity if the changes in fair value are recognized in stockholders' equity;

b. Recognized in profit and loss if the changes in fair value are recognized in profit or loss.

Foreign-currency nonmonetary assets and liabilities that are carried at cost continue to be stated at historical exchange rates at trade dates.

If the functional currency of an equity-method investee is a foreign currency, translation adjustments will result from the translation of the investee's financial statements into the reporting currency of the

Corporation. Such adjustments are accumulated and reported as a separate component of stockholders' equity.

**Accounting Estimates**

Under above guidelines, law and principles, certain estimates and assumptions have been used for the allowance for doubtful accounts, provision for loss on inventories, depreciation, impairment loss on assets, loss on commitments, pension, income tax, bonuses to employees and remuneration to directors and supervisors, etc. Actual results may differ from these estimates.

**Current and Noncurrent Assets and Liabilities**

Current assets include cash and those assets held primarily for trading purposes or to be realized, sold or consumed within one year from the balance sheet date. All other assets such as property, plant and equipment and intangible assets are classified as noncurrent. Current liabilities are obligations incurred for trading purposes or to be settled within one year from the balance sheet date. All other liabilities are classified as noncurrent.

**Financial Assets at Fair Value Through Profit or Loss**

Financial instruments classified as financial assets at fair value through profit or loss ("FVTPL") include financial assets held for trading and those designated as at FVTPL on initial recognition. The Corporation recognizes financial assets on its balance sheet when the Corporation becomes a party to the contractual provisions of the financial instrument. A financial asset is derecognized when the Corporation has lost control of its contractual rights over the financial asset.

Financial instruments at FVTPL are initially measured at fair value. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognized immediately in profit or loss. At each balance sheet date subsequent to initial recognition, financial assets or financial liabilities at FVTPL are remeasured at fair value, with changes in fair value recognized directly in profit or loss in the year in which they arise. Cash dividends received subsequently (including those received in the year of investment) are recognized as income for the year. On derecognition of a financial asset or a financial liability, the difference between its carrying amount and the sum of the consideration received and receivable or consideration paid and payable is recognized in profit or loss. All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis.

A derivative that does not meet the criteria for hedge accounting is classified as a financial asset or a financial liability held for trading. If the fair value of the derivative is positive, the derivative is recognized as a financial asset; otherwise, the derivative is recognized as a financial liability.

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

**Available-for-sale Financial Assets**

Available-for-sale financial assets are initially measured at fair value plus transaction costs that are directly attributable to the acquisition. At each balance sheet date subsequent to initial recognition, available-for-sale financial assets are remeasured at fair value, with changes in fair value recognized in equity until the financial assets are disposed of, at which time, the cumulative gain or loss previously recognized in equity is included in profit or loss for the year. All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis. Fair value is based on the closing price on balance sheet date for listed stocks. For stocks acquired by private subscription and not transferred freely in public market, the fair value is determined using valuation techniques.

The recognition and derecognition bases of available-for-sale financial assets are the same with those of financial assets at FVTPL.

Cash dividends are recognized as investment income on the ex-dividend date, except for dividends distributed from the pre-acquisition profit, which are treated as a reduction of investment cost. Stock dividends are not recognized as investment income but are recorded as an increase in the number of shares. The total number of shares subsequent to the increase is used for recalculation of cost per share.

An impairment loss is recognized when there is objective evidence that the financial asset is impaired. Any subsequent decrease in impairment loss for an equity instrument classified as available-for-sale is recognized directly in equity. If the fair value of a debt instrument classified as available-for-sale subsequently increases as a result of an event which occurred after the impairment loss was recognized, the decrease in impairment loss is reversed to profit.

**Hedge Accounting**

Derivatives and other financial assets that are designated and effective as hedging instruments are measured at fair value, with subsequent changes in fair value recognized either in profit or loss, or in shareholders' equity, depending on the nature of the hedging relationship.

Hedge accounting recognizes the offsetting effects on profit or loss arising from the changes in the fair values of the hedging instrument and the hedged item as follows:

a. Fair value hedge

   The Corporation uses non-derivative financial instruments to hedge exchange rate fluctuations of investments. The gain or loss from remeasuring the hedging instrument at fair value and the gain or loss on the hedged item attributable to the hedged risk are recognized in profit or loss.

b. Cash flow hedge

   The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized in stockholders' equity. The amount recognized in stockholders' equity is recognized as the original cost of the asset while executing the firm commitment. However, if all or a portion of a loss recognized in stockholders' equity is not expected to be recovered in the future, the amount that is not expected to be recovered is reclassified into current profit or loss.

c. Hedge of a net investment in a foreign operation

   The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized in stockholders' equity. The amount recognized in stockholders' equity is recognized in profit or loss upon the disposal of the foreign operation.

The Corporation uses the hedge activities to control the risk of the exchange rate fluctuations.

**Financial Assets Carried at Cost**

Investments in non-publicly traded stocks, stocks traded in the Emerging Stock Market, and certificates of entitlement are measured at their original cost. The accounting treatment for dividends on financial assets carried at cost is the same with that for dividends on available-for-sale financial assets. An impairment loss is recognized when there is objective evidence that the asset is impaired. A reversal of this impairment loss is disallowed.

**Bond Investments with No Active Market**

Bond investments with fixed or determinable payments and with no quoted prices in active market are carried at amortized cost. These financial assets are initially recognized at fair value plus transaction cost that are directly attributable to the acquisition. Profit or loss is recognized when the financial assets are derecognized, impaired or amortized.

An impairment loss is recognized when there is objective evidence that the investment is impaired. The impairment loss is reversed if an increase in the investment's recoverable amount is due to an event which occurred after the impairment loss was recognized; however, the adjusted carrying amount of the investment may not exceed the carrying amount that would have been determined had no impairment loss been recognized for the investment in prior years.

**Impairment and Factoring of Accounts Receivable**

a. Impairment of Accounts Receivable

The Corporation does not provide allowance for doubtful accounts on receivables from sales covered by bank acceptances in transit under letters of credit. Prior to January 1, 2011, the Corporation provides 100% allowance for doubtful accounts on accounts receivable from sales on credit and services that are overdue and assessed as not collectible.

As discussed in Note 3 to the financial statements, on January 1, 2011, the Corporation adopted the third-time revised Statement of Financial Accounting Standards (SFAS) No. 34, "Financial Instruments: Recognition and Measurement." One of the main revisions is that impairment of receivables originated by the Corporation should be covered by SFAS No. 34. Accounts receivable are assessed for impairment at the end of each reporting period and considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the accounts receivable, the estimated future cash flows of the asset have been affected. Objective evidence of impairment includes:

1) Significant financial difficulty of the debtor;
2) Accounts receivable becoming overdue;
3) It becomes probable that the debtor will enter bankruptcy or financial re-organization.

Accounts receivable that are assessed as not impaired individually are further assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of accounts receivable could include the Corporation's past experience of collecting payments, an increase in the number of delayed payments, as well as observable changes in national or regional economic conditions that correlate with defaults on receivables.

The amount of impairment loss recognized is the difference between the asset carrying amount and the present value of estimated future cash flows, after taking into account the related collateral or guarantees, discounted at the receivable's original effective interest rate.

The carrying amount of the accounts receivable is reduced through the use of an allowance account. When accounts receivable are considered uncollectible, they are written off against the allowance account. Recoveries of amounts previously written off are credited to the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

b. Factoring of Accounts Receivable

Factoring of accounts receivable would be accounted for as a sale of receivables if the following three conditions are met:

1) The accounts receivable have been isolated from the Corporation - put presumptively beyond the control of the Corporation.

2) The transferees have obtained the right to pledge or exchange the accounts receivable, and there is no condition which constrains the transferees from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the Corporation.

3) The transferor does not maintain effective control over the transferred assets through either of the following: (i) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity and (ii) the ability to unilaterally cause the holder to return specific assets.

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

**Impairment of Assets**

If the recoverable amount of an asset (mainly property, plant and equipment, intangible assets and investments accounted for by the equity method) is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is charged to earnings unless the asset is carried at a revalued amount, in which case the impairment loss is first treated as a deduction to the unrealized revaluation increment and any remaining loss is charged to earnings.

If an impairment loss subsequently reverses, the carrying amount of the asset is increased accordingly, but the increased carrying amount may not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized in earnings, unless the asset is carried at a revalued amount, in which case the reversal of the impairment loss is first recognized as gains to the extent that an impairment loss on the same revalued asset was previously charged to earnings. Any excess amount is treated as an increase in the unrealized revaluation increment.

For equity method investments on which the Corporation has significant influence but with no control, the carrying amount (including goodwill) of each investment is compared with its own recoverable amount to determine impairment loss.

**Allowance for Sales Discount**

An allowance for sales discount, recorded as other payables, is recognized on the basis of management's judgment and relevant factors.

**Inventories**

Inventories consist of raw materials, supplies, fuel, finished products, work in process and etc. Inventories are stated at the lower of cost or net realizable value. Inventory write-downs are made on item by item basis. Net realizable value is the estimated selling price of inventories less all estimated costs of completion and expenses necessary to make the sale. Inventories are recorded at moving average cost. Unallocated fixed overheads on idle capacity are currently recognized as operating costs when actual production is significantly lower than normal production or the equipment is idle.

**Investments Accounted for by the Equity Method**

Investments in which the Corporation holds 20 percent or more of the investees' voting rights or exercises significant influence over the investees' operating and financial decisions are accounted for by the equity method.

The cost of investment is allocated to the assets and liabilities of the investee on the basis of their fair values at the date of investment, and the investment cost in excess of the fair value of the net identifiable assets of the investee is recognized as goodwill. Goodwill is not amortized. The fair value of the net identifiable assets of the investee in excess of the investment cost is used to reduce the fair value of each of the noncurrent assets of the investee (except for financial assets other than investments accounted for by the equity method, deferred income tax assets, prepaid pension or other postretirement benefit) in proportion to the respective fair values of the noncurrent assets, with any excess recognized as an extraordinary gain.

Profits from downstream transactions with an equity-method investee are eliminated in proportion to the Corporation's percentage of ownership in the investee; however, if the Corporation has control over the investee, all the profits are eliminated. Profits from upstream transactions with an equity-method investee are eliminated in proportion to the Corporation's percentage of ownership in the investee.

When the Corporation subscribes for its investee's newly issued shares at a percentage different from its current percentage of ownership in the investee, the Corporation records the change in its equity in the investee's net assets as an adjustment to investments, with a corresponding amount credited or debited to capital surplus. When the adjustment should be debited to capital surplus, but the capital surplus from long-term investments is insufficient, the shortage is debited to retained earnings.

When the Corporation's share in losses of an investee over which the Corporation has significant influence equals its investment in that investee plus any advances made to the investee, the Corporation discontinues applying the equity method. The Corporation continues to recognize its share in losses of the investee if (a) the Corporation commits to provide further financial support to the investee or (b) the losses of the investee are considered to be temporary and sufficient evidence shows forthcoming return to profitability.

When the Corporation and its investee have mutual equity holdings, the investment income or loss is accounted for by the treasury stock method.

The Corporation's shares held by subsidiaries are recorded as treasury stock. The Corporation's dividends distributed to subsidiaries are debited to investment income and adjusted to capital surplus - treasury stock transaction.

**Property, Plant and Equipment**

Property, plant and equipment, except for land, are stated at cost or cost plus revaluation increment less accumulated depreciation. Borrowing costs directly attributable to the acquisition or construction of property, plant and equipment are capitalized as part of the cost of those assets. Major additions, renewals and improvements are capitalized, while costs of maintenance and repairs are expensed currently.

Spare parts are intended for use in the repairs of machinery and equipment. Depreciation of major spare parts is calculated by the straight-line method over the shorter of useful lives of supported equipment or their own useful lives, whereas depreciation of rollers is calculated based on their level of wear.

Depreciation is calculated by the straight-line method over service lives estimated as follows: land improvements, 15 to 40 years; buildings, 5 to 60 years; machinery and equipment, 3 to 25 years; transportation equipment, 3 to 20 years; and other equipment, 3 to 10 years. Depreciation of revalued assets is provided on a straight-line basis over their remaining estimated useful lives determined at the time of revaluation. Property, plant and equipment still in use beyond their original estimated useful lives are further depreciated over their new estimated useful lives.

Upon disposal of property, plant and equipment, the related cost (including revaluation increment), accumulated depreciation and accumulated impairment loss are derecognized. Any gain or loss on disposal of the asset is included in nonoperating gains or losses in the year of disposal. The related unrealized revaluation increment is transferred to nonoperating income and gains.

**Intangible Assets**

Identifiable intangible assets (mainly computer software, leasehold, patents and trademarks) acquired are initially recorded at cost. Amortization is calculated by the straight-line method over estimated useful lives ranging from 5 to 20 years.

**Assets Leased to Others**

Assets leased to others are stated at the lower of carrying value or recoverable value. Depreciation is calculated by the working-hours method or the straight-line method over sixty years.

**Pension Cost**

Pension cost under defined benefit plan is determined by actuarial valuations and recorded as expenses.

Contributions made under a defined contribution plan are recognized as pension cost during the year in which employees render services.

**Income Tax**

The Corporation applies the intra-year and inter-year allocation methods to income tax, whereby (1) a portion of income tax expense is charged or credited directly to shareholders' equity; and (2) deferred income tax assets and liabilities are recognized for the tax effects of temporary differences and unused tax credits. Valuation allowance is provided to the extent, if any, that it is more likely than not that deferred income tax assets will not be realized. A deferred tax asset or liability is classified as current or noncurrent in accordance with the classification of its related asset or liability. However, if a deferred income tax asset or liability does not relate to an asset or liability in the financial statements, then it is classified as either current or noncurrent based on the expected length of time before it is realized or settled.

If the Corporation can control the timing of the reversal of a temporary difference arising from the difference between the book value and the tax basis of a long-term equity investment in a foreign subsidiary or joint venture and if the temporary difference is not expected to reverse in the foreseeable future and will, in effect, exist indefinitely, then a deferred tax liability or asset is not recognized.

Any tax credit arising from purchases of machinery, equipment and technology, and expenditures of research and development and employee training is recognized using the flow-through method.

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

According to the Income Tax Law, an additional tax at 10% of unappropriated earnings is provided for as income tax in the year the shareholders approve to retain the earnings.

**Stock-based Compensation**

Employee stock options granted on or after January 1, 2008 are accounted for under SFAS No. 39, "Accounting for Share-based Payment." Under the statement, the value of the stock options granted, which is equal to the best available estimate of the number of stock options expected to vest multiplied by the grant-date fair value, is expensed on a straight-line basis over the vesting year, with a corresponding adjustment to capital surplus - employee stock options. The estimate is revised if subsequent information indicates that the number of stock options expected to vest differs from previous estimates.

**Treasury Stock**

Reacquired issued shares of the Corporation are recorded as treasury stock at cost and shown as a deduction in stockholders' equity.

The Corporation accounts for its stock held by subsidiaries as treasury stock. The recorded cost of the stock is based on its carrying amount as of January 1, 2002 and reclassified to treasury stock. Shares of the Corporation that were acquired and held by less than 50%-owned subsidiaries of the Corporation after January 1, 2002 are reclassified to treasury stock at the acquisition cost.

**Revenue Recognition**

Revenues from sales of goods are recognized when the significant risks and rewards of ownership of the goods 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.

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

Service revenues are recognized according to the contract and the percentage of completion of the service. If a service contract is estimated to bear a loss prior to completion, the Corporation recognizes the full amount of the loss immediately. However, if the loss is estimated to be smaller in future years, the difference is reversed and recognized as a gain in the year of determination.

**Reclassifications**

Certain accounts in the financial statements as of and for the year ended December 31, 2010 have been reclassified to conform to the presentation of the financial statements as of and for the year ended December 31, 2011 and are listed as follows:

| | Before Reclassification | After Reclassification |
|---|---|---|
| Balance sheets | | |
| Financial assets carried at cost - noncurrent | $ 3,582,500 | $ - |
| Bond investments with no active market - noncurrent | - | 3,582,500 |
| Spare parts - current | 7,262,805 | - |
| Spare parts - noncurrent | 1,197,500 | - |
| Inventories - supplies | - | 3,696,998 |
| Cost of property, plant and equipment - spare parts | - | 6,780,271 |
| Accumulated depreciation of property, plant and equipment - spare parts | - | 2,016,964 |

## 3. EFFECTS OF CHANGES IN ACCOUNTING PRINCIPLES

**Financial Instruments**

Starting January 1, 2011, the Corporation adopted the newly revised Statement of Financial Accounting Standards (SFAS) No. 34, "Financial Instruments: Recognition and Measurement." The main revisions include: (1) impairment of finance lease receivables is now covered by SFAS No. 34; (2) the scope of the applicability of SFAS No. 34 to insurance contracts is amended; (3) loans and receivables originated by the enterprise are now covered by SFAS No. 34; (4) additional guidelines on impairment of financial assets carried at amortized cost when the debtor has financial difficulties and the terms of obligations have been modified; and (5) accounting treatment by a debtor for modifications in the terms of obligations. This accounting change did not have a significant impact on the Corporation's financial statements as of and for the year ended December 31, 2011.

**Operating Segments**

Starting January 1, 2011, the Corporation adopted the newly issued SFAS No. 41, "Operating Segments." The requirements of the statement are based on the information about the components of the Corporation and its subsidiaries that management uses to make decisions about operating matters. SFAS No. 41 requires identification of operating segments on the basis of internal reports that are regularly reviewed by the Corporation's chief operating decision maker in order to allocate resources to the segments and assess their performance. This statement supersedes SFAS No. 20, "Segment Reporting." The information for the year ended December 31, 2010 has been recast to reflect the new segment reporting requirement.

## 4. CASH

| | December 31 | |
|---|---|---|
| | **2011** | **2010** |
| Cash on hand | $ 15,459 | $ 19,544 |
| Checking accounts and demand deposits | 568,148 | 1,051,072 |
| Time deposits | 100,000 | 1,100,000 |
| | $ 683,607 | $ 2,170,616 |

Foreign bank deposits of the Corporation were as follows:

| | December 31 | |
|---|---|---|
| | **2011** | **2010** |
| Japan - IYO Bank and Mega International Commercial Bank (in thousands) | ¥ 1,877 | ¥ 8,828 |
| Singapore - Daiwa Securities SMBC (in thousands) | 37,221 | 27,927 |
| Total (in thousands) | ¥ 39,098 | ¥ 36,755 |
| Represented by NT dollars (in thousands) | $ 15,272 | $ 13,169 |

The Corporation cooperated with the Ministry of Economic Affairs on "Development of Amorphous Ribbon Manufacturing Technology" and other projects. Deposits for these projects were NT$53,748 thousand (NT$28,750 thousand recorded as restricted assets - current and NT$24,998 thousand recorded as restricted assets - noncurrent) and NT$23,192 thousand (NT$1,000 thousand recorded as restricted assets - current and NT$22,192 thousand recorded as restricted assets - noncurrent), as of December 31, 2011 and 2010, respectively.

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

The financial assets designated as at FVTPL represent open-end bond funds. The purpose of classifying open-end bond funds to this account is to reduce the accounting inconsistency between investment income and interest expense. Those assets are managed as a group and the performance is evaluated on fair value basis, in accordance with the Corporation's documented risk management or investment strategy. Net gains on financial assets designated as at FVTPL for the years ended December 31, 2011 and 2010 were NT$2,828 thousand and NT$12,571 thousand, respectively.

## 6. AVAILABLE-FOR-SALE FINANCIAL ASSETS

| | December 31 | | | |
|---|---|---|---|---|
| | 2011 | | 2010 | |
| | Current | Noncurrent | Current | Noncurrent |
| Quoted stocks | | | | |
| Taiwan Semiconductor Manufacturing Company (TSMC) | $ 2,207,870 | $ - | $ 2,068,057 | $ - |
| Maruichi Steel Tube Ltd. | - | 1,341,320 | - | 1,235,963 |
| Tang Eng Iron Works Corporation (TEI) | - | 865,960 | - | 871,932 |
| CSBC Corporation Taiwan (CSBC) | - | 414,776 | - | 491,653 |
| Yodogawa Steel Works, Ltd. | - | 260,921 | - | 270,837 |
| Private-placement shares | | | | |
| Rechi Precision Co., Ltd. (RPC) | - | 377,429 | - | 265,272 |
| | $ 2,207,870 | $ 3,260,406 | $ 2,068,057 | $ 3,135,657 |

In September 2010, the Corporation invested NT$251,988 thousand to acquire 5% shareholding of RPC through its private subscription. RPC mainly manufactures compressors. Under the Securities Exchange Act, the securities which the Corporation acquired by private subscription could be transferred freely in public market only after holding those shares for three years starting from the delivery date.

The Corporation borrowed foreign-currency bank loans to hedge exchange rate fluctuation risks on the investments in Maruichi Steel Tube Ltd. and Yodogawa Steel Works, Ltd. (Notes 20 and 28). Adjustments for change in valuation arising from exchange difference were recognized as profit or loss.

## 7. HEDGING DERIVATIVE FINANCIAL INSTRUMENTS

The Corporation entered into forward exchange contracts to manage cash flow exposures arising from exchange rate fluctuations on foreign-currency capital expenditure contracts.

Outstanding forward exchange contracts as of December 31, 2011 and 2010 were as follows:

| | Currency | Period for Generating Cash Flows and Maturity Date | Contract Amount (In Thousands) |
|---|---|---|---|
| December 31, 2011 | | | |
| Buy | NTD/USD | January 2012 - September 2015 | NTD2,421,149/USD84,579 |
| | NTD/EUR | March 2012 - October 2013 | NTD133,699/EUR3,216 |
| December 31, 2010 | | | |
| Buy | NTD/EUR | March 2011 - March 2012 | NTD82,353/EUR1,891 |

Movements of hedging derivative financial instruments for the years ended December 31, 2011 and 2010 were as follows:

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Balance, beginning of year | $ (6,414) | $ 61,976 |
| Valuation gain (loss) | 110,481 | (76,627) |
| Transferred to construction in progress and prepayments for equipment | (91) | 8,237 |
| Balance, end of year | $ 103,976 | $ (6,414) |

As of December 31, 2011 and 2010, the balances of hedging derivative financial instruments were as follows:

| | December 31 2011 | December 31 2010 |
|---|---|---|
| Hedging derivative assets - current | $ 22,630 | $ - |
| Hedging derivative assets - noncurrent | 89,387 | - |
| Hedging derivative liabilities - current | (7,620) | (3,537) |
| Hedging derivative liabilities - noncurrent | (421) | (2,877) |
| | $ 103,976 | $ (6,414) |

The valuation gain or loss was recognized as unrealized gain on financial instruments in stockholders' equity.

## 8. ACCOUNTS RECEIVABLE

The Corporation entered into accounts receivable factoring agreements (without recourse) with Mega International Commercial Bank, Bank of Taiwan and Taipei Fubon Bank. Under the agreements, 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 related information for the Corporation's sale of accounts receivable for the years ended December 31, 2011 and 2010 was as follows:

| Transaction Counter-party | Advances Received at Year - beginning | Receivables Sold | Amounts Collected by Bank | Advances Received at Year-end | Interest Rate on Advances Received (%) | Credit Line (In Billions of NTD) |
|---|---|---|---|---|---|---|
| Year ended December 31, 2011 | | | | | | |
| Mega International Commercial Bank | $ 4,300,199 | $ 10,256,117 | $ 10,990,814 | $ 3,565,502 | 1.06-1.51 | $ 9.0 |
| Bank of Taiwan | 923,545 | 3,417,866 | 2,831,655 | 1,509,756 | 1.14-1.51 | 3.0 |
| Taipei Fubon Bank | 63,716 | - | 63,716 | - | - | 0.4 |
| | $ 5,287,460 | $ 13,673,983 | $ 13,886,185 | $ 5,075,258 | | |
| Year ended December 31, 2010 | | | | | | |
| Mega International Commercial Bank | $ 2,723,672 | $ 9,834,614 | $ 8,258,087 | $ 4,300,199 | 0.90-1.26 | 9.0 |
| Bank of Taiwan | 484,607 | 1,883,711 | 1,444,773 | 923,545 | 0.90-1.20 | 3.0 |
| Taipei Fubon Bank | 124,901 | 434,667 | 495,852 | 63,716 | 1.15-1.20 | 0.4 |
| | $ 3,333,180 | $ 12,152,992 | $ 10,198,712 | $ 5,287,460 | | |

## 9. INVENTORIES

| | December 31 2011 | December 31 2010 |
|---|---|---|
| Finished products | $ 11,556,342 | $ 10,362,226 |
| Work in process | 29,285,142 | 16,168,678 |
| Raw materials | 18,617,096 | 13,247,396 |

(Continued)

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Supplies | $ 4,510,559 | $ 4,869,894 |
| Raw materials and supplies in transit | 2,479,581 | 1,987,831 |
| Fuel | 285,713 | 249,225 |
| Others | 606,107 | 72,259 |
| | $ 67,340,540 | $ 46,957,509 |

(Concluded)

As of December 31, 2011 and 2010, the allowance for inventory devaluation was NT$4,034,124 thousand and NT$1,003,671 thousand, respectively, and recorded as reduction in inventories. The cost of inventories recognized as operating costs for the years ended December 31, 2011 and 2010 was NT$218,781,975 thousand and NT$196,235,742 thousand, respectively, which included the items as follows:

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Provision for loss on inventories | $ 3,060,921 | $ 149,012 |
| Loss on purchase commitments | 15,478 | - |
| Gain on physical inventory | (154,684) | (208,180) |
| Income from scrap sales | (226,561) | (213,673) |
| | $ 2,695,154 | $(272,841) |

## 10. FINANCIAL ASSETS CARRIED AT COST - NONCURRENT

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Unquoted common stocks | | |
| Nacional Minerios S.A. | $ 3,268,550 | $ - |
| Dongbu Metal Co., Ltd. | 1,276,092 | 1,276,092 |
| Industrial Bank of Taiwan | 1,000,000 | 1,000,000 |
| CDIB & Partners Investment Holding Corporation | 500,000 | 500,000 |
| Taiwan Rolling Stock Co., Ltd. | 202,048 | 202,048 |
| Adimmune Corporation (AC) | 135,897 | 135,897 |
| TaiGen Biopharmaceuticals Holdings Limited (Note 11) | 103,000 | - |
| CDIB BioScience Ventures I, Inc. | 50,880 | 65,791 |
| Overseas Investment & Development Corporation | 50,000 | 50,000 |
| Mega I Venture Capital Co., Ltd. | 17,400 | 17,400 |
| Taiwan High Speed Rail Corporation (THSRC) | - | - |
| Certificate of entitlement | | |
| Formosa Ha Tinh Steel Corporation | 817,353 | - |
| | $ 7,421,220 | $ 3,247,228 |

The above equity investments, which have no quoted prices in active market and of which verifiable fair value cannot be determined at a reasonable cost, are carried at cost.

In November 2011, the Corporation acquired 4,751 thousand shares (1% shareholding) of Nacional Minerios S.A. by investing NT$3,268,550 thousand (JPY8.5 billion). Nacional Minerios S.A. mainly engages in iron ore mining.

In December 2010, the Corporation acquired 1,500 thousand common shares (5% shareholding) of Dongbu Metal Co., Ltd. by investing NT$1,276,092 thousand (USD41,867 thousand). Dongbu Metal Co., Ltd. mainly manufactures and sells ferromanganese and ferro silico-manganese.

The Corporation increased its investment in AC by NT$7,197 thousand representing 300 thousand common shares in June 2010. In September 2010, the Corporation sold 5,000 thousand shares to the subsidiary, Gains Investment Corporation (GIC), for proceeds of NT$138,683 thousand, and recognized unrealized gain on sale of investment of NT$35,733 thousand, recorded as deferred credits - gain from affiliates (Notes 23 and 29).

In September 2003, the Corporation acquired 100,000 thousand Preferred B shares (representing 4% of ownership) of THSRC for NT$1,000,000 thousand. Dividend on these shares is at 5%, payable on a nonparticipating and cumulative basis. These shares with six years duration could be extended for 13 months prior to 3 months from the due date. In April 2005 and August 2004, the Corporation acquired additional 505,370 thousand Preferred C shares of THSRC for NT$3,199,944 thousand and NT$1,499,997 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 zero percent in the next two years. At the end of four years, if the Corporation does not convert the Preferred C shares into common shares and THSRC cannot redeem the shares, the unredeemed shares will be entitled to receive 4.71% dividend. In the second half of 2008, the Corporation evaluated and recognized an impairment loss of NT$4,738,926 thousand on the investments in preferred shares of THSRC. In order to use tax credits under the Act for Promotion of Private Participation in Infrastructure Projects, the Corporation converted THSRC's preferred shares to 605,370 thousand common shares in August 2009. THSRC mainly builds and operates public transportation systems.

In June and December 2011, the Corporation invested NT$817,353 thousand (USD27,720 thousand) in Formosa Ha Tinh Steel Corporation and acquired 5% ownership. The main business of Formosa Ha Tinh Steel Corporation is manufacture and trading of steel products.

## 11. BOND INVESTMENTS WITH NO ACTIVE MARKET - NONCURRENT

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Unquoted preferred stocks - overseas | | |
| East Asia United Steel Corporation (EAUS) - Preferred A | $ 3,906,000 | $ 3,582,500 |
| TaiGen Biopharmaceuticals Holdings Limited (TGB) - Preferred B | - | 103,000 |
| | $ 3,906,000 | $ 3,685,500 |

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 EAUS was established. The Corporation invested in EAUS JPY10 billion (Notes 20 and 28). The Corporation thus has a stable supply of slab from this joint venture. The Corporation also signed a contract with its affiliate, Chung Hung Steel Corporation (CHSC), to transfer the purchasing right of slabs from EAUS, and the Corporation receives royalty on this contract based on the volume purchased by CHSC. The amounts of royalty income for the years ended December 31, 2011 and 2010 were NT$324,593 thousand and NT$282,757 thousand, respectively (recorded as nonoperating income and gains). As of December 31, 2011 and 2010, the royalty receivable was NT$85,692 thousand and NT$66,956 thousand, respectively (recorded as other receivables).

The Corporation acquired 20,000 thousand Preferred B shares of TGB for NT$300,000 thousand. TGB mainly researches and develops drugs. The Corporation transferred its preferred shares to 28,800 thousand common shares in June 2011. Therefore, the aforementioned investment was reclassified from bond investments with no active market - noncurrent to financial assets carried at cost - noncurrent (Note 10). The Corporation evaluated the investment in TGB and recognized an impairment loss of NT$197,000 thousand.

## 12. INVESTMENTS ACCOUNTED FOR BY THE EQUITY METHOD

| | December 31 | | | |
|---|---|---|---|---|
| | 2011 | | 2010 | |
| | Amount | % of Ownership | Amount | % of Ownership |
| Quoted companies | | | | |
| Chung Hung Steel Corporation (CHSC) | $ 3,509,256 | 29 | $ 4,346,793 | 29 |
| China Steel Chemical Corporation (CSCC) | 1,863,351 | 29 | 1,695,663 | 29 |
| China Steel Structure Corporation (CSSC) | 1,463,032 | 33 | 1,375,228 | 33 |
| China Ecotek Corporation (CEC) | 854,575 | 49 | 814,165 | 49 |
| China Hi-ment Corporation (CHC) | 713,721 | 20 | 703,316 | 20 |
| | 8,403,935 | | 8,935,165 | |
| Less: Shares held by subsidiaries accounted for as treasury stock | 1,589,487 | | 1,591,484 | |
| | 6,814,448 | | 7,343,681 | |
| Unquoted companies | | | | |
| Dragon Steel Corporation (DSC) | 80,358,899 | 100 | 78,841,711 | 100 |
| China Steel Express Corporation (CSE) | 10,332,777 | 100 | 10,373,819 | 100 |
| C. S. Aluminum Corporation (CAC) | 8,654,634 | 100 | 7,781,100 | 100 |
| Gains Investment Corporation (GIC) | 6,019,844 | 100 | 6,424,002 | 100 |
| China Prosperity Development Corporation (CPDC) | 4,894,483 | 100 | 4,890,207 | 100 |
| China Steel Asia Pacific Holdings Pte Ltd. (CSAPH) | 4,411,728 | 100 | 3,726,212 | 100 |
| China Steel Sumikin Vietnam Joint Stock Company (CSVC) | 3,054,014 | 51 | 1,764,253 | 51 |
| China Steel Global Trading Corporation (CSGT) | 2,664,337 | 100 | 1,612,465 | 100 |
| China Steel Machinery Corporation (CSMC) | 1,334,974 | 74 | 1,170,591 | 74 |
| Kaohsiung Rapid Transit Corporation (KRTC) | 814,035 | 31 | 1,278,733 | 31 |
| CSC Steel Australia Holdings Pty Ltd.(CSCAU) | 708,535 | 100 | 681,362 | 100 |
| Info-Champ Systems Corporation (ICSC) | 703,152 | 100 | 648,498 | 100 |
| Horng Yih Investment Corporation (HYI) | 571,364 | 100 | 671,159 | 100 |
| Long Yuan Fa Investment Corporation (LYFI) | 565,559 | 100 | 671,274 | 100 |
| Goang Yaw Investment Corporation (GYI) | 558,685 | 100 | 653,941 | 100 |
| Kaohsiung Arena Development Corporation (KADC) | 478,310 | 18 | 472,790 | 18 |
| China Steel Security Corporation (CSS) | 392,109 | 100 | 374,807 | 100 |
| Hsin Hsin Cement Enterprise Corp. (HHCEC) | 298,414 | 31 | 159,593 | 18 |
| Hi-mag Magnetic Corporation (HMC) | 121,222 | 50 | 114,570 | 50 |
| China Steel Management Consulting Corporation (CSMCC) | 25,850 | 100 | 26,918 | 100 |
| TaiAn Technologies Corporation (TTC) | 8,444 | 17 | 7,850 | 17 |
| | 126,971,369 | | 122,345,855 | |
| Less: Shares held by subsidiaries accounted for as treasury stock | 6,532,974 | | 6,560,137 | |
| | 120,438,395 | | 115,785,718 | |
| | $ 127,252,843 | | $ 123,129,399 | |

The Corporation's total equity in CHSC is 41%, including 29% directly owned and 12% indirectly owned through LYFI, HYI and GYI. The Corporation's total equity in CSSC is 37%, including 33% directly owned and 4% indirectly owned through Ever Wealthy Investment Corporation, CEC and DSC. The Corporation's total equity in KADC is 29%, including 18% directly owned and 11% indirectly owned through United Steel Engineering and Construction Corporation and CPDC. In December 2011, the Corporation increased its investment in HHCEC by NT$155,919 thousand. Consequently, the Corporation's total equity in HHCEC is 39%, including 31% directly owned and 8% indirectly owned through CHC. The Corporation's total equity in TTC is 22%, including 17% directly owned and 5%

indirectly owned through CSCC.

In April 2010, the Corporation invested additional NT$20,000,000 thousand in DSC through its private subscription, with the ownership percentage unchanged. In August 2010, the Corporation invested additional NT$713,569 thousand in CSSC through its private subscription and raised its direct ownership to 33%. Under the Securities Exchange Act, the securities which the Corporation acquired by private subscription could be transferred freely in public market only after holding for three years, starting from the delivery date.

In January 2011, in order to invest in Changzhou China Steel Precision Materials Corporation (originally Changzhou Xinzhong Precision Alloy Forging Products Co. Ltd., changed on March 1, 2011), the Corporation invested additional USD30,520 thousand (NT$888,941 thousand) in CSAPH without changing the percentage of ownership.

In April 2011, the Corporation invested additional USD43,911 thousand (NT$1,279,566 thousand) in CSVC without changing the percentage of ownership.

In November 2011, the Corporation invested additional NT$999,970 thousand in CSGT without changing the percentage of ownership.

The market values of listed equity-method investments as of December 31, 2011 and 2010 were as follows:

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| CSCC | $ 7,944,920 | $ 8,254,462 |
| CHSC | 3,632,943 | 6,768,102 |
| CEC | 2,969,072 | 2,786,275 |
| CHC | 1,765,464 | 1,595,191 |
| CSSC | 1,603,644 | 1,464,770 |
| | $ 17,916,043 | $ 20,868,800 |

The market values of the above listed stocks are calculated at their closing price on balance sheet date, except for stocks acquired by private subscription and not transferred freely in public market that are stated at market values determined by using valuation techniques.

Investment income (loss) under the equity method for the years ended December 31, 2011 and 2010 was as follows:

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| CSE | $ 2,447,058 | $ 2,975,156 |
| DSC | 947,442 | 1,280,374 |
| CAC | 863,846 | 911,840 |
| CSCC | 640,095 | 552,523 |
| CSGT | 498,217 | 498,772 |
| CSMC | 352,019 | 283,112 |
| CEC | 227,791 | 194,131 |
| CSSC | 176,706 | 133,451 |
| ICSC | 167,304 | 136,175 |
| CPDC | 139,564 | 117,238 |
| CHC | 128,039 | 113,619 |
| CSS | 89,717 | 80,283 |

(Continued)

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| CSAPH | $ 18,431 | $ 303,068 |
| GIC | 15,127 | 398,767 |
| CSCAU | 2,892 | 111,982 |
| CHSC | (783,194) | 371,145 |
| KRTC | (464,698) | (416,372) |
| LYFI | (110,381) | 57,451 |
| HYI | (109,624) | 54,413 |
| GYI | (106,942) | 53,098 |
| Others | 12,042 | 37,549 |
| | $ 5,151,451 | $ 8,247,775 |

(Concluded)

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

The Corporation's Board of Directors approved plans for additional investments in DSC, CSVC and other companies. The related subscription schedule depends on the investees' capital increase requirements. As of December 31, 2011, the Corporation's unexecuted investments in these investees aggregated NT$28,529,175 thousand.

The Corporation adopted the purchase method to account for the acquisition of DSC equity. The difference between the investment cost and the Corporation's share in the investee's net assets represents depreciable assets and goodwill. In 2009, the Corporation's total equity in HHCEC was 26% and the fair value of identifiable net assets exceeded the investment cost; the excess had been deducted to reduce the carrying amounts of non-current assets in proportion to their fair values.

Movements of the difference between the cost of investment and the Corporation's share in investees' net assets allocated to depreciable assets and goodwill were as follows:

| | Depreciable Assets | Non-depreciable Assets | Goodwill |
|---|---|---|---|
| Year ended December 31, 2011 | | | |
| Balance, beginning of year | $ 917,351 | $ (1,924) | $ 401,018 |
| Amortization | (84,382) | - | - |
| Balance, end of year | $ 832,969 | $ (1,924) | $ 401,018 |
| Year ended December 31, 2010 | | | |
| Balance, beginning of year | $ 993,548 | $ (1,924) | $ 401,018 |
| Amortization | (76,197) | - | - |
| Balance, end of year | $ 917,351 | $ (1,924) | $ 401,018 |

The depreciable assets comprised of property, plant and equipment, franchise from Carbon credit and Nox credit, developed technology, customer relationship, etc. Non-depreciable assets comprised of land and investments accounted for by the equity method.

## 13. OTHER FINANCIAL ASSETS

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Foreign-currency time deposits | $ 4,297,684 | $ 938,619 |
| Foreign-currency demand deposits | 221,291 | 908,702 |
| | 4,518,975 | 1,847,321 |
| Less: Current portion | 2,399,287 | 1,093,993 |
| | $ 2,119,688 | $ 753,328 |

For the purpose of constructing the third cold-rolled plant, the Corporation signed contracts to purchase imported equipment in total of JPY16.15 billion. For the purposes of managing cash flow exposures arising from exchange rate fluctuations, the Corporation purchased deposits of JPY16 billion (NT$4,878,900 thousand) in January 2008. As of December 31, 2011 and 2010, the balance of the JPY deposits designated as hedging instrument was NT$626,226 thousand (JPY1.6 billion) and NT$656,933 thousand (JPY1.8 billion), respectively.

For the purpose of purchasing imported equipment as well as managing cash flows risk arising from exchange rate fluctuations, the Corporation successively purchased deposits of USD122,874 thousand (NT$3,604,899 thousand). As of December 31, 2011 and 2010, the balance of the U.S. dollar deposits designated as hedging instruments was NT$3,168,070 thousand (USD104,643 thousand) and NT$550,026 thousand (USD18,115 thousand), respectively.

For the purpose of managing cash flow exposures on foreign-currency capital expenditure contracts, the Corporation entered into forward exchange contracts (Note 7). As of December 31, 2011 and 2010, the balance of foreign-currency deposits purchased for expired forward exchange contract was NT$724,679 thousand (USD21,298 thousand and EUR2,039 thousand) and NT$640,362 thousand (USD18,972 thousand and EUR1,653 thousand), respectively.

The unrealized gains of NT$173,396 thousand and NT$23,519 thousand arising from the above deposits designated as hedging instruments were recognized as unrealized gain on financial instruments in stockholders' equity for the years ended December 31, 2011 and 2010, respectively. The unrealized loss on financial instruments of NT$21,985 thousand and the unrealized gain on financial instruments of NT$550,136 thousand in stockholders' equity were transferred to construction in progress and prepayments for equipment for the years ended December 31, 2011 and 2010, respectively.

As of December 31, 2011 and 2010, cash outflows would be expected from aforementioned contracts during the periods from 2012 to 2015 and from 2011 to 2013, respectively.

## 14. PROPERTY, PLANT AND EQUIPMENT

| | Land | Land Improvements | Buildings | Machinery and Equipment | Transportation Equipment | Other Equipment | Spare Parts | Construction in Progress and Prepayments for Equipment | Total |
|---|---|---|---|---|---|---|---|---|---|
| Year ended December 31, 2011 | | | | | | | | | |
| Cost | | | | | | | | | |
| Balance, beginning of year | $ 10,877,244 | $ 4,223,646 | $ 44,640,508 | $ 278,377,356 | $ 1,773,975 | $ 5,011,842 | $ 6,780,271 | $ 35,888,973 | $ 387,573,815 |
| Addition | - | - | 351,596 | 3,943,791 | 89,496 | 282,648 | 1,257,726 | 10,156,222 | 16,081,479 |
| Reclassification | 147,032 | - | - | 232,196 | - | - | (232,196) | - | 147,032 |
| Disposals | - | - | (53,012) | (4,256,840) | (58,789) | (176,357) | (887,529) | - | (5,432,527) |
| Balance, end of year | 11,024,276 | 4,223,646 | 44,939,092 | 278,296,503 | 1,804,682 | 5,118,133 | 6,918,272 | 46,045,195 | 398,369,799 |
| Revaluation increment | | | | | | | | | |
| Balance, beginning of year | 32,754,016 | 492,990 | 2,405,255 | 7,729,939 | 18,108 | 31,644 | - | - | 43,431,952 |
| Addition | 6,088,169 | - | - | - | - | - | - | - | 6,088,169 |
| Disposals | - | - | (2,254) | (622,866) | (9,117) | (26) | - | - | (634,263) |
| Balance, end of year | 38,842,185 | 492,990 | 2,403,001 | 7,107,073 | 8,991 | 31,618 | - | - | 48,885,858 |
| Accumulated depreciation | | | | | | | | | |
| Balance, beginning of year | - | 4,082,253 | 22,892,140 | 215,996,833 | 1,344,836 | 3,712,438 | 2,016,964 | - | 250,045,464 |
| Depreciation expense | - | 69,171 | 1,349,347 | 12,930,190 | 90,994 | 463,263 | 1,159,049 | - | 16,062,014 |
| Disposals | - | - | (23,418) | (4,843,299) | (67,787) | (170,934) | (887,529) | - | (5,992,967) |
| Balance, end of year | - | 4,151,424 | 24,218,069 | 224,083,724 | 1,368,043 | 4,004,767 | 2,288,484 | - | 260,114,511 |
| Net book value, end of year | $ 49,866,461 | $ 565,212 | $ 23,124,024 | $ 61,319,852 | $ 445,630 | $ 1,144,984 | $ 4,629,788 | $ 46,045,195 | $ 187,141,146 |
| Year ended December 31, 2010 | | | | | | | | | |
| Cost | | | | | | | | | |
| Balance, beginning of year | $ 10,692,043 | $ 4,223,646 | $ 42,280,414 | $ 259,574,860 | $ 1,751,261 | $ 4,700,032 | $ 6,597,295 | $ 28,878,043 | $ 358,697,594 |
| Addition | 185,201 | - | 2,367,240 | 20,286,511 | 39,707 | 431,522 | 1,444,583 | 7,010,930 | 31,765,694 |
| Disposals | - | - | (7,146) | (1,484,015) | (16,993) | (119,712) | (1,261,607) | - | (2,889,473) |
| Balance, end of year | 10,877,244 | 4,223,646 | 44,640,508 | 278,377,356 | 1,773,975 | 5,011,842 | 6,780,271 | 35,888,973 | 387,573,815 |
| Revaluation increment | | | | | | | | | |
| Balance, beginning of year | 32,754,016 | 492,990 | 2,405,551 | 7,968,650 | 18,108 | 31,671 | - | - | 43,670,986 |
| Disposals | - | - | (296) | (238,711) | - | (27) | - | - | (239,034) |
| Balance, end of year | 32,754,016 | 492,990 | 2,405,255 | 7,729,939 | 18,108 | 31,644 | - | - | 43,431,952 |
| Accumulated depreciation | | | | | | | | | |
| Balance, beginning of year | - | 4,003,372 | 21,544,619 | 205,084,014 | 1,261,670 | 3,337,411 | 2,127,274 | - | 237,358,360 |
| Depreciation expense | - | 78,881 | 1,350,723 | 12,631,180 | 100,051 | 489,488 | 1,151,297 | - | 15,801,620 |
| Disposals | - | - | (3,202) | (1,718,361) | (16,885) | (114,461) | (1,261,607) | - | (3,114,516) |
| Balance, end of year | - | 4,082,253 | 22,892,140 | 215,996,833 | 1,344,836 | 3,712,438 | 2,016,964 | - | 250,045,464 |
| Net book value, end of year | $ 43,631,260 | $ 634,383 | $ 24,153,623 | $ 70,110,462 | $ 447,247 | $ 1,331,048 | $ 4,763,307 | $ 35,888,973 | $ 180,960,303 |

Information about capitalized interest on the purchase of property, plant and equipment for the years ended December 31, 2011 and 2010 was disclosed as follows:

| | Years Ended December 31 | |
|---|---|---|
| | **2011** | **2010** |
| Interest expense before capitalization | $ 1,394,216 | $ 1,285,593 |
| Less: Capitalized interest - construction in progress and prepayments for equipment | 624,810 | 625,779 |
| Interest expense through income statement | $ 769,406 | $ 659,814 |
| Capitalization annual rates | 1.36%-1.89% | 1.83%-2.15% |

In 1981 and 1994, the Corporation revalued its property, plant and equipment and patents in accordance with government regulations, resulting in increment of NT$17,662,343 thousand. After the deduction of the reserve for land value increment tax of NT$3,370,813 thousand, a net increment of NT$14,291,530 thousand was credited to unrealized revaluation increment. Unrealized revaluation increment of NT$13,952,356 thousand had been capitalized as capital stock, reducing its balance to NT$339,174 thousand. In January 2005, the government revised the land value increment tax law to reduce the tax rate. Thus, the reserve for land value increment tax decreased and the unrealized revaluation increment increased each by NT$1,196,189 thousand. Accordingly, the balance of unrealized revaluation increment increased to NT$1,535,363 thousand. In February 2005, the Corporation disposed part of its land, which resulted in a decrease of NT$3,500 thousand in reserve for land value increment tax. In 2011 and 2008, the Corporation revalued its land in accordance with the current assessed land value. Therefore, the total increments on land revaluation were NT$6,088,169 thousand and NT$26,913,284 thousand, after the deduction of the reserve for land value increment tax of NT$1,338,450 thousand and NT$6,502,342 thousand, and net increments of NT$4,749,719 thousand and NT$20,410,942 thousand were credited to unrealized revaluation increment in 2011 and 2008, respectively. For the years ended December 31, 2011 and 2010, upon retirement or sale of revalued properties, the unrealized revaluation increment decreased by NT$12,781 thousand and NT$4,817 thousand, respectively, and recorded as nonoperating income and gains. As of December 31, 2011 and 2010, the balance of reserve for land value increment tax was NT$10,011,916 thousand and NT$8,673,466 thousand, and the balance of the unrealized revaluation increment was NT$26,610,866 thousand and NT$21,871,755 thousand, respectively.

## 15. ASSETS LEASED TO OTHERS, NET

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Cost | | |
| Land | $ 2,932,945 | $ 3,079,977 |
| Machinery and equipment | - | 2,000,000 |
| Buildings | 161,816 | 161,816 |
| | 3,094,761 | 5,241,793 |
| Accumulated depreciation | | |
| Machinery and equipment | - | 1,401,000 |
| Buildings | 31,401 | 28,748 |
| | 31,404 | 1,429,748 |
| Accumulated impairment | | |
| Machinery and equipment | - | 594,000 |
| Net book value, end of year | $ 3,063,360 | $ 3,218,045 |

Some of the Corporation's land, machinery and equipment and buildings are leased to its subsidiaries (Note 29). The depreciation expense remained NT$2,653 thousand for the years ended December 31, 2011 and 2010.

In March 2011, the Corporation sold the above mentioned machinery and equipment to its subsidiary CAC for proceeds of NT$5,000 thousand, with no significant gain or loss.

## 16. SHORT-TERM LOANS AND OVERDRAFT

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Credit loans - interest at 0.93%-0.95% p.a. | $ 3,700,000 | $ - |
| Letters of credit - due within 180 days; interest at 0.7357%-1.4157% p.a. and 0.5513%-1.41% p.a. as of December 31, 2011 and 2010, respectively | 2,630 | 147,655 |
| Bank overdraft - interest at 0.5%-0.6607% p.a. and 0.26%-1.195% p.a. as of December 31, 2011 and 2010, respectively | 2,764,996 | 1,194,109 |
| | $ 6,467,626 | $ 1,341,764 |

## 17. COMMERCIAL PAPER PAYABLE

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Commercial paper - interest at 0.45%-0.89% p.a. and 0.467%-0.547% p.a. as of December 31, 2011 and 2010, respectively | $ 3,600,000 | $ 3,700,000 |
| Less: Unamortized discounts | 4,123 | 361 |
| | $ 3,595,877 | $ 3,699,639 |

## 18. ACCRUED EXPENSES

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Accrued salaries and incentive bonus | $ 3,683,711 | $ 5,107,932 |
| Bonus to employees, and remuneration to directors and supervisors | 1,425,875 | 2,751,874 |
| Repair and construction | 1,019,581 | 664,244 |
| Severance pay | 499,632 | 707,145 |
| Others | 1,677,310 | 1,501,435 |
| | $ 8,306,109 | $ 10,732,630 |

## 19. BONDS PAYABLE

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| 5-year unsecured bonds - issued at par in: | | |
| June 2006; repaid in June 2011; 2.32% interest p.a. | $ - | $ 8,100,000 |
| November 2006; repaid in November 2011; 2.07% interest p.a. | - | 5,600,000 |
| December 2008; repayable in December 2012 and December 2013; 2.08% interest p.a., payable annually | 13,000,000 | 13,000,000 |
| December 2008; repayable in December 2012 and December 2013; 2.42% interest p.a., payable annually | 9,600,000 | 9,600,000 |
| October 2011; repayable in October 2015 and October 2016; 1.36% interest p.a., payable annually | 9,300,000 | - |
| 7-year unsecured bonds - issued at par in: | | |
| December 2008; repayable in December 2014 and December 2015; 2.30% interest p.a., payable annually | 7,000,000 | 7,000,000 |
| October 2011; repayable in October 2017 and October 2018; 1.57% interest p.a., payable annually | 10,400,000 | - |
| | 49,300,000 | 43,300,000 |
| Less: Issuance cost of bonds payable | 35,574 | 21,934 |
| Current portion | 11,295,086 | 13,697,919 |
| | $ 37,969,340 | $ 29,580,147 |

## 20. LONG-TERM DEBT

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Mortgage loans | | |
| Repayable in 6 semiannual installments from July 2012 (NT$16 billion); interest at 1.42706% p.a. and 1.20% p.a. as of December 31, 2011 and 2010, respectively | $ 16,000,000 | $ 16,000,000 |
| Credit loans | | |
| Repayable in July 2015 (JPY4.95 billion); interest at 0.55133% p.a. and 0.65936% p.a. as of December 31, 2011 and 2010, respectively | 1,933,470 | 1,773,338 |
| Repayable in July 2015 (JPY4.95 billion); interest at 0.57036% p.a. and 0.67838% p.a. as of December 31, 2011 and 2010, respectively | 1,933,470 | 1,773,337 |
| Repayable in February 2013 (USD 58,548 thousand); interest at 0.67712% - 0.71941% p.a. and 0.88616% - 0.92844% p.a. as of December 31, 2011 and 2010, respectively | 1,772,541 | 1,777,693 |
| Repayable in April 2014 (USD43,911 thousand); interest at 0.89641% p.a. | 1,329,406 | - |
| Repayable in December 2012 (JPY2.6 billion); interest at 0.56571% p.a. and 0.67375% p.a. as of December 31, 2011 and 2010, respectively | 1,015,560 | 931,450 |
| Repayable in July 2013 (AUD 16,540 thousand); interest at 5.65328% p.a. and 5.68895% p.a. as of December 31, 2011 and 2010, respectively | 508,357 | 490,891 |
| Repayable in November 2013 (JPY1.214 billion); interest at 0.535% p.a. and 0.59625% p.a. as of December 31, 2011 and 2010, respectively | 474,188 | 434,915 |
| | 24,966,992 | 23,181,624 |
| Less: Current portion | 3,682,227 | - |
| | $ 21,284,765 | $ 23,181,624 |

The Corporation obtained long-term bank loans in Japanese yen, Australian dollar and U.S. dollar to hedge the exchange rate fluctuations on investments in EAUS, CSCAU and CSVC (Note 28) and on the available-for-sale financial assets in Maruichi Steel Tube Ltd. and Yodogawa Steel Works, Ltd. (Notes 6 and 28). The NT dollar loan was made to meet fund requirements.

## 21. LONG-TERM NOTES PAYABLE

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Long-term notes - interest at 0.902%-1.123% p.a. and 0.630%-0.885% p.a. as of December 31, 2011 and 2010, respectively | $ 12,000,000 | $ 4,500,000 |
| Less: Unamortized discounts | 10,992 | 3,027 |
| | $ 11,989,008 | $ 4,496,973 |

The Corporation entered into commercial paper contracts with International Bills Finance Corporation, Mega Bills Finance Corporation, China Bills Finance Corporation, Grand Bills Finance Corp. and Taiwan Cooperative Bills Finance Corporation in September 2011 and April 2009. The duration of the contracts is four years and five years and the cycle of issuance is thirty to sixty days, during which the Corporation only has to pay service fees and interests. Therefore, the Corporation recorded those commercial papers issued as long-term notes payable.

## 22. RETIREMENT BENEFIT PLAN

The pension plan under the Labor Pension Act (the "LPA") is a defined contribution plan. Based on the LPA, the Corporation makes monthly contributions to employees' individual pension accounts at 6% of monthly salaries and wages. Such pension costs were NT$106,862 thousand and NT$72,231 thousand for the years ended December 31, 2011 and 2010, respectively.

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 Bank of Taiwan in the name of, and administered by the employees' pension fund administration committee. According to above regulation, pension cost for the years ended December 31, 2011 and 2010 was NT$1,058,256 thousand and NT$761,279 thousand, respectively.

Since August 1999, the Corporation also makes 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 the officers' pension fund management committee. Pension cost for the years ended December 31, 2011 and 2010 was NT$6,196 thousand and NT$5,129 thousand, respectively.

In order to encourage employees to retire and transfer to affiliates, the Corporation recognized preferential severance pay in accordance with the related preferential severance measures of NT$427,702 thousand for the year ended December 31, 2010.

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

a. Components of net pension cost

| | Years Ended December 31 | |
|---|---|---|
| | **2011** | **2010** |
| Service cost | $ 718,114 | $ 704,700 |
| Interest cost | 505,981 | 431,050 |
| Projected return on plan assets | (375,862) | (359,806) |
| Amortization | 164,728 | (9,536) |
| Settlement loss | 51,491 | - |
| Net pension cost | $ 1,064,452 | $ 766,408 |

b. Reconciliation of the funded status of the plan and accrued pension cost

| | December 31 | |
|---|---|---|
| | **2011** | **2010** |
| Benefit obligation | | |
| Vested benefit obligation | $ 16,979,251 | $ 15,537,647 |
| Non-vested benefit obligation | 1,880,807 | 2,363,885 |
| Accumulated benefit obligation | 18,860,058 | 17,901,532 |

(Continued)

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Additional benefits based on future salaries | $ 3,132,653 | $ 5,018,959 |
| Projected benefit obligation | 21,992,711 | 22,920,491 |
| Fair value of plan assets | (19,094,675) | (18,885,539) |
| Funded status | 2,898,036 | 4,034,952 |
| Unrecognized net asset at transition | 23,432 | 33,375 |
| Unamortized net loss | (2,742,137) | (4,034,690) |
| Accrued pension cost | 179,331 | 33,637 |
| Recorded as accrued expense | 127,840 | 33,637 |
| Recorded as accrued pension cost | $ 51,491 | $ - |
| Vested benefits | $ 19,463,815 | $ 18,262,754 |

(Concluded)

c. Actuarial assumptions

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Discount rate used in determining present values | 2.00% | 2.25% |
| Future salary increase rate | 2.00% | 3.00% |
| Expected rate of return on plan assets | 2.00% | 2.00% |

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| d. Contributions to the fund | $ 923,269 | $ 863,497 |
| e. Payments from the fund | $ 940,318 | $ 110,017 |

## 23. DEFERRED CREDITS - GAIN FROM AFFILIATES

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Gain on disposal of land | $ 1,136,164 | $ 1,136,164 |
| Gain on contracted projects | 968,765 | 836,104 |
| Gain on disposal of stocks | 35,282 | 35,282 |
| | $ 2,140,211 | $ 2,007,550 |

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

The Corporation contracted engineering projects with KRTC and DSC, resulting in deferred gain. Such deferred credits from the projects with KRTC and DSC are recognized as income over 8 to 30 years after completion of the constructions.

In September 2010, the Corporation sold its shares in AC, financial assets carried at cost, to GIC, and recognized unrealized gain on disposal of investments of NT$35,733 thousand (Notes 10 and 29), which will be realized when GIC disposes of the stock.

## 24. STOCKHOLDERS' EQUITY

a. Capital stock

In July 2011 and August 2010, the Corporation issued 678,308 thousand and 433,382 thousand common shares through capital increase out of retained earnings of NT$6,783,084 thousand and NT$4,333,820 thousand, respectively, and have been registered with the government.

The Corporation's Board of Directors approved an issuance of 840,000 thousand new shares with NT$10 par value at issuance price of NT$28.3248 per share, and the record date of capital increase was on August 1, 2011. The increase in paid-in capital has been registered with the government. Total proceeds, net of issuance cost, exceeded par value by NT$15,338,755 thousand, recorded as additional paid-in capital under capital surplus. The 763,668 thousand shares of the new shares were through issuance of 38,183,400 units of global depository receipts (GDR). Each unit represents 20 shares of the Corporation's common stock. The remaining 76,332 thousand shares were allocated for employee stock option; for employees of the Corporation, 74,305 thousand shares, and for employees of the subsidiaries, 2,027 thousand shares. These options were vested immediately. For the year ended December 31, 2011, all the above options were exercised.

For the year ended December 31, 2011, options granted to employees were priced by the Black-Scholes model, and the inputs to the model were as follows:

| | |
|---|---|
| Grant-date share price (NT$) | 29.65 |
| Transferred price (NT$) | 28.3248 |
| Expected volatility | 7.19% |
| Expected duration life (day) | 2 |
| Risk-free interest rate | 0.67% |

For the year ended December 31, 2011, the Corporation recognized compensation expense of NT$98,826 thousand and recognized a capital surplus of NT$2,437 thousand from granting stock option to employees of subsidiaries.

b. Treasury stock

| | Thousand Shares | | | December 31 | |
|---|---|---|---|---|---|
| **Purpose of Treasury Stock** | **Beginning of Year** | **Addition** | **Reduction** | **Thousand Shares** | **Book Value** |
| Year ended December 31, 2011 | | | | | |
| Shares acquired and held by subsidiaries | 284,762 | 26,679 | 16,376 | 295,065 | $ 8,122,461 |
| Year ended December 31, 2010 | | | | | |
| Shares acquired and held by subsidiaries | 279,375 | 15,938 | 10,551 | 284,762 | $ 8,151,621 |

The Corporation’s shares acquired and held by subsidiaries are accounted for as treasury stock (subsidiaries recorded those shares as available-for-sale financial assets - current and available-for-sale financial assets - noncurrent). The Corporation’s shares held by more than 50%-owned subsidiaries are not allowed to participate in the Corporation’s capital increase in cash and have no voting rights; other rights are the same as other common stockholders. The increase of treasury stock was due to acquisition of the Corporation’s shares by subsidiaries in which the Corporation has less than 50% shareholding. The decrease of treasury stock was mainly due to subsidiaries’ sale of the Corporation’s shares and change in percentage of ownership.

For the years ended December 31, 2011 and 2010, the subsidiaries sold 29,274 thousand shares and 24,950 thousand shares of the Corporation for proceeds of NT$916,090 thousand and NT$804,181 thousand, respectively.

For the years ended December 31, 2011 and 2010, the proceeds of treasury stock sold, calculated by shareholding percentage, amounted to NT$511,448 thousand and NT$401,005 thousand, and after deducting book values, resulted in the amounts of NT$106,638 thousand and NT$102,280 thousand (recorded as capital surplus), respectively. As of December 31, 2011 and 2010, the market values of the treasury shares calculated by combined holding percentage were NT$8,497,875 thousand and NT$9,539,536 thousand, respectively.

c. Overseas depositary receipts

In May 1992, February 1997, October 2003 and August 2011, for the purpose of working capital expansion and in accordance with the instruction of the ROC’s Ministry of Economic Affairs (“MOEA”), the largest shareholder of the Corporation, MOEA, sold its holding shares in the Corporation through issuance of 126,512,550 units of GDR while the Corporation issued new shares. The depositary receipts then increased by 6,802,951 units resulting from the capital increase out of retained earnings. Each unit represents 20 shares of the Corporation’s common stock and the issued GDRs account for the Corporation’s common shares totaling 2,666,310,271 shares (including 251 fractional shares). Under relevant regulations, the GDR holders may also request the conversion to the shares represented by the GDR. The foreign investors may also request the reissuance of such depositary receipts within the originally approved units. As of December 31, 2011 and 2010, the outstanding depositary receipts were 3,396,550 units and 4,648,214 units, equivalent to 67,931,271 common shares (including 271 fractional shares) and 92,964,521 common shares (including 241 fractional shares), which represented 0.45% and 0.69% of the outstanding common shares, respectively.

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) The sequence and percentage of appropriation of residual property are the same with common stocks.

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

5) Redemption of stock is through its retained earnings or the proceeds from issuance of new shares; conversion of shares into common stock at the ratio of 1:1.

e. Capital surplus

Capital surplus comprised of the following:

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Additional paid-in capital | $ 31,154,766 | $ 15,717,185 |
| Treasury stock transactions | 4,635,553 | 3,976,052 |
| Long-term stock investments | 449,287 | 371,140 |
| Others | 8,099 | 8,099 |
| | $ 36,247,705 | $ 20,072,476 |

Under relevant regulations, capital surplus from issuance of shares and treasury stock transaction may be used to offset a deficit or capitalized, which however is limited to a certain percentage of the Corporation's paid-in capital and once a year. Under the revised Company Law promulgated on January 4, 2012, the aforementioned capital surplus may also be distributed in cash when the Corporation incurs no loss. The capital surplus from long-term stock investments accounted for under the equity method may not be used for any purpose.

f. Appropriation of retained earnings and dividend policy

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

1) 10% as legal reserve;

2) Preferred stock dividends at 14% of par value;

3) Of the remainder, 0.15% as remuneration to directors and supervisors and 8% as bonus to employees.

4) Common stock dividends at 14% of par value; 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 earnings. If necessary, it may, after appropriating for preferred stock dividends, propose to appropriate a special reserve or to retain certain earnings. 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 parts of the stockholders' equity (including unrealized revaluation increment, unrealized gain (loss) on financial instruments, unrecognized net loss on pension cost and cumulative translation adjustments, excluding treasury stock held by the Corporation). Besides, if the market price of the Corporation's common share is lower than the carrying value of the Corporation's shares held by subsidiaries, the Corporation should appropriate a special reserve in proportion to the percentage of ownership in the equity equal to the difference between market price and carrying value. The Corporation may release a portion of this special reserve when such debit balances are partially or fully reversed. As of December 31, 2011, the Corporation had fully reversed the special reserve for net debit balance of certain items in stockholders' equity, and the remaining unreversed special reserve was held for the capital demand of certain expansion projects.

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

Estimated bonus to employees and remuneration to directors and supervisors were as follows:

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Bonus to employees | $ 1,399,259 | $ 2,701,965 |
| Remuneration to directors and supervisors | 26,236 | 50,662 |
| | $ 1,425,495 | $ 2,752,627 |

The bonus to employees and remuneration to directors and supervisors were calculated based on the percentages provided by the Corporation's Articles of Incorporation and accrued based on past experiences. If the actual amounts subsequently resolved by the stockholders differ from the proposed amounts, the differences are recorded in the year of stockholders' resolution as a change in accounting estimate.

If bonus shares are resolved to be distributed to employees, the number of shares is determined by dividing the amount of bonus by the closing price (after considering the effect of cash and stock dividends) of the shares at the date preceding the stockholders' meeting.

Legal reserve shall be appropriated until it has reached the Corporation's paid-in capital. This reserve may be used to offset a deficit. Under the revised Company Law issued on January 4, 2012, when the Corporation incurs no loss and the legal reserve has exceeded 25% of the Corporation's paid-in capital, the excess may be transferred to capital or distributed in cash.

The Corporation's stockholders in their June 2011 and 2010 meetings approved the following appropriations of the 2010 and 2009 earnings, respectively.

| | Appropriation of Earnings | | Dividends Per Share (NT dollars) | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Legal reserve | $ 3,758,683 | $ 1,952,817 | | |
| Preferred stocks | | | | |
| Cash dividends | 76,153 | 40,947 | $ 1.99 | $ 1.07 |
| Stock dividends | 19,134 | 12,628 | 0.50 | 0.33 |
| | | | $ 2.49 | $ 1.40 |
| Common stocks | | | | |
| Cash dividends | 26,920,523 | 13,225,464 | $ 1.99 | $ 1.01 |
| Stock dividends | 6,763,950 | 4,321,192 | 0.50 | 0.33 |
| | $ 37,538,443 | $ 19,553,048 | $ 2.49 | $ 1.34 |

The bonus to employees and the remuneration to directors and supervisors for 2010 and 2009 approved in the aforementioned stockholders' meetings were as follows (settled by cash):

| | Years Ended December 31 | | | |
|---|---|---|---|---|
| | 2010 | | 2009 | |
| | Bonus to Employees | Remuneration to Directors and Supervisors | Bonus to Employees | Remuneration to Directors and Supervisors |
| Amounts approved in stockholders' meetings | $ 2,701,965 | $ 50,662 | $ 1,528,288 | $ 28,655 |
| Amounts recognized in respective financial statements | 2,701,965 | 50,662 | 1,528,288 | 28,655 |
| Difference | $ - | $ - | $ - | $ - |

The appropriations of earnings for 2011 had been proposed in the board of directors' meeting on March 21, 2012. The appropriations and dividends per share were as follows:

| | Appropriation of Earnings | Dividends Per Share (NT dollars) |
|---|---|---|
| Legal reserve | $ 1,949,368 | |
| Preferred stocks | | |
| Cash dividends | 47,835 | $ 1.25 |
| Stock dividends | 5,740 | 0.15 |
| | | $ 1.40 |
| Common stocks | | |
| Cash dividends | 15,196,671 | $ 1.01 |
| Stock dividends | 2,256,932 | 0.15 |
| | $ 19,456,546 | $ 1.16 |

On March 21, 2012, the board of directors proposed the bonus to employees of NT$1,399,259 thousand and the remuneration to directors and supervisors of NT$26,236 thousand for 2011. The amounts proposed were the same as the amounts recognized in the financial statements for the year ended December 31, 2011.

The 2011 appropriations of earnings, bonus to employees and remuneration to directors and supervisors will be resolved by the stockholders in their meeting scheduled for June 15, 2012.

Information about the bonus to employees and remuneration to directors and supervisors is available on the Market Observation Post System website of the Taiwan Stock Exchange.

g. Unrealized revaluation increment

Unrealized revaluation increment comprised of the following:

| | December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Revaluation increment of property, plant and equipment (Note 14) | $ 26,610,866 | $ 21,871,755 |
| Recognized in proportion to the ownership percentage in long-term stock investments | 146,724 | 2,185 |
| | $ 26,757,590 | $ 21,873,940 |

h. Unrealized gain on financial instruments

For the years ended December 31, 2011 and 2010, movements of unrealized gain on financial instruments were as follows:

| | Available-for-sale Financial Assets | Equity-method Investments | Unrealized Gain or Loss on Cash Flow Hedging | Total |
|---|---|---|---|---|
| Year ended December 31, 2011 | | | | |
| Balance, beginning of year | $ 2,938,550 | $ (593,445) | $ 29,272 | $ 2,374,377 |
| Recognized in stockholders' equity | 141,223 | 251,529 | 231,896 | 624,648 |
| Transferred to construction in progress and prepayments for equipment | - | - | 21,894 | 21,894 |
| Balance, end of year | $ 3,079,773 | $ (341,916) | $ 283,062 | $ 3,020,919 |
| Year ended December 31, 2010 | | | | |
| Balance, beginning of year | $ 3,124,306 | $ 461,850 | $ 630,275 | $ 4,216,431 |
| Recognized in stockholders' equity | (185,756) | (1,055,295) | (59,104) | (1,300,155) |
| Transferred to construction in progress and prepayments for equipment | - | - | (541,899) | (541,899) |
| Balance, end of year | $ 2,938,550 | $ (593,445) | $ 29,272 | $ 2,374,377 |

i. Cumulative translation adjustments

Changes in composition of cumulative translation adjustments for the years ended December 31, 2011 and 2010 were as follows:

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Balance, beginning of year | $ (101,443) | $ 183,001 |
| Recognized in stockholders' equity | 118,635 | (284,444) |
| Balance, end of year | $ 17,192 | $ (101,443) |

## 25. INCOME TAX

a. A reconciliation of income tax based on income before income tax at the statutory rate of 17% and income tax was as follows:

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Income tax at the statutory rate | $ 3,448,398 | $ 7,496,026 |
| Tax effect of adjusting items | | |
| Permanent differences | | |
| Investment income recognized under equity method - domestic investees | (877,828) | (1,332,999) |
| Dividends | (29,987) | (25,488) |
| Unrealized gain on valuation of financial assets and on disposal of investments | (511) | (2,228) |
| Others | 21,395 | 17,947 |
| Temporary differences | | |
| Unrealized provision for loss on inventories | 515,177 | 15,399 |
| Difference between tax reporting and financial reporting - depreciation methods | 112,983 | 123,228 |
| Cash dividends - foreign investees | 36,869 | 60,320 |
| Investment loss (income) recognized under equity method - foreign investees | 2,081 | (69,123) |
| Realized impairment loss of investees | (41,356) | (36,623) |
| Unrealized (realized) preferential severance pay | (35,277) | 47,358 |
| Unrealized (realized) loss on service commitments | (35,011) | 114,281 |
| Realized gain from affiliates | (10,522) | (8,094) |
| Realized gain (loss) on hedging of forward exchange | (3,722) | 92,123 |
| Others | (35,758) | (21,220) |
| Investment tax credits used | (1,533,465) | (1,629,595) |
| Additional 10% income tax on unappropriated earnings | 4,838 | 4,945 |
| Income tax currently payable | 1,538,304 | 4,846,257 |
| Adjustments for prior years' tax | 166,413 | 21,053 |
| Current income tax expense | 1,704,717 | 4,867,310 |
| Deferred tax | | |
| Temporary differences | (543,311) | (309,880) |
| Investment tax credits | (370,392) | 806,532 |
| Loss carryforwards | - | 1,004,197 |
| Effect of tax law changes on deferred assets | - | 139,286 |
| | $ 791,014 | $ 6,507,445 |

b. Changes in income tax payable

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Balance, beginning of year | $ 4,834,790 | $ - |
| Current income tax expense | 1,704,717 | 4,867,310 |
| Payment in the current year | (4,183,530) | (32,520) |
| Transferred to other receivables | 164,700 | - |
| Balance, end of year | $ 2,520,677 | $ 4,834,790 |

The Corporation adopted the linked tax system for tax filing with subsidiary - DSC since 2009. Payment in the current year of NT$4,183,530 thousand included payment of NT$1,165,973 thousand to DSC because the investment tax credits and loss carryforwards of DSC were used by the Corporation when the linked tax was filed.

Under Article 10 of the Statute for Industrial Innovation (SII) passed by the Legislative Yuan in April 2010, a profit-seeking enterprise may deduct up to 15% of its research and development expenditures from its income tax payable for the fiscal year in which these expenditures are incurred, but this deduction should not exceed 30% of the income tax payable for that fiscal year. This incentive took effect from January 1, 2010 and is effective till December 31, 2019, and the investment tax credits under earlier regulations can be used in the current and next four years. The investment tax credits used every year shall not exceed 50% of the total tax payable, but the full remaining creditable amount can be used at the expiration year.

In May 2010, the Legislative Yuan passed an amendment of Article 5 of the Income Tax Law, which reduces a profit-seeking enterprise's income tax rate from 20% to 17%, effective January 1, 2010.

c. Deferred income tax assets and liabilities were as follows:

| | December 31 | |
|---|---|---|
| | **2011** | **2010** |
| Current | | |
| Deferred income tax assets | | |
| Unrealized provision for loss on inventories | $ 684,180 | $ 169,003 |
| Investment tax credits | 370,392 | - |
| Unrealized loss on service commitments | 221,163 | 256,174 |
| Estimated preferential severance pay | 84,905 | 120,182 |
| Unrealized gain from affiliates | 9,686 | 42,760 |
| Others | 30,244 | 23,034 |
| | 1,400,570 | 611,153 |
| Deferred income tax liabilities | | |
| Difference between tax reporting and financial reporting - inventory | (21,236) | (17,651) |
| Total deferred income tax assets - current, net | 1,379,334 | 593,502 |
| Noncurrent | | |
| Deferred income tax assets | | |
| Impairment loss | 944,472 | 985,984 |
| Unrealized gain from affiliates | 164,690 | 142,138 |
| Unrealized settlement gain on hedging of forward exchange | 91,220 | 94,942 |
| Others | 46,364 | 56,026 |
| | 1,246,746 | 1,279,090 |
| Deferred income tax liabilities | | |
| Difference between tax reporting and financial reporting - depreciation methods | (1,206,068) | (1,319,741) |
| Foreign investment income | (347,743) | (386,693) |
| Unrealized gain on cash flow hedge | (57,977) | (5,996) |
| Unrealized exchange gains, net | (46,808) | (54,400) |
| Unrealized gain on revaluation increment | (34,404) | (36,577) |
| | (1,693,000) | (1,803,407) |
| Total deferred income tax liabilities - noncurrent, net | (446,254) | (524,317) |
| Total deferred income tax assets | $ 933,080 | $ 69,185 |

Under the Statute for Upgrading Industries, the Corporation recognized investment tax credits from purchases of machinery and equipment. The expiry year of the tax credits is 2015.

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

The Corporation's income tax returns through 2007 have been examined by the tax authorities.

d. Information about integrated income tax was as follows:

| | December 31 | |
|---|---|---|
| | **2011** | **2010** |
| Imputation credit account (ICA) | $ 211,179 | $ 678,175 |
| Unappropriated earnings generated before January 1, 1998 | 15,440 | 15,440 |

The creditable ratio for distribution of 2011 and 2010 earnings was 14.01% (estimated) and 11.52%, respectively.

For distribution of earnings generated after January 1, 1998, the ratio for the imputation credits allocated to domestic shareholders of the Corporation is based on the balance of the ICA as of the date of dividend distribution. Nonresident stockholders, including holders of overseas depository receipts, are allowed only a tax credit from the 10% income tax on unappropriated earnings, which can be used to offset withholding income tax on dividends paid. The expected creditable ratio for the 2011 earnings may be adjusted, depending on the ICA balance on the date of dividend distribution.

## 26. PERSONNEL, DEPRECIATION AND AMORTIZATION EXPENSES

| | Years Ended December 31 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | | | 2010 | | | |
| | Operating Cost | Operating Expense | Others | Total | Operating Cost | Operating Expense | Others | Total |
| Personnel | | | | | | | | |
| Salary | $ 13,651,003 | $ 2,448,189 | $ 249,154 | $ 16,348,346 | $ 16,483,895 | $ 2,993,411 | $ 546,006 | $ 20,023,312 |
| Labor and health insurance | 630,039 | 104,047 | 6,087 | 740,173 | 580,499 | 102,885 | 15,071 | 698,455 |
| Pension and consolation costs | 931,492 | 269,025 | 10,953 | 1,211,470 | 692,213 | 179,442 | 444,793 | 1,316,448 |
| Others | 405,329 | 164,097 | 14,795 | 584,221 | 394,677 | 154,090 | 18,290 | 567,057 |
| | $ 15,617,863 | $ 2,985,358 | $ 280,989 | $ 18,884,210 | $ 18,151,284 | $ 3,429,828 | $ 1,024,160 | $ 22,605,272 |
| Depreciation | $ 15,694,226 | $ 367,788 | $ 2,653 | $ 16,064,667 | $ 15,430,467 | $ 371,152 | $ 2,653 | $ 15,804,272 |
| Amortization | 42,007 | 357 | - | 42,364 | 52,913 | 22,097 | - | 75,010 |

## 27. EARNINGS PER SHARE

| | Amount (Numerator) | | Shares (Denominator) | Earnings Per Share (NT dollars) | |
|---|---|---|---|---|---|
| | Before Tax | After Tax | (Thousand) | Before Tax | After Tax |
| Year ended December 31, 2011 | | | | | |
| Net income | $ 20,284,693 | $ 19,493,679 | | | |
| Less: Dividends on preferred shares | (55,749) | (53,575) | | | |
| Basic EPS | | | | | |
| Net income attributable to common stockholders | 20,228,944 | 19,440,104 | 14,261,144 | $ 1.42 | $ 1.36 |

(Continued)

| | Amount (Numerator) Before Tax | Amount (Numerator) After Tax | Shares (Denominator) (Thousand) | Earnings Per Share (NT dollars) Before Tax | Earnings Per Share (NT dollars) After Tax |
|---|---|---|---|---|---|
| Effect of dilutive potential common stock | | | | | |
| Add: Dividends on preferred shares | $ 55,749 | $ 53,575 | 38,268 | | |
| Bonus to employees | - | - | 92,101 | | |
| Diluted EPS | | | | | |
| Net income attributable to common stockholders plus effect of potential dilutive common stock | $ 20,284,693 | $ 19,493,679 | 14,391,513 | $ 1.41 | $ 1.35 |
| Year ended December 31, 2010 | | | | | |
| Net income | $ 44,094,271 | $ 37,586,826 | | | |
| Less: Dividends on preferred shares | (62,850) | (53,575) | | | |
| Basic EPS | | | | | |
| Net income attributable to common stockholders | 44,031,421 | 37,533,251 | 13,907,209 | 3.17 | 2.70 |
| Effect of dilutive potential common stock | | | | | |
| Add: Dividends on preferred shares | 62,850 | 53,575 | 38,268 | | |
| Bonus to employees | - | - | 115,235 | | |
| Diluted EPS | | | | | |
| Net income attributable to common stockholders plus effect of potential dilutive common stock | $ 44,094,271 | $ 37,586,826 | 14,060,712 | 3.14 | 2.67 |

(Concluded)

The ARDF issued Interpretation 2007-052 that requires corporations to recognize bonuses paid to employees, directors and supervisors as compensation expenses beginning January 1, 2008. These bonuses were previously recorded as appropriations from earnings. If the Corporation may settle the bonus to employees by cash or shares, the Corporation should presume that the entire amount of the bonus will be settled in shares and the resulting potential shares should be included in the weighted average number of shares outstanding used in the calculation of diluted EPS, if the shares have a dilutive effect. The number of shares is estimated by dividing the amount of bonus by the closing price of the shares at the balance sheet date. The dilutive effect of the shares should be considered until the stockholders resolve the number of shares to be distributed to employees in their meeting in the following year.

The weighted-average number of shares outstanding for EPS calculation has been retroactively adjusted for the issuance of stock bonus distributed out of earnings for the year ended December 31, 2010. The adjustment caused the basic and diluted after income tax EPS for the year ended December 31, 2010 to decrease from NT$2.83 to NT$2.70 and from NT$2.81 to NT$2.67, respectively.

## 28. FINANCIAL INSTRUMENTS

a. As of December 31, 2011 and 2010, the information of fair values was as follows:

| | December 31 | | | |
|---|---|---|---|---|
| | 2011 | | 2010 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Non-derivative financial instruments | | | | |
| Assets | | | | |
| Available-for-sale financial assets (including noncurrent) | $ 5,468,276 | $ 5,468,276 | $ 5,203,714 | $ 5,203,714 |
| Financial assets carried at cost | 7,421,220 | | 3,247,228 | |
| Bond investments with no active market | 3,906,000 | 3,906,000 | 3,685,500 | 3,685,500 |
| Other financial assets (including noncurrent) | 4,518,975 | 4,518,975 | 1,847,321 | 1,847,321 |
| Refundable deposits | 223,215 | 223,215 | 116,518 | 116,518 |
| Liabilities | | | | |
| Bonds payable (including current portion) | 49,264,426 | 49,978,155 | 43,278,066 | 44,230,408 |
| Long-term debt (including current portion) | 24,966,992 | 24,966,992 | 23,181,624 | 23,181,624 |
| Long-term notes payable | 11,989,008 | 11,989,008 | 4,496,973 | 4,496,973 |
| Derivative financial instrument | | | | |
| Hedging derivative assets (including noncurrent) | 112,017 | 112,017 | - | - |
| Hedging derivative liabilities (including noncurrent) | 8,041 | 8,041 | 6,414 | 6,414 |

b. Methods and assumptions used to estimate the fair values of financial instruments were as follows:

1) The carrying amount of cash, notes and accounts receivable (including related parties), other receivables (excluding tax refund receivable), restricted assets, short-term loans and overdraft, commercial paper payable, notes and accounts payable (including related parties), accrued expenses and other payables, approximate fair value because of the short maturities of these instruments.

2) The fair values of available-for-sale financial assets and derivative financial instruments are determined at their market value. If there is no market value available for reference, the fair values are determined through valuation techniques. For stocks acquired through private subscription and not transferred freely in public market, fair values are determined by using valuation techniques adopted by the Corporation based on information from the Market Observation Post System, the Taiwan Stock Exchange, etc. and calculated by using the Black-Scholes Model. For hedging derivative instruments, the information used by the Corporation for determining assumptions applied in valuation is consistent with that used by market participants and is obtained from financial institutions. For fair values of financial instruments denominated in foreign currencies and foreign contracts, the translation to New Taiwan dollars used exchange rates that are based on the buying rates quoted by the Central Bank and on the rates quoted by Reuters.

3) The fair values of long-term liabilities and other financial assets are determined by the present values of future cash flows. If there is market price available for reference, the fair values are determined based on the market price. If there is no market price available for reference, the values are discounted at the interest rates of similar long-term debt and the floating-rate of foreign currency deposits available to the Corporation. Discount rates as of December 31, 2011 and 2010 were from 0.35% to 5.65328% and from 0.6% to 5.68895%, respectively.

4) Financial assets carried at cost issued by non-public corporations have no active market price and their verifiable fair value cannot be determined at a reasonable cost. Therefore, no fair value is presented.

5) The fair value of bond investments with no active market is determined at their carrying values.

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

c. Fair values of the financial assets and financial liabilities based on quoted market prices or using valuation technique were as follows:

| | Amount Determined by Quoted Market Price | | Amount Determined by Using Valuation Technique | |
|---|---|---|---|---|
| | December 31 | | December 31 | |
| | 2011 | 2010 | 2011 | 2010 |
| Assets | | | | |
| Available-for-sale financial assets (including noncurrent) | $ 5,090,847 | $ 4,938,442 | $ 377,429 | $ 265,272 |
| Bond investments with no active market | - | - | 3,906,000 | 3,685,500 |
| Other financial assets (including noncurrent) | - | - | 4,518,975 | 1,847,321 |
| Hedging derivative assets (including noncurrent) | - | - | 112,017 | - |
| Refundable deposits | - | - | 223,215 | 116,518 |
| Liabilities | | | | |
| Hedging derivative liabilities (including noncurrent) | - | - | 8,041 | 6,414 |
| Bonds payables (including current portion) | 49,978,155 | 44,230,408 | - | - |
| Long-term debt (including current portion) | - | - | 24,966,992 | 23,181,624 |
| Long-term notes payable | - | - | 11,989,008 | 4,496,973 |

d. There was no gain or loss from changes in fair value by using valuation technique for the years ended December 31, 2011 and 2010.

e. As of December 31, 2011 and 2010, financial liabilities exposed to cash flow interest rate risk amounted to NT$43,423,626 thousand and NT$29,020,361 thousand, respectively, and financial liabilities exposed to fair value interest rate risk amounted to NT$52,860,303 thousand and NT$46,977,705 thousand, respectively.

f. The Corporation's total interest income and expenses (inclusive of capitalized interest) which were incurred from other than financial assets and liabilities at fair value through profit or loss were NT$121,480 thousand and NT$1,394,216 thousand, respectively, for the year ended December 31, 2011 and NT$91,999 thousand and NT$1,285,593 thousand, respectively, for the year ended December 31, 2010.

g. Financial risks

1) Market risk

Market risk includes fair value risk of interest rate change, exchange rate risk, and market price risk. The Corporation had loans in foreign currencies to hedge the exchange rate fluctuations on its long term investment in foreign currencies, thus, the exchange rate risk can be hedged naturally. The Corporation issues bonds payable with fixed interest rate, but the fair value of the bonds payable may be influenced by market interest rate change. If market interest rate increases or decreases by 1%, the fair value of bonds payable will decrease or increase by about NT$1,601,421 thousand.

The Corporation's investments in stocks of TSMC, Maruichi Steel Tube Ltd., Yodogawa Steel Works, Ltd., TEWC, CSBC and RPC involve market risk. If the share price increases or decreases by 1%, the fair value will increase or decrease by about NT$54,683 thousand.

2) Credit risk

Credit risk represents the potential loss that would be incurred by the Corporation if the counter-parties breached contracts. Financial instruments with positive fair values at the balance sheet date are evaluated for credit risk. The counter-parties to the foregoing financial instruments are reputable financial institutions and business organizations. Management does not expect the Corporation's exposure to default by those parties to be material.

As of December 31, 2011, the maximum credit risk of off-balance-sheet guarantees provided to DSC was NT$13,803,860 thousand (USD455,197 thousand).

3) Liquidity risk

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

Available-for-sale financial assets could be sold readily in the active market at prices approximating fair value. There are liquidity risks for stocks acquired through private placement and not transferred freely in the public market, financial assets carried at cost and bond investments with no active market because no quoted active market prices are available.

4) Cash flow interest rate risk

Market interest rate change will influence the effective interest rate of the financial instruments which have cash flow risk of the interest rate change, and make future cash flow fluctuate. If the market interest rate increases by 1%, the Corporation's cash outflow will increase by about NT$434,236 thousand.

h. Fair value, net investment in foreign operation and cash flow hedge

The Corporation has debt denominated in foreign currencies to effectively hedge the exchange rate fluctuations on the investments in EAUS, Maruichi Steel Tube Ltd., Yodogawa Steel Works Ltd., CSCAU and CSVC; the Corporation purchased time deposit - foreign currency and forward contracts to effectively hedge the exchange rate fluctuations on contracts for purchasing machinery and equipment.

| | | Designated Hedging Instrument | | |
|---|---|---|---|---|
| | | | Changes in Fair Value | |
| | | | Years Ended December 31 | |
| **Hedge Type** | **Hedged Item** | **Financial Instrument** | **2011** | **2010** |
| Fair value hedge | Stock investments in EAUS Corporation (recorded as bond investments with no active market - noncurrent) | Debt in JPY | $ (320,265) | $ (111,375) |
| Fair value hedge | Stock investments in Maruichi Steel Tube Ltd. (recorded as available-for-sale financial assets - noncurrent) | Debt in JPY | (84,110) | (29,250) |
| Fair value hedge | Stock investments in Yodogawa Steel Works, Ltd. (recorded as available-for-sale financial assets - noncurrent) | Debt in JPY | (39,273) | (13,658) |
| Hedge of a net investment in a foreign operation | Stock investment in CSCAU (recorded as investments accounted for by the equity method) | Debt in AUD | (17,466) | (14,932) |
| Hedge of a net investment in a foreign operation | Stock investment in CSVC (recorded as investments accounted for by the equity method) | Debt in USD | (44,687) | 95,257 |
| Cash flow hedge | Contracts for purchasing machinery and equipment | Bank deposit-foreign currency | 173,396 | 23,519 |
| Cash flow hedge | Contracts for purchasing machinery and equipment | Forward contracts | 110,481 | (76,627) |

The fair value of the above hedging instruments would approximate their carrying values. The exchange rate fluctuations of the above fair value hedged item and financial instrument were recorded as gain or loss in the current year. The exchange rate fluctuations of hedged item and financial instrument on hedge of a net investment in a foreign operation and cash flow were recorded as adjustment to stockholders' equity.

As of December 31, 2011 and 2010, the fair values of the above foreign currency deposits on cash flow hedge were NT$4,518,975 thousand and NT$1,847,321 thousand, respectively, recorded as other financial assets (including noncurrent) (Note 13).

## 29. RELATED PARTY TRANSACTIONS

a. Related parties

| Related Parties | Relationship with the Corporation |
|---|---|
| C. S. Aluminum Corporation (CAC) | Affiliate |
| China Steel Express Corporation (CSE) | Affiliate |
| China Steel Chemical Corporation (CSCC) | Affiliate |
| China Steel Global Trading Corporation | Affiliate |
| China Hi-ment Corporation (CHC) | Affiliate |
| China Ecotek Corporation (CEC) | Affiliate |
| China Steel Structure Corporation (CSSC) | Affiliate |
| Chung Hung Steel Corporation (CHSC) | Affiliate |
| China Steel Machinery Corporation (CSMC) | Affiliate |
| Gains Investment Corporation (GIC) | Affiliate |
| China Steel Security Corporation | Affiliate |
| China Prosperity Development Corporation | Affiliate |
| Info-Champ Systems Corporation | Affiliate |
| China Steel Management Consulting Corporation | Affiliate |
| Hi-mag Magnetic Corporation | Affiliate |
| Long Yuan Fa Investment Corporation | Affiliate |
| Horng Yih Investment Corporation | Affiliate |
| Goang Yaw Investment Corporation | Affiliate |
| Dragon Steel Corporation (DSC) | Affiliate |
| China Steel Sumikin Vietnam Joint Stock Company (CSVC) | Affiliate |
| Chung Mao Trading (BVI) Corp. | Affiliate |
| Chung Mao Trading (SAMOA) Co. | Affiliate |
| CSGT (Singapore) Pte. Ltd. | Affiliate |
| CSE Transport Corp. (Panama) (CSEP) | Affiliate |
| Mentor Consulting Corporation | Affiliate |
| Steel Castle Technology Corp. | Affiliate |
| Union Steel Development Corp. | Affiliate |
| Betacera Inc. | Affiliate |
| Wabo Globe Trading Corporation | Affiliate |
| Universal Exchange Inc. | Affiliate |
| United Steel Engineering and Construction Corporation | Affiliate |
| Thintech Materials Technology Co., Ltd. | Affiliate |
| Pao Good Industrial Co., Ltd. | Affiliate |
| CSGT International Corp. | Affiliate |
| CSGT Metals Vietnam Joint Stock Company | Affiliate |
| CSC Steel Sdn. Bhd. (CSSB) | Affiliate |
| Group Steel Corp. (M) Sdn. Bhd. | Affiliate |
| CSGT (JAPAN) Co., Ltd. | Affiliate |
| CSGT Hong Kong Limited | Affiliate |
| CSGT (SHANGHAI) Co., Ltd. | Affiliate |
| Ever Glory International Co., Ltd. | Affiliate |

(Continued)

| Related Parties | Relationship with the Corporation |
|---|---|
| CSC Sonoma Pty Ltd. | Affiliate |
| China Steel Precision Materials Corporation | Affiliate |
| Kaohsiung Rapid Transit Corporation | Equity method investee |
| TaiAn Technologies Corporation | Equity method investee |
| Hsin Hsin Cement Enterprise Co. | Equity method investee |
| Kaohsiung Port Cargo Handling Services Corp. | Equity investee of the Corporation's affiliate |
| CSBC Corporation Taiwan (CSBC) | CSBC's director |
| Tang Eng Iron Works Co., Ltd. (TEI) | TEI's director |
| Rechi Precision Co., Ltd. | RPC's director, elected in June 2011 |
| CSC Educational Foundation | Foundation established mainly from the Corporation's donation |
| Others | Substantial control and significant influence over investees, but no material transactions |

(Concluded)

b. Significant related-party transactions were as follows:

Sales

The sales transactions with related parties were NT$18,597,483 thousand (8%, including CSBC, CSSC and CSCC, etc.) and NT$24,124,098 thousand (10%, including CSSB, CSSC and CSCC, etc.), respectively, for the years ended December 31, 2011 and 2010.

Purchase

The purchases transactions with related parties were NT$25,327,323 thousand (14%, including DSC, CSEP and CAC, etc.) and NT$28,920,926 thousand (19%, including CSEP, DSC and CAC, etc.), respectively, for the years ended December 31, 2011 and 2010.

Sales to and purchases from related parties were made under normal terms applied to similar transactions in the market.

Sale of financial assets carried at cost (only for the year ended December 31, 2010)

In September and December, 2010, the Corporation sold the stock of AC and Mega I Venture Capital Co., Ltd. to GIC for proceeds of NT$138,683 thousand and NT$12,688 thousand, respectively. (Notes 10 and 23)

Assets lease

The Corporation leases its land and machinery equipment to CAC, CSMC, CSCC, CSSC and CHC, etc. Rentals were calculated at 3% p.a. of current assessed land value, 4% to 10% p.a. of land assessed value as published by the government or under normal terms. Rentals were collected semiannually, except for rental from CAC on land and machinery and from CSCC on the storage tank and pipelines, which are collected monthly. Lease information was as follows:

| | Expiry of Contracts | Rental Income for the Years Ended December 31 | | | |
|---|---|---|---|---|---|
| | | 2011 | | 2010 | |
| | | Amount | % | Amount | % |
| CAC | February 2016 | $ 39,142 | 26 | $ 57,010 | 35 |
| CSMC | November 2016 | 30,155 | 20 | 28,765 | 18 |
| CSCC | December 2015 | 23,078 | 15 | 20,084 | 12 |
| Others | May 2018 | 28,919 | 18 | 31,053 | 19 |
| | | $ 121,294 | 79 | $ 136,912 | 84 |

Other revenues

Other revenues pertained to professional services, processing of products, utilities, construction, royalties and other services to related parties. These were recorded in other operating revenues and nonoperating income and gains as follows:

| | Other Operating Revenue | % | Nonoperating Income and Gains | % | Total |
|---|---|---|---|---|---|
| Year ended December 31, 2011 | | | | | |
| DSC | $ 1,748,612 | 29 | $ 10,483 | 1 | $ 1,759,095 |
| TEI | 707,547 | 12 | 125 | - | 707,672 |
| CHSC (Note 11) | 60,766 | 1 | 321,659 | 31 | 382,425 |
| Others | 609,629 | 10 | 98,016 | 9 | 707,645 |
| | $ 3,126,554 | 52 | $ 430,283 | 41 | $ 3,556,837 |
| Year ended December 31, 2010 | | | | | |
| TEI | $ 796,267 | 17 | $ 125 | - | $ 796,392 |
| DSC | 666,641 | 15 | 4,841 | - | 671,482 |
| CHSC (Note 11) | 70,981 | 2 | 294,022 | 30 | 365,003 |
| Others | 470,880 | 10 | 124,446 | 13 | 595,326 |
| | $ 2,004,769 | 44 | $ 423,434 | 43 | $ 2,428,203 |

The Corporation provided technical service to DSC and CSVC and recognized a loss on commitments of NT$56,326 thousand and NT$1,618,612 thousand, respectively, for the years ended December 31, 2011 and 2010.

Other expenditures

Other expenditures paid to related parties for the years ended December 31, 2011 and 2010 (including CEC, CHC and CSMC, etc.) were NT$4,983,283 thousand and NT$3,800,483 thousand, respectively. Other expenditures that pertained to commissions for processing services, export shipping charges, maintenance and repairs, commissions for export and import services, etc., were recorded in other operating costs, manufacturing expenses, operating expenses and nonoperating expenses and losses.

Other expenditures paid to related parties were made under normal terms applied to similar transactions in the market.

Capital expenditures

| | Years Ended December 31 | | | |
|---|---|---|---|---|
| | 2011 | | 2010 | |
| | Amount | % | Amount | % |
| CSMC | $ 1,928,664 | 13 | $ 1,664,035 | 5 |
| CEC | 1,029,230 | 7 | 2,816,365 | 9 |
| Others | 1,189,566 | 7 | 2,195,676 | 8 |
| | $ 4,147,460 | 27 | $ 6,676,076 | 22 |

Guarantees

As of December 31, 2011 and 2010, guarantees provided to DSC for procurement compliance were NT$13,803,860 thousand (USD455,197 thousand), and NT$15,323,971 thousand (USD503,664 thousand), respectively.

Balances at year-end

| | December 31 | | | |
|---|---|---|---|---|
| | 2011 | | 2010 | |
| | Amount | % | Amount | % |
| Notes receivable - related parties | | | | |
| CSBC | $ 468,369 | 35 | $ 537,208 | 43 |
| Others | 30 | - | - | - |
| | $ 468,399 | 35 | $ 537,208 | 43 |
| Accounts receivable - related parties | | | | |
| CSCC | $ 278,479 | 9 | $ 250,312 | 10 |
| Others | 274,737 | 8 | 339,219 | 14 |
| | $ 553,216 | 17 | $ 589,531 | 24 |
| Notes payable - related parties | | | | |
| CHSC | $ - | - | $ 23,163 | 100 |
| Accounts payable – related parties | | | | |
| CSEP | $ 378,810 | 7 | $ 862,534 | 14 |
| Others | 472,504 | 8 | 447,130 | 8 |
| | $ 851,314 | 15 | $ 1,309,664 | 22 |

c. Compensation of directors, supervisors and management personnel

| | Years Ended December 31 | |
|---|---|---|
| | 2011 | 2010 |
| Salaries | $ 78,527 | $ 101,611 |
| Incentives | 21,307 | 30,149 |
| Bonus | 21,534 | 41,167 |
| | $ 121,368 | $ 172,927 |

## 30. PLEDGED ASSETS

Time deposits of NT$5,658,819 thousand and NT$4,658,275 thousand (recorded as restricted assets - current and noncurrent) as of December 31, 2011 and 2010, respectively, have been pledged mainly as collaterals for bank overdraft, etc. As of December 31, 2011 and 2010, land with book value (including revaluation increment) of NT$18,875,450 thousand and NT$17,058,175 thousand, respectively, had been pledged as collateral for a long-term debt.

## 31. SIGNIFICANT COMMITMENTS AND CONTINGENCIES AS OF DECEMBER 31, 2011

a. The Corporation is guaranteed for NT$425,128 thousand by Mega International Commercial Bank, Shanghai Commercial and Savings Bank and the Land Bank of Taiwan for several construction, warranty, lease and payment contracts.

b. Unused letters of credit to import materials and machinery amounted to NT$6.3 billion.

c. Property purchase and construction contracts of NT$9.1 billion were signed but not yet recorded.

d. The Corporation entered into raw material purchase contracts with suppliers in Australia, Brazil, Canada, Japan and domestic companies with contract terms of 1 to 10 years. Contracted current year purchases of 7,630,000 metric tons of coal, 17,470,000 metric tons of iron ore, and 2,510,000 metric tons of limestone are at prices negotiable by the parties. Purchase commitments as of December 31, 2011 were USD15.3 billion (including 13,120,000 metric tons of coal; 86,840,000 metric tons of iron ore; and 930,000 metric tons of limestone).

e. In December 2011, CHSC entered into a syndicated credit facility agreement with Bank of Taiwan and 11 other banks. Under the agreement, the Corporation and its related parties should collectively hold at least 30% of CHSC's outstanding shares and control of its operations. In September 2006, CHSC entered into a syndicated credit facility agreement with Mega International Commercial Bank and 20 other banks. Under the agreement, the Corporation and its related parties should collectively hold at least 30% of CHSC's outstanding shares and should hold no less than half of CHSC's board seats as well as control of its operations. As of December 31, 2011, the Corporation directly and indirectly had total shareholdings in CHSC of 41% and held all seats in the Board of Directors and control on its operations with subsidiaries.

f. DSC entered into two syndicated credit facility agreements for NT$20 billion and NT$51.7 billion, with the Bank of Taiwan and other banks in December 2009 and February 2008, respectively. Under the agreements, the Corporation and its related parties should collectively hold at least 80% and 40%, respectively, of DSC's outstanding shares and should hold no less than half of DSC's board seats. As of December 31, 2011, the Corporation's equity in DSC aggregated 100% and held all board seats.

g. Guarantees provided to related parties for procurement compliance were NT$13,803,860 thousand (USD455,197 thousand) (Note 29).

## 32. SUBSEQUENT EVENTS

On December 28, 2011, the Corporation's board of directors approved investing NT$16,000,000 thousand in DSC through its private subscription. The investment was executed on January 4, 2012.

## 33. OPERATING SEGMENT INFORMATION

The Corporation disclosed its operating segment information in the consolidated financial statements; thus, disclosure in these financial statements is waived.

## 34. EXCHANGE RATE INFORMATION OF FOREIGN-CURRENCY FINANCIAL ASSETS AND LIABILITIES

The significant foreign-currency financial assets and liabilities were as follows:

| | December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | | 2010 | | |
| | Foreign Currencies (Thousands) | Exchange Rate | New Taiwan Dollars (Thousands) | Foreign Currencies (Thousands) | Exchange Rate | New Taiwan Dollars (Thousands) |
| Monetary Financial Assets | | | | | | |
| USD | $ 177,733 | 30.275 | $ 5,380,863 | $ 81,493 | 30.363 | $ 2,472,888 |
| JPY | 12,508,348 | 0.3906 | 4,885,761 | 12,854,121 | 0.3583 | 4,604,941 |
| EUR | 2,059 | 39.18 | 80,658 | 1,661 | 38.92 | 64,659 |
| Non-Monetary Financial Assets | | | | | | |
| JPY | 4,102,000 | 0.3906 | 1,602,241 | 4,206,000 | 0.3583 | 1,506,800 |
| Investments Accounted for by the Equity Method | | | | | | |
| USD | 246,598 | 30.275 | 7,465,742 | 180,827 | 30.363 | 5,490,465 |
| AUD | 23,053 | 30.735 | 708,535 | 22,958 | 29.6791 | 681,362 |
| Monetary Financial Liabilities | | | | | | |
| USD | 258,417 | 30.275 | 7,823,574 | 197,660 | 30.363 | 6,004,760 |
| JPY | 13,899,203 | 0.3906 | 5,429,029 | 14,043,545 | 0.3583 | 5,031,101 |
| AUD | 16,540 | 30.735 | 508,357 | 16,540 | 29.6791 | 490,891 |
| EUR | 142 | 39.18 | 5,554 | 608 | 38.92 | 23,645 |

### Derivative Financial Instruments

| | Currency | Contract Exchange Rate | Contract Amount (In Thousands) |
|---|---|---|---|
| December 31, 2011 | | | |
| Buy | NTD/USD | 27.208-30.238 | NTD2,421,149/USD84,579 |
| | NTD/EUR | 40.58-42.915 | NTD133,699/EUR3,216 |
| December 31, 2010 | | | |
| Buy | NTD/EUR | 42.915-44.165 | NTD82,353/EUR1,891 |