

**Solid State System Co., Ltd.**  
**Financial Statements**  
**June 30, 2010 and 2009**  
**(With Independent Auditors' Report Thereon)**

## Independent Auditors' Report

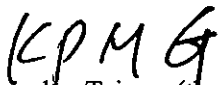
The Board of Directors  
Solid State System Co., Ltd.

We have audited the balance sheets of Solid State System Co, Ltd. as of June 30, 2010 and 2009, and the related statements of operations, changes in stockholders' equity, and cash flows for the six-month periods then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as stated in the following paragraph, we conducted our audits in accordance with the Regulations Governing Auditing and Certification of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China. Those standards and regulations 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.

As described in note 4(5) to the accompanying financial statements, Solid State System Co, Ltd.'s investment in the investee companies accounted for under the equity method stated at \$4,835 thousand and \$918 thousand as of June 30, 2010 and 2009, respectively. Loss on investments related thereto, which amounted to \$167 thousand and \$1,292 thousand for the six months ended June 30, 2010 and 2009, respectively, were determined by evaluations made in accordance with the equity method based on the unaudited financial statements of the related investees.

In our opinion, except for the effects of such adjustment, if any, as might have been determined to be necessary had the investees' financial statements been audited by independent auditors, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Solid State System Co., Ltd. as of June 30, 2010 and 2009, and the results of its operations and its cash flows for the six-month periods then ended, in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, the related financial accounting standards of the Business Entity Accounting Act and of the Regulation on Business Entity Accounting Handling, and accounting principles generally accepted in the Republic of China.



Hsinchu, Taiwan (the Republic of China)  
August 6, 2010

The accompanying financial statements are intended only to present the financial position, results of operations and cash flows in accordance with the 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.

The auditors' report and the accompanying financial statements are the English translation of the Chinese version prepared and used in the Republic of China. If there is any conflict between, or any difference in the interpretation of, the English and Chinese language auditors' report and financial statements, the Chinese version shall prevail.

Solid State System Co., Ltd.

Balance Sheets

June 30, 2010 and 2009

(In thousands of New Taiwan dollars)

	2010		2009			2010		2009	
	Amount	%	Amount	%		Amount	%	Amount	%
<b>Assets</b>									
<b>Current assets:</b>									
Cash (note 4(1))	\$ 692,566	58	740,976	64			\$ 101,410	8	48,045
Financial assets at fair value through profit or loss — current (note 4(2))	-	-	252	-	Accounts payable		115	-	-
Notes and accounts receivable, net (note 4(3))	73,076	6	66,189	6	Income tax payable (note 4(10))		15,606	1	17,850
Accounts receivable — related parties (note 5)	9,083	1	18,730	2	Processing expense payable		22,805	2	25,531
Other financial assets — current	8,486	1	11,719	1	Dividend payable (note 4(9))		24,766	2	-
Inventories, net (note 4(4))	176,090	15	82,804	7	Other current liabilities		32,315	3	32,146
Deferred income tax assets — current (note 4(10))	13,278	1	15,402	1	Accrued pension liability (note 4(8))		197,017	16	123,572
Restricted cash in bank (note 6)	41,000	3	41,000	3	Total liabilities		3,360	1	3,811
Other current assets	6,973	-	4,751	-	Stockholders' equity (note 4(9)):		200,377	17	127,383
	<u>1,020,552</u>	<u>85</u>	<u>981,823</u>	<u>84</u>	Common stock		621,546	52	609,026
<b>Investments:</b>					Capital collected in advance		944	-	570
Long-term investments under equity method (note 4(5))	4,835	-	918	-	Capital surplus:				
Financial assets carried at cost — non-current (note 4(2))	8,500	1	8,500	1	Additional paid-in capital		429,404	36	418,918
Other financial assets — non-current	8,046	1	11,046	1	From long-term equity investments		1,596	-	1,596
	<u>21,381</u>	<u>2</u>	<u>20,464</u>	<u>2</u>	Retained earnings:		431,000	36	420,514
<b>Property, plant and equipment</b>					Legal reserve		3,334	-	-
Land	2,614	-	2,614	-	Special reserve		1,855	-	-
Buildings	4,993	-	4,992	1	Unappropriated earnings (accumulated deficit)		(61,591)	(5)	6,680
Machinery and equipment	30,168	3	24,492	2	Cumulative translation adjustments		(1,855)	-	(1,855)
Office and other equipment	14,219	1	12,746	1	Total stockholders' equity		995,233	83	1,034,935
Less: accumulated depreciation	51,994	4	44,844	4					
Prepayments for equipment	(31,054)	(2)	(28,043)	(2)					
	<u>20,940</u>	<u>2</u>	<u>17,453</u>	<u>2</u>					
<b>Intangible assets (note 4(6))</b>									
Software and system design cost	5,901	1	6,662	-					
Technical know-how	5,248	-	-	-					
	<u>11,149</u>	<u>1</u>	<u>6,662</u>	<u>-</u>					
<b>Other assets:</b>									
Assets leased to others (note 4(7))	90,814	7	91,924	8					
Refundable deposits	2,474	-	2,378	-					
Deferred charges	21,989	2	18,124	2					
Deferred income tax assets — non-current (note 4(10))	6,311	1	23,490	2					
	<u>121,588</u>	<u>10</u>	<u>135,916</u>	<u>12</u>					
<b>Total assets</b>	<u>\$ 1,195,610</u>	<u>100</u>	<u>1,162,318</u>	<u>100</u>	<b>Commitments and contingencies (note 7)</b>		<u>\$ 1,195,610</u>	<u>100</u>	<u>1,162,318</u>
					<b>Total liabilities and stockholders' equity</b>		<u>\$ 1,195,610</u>	<u>100</u>	<u>1,162,318</u>

See accompanying notes to financial statements.

**Solid State System Co., Ltd.**

**Statements of Operations**

**For the six months ended June 30, 2010 and 2009**  
**(In thousands of New Taiwan dollars, except for earnings per common share)**

	2010		2009	
	Amount	%	Amount	%
<b>Sales</b>	\$ 303,922	100	371,574	100
<b>Less: Sales returns and allowances</b>	-	-	471	-
<b>Service revenue</b>	1,031	-	201	-
<b>Net sales (note 5)</b>	304,953	100	371,304	100
<b>Cost of goods sold (note 4(4))</b>	230,119	75	250,715	68
<b>Gross profit</b>	74,834	25	120,589	32
<b>Operating expenses:</b>				
Selling	21,550	7	19,175	5
General and administrative	16,776	6	16,955	5
Research and development	93,863	31	76,807	21
	132,189	44	112,937	31
<b>Operating income (loss)</b>	(57,355)	(19)	7,652	1
<b>Non-operating income and gains:</b>				
Interest income	1,870	1	3,375	1
Gain on valuation of financial liability (note 4(2))	310	-	2,206	1
Others (notes 4(2) and 7(2))	5,762	2	8,715	2
	7,942	3	14,296	4
<b>Non-operating expenses and losses:</b>				
Loss on investments accounted for using equity method (note 4(5))	167	-	1,292	-
Foreign exchange loss, net	487	1	1,084	-
Others	1,115	-	3,890	1
	1,769	1	6,266	1
<b>Income (loss) before income tax</b>	(51,182)	(17)	15,682	4
<b>Income tax expenses (note 4(10))</b>	13,793	4	9,002	2
<b>Net income (loss)</b>	\$ (64,975)	(21)	6,680	2
	<b>Before</b>	<b>After</b>	<b>Before</b>	<b>After</b>
	<b>Income</b>	<b>Income</b>	<b>Income</b>	<b>Income</b>
	<b>Tax</b>	<b>Tax</b>	<b>Tax</b>	<b>Tax</b>
<b>Earnings per common share (NT\$, note 4(11))</b>				
Basic earnings per common share	\$ (0.82)	(1.05)	0.26	0.11
Diluted earnings per common share			\$ 0.25	0.11

See accompanying notes to financial statements.

Solid State System Co., Ltd.

Statements of Changes in Stockholders' Equity

For the six months ended June 30, 2010 and 2009  
(In thousands of New Taiwan dollars)

	Retained Earnings						Total	
	Common Stock	Capital Collected in Advance	Capital Surplus	Legal Reserve	Special Reserve	Unappropriated Earnings (Accumulated Deficit)		Cumulative Translation Adjustments
Balance at January 1, 2009	\$ 606,746	224	506,728	74,967	-	(162,321)	(1,855)	1,024,489
Deficit to be offset by legal reserve	-	-	-	(74,967)	-	74,967	-	-
Deficit to be offset by capital surplus	-	-	(87,354)	-	-	87,354	-	-
Issuance of stock from exercising stock options	2,280	346	1,140	-	-	-	-	3,766
Net income for the six months ended June 30, 2010	-	-	-	-	-	6,680	-	6,680
Balance at June 30, 2009	<u>\$ 609,026</u>	<u>570</u>	<u>420,514</u>	<u>-</u>	<u>-</u>	<u>6,680</u>	<u>(1,855)</u>	<u>1,034,935</u>
Balance at January 1, 2010	\$ 614,836	4,620	423,419	-	-	33,339	(1,855)	1,074,359
Appropriation of earnings:								
Legal reserve	-	-	-	3,334	-	(3,334)	-	-
Special reserve	-	-	-	-	1,855	(1,855)	-	-
Cash dividends	-	-	-	-	-	(24,766)	-	(24,766)
Issuance of stock from exercising stock options	6,710	(3,676)	7,581	-	-	-	-	10,615
Net loss for the six months ended June 30, 2010	-	-	-	-	-	(64,975)	-	(64,975)
Balance at June 30, 2010	<u>\$ 621,546</u>	<u>944</u>	<u>431,000</u>	<u>3,334</u>	<u>1,855</u>	<u>(61,591)</u>	<u>(1,855)</u>	<u>995,233</u>

Note: Remuneration to directors and supervisors and employees' bonuses in the amount of \$563 thousand and \$4,501 thousand, respectively, had been charged against earnings of 2009.

See accompanying notes to financial statements.

**Solid State System Co., Ltd.**

**Statements of Cash Flows**

**For the six months ended June 30, 2010 and 2009**  
**(In thousands of New Taiwan dollars)**

	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (64,975)	6,680
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	12,016	11,887
Provision for (reversal of) doubtful accounts	1,273	(485)
Provision for inventory devaluation loss	4,083	1,283
Loss on investments accounted for using equity method	167	1,292
Other loss with no cash impacts	1,297	2,460
Decrease in deferred income tax assets	15,388	8,761
Decrease in financial assets at fair value through profit or loss	365	-
Decrease in notes and accounts receivable (including related parties)	51,495	47,904
Decrease in inventories	11,618	22,522
Decrease in other financial assets – current	6,070	8,593
Increase in other current assets	(3,540)	(580)
Decrease in notes and accounts payable	(2,720)	(16,428)
Increase in financial liabilities at fair value through profit or loss	115	-
Decrease in other current liabilities	(36,849)	(17,960)
Decrease in accrued pension liabilities	(142)	(321)
<b>Net cash provided by (used in) operating activities</b>	<b>(4,339)</b>	<b>75,608</b>
<b>Cash flows from investing activities:</b>		
Decrease in other financial assets	1,619	938
Acquisition of property, plant, and equipment, and assets leased to others	(4,685)	(2,948)
Proceeds from disposal of property, plant, and equipment, and assets leased to others	200	-
Increase in intangible assets	(5,442)	(2,479)
Decrease in restricted cash in bank	-	5,000
Increase in refundable deposits	(4)	(480)
Increase in deferred charges	(16,611)	(12,138)
<b>Net cash used in investing activities</b>	<b>(24,923)</b>	<b>(12,107)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from exercise of employee stock options	10,615	3,766
<b>Net increase in cash</b>	<b>(18,647)</b>	<b>67,267</b>
<b>Cash at beginning of year</b>	<b>711,213</b>	<b>673,709</b>
<b>Cash at end of year</b>	<b>\$ 692,566</b>	<b>740,976</b>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for income tax	\$ 649	375
<b>Non-Cash investing and financing activities</b>		
Declared cash dividend to be distributed	\$ 24,766	-

See accompanying notes to financial statements.

**Solid State System Co., Ltd.**

**Notes to Financial Statements**

**June 30, 2010 and 2009**

**(Amounts expressed in thousands of New Taiwan dollars,  
except for per share information and unless otherwise noted)**

**1. Organization and Business Scope**

Solid State System Co., Ltd. (the Company) was incorporated on November 26, 1998. The Company's main activities are the design, research, development, manufacture and sale of integrated circuits (ICs).

The Company's common shares have been publicly listed on the GreTai Securities Market since December 24, 2007. As of June 30, 2010 and 2009, the Company had 150 and 148 employees, respectively.

**2. Summary of Significant Accounting Policies**

The financial statements are prepared in accordance with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, the Business Entity Accounting Act, the Regulation on Business Entity Accounting Handling, and accounting principles generally accepted in the Republic of China (ROC). The significant accounting policies adopted in preparing the accompanying financial statements are summarized as follows:

**(1) Use of estimates**

The preparation of the accompanying financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

(Continued)

**Solid State System Co., Ltd.****Notes to Financial Statements****(2) Foreign currency transactions and translation**

The Company's reporting currency is the New Taiwan dollar. Non-derivative foreign currency transactions are recorded at the exchange rates prevailing at the transaction dates. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated into the New Taiwan dollars using the exchange rates on that date. The resulting unrealized exchange gains or losses from such translations are reflected in the accompanying statements of operations. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into the reporting currency at the foreign exchange rates ruling at the dates the fair value was determined. If the non-monetary assets or liabilities are measured at fair value through profit or loss, then the resulting unrealized exchange gains or losses from such translation are recorded in the accompanying statements of operations. If the non-monetary assets or liabilities are measured at fair value through stockholders' equity, then the resulting unrealized exchange gains or losses from such translation are recorded as a separate component of stockholders' equity.

Financial statements of a foreign investee, which is accounted for by the equity method, are prepared in the functional currency. Translation differences are recorded in cumulative translation adjustment, a separate component of stockholders' equity, if the functional currency differs from that of the reporting entity. In translating those foreign currency financial statements into the reporting currency, all assets and liabilities are translated at the current rate as at the balance sheet date; stockholders' equity accounts are translated at the historical rates except for the beginning balance of the retained earnings, which is the translated amount carried over from the last period; dividends are translated at the spot rate of the declared date; and revenue and expense are translated at the weighted-average rate of the current period.

**(3) Principles of classifying assets and liabilities as current and non-current**

Cash or cash equivalents, and assets held for trading purposes or expected to be converted to cash within 12 months from the balance sheet date are classified as current assets; all other assets shall be classified as non-current.

Liabilities incurred for trading purposes or expected to be settled within 12 months from the balance sheet date are classified as current liabilities; all other liabilities shall be classified as non-current.

(Continued)

**Solid State System Co., Ltd.****Notes to Financial Statements****(4) Asset impairment**

The Company assesses at each balance sheet date whether there is any indication that an asset (individual asset or cash-generating unit other than goodwill) may have been impaired. If any such indication exists, the Company estimates the recoverable amount of the asset. The Company recognizes impairment loss for an asset whose carrying value is higher than the recoverable amount. The Company reverses an impairment loss recognized in prior periods for assets other than goodwill if there is any indication that the impairment loss recognized no longer exists or has decreased. The carrying value after the reversal should not exceed the recoverable amount or the depreciated or amortized balance of the asset assuming no impairment loss was recognized in prior periods.

**(5) Financial instruments**

The Company adopted transaction-date accounting for financial instrument transactions. Upon initial recognition, financial instruments are measured at fair value. Except for financial instruments measured at fair value through profit or loss, acquisition cost or issuance cost is added to the originally recognized amount.

Financial instruments are classified into the following categories in accordance with the holding or issuing purpose:

- A. Financial assets and liabilities measured at fair value through profit or loss: Financial instruments are classified into this category if the purpose of acquisition is principally for selling or repurchasing in the near term. Except for effective hedging derivative financial instruments, all financial derivatives are included in this category.
- B. Financial assets carried at cost: Financial instruments whose fair value could not be measured with reasonable certainty are measured at their original cost. However, if there is any objective evidence of impairment, a loss should be recognized thereon. Thereafter, the loss could not be reversed.

The Company holds derivative financial instruments to hedge its exposure to foreign exchange risks arising from operating, financing and investing activities. When a hedging-purpose derivative financial instrument cannot meet all the conditions for hedge accounting, it is accounted for as a financial instrument held for trading purposes.

**(6) Allowance for doubtful accounts**

The allowance for doubtful accounts is provided based on the expected collectibility of accounts receivable. The amount of allowance for doubtful accounts is determined by historical experience of collectibility, credit quality, aging analysis, and credit terms.

(Continued)

**Solid State System Co., Ltd.****Notes to Financial Statements****(7) Inventories**

The cost of inventories shall comprise all costs of purchase, costs of conversion, and other costs incurred in bringing the inventories to their present location and condition. The allocation of fixed production overheads to the finished goods and work in progress is based on the normal capacity of the production facilities. However, the allocation of fixed production overheads can be based on the actual capacity when there is no significant difference compared with normal capacity. Variable production overheads are allocated to each unit of production based on the actual capacity. Inventories are measured at the lower of cost or net realizable value. The cost of inventories is based on the weighted-average-cost principle. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses at the end of the period.

**(8) Long-term investments accounted for using equity method**

Long-term investments in which the Company, directly or indirectly, owns 20% or more of the investee companies' voting shares, or owns less than 20% of the investee companies' voting shares but has significant influence on the investee companies, are accounted for by the equity method. If an investee company issues new shares and the Company does not subscribe to new shares in proportion to its original ownership percentage, the Company's equity in the investee's net assets might be changed. The resulting change in the equity interest is adjusted to capital surplus and long-term investments.

For long-term equity investments on which the Company exercises significant influence but has no power to control the investee company, investment losses are recognized to the extent of the original investment plus receivable from the investee unless the Company has committed to provide financial support for the investee or the investee's loss is temporary in nature. Any additional loss recognized by the Company in excess of the carrying value of the investment and receivables from that investee company is accounted for as a long-term equity investment credit, which is reflected as a liability.

In addition to recognized investment income or loss by the equity method in non-consolidated financial statements, the Company compiles consolidated financial statements for investee companies which the Company has the power to control on a semi-annual and annual basis. The Company also prepares consolidated financial statements for the first and third quarters.

**(9) Property, plant and equipment, and assets leased to others**

Property, plant and equipment are stated at cost; costs associated with significant additions, improvements, and replacements to property and equipment are capitalized; repairs and maintenance are charged to expenses as incurred.

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**Solid State System Co., Ltd.****Notes to Financial Statements**

Depreciation of property, plant and equipment is provided for by using the straight-line method over the estimated useful lives of the assets; depreciation of leasehold improvement is provided over the shorter of the rent period or estimated useful life using the straight-line method. If fully depreciated assets continue to be used, the residual value of the assets is depreciated over the remaining useful life.

The estimated useful lives of property, plant and equipment are as follows:

- A. Machinery and equipment: 5 years.
- B. Office equipment: 3~5 years.

Land and buildings being leased to others are classified as other assets and stated at cost. Buildings are depreciated by using the straight-line method based on an estimated useful life of 50 years.

The residual value, the depreciation period, and the depreciation method for property, plant and equipment, and assets leased to others with a finite useful life shall be reviewed at least at each financial year-end. Any changes shall be accounted for as changes in accounting estimates.

Gain or losses on the disposal of property, plant and equipment are accounted for as non-operating income or losses in the statement of operations.

**(10) Intangible assets**

Except when it forms part of the cost of a business combination, expenditure on research is recognized as an expense when it is incurred; an intangible asset arising from development shall be recognized if, and only if, a company can demonstrate all of the following:

- A. the technical feasibility of completing the intangible asset so that it will be available for use or sale.
- B. its intention to complete the intangible asset and use or sell it.
- C. its ability to use or sell the intangible asset.
- D. the probability that the intangible asset will generate future economic benefits.
- E. the availability of adequate technical, financial and other resources to complete the development.
- F. its ability to measure reliably the expenditure attributable to the intangible asset during its development.

The residual value, the amortization period, and the amortization method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. Any changes shall be accounted for as changes in accounting estimates.

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**Solid State System Co., Ltd.****Notes to Financial Statements****(11) Deferred charges**

Masks for production are recorded as deferred charges and amortized over one to two years starting from the mass production date on a straight-line basis, and the residual value of masks shall be written off if future economic benefit is not expected as a result of periodic evaluation.

**(12) Retirement plan**

The Company has established an employee noncontributory defined benefit retirement plan (the Plan) covering full-time employees. In accordance with the Plan, payments of retirement benefits are based on years of service and the average salary for the six-month period before the employee's retirement. Each employee earns two months of salary for the first fifteen years of service, and one month of salary for each year of service thereafter. The maximum retirement benefit is 45 months of salary. Beginning July 1, 2005, pursuant to the ROC Labor Pension Act (hereinafter referred to as the "new Act"), employees who elected to participate in the new Act or joined the Company after July 1, 2005, are subject to a defined contribution plan under the new Act. For these employees, the Company is required to make a monthly contribution at a rate of no less than 6% of the employee's monthly wages to the employee's individual pension fund account at the ROC Bureau of Labor Insurance.

For the Plan, the Company performs an actuarial calculation of its pension obligation as of each fiscal year-end. Based on the actuarial calculation, the Company recognizes a minimum pension liability and periodic pension costs covering the service lives of the Plan participants, including current service cost, net obligation at transition, prior service cost, and pension gains or losses on a straight-line basis. In accordance with the requirement of the ROC Labor Standards Law, the Company has contributed monthly payments of 2% of salaries and wages to a pension fund maintained with Bank of Taiwan.

Under the new Act, the Company contributes 6% of each employee's monthly wages to the Bureau of Labor Insurance. The contribution for a period is recognized as pension cost for that period.

**(13) Share-based payment**

The accounting treatments of share-based payment transactions are according to SFAS 39 if the employee stock options were granted after January 1, 2008. For the employee stock options that were granted in the period from January 1, 2004, to December 31, 2007, the Company applies Interpretations Nos. (92)070, 071 and 072 issued by the Accounting Research and Development Foundation ("ARDF").

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**Solid State System Co., Ltd.****Notes to Financial Statements**

The Company need not apply SFAS 39 retrospectively to the employee stock options that were granted before January 1, 2008; however, the pro-forma net income, earnings per share, and related information on the share-based payment must still be disclosed.

**(14) Treasury stock**

The Company accounts for the purchase of its outstanding shares using the cost method. When treasury stock is sold, if the selling price is above the book value, the difference should be credited to the capital surplus—treasury stock transactions account. If the selling price is below the book value, the difference should first be offset against capital surplus from the same class of treasury stock transactions, and the remainder, if any, debited to retained earnings. The book value of treasury stock is calculated using the weighted-average method and separately accounted for based on the purpose of acquisition.

When a company's treasury stock is retired, the treasury stock account should be credited, and the capital surplus—premium on stock account and capital stock account should be debited proportionately according to the share ratio. An excess of the carrying value of treasury stock over the sum of its par value and premium on stock should first be offset against capital surplus from the same class of treasury stock transactions, and the remainder, if any, debited to retained earnings. An excess of the sum of the par value and premium on treasury stock over its carrying value should be credited to capital surplus from the same class of treasury stock transactions.

**(15) Revenue recognition**

Revenue is recognized when products are delivered to customers and the significant risks and rewards of ownership are transferred to the customers.

Service revenue is recognized according to the degree of service completion on the balance sheet date when the outcome of rendering service can be reasonably estimated. When the outcome of the service cannot be reasonably estimated, the service revenue is not recognized until the estimation is available or the service is completed.

**(16) Employee bonuses and remuneration paid to directors and supervisors**

Effective January 1, 2008, the Company estimates the amount of employee bonuses and remuneration paid to directors and supervisors, and recognizes it as cost of goods sold and operating expenses, as appropriate, in accordance with Interpretation (96)052 issued by the ARDF. The difference, if any, between the amount approved in the shareholders' meeting of the subsequent year and recognized in the financial statements is accounted for as a change in accounting estimates, and charged to profit or loss in the subsequent year.

(Continued)

**Solid State System Co., Ltd.****Notes to Financial Statements****(17) Income taxes**

Income taxes are accounted for under the asset and liability method. Deferred income taxes are determined based on differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect during the years in which the differences are expected to reverse. The income tax effects resulting from taxable temporary differences are recognized as deferred income tax liabilities. The income tax effects resulting from deductible temporary differences, net operating loss carryforwards, and investment tax credits are recognized as deferred income tax assets. The realization of the deferred income tax assets is evaluated, and if it is considered more likely than not that the deferred tax assets will not be realized, a valuation allowance is recognized accordingly.

Classification of deferred income tax assets or liabilities as current or non-current is based on the classification of the related asset or liability. If the deferred income tax asset or liability is not directly related to a specific asset or liability, then the classification is based on the asset's or liability's expected realization date.

Investment tax credits arising from the Company's purchase of equipment, expenditures for research and development, and employee training are recognized by using the flow-through method.

According to the ROC Income Tax Act, the Company's undistributed income is subject to an additional 10 percent corporate income surtax. The surtax is charged to income tax expense after the appropriation of earnings is approved by the stockholders in the following year.

**(18) Earnings per common share**

Earnings per common share are computed based on the weighted-average number of common shares outstanding during the period. The weighted-average number of outstanding shares is retroactively adjusted for the effect of stock dividends transferred from unappropriated earnings and capital surplus and employee stock bonuses approved by stockholders in and prior to year 2008.

The Company's common stock to be issued for the employee stock options and employee bonuses to be settled through the issuance of stock upon approval by stockholders are considered potential common stock. When potential common stock is anti-dilutive, only the basic EPS are disclosed, and when potential common stock has dilutive effects, diluted EPS are disclosed in addition to basic EPS. In computing diluted EPS, the net income and the weighted-average number of common shares outstanding during the accounting period are adjusted to include the dilutive effects of the potential common stock, assuming potential dilutive common stock was outstanding during the entire period.

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

## 3. Reasons for and Effect of Changes in Accounting Principles

Effective January 1, 2009, the Company adopted the amendment of SFAS No. 10, "Inventories." There was no significant impact on net loss and earnings per share for the six months ended June 30, 2009.

## 4. Details of Significant Accounts

## (1) Cash

	<u>June 30,</u>	
	<u>2010</u>	<u>2009</u>
Cash on hand	\$ 788	525
Checking and savings accounts	70,114	84,705
Time deposit	<u>621,664</u>	<u>655,746</u>
	<u>\$ 692,566</u>	<u>740,976</u>

## (2) Financial instruments

## A. Derivative financial instruments

For the six months ended June 30, 2010 and 2009, the Company entered into derivative financial instruments to hedge its exposure to foreign currency exchange risk arising from operating activities. For a hedging-purpose derivative financial instrument that cannot meet the conditions for hedge accounting, it is accounted for as a financial instrument for trading purposes. As of June 30, 2010 and 2009, outstanding foreign currency forward contracts were as follows:

<u>June 30, 2010</u>				
<u>Buy</u>	<u>Sell</u>	<u>Nominal Principal (in USD thousands)</u>	<u>Settlement Date</u>	<u>Book value (thousands)</u>
NTD	USD	250	June 01, 2010~ August 2, 2010	\$ (59)
NTD	USD	250	May 20, 2010~ July 20, 2010	<u>(56)</u>
				<u>\$ (115)</u>

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

June 30, 2009				
Buy	Sell	Nominal Principal (in USD thousands)	Settlement Date	Book value (thousands)
NTD	USD	250	June 4, 2009~August 5, 2009	\$ (55)
NTD	USD	250	June 11, 2009~August 10, 2009	(31)
NTD	USD	250	June 25, 2009~September 23, 2009	33
NTD	USD	250	April 8, 2009~July 6, 2009	241
NTD	USD	250	May 6, 2009~July 6, 2009	64
				<u>\$ 252</u>

Related derivative financial instruments were recorded as financial assets(liabilities) at fair value through profit or loss—current.

The gains on financial instruments measured at fair value were \$310 and \$2,206 for the six months ended June 30, 2010 and 2009, respectively.

## B. Non-derivative financial instruments

	June 30,	
	2010	2009
Financial assets carried at cost—non-current:		
Common stock—Goang Zhi Technologies Co., Ltd. (Goang Zhi)	\$ <u>8,500</u>	<u>8,500</u>

In addition to common stock, the Company also had subscribed for a total of \$19,000 thousand of non-voting cumulative preferred shares in ViCHIP. As of December 31, 2006, the Company had recognized investment loss in excess of the carrying value of ViCHIP amounting to \$18,854 thousand, and the excess was offset by the investment in preferred stock of ViCHIP. In addition, an investment loss of \$146 thousand was recognized in 2006 to reflect a permanent impairment of the investment value of ViCHIP. Based on the above, the Company recognized a total investment loss of \$19,000 thousand. However, as of September 25, 2009, ViCHIP had repurchased its total preferred shares in the amount of \$2 thousand.

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

As of June 30, 2010 and 2009, the original cost of investment in Media Tek Inc. was \$21,153 thousand. In the fourth quarter of 2008 and 2006, the Company recognized investment losses of \$3,074 thousand and \$18,079 thousand, respectively, to reflect the permanent impairment of the investment value of Media Tek Inc. In addition, in October 2009, Media Tek Inc. entered into the process of liquidation and refunded cash to the Company amounting to \$642 thousand, which the Company recorded under other income.

## (3) Notes and accounts receivable

	<u>June 30,</u>	
	<u>2010</u>	<u>2009</u>
Notes receivable	\$ -	1,093
Accounts receivable	<u>74,690</u>	<u>65,096</u>
	74,690	66,189
Less: allowance for doubtful accounts	<u>(1,614)</u>	<u>-</u>
	<u>\$ 73,076</u>	<u>66,189</u>

As of June 30, 2010 and 2009, accounts receivable amounting to \$16,654 thousand and \$17,890 thousand, respectively, were classified as overdue receivable under other assets. The amount of overdue receivable was provided a 100% allowance for bad debt.

## (4) Inventories

	<u>June 30,</u>	
	<u>2010</u>	<u>2009</u>
Finished goods	\$ 82,313	112,707
Less: Provision for inventory devaluation	<u>(37,181)</u>	<u>(56,636)</u>
	45,132	56,071
Work in process	95,164	43,281
Less: Provision for inventory devaluation	<u>(4,321)</u>	<u>(17,169)</u>
	<u>90,843</u>	<u>26,112</u>
Raw materials	41,886	2,509
Less: Provision for inventory devaluation	<u>(2,000)</u>	<u>(2,011)</u>
	<u>39,886</u>	<u>498</u>
Merchandise inventory	409	234
Less: Provision for inventory devaluation	<u>(180)</u>	<u>(111)</u>
	<u>229</u>	<u>123</u>
	<u>\$ 176,090</u>	<u>82,804</u>

For the six months ended June 30, 2010 and 2009, the Company recognized inventory devaluation losses of \$4,083 thousand and \$1,283 thousand, respectively, recorded as cost of goods sold.

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

## (5) Long-term investments under equity method

A. As of June 30, 2010 and 2009, the long-term equity investments were as described below:

<u>Name of investee company</u>	<u>June 30, 2010</u>			<u>For the six months ended June 30, 2010</u>
	<u>Equity holding (%)</u>	<u>Original investment</u>	<u>Book value</u>	<u>Investment loss</u>
Innovative Strength Resources Ltd. (Innovative)	100.00	\$ 63,069	-	-
ViCHIP Corporation Limited (ViCHIP)	100.00	52,400	4,835	167
Fusion Media Tech Co., Ltd. (Fusion)	40.00	12,000	-	-
			<u>\$ 4,835</u>	<u>167</u>

<u>Name of investee company</u>	<u>June 30, 2009</u>			<u>For the six months ended June 30, 2009</u>
	<u>Equity holding (%)</u>	<u>Original investment</u>	<u>Book value</u>	<u>Investment loss</u>
Innovative Strength Resources Ltd. (Innovative)	100.00	\$ 63,069	-	-
ViCHIP Corporation Limited (ViCHIP)	25.10	47,400	-	-
Fusion Media Tech Co., Ltd. (Fusion)	40.00	12,000	918	1,292
			<u>\$ 918</u>	<u>1,292</u>

B. On November 11, 2002, the Company established Innovative in the British Virgin Islands for the purpose of investing in overseas business.

C. Long-term investment in ViCHIP was accounted for by the equity method because the Company and its affiliated companies own more than 20% of the voting shares. As of December 31, 2006, the Company and Innovative had recognized investment loss in excess of the carrying value of ViCHIP amounting to \$18,854 thousand, and the excess offset the carrying value of preferred stock. Please refer note 4(2) for the related information.

(Continued)

**Solid State System Co., Ltd.**

**Notes to Financial Statements**

- D. The Company purchased common stock and preferred stock of ViCHIP for \$2 thousand from Innovative and other stockholders in the period from August to September 2009. ViCHIP become a 100%-owned subsidiary of the Company. For the purpose of extending operations, the Company injected capital of \$5,000 thousand in ViCHIP.
- E. Investment losses which amounted to \$167 thousand and \$1,292 thousand for the six months ended June 30, 2010 and 2009, respectively, were recognized based upon the financial statements prepared by the investee companies, which were not reviewed by independent auditors.
- F. As of June 30, 2010 and 2009, there were no pledges of the Company's long-term equity investments.

(6) Intangible assets

The information on intangible assets and their amortization for the six months ended June 30, 2010 and 2009, is as follows:

	<u>Technical know-how</u>	<u>Software and system design cost</u>	<u>Total</u>
Book value:			
Balance at January 1, 2010	\$ -	5,618	5,618
Additions	5,360	82	5,442
Reclassification	-	2,287	2,287
Amortization	(112)	(2,086)	(2,198)
Balance at June 30, 2010	<u>\$ 5,248</u>	<u>5,901</u>	<u>11,149</u>
Balance at January 1, 2009	\$ -	7,130	7,130
Additions	-	2,479	2,479
Reclassification	-	-	-
Amortization	-	(2,947)	(2,947)
Balance at June 30, 2009	<u>\$ -</u>	<u>6,662</u>	<u>6,662</u>

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

## (7) Assets leased to others

For the purpose of future operations and in consideration of cost effectiveness, the effective use of capital, and an opportunity for purchasing, the Company purchased land and building for \$101,071 thousand from Intraco Taiwan Corp in March 2008. Due to operating considerations at the time of purchase building, the Company temporarily leased the land and building to ELS System Technology Corp. In April 2009, the Company reclaimed part of the lease area for operational use and reclassified it as land and building under fixed assets. As of June 30, 2010, the carrying value of assets leased to others amounted to \$90,814 thousand (less accumulated depreciation), recorded under other assets.

## (8) Retirement plan

Pension information for the six months ended June 30, 2010 and 2009, is summarized below:

	For the six months ended	
	June 30,	
	<u>2010</u>	<u>2009</u>
Balance of pension fund for defined benefit plan	\$ <u>10,995</u>	<u>10,120</u>
Net pension cost:		
Defined benefit plan	\$ 242	(85)
Defined contribution plan	<u>3,774</u>	<u>3,504</u>
Total net pension cost	\$ <u>4,016</u>	<u>3,419</u>
Accrued pension liability	\$ <u>3,360</u>	<u>3,811</u>

## (9) Stockholders' equity

## A. Common stock

In order to appeal to strategic investors for strengthening the Company's stockholder structure and improving competitiveness, on August 8, 2008, based on the resolution of a special stockholders' meeting, the board of directors approved the proposal to raise \$100,205 thousand through private placement of 5,726 thousand shares of common stock at a premium price of \$17.5 per share. The premium amounted to \$42,945 thousand and was recognized as capital surplus—additional paid-in capital. The effective date of the capital increase was August 25, 2008, and the required registration process was completed on September 8, 2008. Rights of the holders of privately issued common shares are principally identical to rights to holders of current outstanding common shares; however, pursuant to the Securities and Exchange Act, transfer of such privately issued common shares is not permitted within 3 years of the issuance date.

(Continued)

**Solid State System Co., Ltd.**

**Notes to Financial Statements**

In the six months ended June 30, 2009, 251 thousand shares of common stock were issued for the exercise of stock options which were granted in 2004. As of June 30, 2009, \$570 thousand had been received for 38 thousand shares, which had not yet been registered with the governmental authorities, and was recorded as capital collected in advance for common stock. In the six months ended June 30, 2010, 67 thousand shares and 446 thousand shares of common stock were issued for the exercise of stock options which were granted in 2004 and 2007, respectively. As of June 30, 2010, \$944 thousand had been received for 41 thousand shares, which had not yet been registered with the governmental authorities, and was recorded as capital collected in advance for common stock.

As of June 30, 2010 and 2009, the Company's authorized capital was \$750,000 thousand (including \$50,000 thousand which was reserved for employee stock options), and the Company's issued capital was \$621,546 thousand and \$609,026 thousand, respectively. The par value of the Company's common stock is \$10 per share.

**B. Employee stock options**

As of June 30, 2010, the employee stock options issued were as below:

<u>Issuance</u>	<u>Granted date</u>	<u>Units granted (thousands)</u>	<u>Exercise period</u>	<u>Vesting period</u>
Employee stock options in 2004	September 15, 2004	3,000	September 15, 2004~ September 14, 2011	2~4 years
Employee stock options in 2007	November 30, 2007	2,000	November 30, 2007~ November 29, 2014	2~4 years

The Company adopted the intrinsic value method to recognize the compensation cost for the above employee stock options. The exercise price of the employee stock options which were granted on September 15, 2004, was not lower than the 2003 audited equity per share, and the exercise price of the employee stock options which were granted on November 30, 2007, was equal to the market price of the Company's stock on the measurement date. As a result, there was no compensation cost recognized based on the intrinsic value method.

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

If the Company recognized compensation cost using the Black-Sholes option pricing model in accordance with SFAS No. 39, the fair value of the options would be \$0.3 per unit. The assumptions would be as follows:

	<u>Granted in 2007</u>	<u>Granted in 2004</u>
Initial exercise price (New Taiwan dollars)	25.0	24.0
Adjusted exercise price (New Taiwan dollars)	24.3	15.0
Expected life of the option	7 years	7 years
Expected dividend yield	10.85%	17.5%
Expected volatility	17.36%	29.75%
Risk-free interest rate	2.67%	1.98%

Information as of and for the six months ended June 30, 2010 and 2009, related to the Company's employee stock option plans is as follows:

	<u>For the six months ended June 30,</u>			
	<u>2010</u>		<u>2009</u>	
	<u>Options (thousands)</u>	<u>Weighted- average exercise price (New Taiwan dollars)</u>	<u>Options (thousands)</u>	<u>Weighted- average exercise price New Taiwan (dollars)</u>
Outstanding at beginning of year	2,378	\$ 22.65	3,414	\$ 20.40
Granted	-	-	-	-
Exercised	(513)	23.09	(251)	15.00
Forfeited	(9)	24.30	(6)	15.00
Outstanding at end of year	<u>1,856</u>	22.52	<u>3,157</u>	20.89
Exercisable at end of year	<u>\$ 1,106</u>		<u>1,157</u>	

The exercise price of the options mentioned above has been adjusted according to changes in the number of common shares.

For share options exercised during the six months ended June 30, 2010 and 2009, the weighted-average exercise price at the date of exercise was \$34.32 and \$19.15, respectively. As of June 30, 2010, the weighted-average remaining contractual life of the outstanding employee stock options was 3.88 years.

(Continued)

**Solid State System Co., Ltd.**

**Notes to Financial Statements**

If the Company recognized compensation cost in accordance with SFAS No. 39, the pro forma information on net income and earnings per share in the six months ended June 30, 2010 and 2009, would be as follows:

		<b>For the six months ended June 30,</b>	
		<u>2010</u>	<u>2009</u>
Net income	Net income (loss)	\$ (64,975)	6,680
	Pro forma net income (loss)	\$ (65,068)	6,548
Basic earnings per share	Earnings per share (NT\$)	\$ (1.05)	0.11
	Pro forma earnings per share (NT\$)	\$ (1.05)	0.11
Diluted earnings per share	Earnings per share (NT\$)		\$ 0.11
	Pro forma earnings per share (NT\$)		\$ 0.11

C. Capital surplus

Pursuant to the ROC Company Act, capital surplus can only be used to offset a deficit. However, capital surplus derived from additional paid-in capital and donations (donated capital) can be used to increase common stock if there is no accumulated deficit. According to the Enforcement Rules of the Securities and Exchange Act, the total capital surplus capitalized per annum cannot exceed 10 percent of the issued common stock. Additionally, issuance of new stock from capital surplus derived from paid-in capital in excess of par value can only be used to increase common stock one year after the initial capital increase is registered with the competent government authorities.

D. Legal reserve

According to the ROC Company Act, 10 percent of the annual net income shall be set aside as legal reserve until accumulated legal reserve equals the issued common stock. Legal reserve can only be used to offset accumulated deficits and cannot be used to declare cash dividends.

(Continued)

**Solid State System Co., Ltd.****Notes to Financial Statements****E. Distribution of earnings and dividend policy**

According to the Company's articles of incorporation, 10% of its annual net income, after offsetting any accumulated deficit, shall be set aside as legal reserve until legal reserve is equal to issued common stock, and a special reserve can be set aside if necessary. No more than 2% of the remainder shall be appropriated as remuneration to directors and supervisors, and no less than 10% of the remainder shall be appropriated as employee bonuses. The distribution of employee bonuses in the form of stock bonuses may also apply to employees of affiliated companies. The board of directors is authorized to set out related terms and conditions. After the above appropriations, the distribution of remaining earnings is proposed by the board of directors and approved by the stockholders.

In consideration of financial planning, distribution of profits shall be made by stock dividends and cash dividends. The cash dividends should not be lower than 10% of total dividends. The above dividend policy may be adjusted after approval by the stockholders.

Based on a stockholder resolution on June 18, 2009, the Company decided to use legal reserve amounting to \$74,967 thousand and capital surplus amounting to \$87,354 thousand to offset accumulated deficit amounting to \$162,321 thousand. As the aforementioned plan to offset accumulated deficits was approved at the shareholder's meeting, 10% of the earnings for the six months ended June 30, 2009, was set aside as a legal reserve, and the remaining earnings, taking into consideration the Company's articles of incorporation and overall operational condition, were distributed as follows:

- (1) 15% as employee bonuses; and
- (2) 2% as remuneration to directors and supervisors.

The amounts of employee bonuses and remuneration to directors and supervisors were estimated at \$1,767 thousand and \$235 thousand, respectively.

Based on a stockholder resolution on June 18, 2010, the Company decided to distribute earnings as legal reserve amounting to \$3,334 thousand, special reserve amounting to \$1,855 thousand, directors' and supervisors' remuneration amounting to \$563 thousand, employee bonuses amounting to \$4,501 thousand, and cash dividends amounting to \$24,766 thousand (cash dividends of \$0.4 per common share).

The aforementioned distribution of earnings was consistent with the resolution in the board of directors' meeting. Accrued expenses recognized in 2009 were \$5,101 thousand, which was different from the actual distribution of \$5,064 thousand, and the \$37 thousand difference was categorized as a deduction from expenses in 2010.

(Continued)

**Solid State System Co., Ltd.**

**Notes to Financial Statements**

The stockholders authorized the board of directors to set the ex-dividend date for 2009 appropriation of earnings. Related information will be available on the Market Observation Post System.

(10) Income tax

- A. The Company designs and manufactures advanced ICs. Its initial investment and the expanded operations accompanying capital increases meet the criteria for an “important technology-based industry” and an “important strategic industry” as prescribed under the Statute for Upgrading Industries, and the Company could choose to apply a shareholders’ investment credit or an income tax exemption over a period of five years.

As of June 30, 2010, the details of the Company’s tax exemption due to the capital increase were as summarized below.

<u>Year of investment</u>	<u>Applied law</u>	<u>Tax exemption</u>	<u>Approval of Ministry of Finance</u>	<u>Tax exemption period</u>
1 <sup>st</sup> capital increase for cash in 2002	Emerging, important and strategic industry	Exemption from corporate income taxes for five years	May 2005	2005.01.01~ 2009.12.31
2 <sup>nd</sup> capital increase for cash in 2002	Emerging, important and strategic industry	Exemption from corporate income taxes for five years	March 2007	2006.01.01~ 2010.12.31
Capital increase from transfer of dividend and bonus in 2002	Emerging, important and strategic industry	Exemption from corporate income taxes for five years	December 2008	2009.01.01~ 2013.12.31
Capital increase from transfer of dividend and bonus in 2003	Emerging, important and strategic industry	Exemption from corporate income taxes for five years	June 2009	2009.01.01~ 2013.12.31

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

<u>Year of investment</u>	<u>Applied law</u>	<u>Tax exemption</u>	<u>Approval of Ministry of Finance</u>	<u>Tax exemption period</u>
Capital increase from transfer of dividend and bonus in 2004	Emerging, important and strategic industry	Exemption from corporate income taxes for five years	—	The investment plan is not completed
Capital increase from transfer of dividend and bonus in 2005, and plan to increase capital for cash	Emerging, important and strategic industry	Exemption from corporate income taxes for five years	—	The investment plan is not completed
Capital increase from transfer of dividend and bonus in 2006, and plan to increase capital for cash	Emerging, important and strategic industry	Exemption from corporate income taxes for five years	—	The investment plan is not completed

- B. The components of income tax expense for the six months ended June 30, 2010 and 2009, are summarized as follow:

	<u>For the six months ended</u>	
	<u>June 30,</u>	
	<u>2010</u>	<u>2009</u>
Current	\$ (1,595)	241
Deferred	<u>15,388</u>	<u>8,761</u>
	<u>\$ 13,793</u>	<u>9,002</u>

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

- C. According to the amendment of the Income Tax Act which was announced on May 27, 2009, the statutory income tax rate applicable to the Company was changed from 25% to 20%. The Income Tax Act was further amended on June 15, 2010, the statutory income rate applicable to the Company was changed to 17%. The statutory income tax rate of the company is 17% and 25% in 2010 and 2009, respectively, and the Income Basic Tax Act should be also complied with. The differences between the expected income tax based on the pre-tax income at enacted income tax rates and the actual income tax expense reported in the statements of operations are summarized as follows:

	For the six months ended June 30,	
	2010	2009
Expected income tax expense based on the pre-tax income	\$ (8,701)	3,921
Effect of tax-exempt income and permanent difference	28	(1,463)
Increase in investment tax credits	-	(16,506)
Change in valuation allowance for deferred tax assets	14,829	14,945
Effect of income tax rate adjustment	8,051	7,864
Prior years' adjustment for estimation of deferred income tax assets	(414)	241
Income tax expense	<u>\$ 13,793</u>	<u>9,002</u>

- D. The components of deferred income tax assets as of June 30, 2010 and 2009, are summarized as follows:

	June 30,			
	2010		2009	
	<u>Amount</u>	<u>Income tax effect</u>	<u>Amount</u>	<u>Income tax effect</u>
Deferred tax assets—current:				
Allowance for bad debt	\$ 17,263	2,935	16,862	3,372
Allowance for inventory devaluation	43,682	7,426	75,927	15,186
Unrealized exchange loss	(226)	(38)	1,083	217
Investment tax credits	42,969	42,969	43,289	43,289
Operating loss carryforwards	32,653	5,551	-	-
		58,843		62,064
Less: valuation allowance		<u>(45,565)</u>		<u>(46,662)</u>
		<u>13,278</u>		<u>15,402</u>

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

	June 30,			
	2010		2009	
	<u>Amount</u>	<u>Income tax effect</u>	<u>Amount</u>	<u>Income tax effect</u>
Deferred tax assets—non-current:				
Accrued pension liabilities	\$ 3,360	571	3,811	762
Cumulative translation adjustment	2,473	420	2,473	495
Investment loss under equity method	78,644	13,369	78,644	15,729
Investment tax credits	105,369	105,369	133,408	133,408
Operating loss carryforwards	141,545	24,063	107,874	21,574
		143,792		171,968
Less: valuation allowance		(137,481)		(148,478)
		<u>\$ 6,311</u>		<u>23,490</u>
Total gross deferred tax assets		<u>\$ 202,673</u>		<u>234,032</u>
Total gross deferred tax liabilities		<u>\$ (38)</u>		<u>=</u>
Total valuation allowance		<u>\$(183,046)</u>		<u>(195,140)</u>

- E. The expenditure for research and development entitles the Company to tax credits according to the ROC Statute for Upgrading Industries. This credit may be applied over a period of five years, and the total amount of investment tax credits that can be utilized per year is limited to 50% of the year's current income tax payable. However, the foregoing limit does not apply to the last year of the investment tax credit's expiration period. As of June 30, 2010, the estimated unused investment tax credits and the related years of expiration were as follows:

<u>Year occurred</u>	<u>Total assessed or declared tax credits</u>	<u>Unused tax credits</u>	<u>Expiration year</u>
2006 (assessed)	\$ 43,308	42,969	2010
2007 (assessed)	38,379	38,379	2011
2008 (assessed)	33,535	33,535	2012
2009 (declared)	<u>33,455</u>	<u>33,455</u>	2013
	<u>\$ 148,677</u>	<u>148,338</u>	

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

- F. Pursuant to the ROC Income Tax Act as amended on January 21, 2009, unused net operating loss as assessed by the tax authorities that is allowed to be carried forward to offset future taxable income is extended from a period of 5 years to 10 years. As of June 30, 2010, the unused operating loss carryforwards were as described below:

<u>Year occurred</u>	<u>Total declared operating loss carryforwards</u>	<u>Operating loss carryforwards</u>	<u>Expiration year</u>
2007 (assessed)	\$ 3,345	1,214	2017
2008 (assessed)	113,603	113,603	2018
The six months ended June 30, 2010 (estimated)	<u>59,381</u>	<u>59,381</u>	2020
	\$ <u><u>176,329</u></u>	<u><u>174,198</u></u>	

As of June 30, 2010, the Company's income tax returns had been examined by the tax authorities through 2008.

For the Company's 2005 income tax return, the tax authorities had a different interpretation from the Company's and reduced the Company's income tax exemption amount by \$140,849 thousand, reduced the Company's investment tax credits amount by \$3,632 thousand, and assessed additional tax liability of \$15,606 thousand. The Company did not agree with the assessment and filed a tax appeal for the 2005 income tax return.

With respect to the aforementioned assessment, the Company has estimated related tax effects in the financial statements by applying the conservative principle in accounting.

- G. Information relating to the imputation credit account (ICA) is summarized as follows:

	(Unit: thousands of shares)	
	<u>June 30,</u>	
	<u>2010</u>	<u>2009</u>
Unappropriated retained earnings:		
Earned after June 30, 1998	\$ <u>(61,591)</u>	<u>6,680</u>
ICA balance	\$ <u>(1,266)</u>	<u>2,099</u>
	<u>2009</u>	<u>2008</u>
Creditable ratio for earnings distribution to resident stockholders	- (actual)	- (actual)

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

## (11) Earnings per share ("EPS")

Basic and diluted EPS for the six months ended June, 30, 2010 and 2009, were computed as follows:

	For the six months ended June 30,			
	2010		2009	
	Pre-tax	After-tax	Pre-tax	After-tax
Basic earnings per share:				
Net income (loss)	\$ <u>(51,182)</u>	<u>(64,975)</u>	<u>15,682</u>	<u>6,680</u>
Weighted-average common shares outstanding (thousands):				
Beginning balance (including capital collected in advance)	61,677	61,677	60,690	60,690
Add: Weighted-average common shares outstanding due to issuance of stock from exercise of stock options	413	413	152	152
Less: purchase of treasury stock	-	-	-	-
	<u>62,090</u>	<u>62,090</u>	<u>60,842</u>	<u>60,842</u>
Basic EPS (NT\$)	\$ <u>(0.82)</u>	<u>(1.05)</u>	<u>0.26</u>	<u>0.11</u>
Diluted earnings per share:				
Net income			\$ <u>15,682</u>	<u>6,680</u>
Weighted-average common shares outstanding (thousands)			60,842	60,842
Effects of potential common stock			<u>602</u>	<u>602</u>
			<u>61,444</u>	<u>61,444</u>
Diluted EPS (NT\$)			\$ <u>0.25</u>	<u>0.11</u>

Diluted earnings per share were not computed due to the anti-dilutive effect of losses for the six-month period ended June 30, 2010.

## (12) Financial instruments

## A. Derivative financial instruments

The Company engaged in derivative financial instruments as disclosed further in note 4(2).

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

B. The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- (a) If a published price quotation in an active market exists for a financial instrument, the quoted price is used to measure its fair value. If it does not exist, the fair value is measured by using a valuation technique. In applying valuation techniques, an entity uses estimates and assumptions that are consistent with the estimates and assumptions that market participants would use in setting a price for the financial instrument.
- (b) The short-term non-derivative financial instruments of the Company include notes and accounts receivable (including related parties), other financial assets – current, and notes and accounts payable. Their book value was used as their fair value at the balance sheet date because their carrying amounts approximate fair value as these instruments have short maturities.
- (c) Financial assets carried at cost: cost is adopted in measuring unlisted equity securities whose fair value cannot be reasonably estimated. The related information on financial instruments is disclosed further in note 4(2).

C. The details of fair value of financial assets and liabilities derived from quoted prices in an active market or an evaluation method are as follows:

	June 30,			
	2010		2009	
	Public quoted price	Evaluation method	Public quoted price	Evaluation method
Financial assets:				
Cash	\$ 692,566	-	740,976	-
Beneficiary certificates	-	-	-	-
Forward foreign currency exchange contracts	-	-	-	252
Notes and accounts receivable (including related parties)	-	82,159	-	84,919
Other financial assets – current	-	8,486	-	11,719
Restricted cash in bank	41,000	-	41,000	-
Other financial assets – non-current	-	8,046	-	11,046
Financial liabilities:				
Accounts payable	-	101,410	-	48,045
Forward foreign currency exchange contracts	-	115	-	-

(Continued)

**Solid State System Co., Ltd.**

**Notes to Financial Statements**

D. Financial risk information:

(a) Credit risk

The Company's potential credit risk is derived primarily from cash and notes and accounts receivable. The Company maintains its cash in various creditworthy financial institutions. The Company monitors its exposure with these financial institutions; therefore, the Company believes that there is no concentration of credit risk in cash.

The Company's sales revenue attributable to the clients accounting for over 10% of total sales was 76% and 75% as of June 30, 2010 and 2009, respectively. To reduce the concentration of credit risk, the Company continuously evaluates the credit status of its customers and the collectability of trade receivables, and provides an allowance for doubtful accounts applicable. It is management's belief that such concentration of credit risk is under control.

(b) Liquidity risk

There is no liquidity risk of being unable to raise capital to settle the contract obligations as the Company has sufficient capital and working capital to fulfill the contract obligations.

The Company entered into foreign exchange forward contracts to manage the foreign currency exchange risk of net foreign currency assets and net foreign currency liabilities. When they expire, the positive and negative cash flows are expected to offset each other. Therefore, the Company expects to have no significant risk of cash flow. Some of the investments of the Company are recognized as financial assets carried at cost, and they are expected to have liquidity risk owing to no active market.

**5. Transactions with Related Parties**

(1) Name and relationship of related parties

<u>Name of related party</u>	<u>Relationship with the Company</u>
Toshiba Corporation (Toshiba)	A member of the board of the Company
Fucion Media Tech Co., Ltd. (Fucion)	An investee which the Company accounted for under the equity method

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

## (2) Significant transactions with related parties

## A. Sales and accounts receivable

## (a) Sales

Net sales to related parties were as follows:

	<u>For the six months ended June 30,</u>			
	<u>2010</u>		<u>2009</u>	
	<u>Amount</u>	<u>Percentage of net sales (%)</u>	<u>Amount</u>	<u>Percentage of net sales (%)</u>
Toshiba	\$ 140,960	46	88,496	24
Fucion	482	-	334	-
	<u>\$ 141,442</u>	<u>46</u>	<u>88,830</u>	<u>24</u>

The accounts receivable resulting from sales to related parties were as follows:

	<u>June 30,</u>			
	<u>2010</u>		<u>2009</u>	
	<u>Amount</u>	<u>Percentage of total accounts receivable (%)</u>	<u>Amount</u>	<u>Percentage of total accounts receivable (%)</u>
Toshiba	\$ 9,083	11	18,709	22
Fucion	-	-	21	-
	<u>\$ 9,083</u>	<u>11</u>	<u>18,730</u>	<u>22</u>

The collection terms for sales to related parties were month-end 30 to 45 days; the prices of products sold to related parties were determined by the product specifications and the situation of market supply and demand, and there was no obvious difference from non-related parties.

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

## 6. Pledged Assets

<u>Pledged assets</u>	<u>Pledged to secure</u>	<u>June 30,</u>	
		<u>2010</u>	<u>2009</u>
Pledged time deposits	Guarantees for purchase (Faraday)	\$ 5,000	5,000
Pledged time deposits	Guarantees for purchase (UMC)	<u>36,000</u>	<u>36,000</u>
		<u>\$ 41,000</u>	<u>41,000</u>

## 7. Commitments and Contingencies

- (1) According to current leasing contracts for the offices, the minimum future rental payments are as below:

<u>Period</u>	<u>Amount</u>
2010.7.1~2010.12.31	\$ 4,965
2011.1.1~2011.7.31	<u>5,373</u>
	<u>\$ 10,338</u>

- (2) In accordance with the "digital MEMS microphone technological development plan," the Company entered into a project with the Ministry of Economic Affairs in 2008. Total funding amounted to \$38,200 thousand, \$12,730 thousand of which was subsidies from the Ministry of Economic Affairs. The project runs from April 1, 2008, through September 30, 2010. The knowledge, technology and intellectual property rights acquired during research and development (hereinafter referred to as "R&D efforts") belong to the Company. However, under certain circumstances, the Ministry of Economic Affairs may request the Company to grant the R&D efforts to a third party at no cost. For the six months ended June 30, 2010, government grant received by the Company was \$2,126 thousand, recorded as other income.
- (3) As of June 30, 2010, the Company had entered into technology licensing agreements with other companies to provide certain technology. The Company has not yet fulfilled the aforementioned agreements amounting to \$7,892 thousand.
- (4) The Company has licenses to use other companies' technology, which require monthly royalty payments based on sales volume.

(Continued)

## Solid State System Co., Ltd.

## Notes to Financial Statements

## 8. Others

The information on personnel expenses, depreciation and amortization by function is summarized as follows:

	For the six months ended June 30,					
	2010			2009		
	Cost of goods sold	Operating expenses	Total	Cost of goods sold	Operating expenses	Total
Personnel expenses						
Salary	\$ 845	78,458	79,303	1,368	68,063	69,431
Labor and health insurance	63	5,172	5,235	68	4,576	4,644
Pension	47	3,969	4,016	50	3,369	3,419
Others	32	2,727	2,759	46	2,425	2,471
Depreciation	-	2,050	2,050	25	1,820	1,845
Amortization	7,153	2,208	9,361	5,346	4,057	9,403

Note: For the six months ended June 30, 2010 and 2009, the depreciation of assets leased to others was recorded as other loss amounting to \$605 thousand and \$639 thousand, respectively.

## 9. Segment Information

The Company consists of a reportable operating segment, namely, the research, development, manufacture and sale of integrated circuits (ICs). In accordance with ROC SFAS No. 23, "Interim Financial Reporting," paragraph 25, no segment information is required to be disclosed in interim financial statements.