

ACER INCORPORATED AND SUBSIDIARIES
Consolidated Financial Statements
December 31, 2005 and 2006
(With Independent Auditors' Report Thereon)

Independent Auditors' Report

The Board of Directors
Acer Incorporated:

We have audited the consolidated balance sheets of Acer Incorporated (the "Company") and subsidiaries as of December 31, 2005 and 2006, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the "Regulations Governing Auditing and Certification of Financial Statements by Certified Public Accountants" in the Republic of China. Those standards and regulations require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 consolidated financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Acer Incorporated and subsidiaries as of December 31, 2005 and 2006, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the Republic of China.

Acer Incorporated and subsidiaries adopted Statement of Financial Accounting Standards ("SFAS") No. 35 "Impairment of Assets" starting from January 1, 2005. In addition, the Company and subsidiaries adopted SFAS No. 34 "Financial Instruments: Recognition and Measurement", SFAS No. 36 "Financial Instruments: Disclosure and Presentation" and the newly amended SFAS No. 1 "Conceptual Framework for Financial Accounting and Preparation of Financial Statements", and SFAS No. 5 "Long-term Investments under Equity Method" commencing from January 1, 2006. The effects of those accounting changes are discussed in note 3 to the consolidated financial statements.

The accompanying consolidated financial statements as of and for the year ended December 31, 2006, have been translated into United States dollars solely for the convenience of the readers. We have audited the translation, and in our opinion, the consolidated financial statements expressed in New Taiwan dollars have been translated into United States dollars on the basis set forth in note 2(u) of the notes to the consolidated financial statements.

Taipei, Taiwan (the Republic of China)
March 12, 2007

Note to Readers

The accompanying consolidated financial statements are intended 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 consolidated financial statements are those generally accepted and applied in the Republic of China.

ACER INCORPORATED AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2005 and 2006

(in thousands of New Taiwan dollars and US dollars)

Assets	2005 NT\$	2006 NT\$	2006 US\$	Liabilities and Stockholders' Equity	2005 NT\$	2006 NT\$	2006 US\$
Current assets:				Current liabilities:			
Cash and cash equivalents (note 4(1))	28,482,653	44,685,211	1,370,880	Short-term borrowings (notes 4(12) and 6)	3,400,617	7,629,178	234,053
Notes and accounts receivable, net of allowance for doubtful accounts of NT\$855,489 and NT\$677,092 as of December 31, 2005 and 2006, respectively (notes 4(2) and 6)	63,861,995	69,621,856	2,135,902	Current installments of long-term debt (notes 4(13) and 6)	42,238	28,377	871
Notes and accounts receivable from related parties (note 5)	6,040,397	940,950	28,867	Notes and accounts payable	64,779,336	65,591,958	2,012,270
Other receivable from related parties (note 5)	724,502	89,937	2,759	Notes and accounts payables to related parties (note 5)	8,598,247	824,288	25,288
Other receivables (note 10)	2,448,837	3,740,455	114,752	Financial liabilities at fair value through profit or loss (notes 4(4) and 4(18))	-	1,202,186	36,881
Financial assets at fair value through profit or loss-current (notes 4(4) and 4(18))	684,860	99,965	3,067	Other payables to related parties (note 5)	73,366	573,586	17,597
Available-for-sale financial assets—current (notes 4(3)(18) and 6)	6,160,138	13,805,760	423,542	Hedging purpose derivative financial liabilities—current (notes 4(4) and 4(18))	-	321,016	9,848
Hedging purpose derivative financial assets—current (notes 4(4) and 4(18))	66,062	66,541	2,041	Royalties payable	4,677,416	8,562,475	262,685
Inventories (notes 4(5) and 6)	29,055,723	25,941,852	795,860	Accrued expenses and other current liabilities (notes 4(9) and 4(15))	<u>20,587,381</u>	<u>25,237,396</u>	<u>774,248</u>
Prepaid expenses and other current assets	647,089	1,073,120	32,921	Total current liabilities	<u>102,158,601</u>	<u>109,970,460</u>	<u>3,373,741</u>
Deferred income tax assets—current (note 4(15))	1,051,878	972,714	29,842	Long-term liabilities:			
Pledged time deposits (note 6)	<u>18,426</u>	<u>229,300</u>	<u>7,035</u>	Long-term debt, excluding current installments (notes 4(13) and 6)	146,623	168,627	5,173
Total current assets	<u>139,242,560</u>	<u>161,267,661</u>	<u>4,947,468</u>	Other liabilities (note 4(14))	326,510	545,320	16,730
Funds and investments				Deferred income tax liabilities—noncurrent (note 4(15))	<u>1,700,757</u>	<u>2,260,108</u>	<u>69,337</u>
Long-term equity investments under equity method (notes 4(7) and 4(18))	13,299,186	6,613,462	202,892	Total long-term liabilities	<u>2,173,890</u>	<u>2,974,055</u>	<u>91,240</u>
Financial assets carried at cost (notes 4(6) and 4(18))	4,112,438	4,837,842	148,418	Total liabilities	<u>104,332,491</u>	<u>112,944,515</u>	<u>3,464,981</u>
Available-for-sale financial assets—noncurrent (notes 4(8) and 4(18))	<u>194,349</u>	<u>2,384,234</u>	<u>73,145</u>	Stockholders' equity and minority interest (notes 3 and 4(16))			
Total funds and investments	<u>17,605,973</u>	<u>13,835,538</u>	<u>424,455</u>	Common stock	22,545,187	23,370,637	716,979
Property, plant and equipment (note 6):				Capital surplus	30,552,133	29,947,020	918,733
Land	2,510,171	1,478,486	45,358	Retained earnings			
Buildings and improvements	6,687,113	3,842,966	117,897	Legal reserve	5,621,115	6,468,865	198,456
Computer equipment and machinery	3,444,609	2,609,649	80,060	Special reserve	2,017,819	283,921	8,710
Transportation equipment	128,246	134,293	4,120	Unappropriated earnings	8,484,278	11,531,479	353,769
Office equipment	767,100	946,829	29,047	Other stockholders' equity components	-	-	-
Leasehold improvement	334,426	397,339	12,190	Unrealized loss on long-term equity investments	(454)	-	-
Other equipment	806,958	686,227	21,053	Foreign currency translation adjustment	(226,806)	1,335,500	40,971
Construction in progress and advance payments for purchases of property and equipment	<u>142,396</u>	<u>12,390</u>	<u>380</u>	Unrealized gain on available-for-sale financial assets	-	4,374,388	134,200
	14,821,019	10,108,179	310,105	Hedging reserve	66,062	(12,780)	(392)
Less: accumulated depreciation	(4,600,862)	(3,660,678)	(112,305)	Treasury stock	<u>(3,270,920)</u>	<u>(3,270,920)</u>	<u>(100,347)</u>
accumulated asset impairment	<u>(752,000)</u>	<u>(257,000)</u>	<u>(7,884)</u>	Total stockholders' equity	65,788,414	74,028,110	2,271,079
Net property, plant and equipment	<u>9,468,157</u>	<u>6,190,501</u>	<u>189,916</u>	Minority interest	<u>1,461,037</u>	<u>1,527,673</u>	<u>46,867</u>
Intangible assets (note 4(10))	501,878	396,682	12,170	Total stockholders' equity and minority interest	67,249,451	75,555,783	2,317,946
Property not used in operations (notes 4(9) and 6)	3,478,937	4,896,809	150,227	Commitments and contingencies (notes 4(4), 5 and 7)			
Other financial assets (notes 4(11), 4(18) and 6)	988,033	1,294,344	39,709				
Deferred expenses and other assets (notes 4(14) and 4(15))	296,404	618,763	18,982				
Total assets	<u>171,581,942</u>	<u>188,500,298</u>	<u>5,782,927</u>	Total liabilities and stockholders' equity	<u>171,581,942</u>	<u>188,500,298</u>	<u>5,782,927</u>

See accompanying notes to consolidated financial statements.

ACER INCORPORATED AND SUBSIDIARIES

Consolidated Statements of Income

For the years ended December 31, 2005 and 2006

(in thousands of New Taiwan dollars and US dollars, except earnings per share data)

	2005 NT\$	2006 NT\$		2006 US\$
Revenues (note 5)	318,087,679	369,092,974		11,323,259
Cost of revenues (note 5)	<u>(283,966,218)</u>	<u>(330,194,293)</u>		<u>(10,129,902)</u>
Gross profit	<u>34,121,461</u>	<u>38,898,681</u>		<u>1,193,357</u>
Operating expenses (notes 5 and 10)				
Selling	(23,168,521)	(27,907,989)		(856,178)
Administrative	(2,866,287)	(2,793,833)		(85,711)
Research and development	<u>(437,692)</u>	<u>(384,829)</u>		<u>(11,806)</u>
Total operating expenses	<u>(26,472,500)</u>	<u>(31,086,651)</u>		<u>(953,695)</u>
Operating income	<u>7,648,961</u>	<u>7,812,030</u>		<u>239,662</u>
Non-operating income and gains:				
Interest income	402,634	948,250		29,091
Investment gain recognized by equity method (note 4(7))	-	427,803		13,124
Gain on disposal of property and equipment	46,605	97,011		2,976
Gain on disposal of investments, net (notes 4(3) and 4(7))	5,634,709	5,619,929		172,412
Foreign currency exchange gain, net	-	679,103		20,834
Other income (note 10)	<u>1,092,426</u>	<u>2,182,152</u>		<u>66,946</u>
	<u>7,176,374</u>	<u>9,954,248</u>		<u>305,383</u>
Non-operating expenses and loss:				
Interest expense	(385,293)	(547,191)		(16,787)
Investment loss recognized by equity method (note 4(7))	(42,179)	-		-
Other investment loss (notes 4(3), 4(6) and 4(8))	(2,294,293)	(545,868)		(16,746)
Foreign currency exchange loss, net	(69,393)	-		-
Financial liabilities revaluation loss (note 4(4))	-	(1,333,671)		(40,915)
Asset impairment loss (notes 3 and 4(9))	(805,000)	(995,000)		(30,525)
Other loss	<u>(576,645)</u>	<u>(554,522)</u>		<u>(17,013)</u>
	<u>(4,172,803)</u>	<u>(3,976,252)</u>		<u>(121,986)</u>
Income before income taxes	10,652,532	13,790,026		423,059
Income tax expense (note 4(15))	<u>(2,187,044)</u>	<u>(3,448,986)</u>		<u>(105,810)</u>
Consolidated net income	<u>8,465,488</u>	<u>10,341,040</u>		<u>317,249</u>
Net income attributable to:				
Shareholders of parent company	8,477,502	10,218,242		313,482
Minority shareholders	<u>(12,014)</u>	<u>122,798</u>		<u>3,767</u>
	<u>8,465,488</u>	<u>10,341,040</u>		<u>317,249</u>
	Before	After	Before	After
	income	income	income	income
	taxes	taxes	taxes	taxes
Earnings per common share (in dollars) (note 4(17)):	NT\$	NT\$	US\$	US\$
Basic earnings per common share — retroactively adjusted	<u>4.21</u>	<u>3.69</u>	<u>5.13</u>	<u>0.16</u>
	<u>4.45</u>	<u>0.14</u>		

See accompanying notes to consolidated financial statements.

ACER INCORPORATED AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
For the years ended December 31, 2005 and 2006
(in thousands of New Taiwan dollars)

	<u>Retained earnings</u>					Unrealized loss on long-term equity investments	Foreign currency translation adjustment	Unrealized gain on available-for-sale financial assets	Hedging reserve	Treasury stock	Minority interest	Total stockholders' equity
	Common stock	Capital surplus	Legal reserve	Special reserve	Unappropriated earnings							
Balance at January 1, 2005	\$ 20,933,677	30,541,968	4,919,949	1,261,851	7,029,767	(214,814)	132,516	-	(516,611)	(3,411,280)	1,540,696	62,217,719
2005 net income	-	-	-	-	8,477,502	-	-	-	-	-	(12,014)	8,465,488
Foreign currency translation adjustment	-	-	-	-	-	-	(359,322)	-	-	-	-	(359,322)
Change in fair values of financial instruments	-	-	-	-	-	-	-	-	582,673	-	-	582,673
Appropriation approved by the stockholders (note 4(16)):	-	-	-	-	-	-	-	-	-	-	-	-
Legal reserve	-	-	701,166	-	(701,166)	-	-	-	-	-	-	-
Stock dividends and employees' bonuses in stock	606,694	-	-	-	(606,694)	-	-	-	-	-	-	-
Special reserve	-	-	-	755,968	(755,968)	-	-	-	-	-	-	-
Capital surplus transferred to common stock	1,004,816	(1,004,816)	-	-	-	-	-	-	-	-	-	-
Cash dividends	-	-	-	-	(4,814,746)	-	-	-	-	-	-	(4,814,746)
Directors' and supervisors' remuneration	-	-	-	-	(55,545)	-	-	-	-	-	-	(55,545)
Employees' bonuses in cash	-	-	-	-	(88,872)	-	-	-	-	-	-	(88,872)
Change in unrealized loss on long-term equity investments	-	-	-	-	-	214,360	-	-	-	-	-	214,360
Cash dividends distributed to subsidiaries	-	68,318	-	-	-	-	-	-	-	-	-	68,318
Increase in capital surplus resulting from long-term equity investments accounted for by the equity method (note 4(7))	-	985,448	-	-	-	-	-	-	-	-	-	985,448
Disposal of treasury stock	-	(38,785)	-	-	-	-	-	-	-	140,360	-	101,575
Change in minority interest	-	-	-	-	-	-	-	-	-	-	(67,645)	(67,645)
Balance at December 31, 2005	<u>\$ 22,545,187</u>	<u>30,552,133</u>	<u>5,621,115</u>	<u>2,017,819</u>	<u>8,484,278</u>	<u>(454)</u>	<u>(226,806)</u>	<u>-</u>	<u>66,062</u>	<u>(3,270,920)</u>	<u>1,461,037</u>	<u>67,249,451</u>
Effect of adoption of Statement of Financial Accounting Standards No. 34 "Financial Instruments: Recognition and Measurement" starting from January 1, 2006 (note 3)	\$ -	-	-	-	-	-	-	4,503,791	-	-	-	4,503,791
2006 net income	-	-	-	-	10,218,242	-	-	-	-	-	122,798	10,341,040
Foreign currency translation adjustment	-	-	-	-	-	-	1,562,306	-	-	-	-	1,562,306
Change in fair values of financial instruments	-	-	-	-	-	-	-	-	(78,842)	-	-	(78,842)
Appropriation approved by the stockholders (note 4(16)):	-	-	-	-	-	-	-	-	-	-	-	-
Legal reserve	-	-	847,750	-	(847,750)	-	-	-	-	-	-	-
Stock dividends and employees' bonuses in stock	825,450	-	-	-	(825,450)	-	-	-	-	-	-	-
Special reserve	-	-	-	(1,733,898)	1,733,898	-	-	-	-	-	-	-
Cash dividends	-	-	-	-	(6,763,556)	-	-	-	-	-	-	(6,763,556)
Directors' and supervisors' remuneration	-	-	-	-	(93,637)	-	-	-	-	-	-	(93,637)
Employees' bonuses in cash	-	-	-	-	(374,546)	-	-	-	-	-	-	(374,546)
Change in unrealized loss on long-term equity investments	-	-	-	-	-	454	-	-	-	-	-	454
Cash dividends distributed to subsidiaries	-	93,240	-	-	-	-	-	-	-	-	-	93,240
Decrease in capital surplus resulting from long-term equity investments accounted for by the equity method (note 4(7))	-	(698,353)	-	-	-	-	-	-	-	-	-	(698,353)
Unrealized loss on available-for-sale financial assets	-	-	-	-	-	-	-	(129,403)	-	-	-	(129,403)
Change in minority interest	-	-	-	-	-	-	-	-	-	-	(56,162)	(56,162)
Balance at December 31, 2006	<u>\$ 23,370,637</u>	<u>29,947,020</u>	<u>6,468,865</u>	<u>283,921</u>	<u>11,531,479</u>	<u>-</u>	<u>1,335,500</u>	<u>4,374,388</u>	<u>(12,780)</u>	<u>(3,270,920)</u>	<u>1,527,673</u>	<u>75,555,783</u>

See accompanying notes to consolidated financial statements.

ACER INCORPORATED AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the years ended December 31, 2005 and 2006
(in thousands of New Taiwan dollars and US dollars)

	2005	2006	
	NT\$	NT\$	US\$
Cash flows from operating activities:			
Consolidated net income	8,465,488	10,341,040	317,249
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	976,348	841,138	25,805
Amortization	519,946	250,870	7,696
Loss on disposal of assets, net	(46,605)	(97,011)	(2,976)
Gain on disposal of investments, net	(5,634,709)	(5,619,929)	(172,412)
Net investment gain on long-term equity investments accounted for by equity method, net of cash dividends received	246,985	1,564,267	47,990
Other investment loss	2,294,293	545,868	16,746
Asset impairment loss	805,000	995,000	30,525
Gain on disposal of businesses and operations (note 10)	-	(1,504,945)	(46,170)
Allowance for doubtful advances to related parties	-	385,043	11,813
Deferred income tax expense	1,222,533	733,685	22,508
Changes in operating assets and liabilities:			
Notes and accounts receivable	(29,922,879)	(5,845,423)	(179,329)
Receivables from related parties	(4,353,425)	5,077,680	155,776
Inventories	(15,722,725)	3,421,113	104,955
Other financial assets, prepaid expenses and other current assets	(1,039,041)	258,683	7,936
Noncurrent receivable	(366,555)	6,454	198
Notes and accounts payable	41,186,404	820,928	25,185
Payables to related parties	5,317,805	(7,281,227)	(223,378)
Royalties payable, accrued expenses and other current liabilities	3,536,327	8,122,849	249,198
Other liabilities	(360,105)	218,810	6,713
Cash provided by operating activities	<u>7,125,085</u>	<u>13,234,893</u>	<u>406,028</u>
Cash flow from investing activities:			
Decrease (increase) in available-for-sale financial assets	11,958,174	(1,439,537)	(44,163)
Proceeds from sales of long-term investments	5,269,601	6,028,639	184,950
Increase in long-term investments	(304,205)	(44,366)	(1,361)
Return of capital from investees	294,835	294,501	9,035
Proceeds from disposal of businesses and operations (note 10)	-	1,379,364	42,317
Proceeds from disposal of property, plant and equipment and property not used in operations	3,248,469	1,339,539	41,095
Additions to property and equipment	(505,397)	(1,205,199)	(36,974)
Increase in intangible assets	(126,186)	(57,429)	(1,762)
Decrease in loans and advances to related parties	12,116	249,522	7,655
Decrease (increase) in refundable deposits, deferred expenses and other assets	16,064	(480,837)	(14,751)
Cash provided by investing activities	<u>19,863,471</u>	<u>6,064,197</u>	<u>186,041</u>
Cash flows from financing activities:			
Increase (decrease) in short-term borrowings	(1,781,443)	4,228,561	129,726
Disposal of treasury stock	90,288	-	-
Redemption of bonds payable	(6,000,000)	-	-
Increase (decrease) in long-term debt	(135,541)	8,143	250
Payment of cash dividends, employees' bonus, and directors' and supervisors' remuneration	(4,959,163)	(7,138,499)	(218,999)
Increase (decrease) in deposits received	(823,056)	-	-
Cash used in financing activities	<u>(13,608,915)</u>	<u>(2,901,795)</u>	<u>(89,023)</u>
Net increase in cash and cash equivalents	13,379,641	16,397,295	503,046
Effects of exchange rate changes	(583,693)	(194,737)	(5,974)
Cash and cash equivalents at beginning of year	<u>15,686,705</u>	<u>28,482,653</u>	<u>873,808</u>
Cash and cash equivalents at end of year	<u><u>28,482,653</u></u>	<u><u>44,685,211</u></u>	<u><u>1,370,880</u></u>
Supplemental disclosures of cash flow information			
Interest paid	<u>556,946</u>	<u>545,690</u>	<u>16,741</u>
Income taxes paid	<u>928,813</u>	<u>2,247,298</u>	<u>68,944</u>
Supplementary schedules of non-cash investing and financing activities:			
Change in foreign currency translation adjustment	<u>(359,322)</u>	<u>1,562,306</u>	<u>47,929</u>

See accompanying notes to consolidated financial statements.

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2005 and 2006

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

1. Reporting Entities of the Consolidated Financial Statements and Their Business Scopes

Acer Sertek Inc. (the “Company”) was incorporated on August 1, 1976, as a company limited by shares under the laws of the Republic of China (“ROC”). The Company was engaged in the marketing and sale of IT products and professional electronic services.

For the purpose of integrating resources, expanding business scale, and building up efficiency and competitiveness, the Company merged with Acer Incorporated (“AI”) on March 27, 2002, with the Company as the surviving entity from the merger but renaming itself Acer Incorporated. After the merger, the principal activities of the Company are those related to the sale and marketing of “Acer” brand-name IT products in foreign and domestic markets. Moreover, to promote E-commerce services, the Company provides E-commerce solutions to clients.

The reporting entities of the consolidated financial statements included the Company and its subsidiaries (hereinafter referred to collectively as the “Consolidated Companies”). For the purpose of preparing the consolidated financial statements, an entity is deemed a subsidiary if the Company is able to exercise control over its operations and financial policies. On December 31, 2005 and 2006, the number of employees of the Consolidated Companies was 6,554 and 5,964, respectively. The Consolidated Companies are summarized below according to their primary business activity.

(a) Sale and maintenance of “Acer” brand-name information technology products:

	<u>Investor</u>	Percentage of Ownership by the Company at December 31,	
		2005	2006
(1) Acer Incorporated			
(2) Acer Greater China (B.V.I.) Corp. (“AGC”, British Virgin Islands) and its subsidiaries	The Company	100.00	100.00
• Acer Market Services Limited (“AMS”, Hong Kong)	AGC	100.00	100.00
• Acer Computer (Far East) Limited (“AFE”, Hong Kong)	AGC	100.00	100.00
• Acer Information (Zhong Shan) Co., Ltd. (“AIZS”, China)	AMS	100.00	100.00
• Beijing Acer Information Co., Ltd. (“BJAI”, China)	AMS	100.00	100.00
• Acer Computer (Shanghai) Ltd. (“ACCN”, China)	AMS	100.00	100.00

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

	<u>Investor</u>	<u>Percentage of Ownership by the Company at December 31,</u>	
		<u>2005</u>	<u>2006</u>
(3) Acer European Holding N.V. (“AEH”, Netherlands The Company Antilles) and its subsidiaries		100.00	100.00
• Acer Europe B.V. (“AHN”, the Netherlands)	AEH	100.00	100.00
• Acer Computer B.V. (“ACH”, the Netherlands)	AEH	100.00	100.00
• Acer Computer France S.A.R.L. (“ACF”, France)	AHN	100.00	100.00
• Acer U.K. Limited (“AUK”, the United Kingdom)	AHN	100.00	100.00
• Acer Italy S.R.L. (“AIT”, Italy)	AHN	100.00	100.00
• Acer Computer GmbH (“ACG”, Germany)	AHN	100.00	100.00
• Acer AUSTRIA GmbH (“ACV”, Austria)	AHN	100.00	100.00
• Acer Europe Services S.R.L. (“AES”, Italy)	AHN	100.00	100.00
• Acer Europe AG (“AEG”, Switzerland)	AHN	100.00	100.00
• Acer Czech Republic S.R.O. (“ACZ”, Czech)	AHN	100.00	100.00
• ESPLEX Limited (“AEX”, the United Kingdom)	AHN	100.00	100.00
• Acer Computer Iberica, S.A. (“AIB”, Spain)	AHN	100.00	100.00
• Acer Computer (Switzerland) AG (“ASZ”, Switzerland)	AHN	100.00	100.00
• Acer Slovakia s.r.o. (“ASK”, Slovakia)	AHN	-	100.00
• Acer International Services GmbH (“AIS”, Switzerland)	AHN	-	100.00
• Acer Computer Norway AS (“ACN”, Norway)	ACH	100.00	100.00
• Acer Computer Finland Oy (“AFN”, Finland)	ACH	100.00	100.00
• Acer Computer Sweden AB (“ACW”, Sweden)	ACH	100.00	100.00
• Acer Denmark A/S (“ACD”, Denmark)	ACH	100.00	100.00
• Acer CIS Incorporated (“ACR”, British Virgin Islands)	AEH	100.00	100.00
• Acer Computer (M.E.) Limited (“AME”, British Virgin Islands) and its subsidiaries	AEH	100.00	100.00
• Acer Africa (Proprietary) Limited (“AAF”, South Africa)	AEH	100.00	100.00
(4) Boardwalk Capital Holding Limited (“Boardwalk”, The Company British Virgin Islands) and its subsidiaries		100.00	100.00
• Acer America Corporation (“AAC”, U.S.A.)	Boardwalk	100.00	100.00
• Acer Service Corporation (“ASC”, U.S.A.)	Boardwalk	-	100.00
• Acer Computer Mexico, S.A. de C.V. (“AMEX”, Mexico)	Boardwalk	99.89	99.89

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

	<u>Investor</u>	<u>Percentage of Ownership by the Company at December 31,</u>	
		<u>2005</u>	<u>2006</u>
• Acer Latin America, Inc. (“ALA”, U.S.A.)	Boardwalk	99.89	99.89
(5) Acer Holding International, Incorporated (“AHI”, British Virgin Islands) and its subsidiaries	The Company	100.00	100.00
• Acer Computer Co., Ltd. (“ATH”, Thailand)	AHI	100.00	100.00
• Acer Japan Corp. (“AJC”, Japan)	AHI	100.00	100.00
• Acer Computer Australia Pty. Limited (“ACA”, Australia)	AHI	100.00	100.00
• Acer Sales and Service Sdn. Bhd. (“ASSB”, Malaysia)	AHI	100.00	100.00
• Acer Computer (Singapore) Pte. Ltd. (“ACS”, Singapore)	AHI	100.00	100.00
• Acer Computer New Zealand Ltd. (“ACNZ”, New Zealand)	AHI	100.00	100.00
• PT Acer Indonesia (“AIN”, Indonesia)	AHI	100.00	100.00
• Acer India Private Limited (“AIL”, India)	AHI	100.00	100.00
• Acer Vietnam Co., Ltd. (“AVN”, Vietnam)	AHI	100.00	100.00
• Acer Philippines, Inc. (“APHI”, Philippines)	AHI	100.00	100.00
(6) Acer Computer International Ltd. (“ACI”, Singapore)	The Company	100.00	100.00
(7) Acer Sales & Distribution Ltd. (“ASD”, Hong Kong)	The Company	100.00	100.00
(b) Sales and distribution of computer products, electronic communication products, and integrated circuits:			
(1) Weblink International Inc. (“WII”, Taiwan)	The Company	99.79	99.79
(2) Sertek Incorporated (“SNX”, Taiwan)	The Company	100.00	100.00
(3) Digital Computer System Co., Ltd. (“DCS”, Taiwan)	The Company	100.00	100.00
(4) Weblink (H.K.) International Ltd. (“WHI”, Hong Kong)	WII	99.79	99.79
(5) Weblink Shanghai International Limited (“WSHI”, China)	WII	99.79	99.79
(6) Sertek Limited (“STKL, Hong Kong)	SNX	100.00	100.00
(7) Sertek (Shanghai) Limited (“STKS”), China)	SNX	100.00	100.00
(8) Servex (Malaysia) Sdn Bhd (“SMA”, Malaysia) and its subsidiaries	ASSSB	100.00	100.00
(9) Servex International (Thailand) Co., Ltd. (“STH”, Thailand)	ATH	100.00	100.00
(10) Logistron Services Ptd Ltd. (LGS, Singapore) and its subsidiaries	ACS	100.00	100.00

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(c) Research, design, manufacture and sale of memory modules and consumer electronic products:

	<u>Investor</u>	Percentage of Ownership by the Company at December 31,	
		2005	2006
(1) Apacer Technology Inc. (“AMT”, Taiwan)	The Company	53.95	53.95
(2) Apacer Electronic (Shanghai) Co., Ltd. (“AMC”, China)	AMT	53.95	53.95
(3) Apacer Memory America Inc. (“AMA”, U.S.A)	AMT	53.95	53.95
(4) Apacer Technology B.V. (“AMH”, the Netherlands)	AMT	53.95	53.95
(5) Apacer Technology Japan Corp. (“ATJ”, Japan)	AMT	53.95	53.95
(6) AQR Technology Inc. (“AQR”, Taiwan)	AMT	53.95	53.95
(7) Kingdom Corporation Limited (“AMK”, Hong Kong)	AMT	53.95	53.95

(d) Investing and holding companies:

(1) Multiventure Investment Inc. (“MVI”, Taiwan)	The Company	100.00	100.00
(2) Acer Digital Service Co. (“ADSC”, Taiwan)	The Company	100.00	100.00
(3) Acer Worldwide Incorporated (“AWI”, British Virgin Islands)	The Company	100.00	100.00
(4) Cross Century Investment Limited (“CCI”, Taiwan)	The Company	100.00	100.00
(5) Acer SoftCapital Incorporated. (“ASCBVI”, British Virgin Islands)	The Company	100.00	100.00
(6) Acer Venture Associates (“AVA”, Cayman Islands)	ASCBVI	100.00	100.00
(7) Acer Capital Limited (“ACBVI”, British Virgin Islands)	ASCBVI	100.00	100.00
(8) ASC Cayman, Limited (“ASCCAM”, Cayman Islands)	ASCBVI	100.00	100.00
(9) Acer Capital Corporation (“ACT”, Taiwan)	The Company	100.00	100.00
(10) Acer Technology Partners Fund (“ATPF”, Australia)	The Company	100.00	100.00
(11) Aspire Incubation Venture Capital (“AIVC”, Taiwan)	The Company	100.00	100.00
(12) Acer Digital Services (B.V.I.) Holding Corp. (“ADSBH”, British Virgin Islands)	The Company	100.00	100.00
(13) Acer Digital Services (Cayman Islands) Corp. (“ADSCC”, Cayman Islands)	ADSBH	100.00	100.00

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(e) Property development:

	<u>Investor</u>	Percentage of Ownership by the Company at December 31,	
		2005	2006
(1) Acer Property Development Inc. (“APDI”, Taiwan)	ADSC	100.00	100.00
(2) Aspire Service & Development Inc. (“ASDI”, Taiwan)	ADSC	100.00	100.00

(f) Internet, e-commerce, electronic data supply or processing service, data storage and processing:

(1) EB EASY Business Services Limited (“AGES”, Hong Kong)	ADSCC	85.00	85.00
(2) EB EASY (TWN) Corp. (“AGEST”, Taiwan)	AGES	85.00	85.00
(3) Acer Cyber Center Services Ltd. (“ACCSI”, Taiwan)	The Company	100.00	100.00
(4) Lottery Technology Service Corp. (“LTS”, Taiwan)	The Company	56.00	56.00
(5) Minly Corp. (“MINLY”, Taiwan)	The Company	100.00	100.00
(6) Taiwan ETC Service Corporation (“TESC”, Taiwan)	The Company	60.00	60.00

(g) Software research, development, design, trading and consultation:

(1) TWP Corporation (“TWP”, Taiwan)	The Company	100.00	100.00
(2) BRAVO Information Technology Co., Ltd. (“BIT”, Taiwan)	TWP	100.00	100.00
(3) Acer TWP Innovation Information Co. Ltd. (ATIM, Taiwan)	TWP	100.00	100.00
(4) TWP International Inc. (“TWP BVI”, British Virgin Islands)	TWP	100.00	100.00
(5) Acer Third Wave Software (Beijing) Co., Ltd. (“TWPBJ”, China)	TWPBVI	100.00	100.00
(6) TWP Game Zone (Beijing) Ltd. (“TWPGZ”, China)	TWPBVI	100.00	100.00

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)****2. Summary of Significant Accounting Policies****(a) Principles for preparation and presentation of consolidated financial statements**

The accompanying financial statements are prepared in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China (ROC). In preparing financial statements in conformity with these guidelines and principles, the Consolidated Companies are required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and revenues and expenses. Actual results could differ from these estimates. These consolidated financial statements are not intended to present the consolidated financial position of the Consolidated Companies and the related consolidated results of operations and consolidated cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than the ROC.

The financial statements of the Consolidated Companies have been prepared in the local currency and in Chinese. These financial statements have been translated into English. The translated information is consistent with the Chinese language financial statements from which it is derived.

The consolidated financial statements include the accounts of the Company and subsidiaries in which the Company is able to exercise control over the subsidiary's operations and financial policies. The operating activity of the subsidiary is included in the consolidated statement of income from the date of acquisition. All significant inter-company transactions among the Consolidated Companies are eliminated in consolidation.

(b) Foreign currency transactions and translations

The Consolidated Companies' functional and reporting currency is the New Taiwan dollar. Non-derivative foreign currency transactions are recorded at the exchange rates prevailing at the transaction date. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated using the exchange rates on the date. The resulting unrealized exchange income (loss) from such translations is reflected in the accompanying consolidated statements of income. In accordance with amended Statement of Financial Accounting Standards (SFAS) No. 14 "The Effects of Changes in Foreign Exchange Rates", commencing from January 1, 2006, 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. If the financial assets or liabilities are evaluated at fair value through profit or loss, non-monetary assets and liabilities are translated using the spot rate on the balance sheet date, and the resulting unrealized exchange income (loss) from such translations is reflected in the accompanying consolidated statements of income. If the financial assets or liabilities are evaluated at fair value through stockholders' equity, the resulting unrealized exchange income (loss) from such translations is recorded as a separate component of stockholders' equity.

In preparation of the consolidated financial statements, all foreign subsidiaries translate their foreign currency financial statements into the Company's reporting currency (New Taiwan dollars). Translation adjustments resulting from the translation of foreign currency financial statements into the Company's reporting currency, and from the translation of the Company's foreign currency loans to

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)**

its subsidiaries of a long-term investment nature are accounted for as translation adjustment, a separate component of stockholders' equity. If the foreign currency is not the functional currency of the subsidiary, the subsidiary's financial statements are remeasured into the functional currency prior to the translation into the Company's reporting currency. Any remeasurement differences are accounted for as exchange gains or losses in the accompanying consolidated statements of income.

(c) Classification criteria for current or non-current assets and liabilities

Cash and cash equivalents and assets held for trading purposes or held for the short term and expected to be liquidated within 12 months after the balance sheet date are recorded as current assets; other assets are recorded as non-current assets.

Liabilities estimated to be paid within 12 months after the balance sheet date are listed as current liabilities; other liabilities are recorded as non-current liabilities.

(d) Cash and cash equivalents

The Consolidated Companies' cash and cash equivalents consist of cash on hand, cash in banks, miscellaneous petty cash, and other highly liquid investments which do not have a significant level of market or credit risk from potential interest rate changes.

(e) Allowance for doubtful accounts

Allowance for doubtful accounts is provided based on the collectibility, aging and quality analysis of notes and accounts receivable.

(f) Inventories; land held for sale and development

Inventories are stated at the lower of cost or market value. For Acer brand name information technology business, costs of inventory are determined using the weighted-average method. For channel business, costs of inventory are determined using the first-in, first-out method. Market value represents net realizable value or replacement cost.

For property development business, land held for the purpose of development and future sale are recorded under "property not used in operation" and are stated at the lower of cost or market value. The market value of land is determined by independent appraisers.

(g) Financial instruments

The Consolidated Companies adopted SFAS No. 34 "Financial Instruments: Recognition and Measurement" commencing from January 1, 2006. Financial assets are classified into four categories: financial assets/liabilities at fair value through profit or loss; hedging purpose derivative financial assets/liabilities; available-for-sale financial assets; and financial assets carried at cost.

The Consolidated Companies adopted transaction-date accounting and settlement-date accounting for derivative financial instrument transactions and non-derivative financial instrument transactions, respectively. Upon initial recognition, financial instruments are evaluated at fair value. Except for

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)**

trading-purpose financial instruments, acquisition cost or issuance cost is added to the original recognized amount.

The financial instruments the Consolidated Companies held or issued are classified into the following categories in accordance with the purpose of holding or issuing after the initial recognition:

- (1) Financial assets at fair value through profit or loss: Except for the derivative financial instruments that the Consolidated Companies held for hedging purposes and are considered effective, all derivative financial instruments should be classified into this account.
- (2) Available-for-sale financial assets: These are evaluated at fair value, and any changes are recorded as a separate component of stockholders' equity. The fair value of publicly listed stocks is the closing price at the balance sheet date. The fair value of open-end mutual funds is based on the net asset value of the mutual funds at the balance sheet date. If there is evidence of impairment, impairment loss should be recognized. If the impairment losses decrease subsequently, the decreased amount of impairment for an investment in an equity instrument should be recorded as an adjustment of stockholders' equity.
- (3) Financial assets carried at cost: Equity investments which cannot be evaluated at fair value are booked at original cost. If there is evidence of impairment, impairment loss should be recognized, and the impairment amount cannot be reversed.

The investments of the Consolidated Companies as of December 31, 2005, are classified into short-term investments and long-term investments, in accordance with their holding purposes. Investments are accounted for at acquisition cost and are evaluated at the lower of cost or market value. The market value used for publicly listed stocks is the average closing price of the last month of the period. The market value of open-end mutual funds is based on the net asset value of the mutual funds at the balance sheet date. Devaluation loss on long-term investments is recorded under stockholders' equity. Devaluation loss on short-term investments is recorded in the accompanying consolidated statements of income.

(h) Derivative financial instruments and hedging activities

The purpose of hedging purpose derivative instruments is to hedge the risk of changes in exchange rates resulting from operating and financing activities denominated in foreign currency. When the derivative financial instruments do not meet the criteria for hedge accounting, they are accounted for under "financial assets/liabilities at fair value through profit or loss".

All derivative instruments are recorded on the balance sheet date at fair value. The accounting treatments of the changes in the fair values are as follows:

- (1) Fair value hedge: If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings in the current period.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)**

(2) Cash flow hedge: If the derivative is designated as a cash flow hedge, the effective portion of changes in the fair value of the derivative is recorded in shareholders' equity and is recognized in the statement of income when the hedged item affects earnings.

(i) Long-term equity investments

Long-term equity investments in which the Consolidated Companies, directly or indirectly, own 20% or more of the investee's voting shares, or less than 20% of the investee's voting shares but are able to exercise significant influence over the investee's operations and financial policies, are accounted for by the equity method. Differences between investment cost and net equity in investments prior to December 31, 2005, that cannot be attributed to any reason are amortized over five years as investment income or losses.

The Consolidated Companies adopted amended SFAS No. 5 "Long-term Investments under Equity Method" commencing from January 1, 2006. The investment cost in excess of net equity is recorded as goodwill. Differences between investment cost and net equity in the previous investments that cannot be attributed to any reason and were originally amortized over five years are no longer amortized starting from January 1, 2006.

The difference between the selling price and the book value of the long-term equity investments under the equity method is recognized as disposal gain or loss in the accompanying consolidated statements of income. If there are capital surplus and separate components of shareholders' equity resulting from long-term equity investments, they should be debited to disposal gain/loss based on the disposal ratio.

When investee companies issue common stock and the Consolidated Companies do not purchase the stock in accordance with their ownership holding ratio, the Consolidated Companies adjust their capital surplus based on the net changes in the capital surplus and long-term equity investment. If the capital surplus resulting from the equity method is insufficient, the deficiency is debited to retained earnings.

Unrealized gains and losses resulting from transactions between the Consolidated Companies and investees accounted for under the equity method are deferred. The gains and losses resulting from depreciated or amortized assets are recognized over their estimated useful lives. Gains and losses from other assets are recognized when realized.

(j) Leases

In accordance with the nature of the leasing agreement, accounting for capital lease or operating lease is used.

For capital leases, where the Consolidated Companies act as the lessor, the Consolidated Companies account for all installment rental receivables plus bargain purchase price or guaranteed residual value and their related imputed interest as lease receivables and recognize interest income thereon over the lease terms.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)**

Property leased to others under operating leases is classified as lease assets and stated at cost. The value of the assets is depreciated using the straight-line method over the estimated useful lives.

(k) Property and equipment, property leased to others, and property not used in operation

Property and equipment are stated at cost. Interest expense related to the purchase and construction of property and equipment is capitalized and included in the cost of the related asset. Significant additions, improvements and replacements are capitalized. Maintenance and repair costs are expensed in the period incurred. Gains and losses on the disposal of property and equipment are recorded in the non-operating section in the accompanying consolidated statements of income.

Property leased to others is classified as other assets. Property not in use is classified to other assets and stated at the lower of book value or net realizable value.

Depreciation is provided for property and equipment and property leased to others over the estimated useful life using the straight-line method. The estimated useful lives of the respective classes of assets are as follows:

1. Buildings and improvements: 20~50 years
2. Computer equipment and machinery: 3~5 years
3. Transportation equipment: 3~5 years
4. Office equipment: 3~5 years
5. Other equipment: 3~10 years
6. Leasehold improvement: 1~10 years

(l) Intangible assets

Intangible assets are stated at cost and primarily consist of goodwill and computer software obtained for internal use. Software costs are amortized using the straight-line method over three years, and goodwill previously was amortized using the straight-line method over five years. Commencing from January 1, 2006, the Consolidated Companies adopted SFAS No. 1 "Conceptual Framework for Financial Accounting and Preparation of Financial Statements", which resulted in ceasing the goodwill amortization. Starting from 2005, goodwill is also subject to impairment test at each balance sheet date.

(m) Deferred expenses

Deferred expenses are stated at cost and primarily consist of additions and improvements to office buildings. These costs are amortized using the straight-line method over their estimated useful lives.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)****(n) Asset impairment**

Effective January 1, 2005, the Consolidated Companies adopted SFAS No. 35 "Impairment of Asset". In accordance with SFAS No. 35, the Consolidated Companies assess 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 Consolidated Companies estimate the recoverable amount of the asset. The Consolidated Companies recognize impairment loss for an asset whose carrying value is higher than the recoverable amount. An impairment loss recognized in prior periods is reversed for assets other than goodwill if there is 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 assets assuming no impairment loss was recognized in prior periods.

The Consolidated Companies perform an impairment test on the cash-generating unit to which goodwill is allocated on an annual basis and recognize an impairment loss on the excess of carrying value over the recoverable amount.

(o) Revenue recognition

Revenue from sales of products is recognized at the time products are delivered and the significant risks and rewards of ownership are transferred to customers. Revenue generated from service is recognized when the service is provided and the amounts becomes billable currently. Revenue generated from property development is recognized when the development and construction have been completed and the property title has been transferred to the customer.

(p) Selling and administrative expenses

The Company's selling and administrative ("S&A") expenses include direct expenses incurred for the business unit within the Company, and expenses incurred for managing the investee companies.

To reflect the operating income of the Consolidated Companies, S&A expenses are divided into two parts. The first part, representing the direct expenses for the Consolidated Companies, is included as administrative expenses in the accompanying consolidated statements of income. The second part, representing expenses incurred for managing the investee companies of the Acer Group, is presented as a reduction of net investment income (loss) in the consolidated statements of income.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)**

(q) Retirement plan

(1) Defined benefit retirement plans

The Company and its domestic subsidiaries established individual noncontributory defined benefit retirement plans (the "Plans") and retirement fund administration committees. The Plans provide for lump-sum retirement benefits to retiring employees based on length of service, age, and certain other factors. In accordance with the requirements of the ROC Labor Standards Law, the funding of retirement plans by the Company and its domestic subsidiaries are based on a percentage of employees' total salaries.

Under the defined benefit retirement plan, the Consolidated Companies recognize a minimum pension liability equal to the amount by which the actuarial present value of the accumulated benefit obligation exceeds the fair value of the retirement plan's assets. The Consolidated Companies also recognize the net periodic pension cost using actuarial techniques.

(2) Defined contribution retirement plans

Starting from July 1, 2005, in accordance with the enforcement rules of the newly enacted Labor Pension Act (the "New Act"), the Company and its domestic subsidiaries contribute monthly an amount equal to 6% of the employee's monthly salaries to an individual labor pension fund account of the following categories of employees:

- (i) employees who originally adopted the Plans and opted to be subject to the pension mechanism under the New Act; or
- (ii) employees who commenced working after the enforcement date of the New Act.

Certain of the Company's foreign subsidiaries adopt defined contribution retirement plans. These plans are funded in accordance with the regulations of their respective countries. Contributions to defined contribution retirement plans are expensed as incurred.

(r) Income taxes

Income taxes are accounted for under the asset and liability method. Deferred income tax is 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 income 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 asset will not realized, a valuation allowance is recognized accordingly.

Classification of the deferred income tax assets or liabilities as current or noncurrent 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.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)**

Income tax is reduced by investment tax credits in the year when the credit arises.

According to the ROC Income Tax Act, the Company's undistributed earnings, if any, earned after December 31, 1997, are subject to an additional 10% retained earnings tax. The surtax is accounted for as income tax expense in the following year when the stockholders decide not to distribute the earnings.

(s) Treasury stock

Treasury stock is accounted for at acquisition cost. Upon disposal of the treasury stock, the sale proceeds in excess of cost is accounted for as capital surplus—treasury stock. If the sale proceeds are less than cost, the deficiency is accounted for as a reduction of the remaining balance of capital surplus—treasury stock. If the remaining balance of capital surplus—treasury stock is insufficient to cover the deficiency, the remainder is recorded as a reduction of retained earnings. The cost of treasury stock is computed using the weighted-average method. Cash dividends paid by the Company to its consolidated subsidiaries that hold the treasury stock are also accounted for as capital surplus—treasury stock.

If treasury stock is retired, the weighted-average cost of the retired treasury stock is written off to offset the par value and the capital surplus premium, if any, of the stock retired. If the weighted-average cost written off exceeds the sum of both the par value and the capital surplus premium, the difference is accounted for as a reduction of capital surplus—treasury stock, or a reduction of retained earnings for any deficiency where capital surplus—treasury stock is insufficient to cover the difference. If the weighted-average cost written off is less than the sum of both the par value and capital surplus premium, if any, of the stock retired, the difference is accounted for as an increase in capital surplus—treasury stock.

In accordance with SFAS No. 30 “Accounting for Treasury Stock”, the Company's common stock held by its subsidiaries is considered as the Company's treasury stock. Cash dividends paid by the Company to its consolidated subsidiaries that hold the treasury stock are accounted for as capital surplus-treasury stock.

(t) Earnings per common share

Basic earnings per common share are based on net income divided by the weighted-average number of outstanding common shares. The increase in the number of outstanding shares through distribution of stock dividends from retained earnings or capital surplus is included in the outstanding shares retroactively.

(u) Convenience translation into U.S. dollars

The consolidated financial statements are stated in New Taiwan dollars. Translations of the 2006 New Taiwan dollar amount financial statement into U.S. dollar amounts, using the spot rate on December 31, 2006, of NT\$32.596 to US\$1, is included solely for the convenience of the readers. The convenience translations should not be construed as representations that the New Taiwan dollar

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

3. Changes in Accounting Policies

The Consolidated Companies adopted ROC SFAS No. 34 “Financial Instruments: Recognition and Measurement”, SFAS No. 36 “Financial Instruments: Disclosure and Presentation”, amended SFAS No. 1 “Conceptual Framework for Financial Accounting and Preparation of Financial Statements”, and SFAS No. 5 “Long-term Investments under Equity Method” starting from January 1, 2006. The above-mentioned changes in accounting policies increased net income by NT\$344,812 and basic earnings per common share by NT\$0.15 as a result of the ceasing of amortization of goodwill and the differences between investment cost and net equity in the previous investments that cannot be attributed to any reason. In addition, available-for-sale financial assets were measured at fair value and reclassified; therefore, an unrealized gain of NT\$4,503,791 on available-for-sale financial assets was recorded under stockholders’ equity as of January 1, 2006, and there was no impact on net income and earnings per common share in 2006.

The Consolidated Companies adopted ROC SFAS No. 35 “Impairment of Assets” in 2005. After performing an impairment test, the Consolidated Companies recognized an impairment loss amounting to \$805,000 for property and equipment and property not used in operation. The adoption of this new accounting policy decreased net income by NT\$805,000 and basic earnings per common share by NT\$0.35 in 2005.

4. Significant Account Disclosures

(1) Cash and cash equivalents

	December 31, 2005	December 31, 2006	
	NT\$	NT\$	US\$
Cash on hand	2,741,698	593,543	18,209
Saving and checking accounts	19,229,592	13,793,434	423,163
Time deposits	6,278,692	30,048,234	921,838
Investments in redeemable government bonds	<u>232,671</u>	<u>250,000</u>	<u>7,670</u>
	<u>28,482,653</u>	<u>44,685,211</u>	<u>1,370,880</u>

(2) Notes and accounts receivable

	December 31, 2005	December 31, 2006	
	NT\$	NT\$	US\$
Notes and accounts receivable	64,717,484	70,298,948	2,156,674
Allowance for doubtful accounts	<u>(855,489)</u>	<u>(677,092)</u>	<u>(20,772)</u>
	<u>63,861,995</u>	<u>69,621,856</u>	<u>2,135,902</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

In 2005 and 2006, the Consolidated Companies sold raw materials to Taiwan ODMs or their foreign subsidiaries and purchased the finished goods after being processed by them. To avoid overstating the revenues, sales of raw materials to ODMs amounting to NT\$103,324,407 and NT\$142,437,007 for the years ended December 31, 2005 and 2006, respectively, were excluded from the consolidated revenues. However, the outstanding receivables and payables resulting from the above-mentioned transactions cannot be offset due to the lack of legally enforceable rights. As of December 31, 2005 and 2006, the related accounts receivable and payable amounted to NT\$16,171,226 and NT\$6,636,014, respectively.

As of December 31, 2005 and 2006, the factored accounts receivable which conformed to the derecognition criteria were as follows:

December 31, 2005							
Buyer	Factored amount	Factoring credit limit	Advance amount	Interest rate	Collateral	Important derecognition clause	Derecognized amount
China Trust Bank	\$ 538,422	1,500,000	538,422		-	without recourse	538,422
HSBC Bank	582,336	985,050	582,336		-	"	582,336
Ifitalia Factor S.P.A.	<u>5,526,212</u>	<u>8,431,800</u>	<u>5,526,212</u>		-	"	<u>5,526,212</u>
	<u>\$ 6,646,970</u>	<u>10,916,850</u>	<u>6,646,970</u>	<u>0.20%~5.29%</u>			<u>6,646,970</u>
December 31, 2006							
Buyer	Factored amount	Factoring credit limit	Advance amount	Interest rate	Collateral	Important derecognition clause	Derecognized amount
China Trust Bank	\$ 373,126	1,800,000	373,126		-	without recourse	373,126
Taishin Bank	2,375,314	5,923,620	2,137,782		Promissory note	"	2,137,782
Taishin Bank	118,520	945,284	105,889		"	"	105,889
La Caixa Bank	2,529,983	2,430,828	2,066,119		-	"	2,066,119
HSBC Bank	1,200,649	2,444,700	1,200,649		-	"	1,200,649
Standard Chartered Bank	368,227	977,880	368,227		-	"	368,227
Emirates Bank	141,075	162,980	141,075		-	"	141,075
ABN AMRO Bank	1,727,016	4,302,000	1,727,016		-	"	1,727,016
Ifitalia Factor S.P.A.	<u>7,359,395</u>	<u>11,379,716</u>	<u>4,273,802</u>		-	"	<u>4,273,802</u>
	<u>\$ 16,193,305</u>	<u>30,367,008</u>	<u>12,393,685</u>	<u>1.53%~6.02%</u>			<u>12,393,685</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(3) Available-for-sale financial assets—current

	December 31, 2005	December 31, 2006	
	NT\$	NT\$	US\$
Equity securities	2,932,665	5,301,377	162,639
Mutual funds	<u>3,227,473</u>	<u>8,504,383</u>	<u>260,903</u>
	<u>6,160,138</u>	<u>13,805,760</u>	<u>423,542</u>

In 2005 and 2006, the Consolidated Companies disposed of portions of these investments and recognized gains on disposal thereon of NT\$3,430,745 and NT\$2,601,934, respectively. The gains were recorded as “gain on disposal of investments” in the accompanying consolidated statements of income.

In 2005, the Consolidated Companies recognized a decline in value of part of their equity securities amounting to NT\$1,470,051 as the fair value of such equity securities has been continually decreased to some extent and for some period. The losses were recorded as “other investment losses” in the accompanying consolidated statements of income.

Following the interpretation of the ROC Accounting Research Foundation, the Consolidated Companies reclassified their 2005 financial statements in accordance with SFAS No. 34. As of December 31, 2005, investments originally accounted for under the cost or lower-of-cost-or-market methods amounting to NT\$6,160,138 were reclassified as available-for-sale financial assets—current.

(4) Derivative financial instruments and hedging activities

(a) As of December 31, 2005 and 2006, the fair values of the derivative financial instruments held by the Consolidated Companies were as follows:

	December 31, 2005	December 31, 2006	
	NT\$	NT\$	US\$
Foreign currency options	90,336	(41,082)	(1,260)
Foreign currency forward contracts	<u>660,586</u>	<u>(1,315,614)</u>	<u>(40,361)</u>
	<u>750,922</u>	<u>(1,356,696)</u>	<u>(41,621)</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(b) The derivative financial instruments described above were accounted for under the following accounts:

	December 31, 2005 NT\$	December 31, 2006 NT\$	US\$
Financial assets at fair value through profit or loss — current	<u>684,860</u>	<u>99,965</u>	<u>3,067</u>
Hedging purpose derivative financial assets — current	<u>66,062</u>	<u>66,541</u>	<u>2,041</u>
Financial liabilities at fair value through profit or loss — current	<u>-</u>	<u>(1,202,186)</u>	<u>(36,881)</u>
Hedging purpose derivative financial liabilities — current	<u>-</u>	<u>(321,016)</u>	<u>(9,848)</u>

The Consolidated Companies entered into the above-mentioned derivative financial instruments primarily for the purpose of hedging exchange risk associated with the assets, liabilities, or commitments denominated in foreign currencies. The financial instruments that are not designated as hedging instruments are classified under “financial assets at fair value through profit or loss — current” and “financial liabilities at fair value through profit or loss — current”.

(c) The details of the Consolidated Companies’ derivative financial instruments described above were as follows:

(i) Foreign currency options:

A. Long options:

	December 31, 2005		
	Notional amount (in thousands)	Maturity date	
USD CALL/EUR PUT	EUR 33,586	01/26/2006~02/28/2006	
EUR CALL/GBP PUT	EUR 12,500	01/16/2006~02/15/2006	
USD CALL/AUD PUT	AUD 115,750	01/04/2006~04/26/2006	
	December 31, 2006		
	Notional amount (in thousands)	Maturity date	
USD CALL/EUR PUT	USD 50,854	01/31/2007~02/28/2007	
EUR CALL/GBP PUT	EUR 3,000	02/26/2007	

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

B. Short options

	December 31, 2005	
	Notional amount (in thousands)	Maturity date
EUR CALL/USD PUT	EUR 35,644	01/26/2006~02/28/2006
GBP CALL/EUR PUT	EUR 12,500	01/16/2006~02/15/2006
AUD CALL/USD PUT	AUD 115,750	01/04/2006~04/26/2006

	December 31, 2006	
	Notional amount (in thousands)	Maturity date
EUR CALL/USD PUT	USD 50,854	01/31/2007~02/28/2007
GBP CALL/EUR PUT	EUR 3,000	02/26/2007

(ii) Foreign currency forward contracts:

As of December 31, 2005 and 2006, the Consolidated Companies had the following forward contracts outstanding:

	December 31, 2005	
	Notional amount (in thousands)	Contract period
EUR/CHF	EUR 31,000	01/30/2006~05/22/2006
EUR/GBP	EUR 74,500	01/16/2006~03/31/2006
USD/EUR	USD 202,000	01/31/2006~04/13/2006
USD/EUR	EUR 815,000	01/26/2006~04/28/2006
USD/MYR	USD 9,238	01/15/2006~04/07/2006
USD/INR	USD 22,414	01/31/2006~03/31/2006
USD/CAD	USD 77,500	01/13/2006~04/13/2006
USD/THB	USD 34,000	01/17/2006~03/29/2006
AUD/NZD	NZD 8,000	01/24/2006~02/23/2006
USD/JPY	USD 5,000	02/27/2006~04/04/2006

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

	December 31, 2006	
	Notional amount (in thousands)	Contract period
EUR/CHF	EUR 26,000	02/05/2007~04/13/2007
EUR/DKK	EUR 28,363	01/15/2007~02/15/2007
EUR/GBP	EUR 147,000	01/15/2007~03/30/2007
EUR/NOK	EUR 21,000	01/15/2007~03/15/2007
EUR/SEK	EUR 26,672	01/15/2007~03/15/2007
USD/NTD	USD 1,000	01/08/2007
USD/CAD	USD 64,884	01/12/2007~02/27/2007
USD/EUR	EUR 1,036,000	01/16/2007~05/31/2007
USD/EUR	USD 264,500	01/16/2007~05/31/2007
USD/INR	USD 19,000	01/31/2007~03/31/2007
USD/MYR	USD 22,060	01/12/2007~02/15/2007
USD/NZD	USD 4,500	01/18/2007~03/16/2007
USD/THB	USD 34,000	01/12/2007~02/27/2007
USD/JPY	USD 6,000	01/12/2007~03/16/2007
USD/PHP	USD 1,100	01/30/2007
USD/MXN	USD 24,000	01/16/2007~04/30/2007
USD/AUD	USD 65,617	01/18/2007~04/30/2007
CNY/USD	USD 18,000	01/12/2007~02/15/2007
USD/ZAR	USD 24,000	01/02/2007~01/16/2007
USD/SGD	USD 4,000	01/31/2007

(d) Hedge accounting:

(i) Fair value hedging

The Consolidated Companies entered into foreign currency forward contracts and foreign currency options to hedge exchange risk resulting from assets and liabilities denominated in foreign currency which the Consolidated Companies assessed to be significant. As of December 31, 2006, the fair value hedged item and derivative financial hedging instruments were as follows:

Hedged item	Hedging instruments	Fair value of assigned hedging instruments
Exchange rate of accounts receivable/payable	Foreign currency forward contracts and foreign currency options	NT\$ <u>(241,695)</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(ii) Cash flow hedging

The Consolidated Companies entered into foreign currency forward contracts and foreign currency options to hedge exchange risk associated with cash flows resulting from anticipated transactions in foreign currency. The Consolidated Companies evaluated the risk as significant.

As of December 31, 2005, the cash flow hedged item and derivative financial hedging instruments were as follows:

Hedging item	Hedging instruments	Fair value of assigned hedging instruments	Period of generating cash flow	Period of related gain or loss recognized in income statement
Exchange rate of future accounts receivable/ payable	Foreign currency forward contracts and foreign currency options	NT\$ <u>66,062</u>	2006/01~ 2006/03	2006/01~ 2006/03

As of December 31, 2006, the cash flow hedged item and derivative financial hedging instruments were as follows:

Hedging item	Hedging instruments	Fair value of assigned hedging instruments	Period of generating cash flow	Period of related gain or loss recognized in income statement
Exchange rate of future accounts receivable/ payable	Foreign currency forward contracts and foreign currency options	NT\$ <u>(12,780)</u>	2007/01~ 2007/03	2007/01~ 2007/03

(5) Inventories

	December 31, 2005	December 31, 2006	
	NT\$	NT\$	US\$
Raw materials	5,320,857	6,288,997	192,938
Work in process	58,405	51,494	1,580
Finished goods	11,255,880	9,889,920	303,409
Spare parts	2,313,856	2,821,408	86,557
Inventories in transit	12,017,220	9,074,810	278,402
Construction in process	42,515	-	-
Less: provision for obsolescence	<u>(1,953,010)</u>	<u>(2,184,777)</u>	<u>(67,026)</u>
	<u>29,055,723</u>	<u>25,941,852</u>	<u>795,860</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(6) Financial assets carried at cost — noncurrent

	December 31, 2005		2005
	Percentage of	Book value	Investment
	ownership	NT\$	income (loss)
	%		NT\$
Privately held stock:			
Gravel Advance Technology Ltd.	4.00	-	(23,000)
National Securities Corp.	9.24	12,188	(37,813)
Prosperity Venture Capital Corp	9.76	72,000	(8,000)
Sheng-Hua Venture Capital Corp	10.00	200,000	-
Legend Technology	10.13	56,000	-
Taiwan Fixed Network Co., Ltd.	3.25	2,100,000	-
W.I. Harper International Corp.	7.00	29,400	(21,000)
China Development Technology Co., Ltd.	7.04	30,000	-
Yam Digital Technology Co., Ltd.	5.00	-	(33,000)
Megic Corp.	1.49	36,200	-
InCOMM Technologies Co., Ltd.	10.00	20,850	-
Shanghai Kingstar Media Co., Ltd.	12.97	30,087	-
IP Fund II	19.84	108,000	-
Dragon Investment Co. Ltd.	19.94	323,000	-
World Venture, Inc.	19.35	300,000	-
iD Reengineering Inc.	19.99	119,940	-
DYNA Fund	8.87	-	(22,736)
DYNA Fund II	3.18	29,058	(22,500)
E2 Open LLC	6.91	-	(54,648)
IP Fund III	20.00	197,568	-
GE Fund	4.97	46,076	-
Harmonix Music System	3.72	32,260	-
Origin Partners	4.07	-	(51,730)
Routefree	7.91	197,010	-
Sino Century VC	15.00	-	(48,306)
iD5 Fund LTP	19.40	113,314	(36,070)
Ven Global Capital International Fund	11.30	-	(47,353)
Yesmobile Technology Holding	5.09	-	(38,645)
Other		<u>59,487</u>	<u>(60,904)</u>
Total		<u>4,112,438</u>	<u>(505,705)</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

	December 31, 2006		2006
	Percentage of ownership %	Book value NT\$	Investment income (loss) NT\$
Privately held stock:			
National Securities Corp.	9.24	12,188	-
Prosperity Venture Capital Corp.	9.76	72,000	-
Sheng-Hua Venture Capital Corp.	10.00	50,000	-
Legend Technology	10.13	39,200	-
Taiwan Fixed Network Co., Ltd. ("TFNC")	3.25	1,743,000	(357,000)
W.I. Harper International Corp.	7.00	26,250	-
Megic Corp.	2.90	647	-
InCOMM Technologies Co., Ltd.	8.70	7,080	(13,770)
IP Fund II	19.82	32,400	-
Dragon Investment Co. Ltd.	19.94	323,000	-
World Venture, Inc.	19.35	300,000	-
iD Reengineering Inc.	19.99	119,940	-
DYNA Fund II	3.18	20,982	-
IP Fund III	19.99	196,130	-
GE Fund	4.97	45,741	-
Routefree	-	-	(156,192)
iD5 Fund LTP	19.40	86,833	-
IP Cathay One, L.P.	8.14	65,192	-
IP Fund One L.P.	25.30	1,632,438	-
Other		<u>64,821</u>	<u>(18,906)</u>
Total		<u>4,837,842</u>	<u>(545,868)</u>

In 2005, the Consolidated Companies sold portions of their investments in JCI, Seek Communication and other investees, and an aggregate gain of NT\$188,120 was recognized from these sales. In 2006, the Consolidated Companies sold portions of their investments in Harmonix Music System, CDIB and other investees, and an aggregate gain of NT\$183,306 was recognized from these sales. In 2005, Legend Technology and other investees decreased capital and refunded NT\$24,000 and NT\$13,552, respectively, to the Consolidated Companies. In 2006, Legend Technology, IP Fund II, Sheng-Hua Venture Capital and other investees decreased capital and refunded NT\$16,800, NT\$75,600, NT\$150,000, and NT\$3,150, respectively, to the Consolidated Companies.

The Consolidated Companies recognized an impairment loss on financial assets carried at cost. The impaired amounts amounting to NT\$505,705 and NT\$545,868 for the years ended December 31, 2005 and 2006, respectively, were recorded as "other investment losses" in the accompanying consolidated statements of income.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(7) Long-term equity investments under equity method

	December 31, 2005		2005
	Percentage of	Book value	Investment
	ownership	NT\$	income (loss)
	%		NT\$
Wistron Corporation (“Wistron”)	23.40	6,075,929	1,188,970
BenQ Corporation (“BenQ”)	7.18	3,319,771	(543,595)
IP Fund One, L.P.	33.67	1,797,327	(252,864)
e-Life Mall Corp.	22.41	642,026	(11,057)
Aegis Semiconductor Technology Inc.	44.03	267,832	(145,240)
HiTRUST.Com Inc.	31.56	960,838	107,003
Hontang Venture Capital Co., Ltd.	24.48	109,186	(21,682)
Tornado.Com	29.51	-	(28,595)
ECOM Software Inc.	33.93	35,826	407
Acer eCard Service Inc.	19.42	-	(18,725)
Hyperemia Tech. Co., Ltd.	30.22	8,009	(86)
Spring House Technology Entertainment Inc.	28.65	11,274	1,280
The Eslite Bookstore	17.78	382,727	(113,553)
Bluechip Infotech Pty Ltd.	43.41	60,187	(3,303)
Kbest Technology Inc.	40.01	(1,572)	(49,470)
Other		(313,296)	715
Deferred credits		(56,878)	61,613
		<u>13,299,186</u>	171,818
Less: Allocation of corporate expense			<u>(213,997)</u>
			<u>(42,179)</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

	December 31, 2006		2006
	Percentage of	Book value	Investment
	ownership	NT\$	income (loss)
	%		NT\$
Wistron Corporation	14.85	4,388,572	923,204
BenQ Corporation	-	-	(480,304)
e-Life Mall Corp.	21.96	660,038	107,137
Aegis Semiconductor Technology Inc.	44.04	107,461	(102,597)
HiTRUST.Com Inc.	46.42	919,598	(13,289)
Hontang Venture Capital Co., Ltd.	24.48	62,250	663
ECOM Software Inc.	26.47	43,498	7,673
Hyperemia Tech. Co., Ltd	30.22	10,949	2,940
The Eslite Bookstore	17.77	401,691	35,903
Bluechip Infotech Pty Ltd.	43.41	68,688	4,445
Other		(34,591)	(8,303)
Deferred credits		(14,692)	55,217
		<u>6,613,462</u>	<u>532,689</u>
Less: Allocation of corporate expense			<u>(104,886)</u>
			<u>427,803</u>

Deferred credits of long-term equity investments represent the unamortized balance of deferred gains and losses derived from the sale of equity investment among the affiliated companies.

Commencing from June 30, 2006, the Consolidated Companies had no significant influence over BenQ, and as a result, the long-term equity investments in BenQ were reclassified as “available-for-sale financial assets – noncurrent”.

In 2005, the Consolidated Companies sold portions of their investments in Wistron and other investees, and an aggregate gain of NT\$1,947,090 was recognized from these sales. In 2006, the Consolidated Companies sold portions of their investments in Wistron, BenQ and other investees, and an aggregate gain of NT\$2,736,565 was recognized from these sales.

In 2005, AVBVI, IP Fund One and other investees decreased capital and refunded NT\$126,935, NT\$117,907 and NT\$12,441, respectively, to the Consolidated Companies. In 2006, Hontang Venture Capital decreased capital and refunded NT\$48,951 to the Consolidated Companies.

The Consolidated Companies increased their capital surplus by NT\$985,448 in 2005 and decreased their capital surplus by NT\$698,363 in 2006 for the following reasons: GDRs issued by their investees for which the Consolidated Companies did not subscribe in proportion to their respective ownership percentage, stock dividends distributed to employees as bonuses, investees’ convertible bonds converted into common stock, additional common stock issued to investees’ employees due to the exercise of employee stock options, and sale of stock of investee companies.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

Following the interpretation of the ROC Accounting Research and Development Foundation, the Consolidated Companies reclassified their 2005 financial statements in accordance with SFAS No. 34. As of December 31, 2005, investments originally accounted for under the cost or lower-of-cost-or-market methods amounting to NT\$194,349 were reclassified as available-for-sale-financial assets—noncurrent, and investments originally accounted for under the cost method amounting to NT\$4,112,438 were reclassified as financial assets carried at cost—noncurrent.

(8) Available-for-sale financial assets—noncurrent

	December 31, 2005		2005
	Percentage of ownership	Book value	Investment
	%	NT\$	income (loss) NT\$
Publicly traded stock:			
Granal Tech C.G. Systems Inc. (“Granal Tech”)	8.08	26,276	-
RDC Semiconductor Co., Ltd. (“RDC”)	9.05	67,220	-
Interserv International Inc. (“Interserv”)	9.77	30,110	(32,607)
Silicon Storage Technology Inc.	0.54	61,509	(285,930)
Phoenix Precision Technology Corporation	0.06	5,693	-
Lung Hwa Electronics Co., Ltd.	0.31	3,534	-
Simplo Technology Co., Ltd.	-	<u>7</u>	<u>-</u>
		<u>194,349</u>	<u>(318,537)</u>
	December 31, 2006		
	Percentage of ownership	Book value	
	%	NT\$	
Publicly traded stock:			
BenQ Corporation (BenQ)	4.96	2,273,775	
Silicon Storage Technology Inc.	0.54	74,092	
International Semiconductor Technology Ltd.	0.31	<u>36,367</u>	
		<u>2,384,234</u>	

The Consolidated Companies recognized an impairment loss on available-for-sale financial assets—noncurrent. The impaired amounts amounting to NT\$318,537 for the year ended December 31, 2005, were recorded as “other investment losses” in the accompanying consolidated statements of income.

In 2005, the Consolidated Companies sold portions of their investments in RDC, Granal Tech and other investees, and an aggregate gain of NT\$68,754 was recognized from these sales. In 2006, the Consolidated Companies sold portions of their investments in RDC and other investees, and an aggregate gain of NT\$98,124 was recognized from these sales.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(9) Property not used in operations

	December 31, 2005	December 31, 2006	
	NT\$	NT\$	US\$
Leased assets — land	-	818,630	25,114
Leased assets — buildings	-	2,892,886	88,750
Damaged office premises	457,558	457,558	14,037
Property held for sale and development	3,089,584	2,814,503	86,345
Less: Accumulated depreciation	(15,205)	(543,769)	(16,682)
Accumulated asset impairment	<u>(53,000)</u>	<u>(1,543,000)</u>	<u>(47,337)</u>
	<u>3,478,937</u>	<u>4,896,808</u>	<u>150,227</u>

In 2006, the Company decided to gradually dispose of real estate property and business managed by the Construction Business Unit, and as a result, the related property amounting to NT\$3,288,806 was reclassified from “property, plant and equipment” to “property not used in operations”.

In 2005, the operating results of certain property not used in operations were not as management had expected, and the Consolidated Companies recognized an impairment loss on the carrying value in excess of the recoverable amount amounting to NT\$752,000. The recoverable amount was determined on the basis of value-in-use calculations using a discount rate of 7.28%. In 2006, the Consolidated Companies recognized an impairment loss of NT\$995,000 on property not used in operations on the carrying value in excess of the recoverable amount, which was determined on the basis of fair value.

In 2001, a portion of the Consolidated Companies’ office premises suffered fire damage. Since the building had not yet been repaired, the Consolidated Companies reclassified the land and the damaged building at their carrying amounts of NT\$180,592 and NT\$276,966, respectively, and recorded them as “property not used in operations”. As of December 31, 2005 and 2006, the Consolidated Companies estimated the building repair cost at approximately NT\$116,308 and NT\$161,308, respectively, which will not be indemnified by the insurance company. A provision for building repair cost was accrued and recognized as “other current liabilities” in the accompanying consolidated balance sheets. In 2005, the Consolidated Companies recognized an impairment loss on the carrying value in excess of the recoverable amount amounting to \$53,000.

For certain land acquired, the registered ownership has not been transferred to the land acquirer, APDI, a subsidiary of the Company. To protect APDI’s interests, APDI has obtained signed contracts from the titleholders assigning all rights and obligations related to the land to APDI. Additionally, the land title certificates are held by APDI, and APDI has registered its liens thereon.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(10) Intangible assets

	December 31, 2005 NT\$	December 31, 2006 NT\$	US\$
Goodwill	306,616	244,328	7,496
Deferred software costs	194,747	148,775	4,564
Others	<u>515</u>	<u>3,579</u>	<u>110</u>
	<u>501,878</u>	<u>396,682</u>	<u>12,170</u>

(11) Other financial assets — noncurrent

	December 31, 2005 NT\$	December 31, 2006 NT\$	US\$
Refundable deposits	501,042	813,807	24,967
Noncurrent receivables	<u>486,991</u>	<u>480,537</u>	<u>14,742</u>
	<u>988,033</u>	<u>1,294,344</u>	<u>39,709</u>

(12) Short-term borrowings

	December 31, 2005 NT\$	December 31, 2006 NT\$	US\$
Commercial paper	199,975	100,000	3,068
Bank loans	<u>3,200,642</u>	<u>7,529,178</u>	<u>230,985</u>
	<u>3,400,617</u>	<u>7,629,178</u>	<u>234,053</u>

Please refer to note 6 for a description of pledged assets related to these borrowings.

(13) Long-term debt

	December 31, 2005 NT\$	December 31, 2006 NT\$	US\$
Bank loans	188,861	197,004	6,044
Less: current installments	<u>(42,238)</u>	<u>(28,377)</u>	<u>(871)</u>
	<u>146,623</u>	<u>168,627</u>	<u>5,173</u>

Please refer to note 6 for a description of pledged assets related to these loans.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(14) Retirement plans

The following table sets forth the benefit obligation and net retirement plan liabilities related to the Consolidated Companies' defined benefit retirement plans as of December 31, 2005 and 2006:

	2005		2006	
	Plan assets in excess of accumulated benefit obligation NT\$	Accumulated benefit obligation in excess of plan assets NT\$	Plan assets in excess of accumulated benefit obligation NT\$	Accumulated benefit obligation in excess of plan assets NT\$
Benefit obligation:				
Vested benefit obligation	(14,675)	(47,819)	-	(94,729)
Nonvested benefit obligation	<u>(53,439)</u>	<u>(408,680)</u>	<u>(4,836)</u>	<u>(15,114)</u>
Accumulated benefit obligation	(68,114)	(456,499)	(4,836)	(18,020)
Projected compensation increases	<u>(36,243)</u>	<u>(269,609)</u>	<u>(1,392)</u>	<u>(10,608)</u>
Projected benefit obligation	(104,357)	(726,108)	(6,228)	(28,628)
Plan assets at fair value	<u>116,743</u>	<u>412,630</u>	<u>7,878</u>	<u>13,133</u>
Funded status	12,386	(313,478)	1,650	(15,495)
Unrecognized net loss	13,559	199,439	(2,380)	10,587
Unrecognized transition (assets) obligation	<u>(731)</u>	<u>10,419</u>	-	613
Net retirement plan assets (liabilities)	<u><u>25,214</u></u>	<u><u>(103,620)</u></u>	<u><u>(730)</u></u>	<u><u>(5,109)</u></u>
			US\$	US\$
			-	19
			-	(3,408)
			-	(3,748)
			<u>(730)</u>	<u>(115)</u>
			<u><u>(22)</u></u>	<u><u>(166,546)</u></u>

Net retirement plan assets are included in "deferred expenses and other assets". Net retirement plan liabilities are included in "other liabilities" in the accompanying consolidated balance sheets.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

The components of the net periodic pension cost for 2005 and 2006 were as follows:

	2005		2006
	NT\$	NT\$	US\$
Service cost	54,309	34,779	1,067
Interest cost	29,974	30,799	945
Actual return on plan assets	(7,769)	(11,650)	(357)
Amortization and deferral	(10,667)	1,173	36
Curtailment (gain) loss	(15,498)	<u>102,747</u>	<u>3,152</u>
Net periodic pension cost	<u>50,349</u>	<u>157,848</u>	<u>4,843</u>

Significant actuarial assumptions used in the above calculations were as follows:

	2005	2006
Discount rate	3.50%	2.75%
Rate of increase in future compensation	3.00%	3.00%
Expected rate of return on plan assets	3.50%	2.75%

In 2005 and 2006, pension cost was NT\$320,231 and NT\$215,208, respectively, under the defined contribution retirement plans.

(15) Income taxes

(a) Each consolidated entity should file its own separate income tax return.

(b) The components of income tax expense for the years ended December 31, 2005 and 2006, were as follows:

	2005		2006
	NT\$	NT\$	US\$
Current income tax expense	964,511	2,715,301	83,302
Deferred income tax expense	<u>1,222,533</u>	<u>733,685</u>	<u>22,508</u>
Income tax expense	<u>2,187,044</u>	<u>3,448,986</u>	<u>105,810</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(c) The income tax calculated on the pre-tax income at the Company's statutory income tax rate (25%) was reconciled with the actual income tax expense reported in the accompanying consolidated statements of income as follows:

	2005 NT\$	2006 NT\$	US\$
Income tax calculated on pre-tax income at the statutory tax rate	2,663,133	3,447,507	105,765
Effect of different tax rates applied to the Company's subsidiaries	330,029	1,631,667	50,057
Tax-exempt investment income	(483,488)	(869,161)	(26,665)
Prior year adjustments	(289,337)	(99,230)	(3,044)
Gain on disposal of marketable securities not subject to income tax	(1,340,876)	(1,438,940)	(44,145)
Investment tax credits	(145,170)	1,002,197	30,746
Valuation allowance for deferred tax assets	1,441,695	(333,013)	(10,216)
Net operating loss carryforwards that cannot be used	(27,701)	375,500	11,520
Tax-exempt income from operational headquarters	(837,877)	(746,247)	(22,894)
10% surtax on undistributed earnings	350,145	293	9
Land impairment loss	-	78,750	2,416
Income basic tax	-	219,061	6,720
Others	526,491	180,602	5,541
Income tax expense	<u>2,187,044</u>	<u>3,448,986</u>	<u>105,810</u>

(d) The deferred income tax assets (liabilities) as of December 31, 2005 and 2006, were as follows:

	December 31, 2005 NT\$	December 31, 2006 NT\$	US\$
Current:			
Deferred income tax assets	1,553,529	1,977,846	60,678
Valuation allowance	(501,651)	(1,005,132)	(30,836)
Net deferred income tax assets	<u>1,051,878</u>	<u>972,714</u>	<u>29,842</u>
Deferred income tax liabilities	<u>(459,962)</u>	<u>(566,319)</u>	<u>(17,374)</u>
Non-current:			
Deferred income tax asset	6,591,936	4,589,737	140,807
Valuation allowance	(6,520,216)	(4,506,829)	(138,263)
Net deferred income tax assets	<u>71,720</u>	<u>82,908</u>	<u>2,544</u>
Deferred income tax assets	449,401	359,808	11,038
Deferred income tax liabilities	(2,150,158)	(2,619,916)	(80,375)
Net deferred income tax liabilities	<u>(1,700,757)</u>	<u>(2,260,108)</u>	<u>(69,337)</u>
Total deferred income tax assets	<u>8,594,866</u>	<u>6,927,391</u>	<u>212,523</u>
Total deferred income tax liabilities	<u>(2,610,120)</u>	<u>(3,186,235)</u>	<u>(97,749)</u>
Total valuation allowance	<u>(7,021,867)</u>	<u>(5,511,961)</u>	<u>(169,099)</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(e) The components of deferred income tax assets (liabilities) as of December 31, 2005 and 2006, were as follows:

	December 31, 2005	December 31, 2006	
	NT\$	NT\$	US\$
Deferred income tax assets:			
Investment loss recognized by the equity method	3,492,996	939,187	28,813
Net operating loss carryforwards	2,755,395	3,163,338	97,047
Unused investment tax credits	633,306	747,783	22,941
Accrued advertising expense	213,277	222,240	6,818
Accrued sales discounts	104,361	-	-
Accrued non-recurring engineering cost	-	117,298	3,599
Accrued cost of sales	156,024	74,179	2,276
Warranty provisions	188,349	285,244	8,751
Provision for asset impairment loss	165,925	397,742	12,202
Financial instrument revaluation loss	-	395,487	12,133
Unrealized exchange gains	-	(267,062)	(8,193)
Other	885,233	851,955	26,136
	<u>8,594,866</u>	<u>6,927,391</u>	<u>212,523</u>
Deferred income tax liabilities:			
Investment income recognized by the equity method	2,130,945	2,627,738	80,615
Other	479,175	558,497	17,134
	<u>2,610,120</u>	<u>3,186,235</u>	<u>97,749</u>

(f) The domestic Consolidated Companies were granted investment tax credits for investment in certain high-tech industries, for the purchase of automatic machinery and equipment, for research and development expenditures, and for employee training expenditures. The investment tax credits can be used to offset the current year's income tax liability (up to a maximum of 50% of the income tax liability can be offset against investment tax credits related to high-tech investment and up to a maximum of 50% can be offset against investment tax credits related to the combined cost of machinery and equipment purchases, research and development expenditures, and employee training expenditures). Generally, any unused tax credits can be carried forward for the next four years.

As of December 31, 2006, unused investment tax credits available to the Consolidated Companies were as follows:

Expiration date	NT\$	US\$
December 31, 2007	34,565	1,060
December 31, 2008	316,024	9,695
December 31, 2009	325,778	9,995
December 31, 20010	71,416	2,191
	<u>747,783</u>	<u>22,941</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

- (g) The tax effects of net operating loss carryforwards available to the Consolidated Companies as of December 31, 2006, were as follows:

Expiration date	NT\$	US\$
December 31, 2007	418,499	12,839
December 31, 2008	69,774	2,141
December 31, 2009	273,320	8,385
December 31, 2010	80,038	2,455
Thereafter	<u>2,321,707</u>	<u>71,227</u>
	<u>3,163,338</u>	<u>97,047</u>

- (h) Imputation credit account (“ICA”) and creditable ratio

Beginning in 1998, an integrated income tax system was implemented. Under the tax system, the income tax paid at the corporate level can be offset with the ROC resident stockholders’ individual income tax liability. The Company was required to establish an ICA to maintain a record of the corporate income taxes paid and imputation credit that can be allocated to each resident stockholder. The credit available to the ROC resident stockholders is calculated by multiplying the dividend by the creditable ratio. The creditable ratio is calculated by dividing the balance of the ICA by earnings retained since January 1, 1998.

Non-resident stockholders are not eligible for the imputation credit. However, the 10% surtax paid on any unappropriated earnings for the years following December 31, 1997, can be offset with the dividend withholding tax for non-resident stockholders upon distribution of such earnings to such stockholders. As of December 31, 2005 and 2006, the information related to the integrated tax system was as follows:

Unappropriated earnings:

	December 31, 2005	December 31, 2006	
	NT\$	NT\$	US\$
Before January 1, 1998	6,776	6,776	208
From January 1, 1998	<u>8,477,502</u>	<u>11,524,703</u>	<u>353,561</u>
	<u>8,484,278</u>	<u>11,531,479</u>	<u>353,769</u>
Balance of ICA	<u>104,732</u>	<u>127,253</u>	<u>3,904</u>

The Company’s estimated creditable ratio for the 2006 earnings distribution to domestic stockholders is approximately 2.27%; and the actual creditable ratio for the 2005 earnings distribution to domestic stockholders was 2.32%.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)**

- (i) The ROC income tax authorities have examined the income tax returns of the Company for all fiscal years through 2004. However, the Company disagrees with the assessment for its 2002, 2003 and 2004 income tax returns and has filed a request with the tax authorities for a recheck. The recheck of its 2002, 2003 and 2004 income tax returns was still in process. The ROC income tax authorities have examined the income tax returns of AI for all fiscal years through 2002. However, AI disagrees with the assessment for its 2001 and 2002 income tax returns and has filed an administrative appeal with the tax authorities.
- (16) Stockholders' equity
- (a) Common stock

As of December 31, 2005 and 2006, the Company's authorized common stock consisted of 2,800,000,000 shares, of which 2,254,518,705 shares and 2,337,063,681 shares, respectively, were issued and outstanding. The par value of the Company's common stock is NT\$10 per share.

The Company's shareholders decided to appropriate NT\$2.3 per share from retained earnings as of December 31, 2004, as cash dividends in the meeting on June 14, 2005. Such cash dividends amounted to NT\$4,814,746. The shareholders also decided to appropriate NT\$606,694 from retained earnings and NT\$1,004,816 from capital surplus for a total of 161,151,000 new shares as stock dividends and employee bonus. The stock issuance was authorized by and registered with the governmental authorities.

The Company's shareholders decided to appropriate NT\$3.0 per share from retained earnings as of December 31, 2005, as cash dividends in the meeting on June 15, 2006. Such cash dividends amounted to NT\$6,763,556. The shareholders also decided to appropriate NT\$825,450 from retained earnings for a total of 82,545,000 new shares as stock dividends and employee bonuses. The stock issuance was authorized by and registered with the governmental authorities.

In November 1995 and July 1997, AI issued 27,000,000 units of global depository receipts (GDRs) representing 135,000,000 shares of common stock, at par value of NT\$10 per share. Each GDR represents five shares of common stock. The offer price was US\$32.475 (in dollars) and US\$40.15 (in dollars) per GDR, respectively. AI received capital totaling US\$381,430, and after deducting the underwriting expense of US\$12,130, the net amount was US\$369,300, equivalent to NT\$10,154,226. The paid-in capital in excess of par value amounting to NT\$8,804,226 was recognized in "capital surplus—proceeds in excess of par value". The offer and issuance of the GDRs were authorized and approved by the ROC Securities and Futures Bureau (SFB).

AI was merged with the Company on March 27, 2002, and as a result, AI's GDRs were converted into the Company's GDRs in a ratio of 2.5 units of AI's GDRs into 1 unit of the Company's GDRs. The Company's GDRs were listed on the London Stock Exchange.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(b) Treasury stock

In 1997, AWI purchased GDRs issued by AI for the implementation of its overseas employee stock option plan. Further, AWI and CCI also purchased common stock of AI. This stock was converted into the Company's common shares in a ratio of 2.5 shares of AI's common stock to 1 share of the Company's common stock on March 27, 2002. Additionally, TWP's treasury shares and CCI's investments in TWP were converted into the Company's shares after the acquisition of TWP's minority shares through share swap. The subsidiary-owned common stock and GDRs of the Company as of December 31, 2005 and 2006, were as follows (expressed in thousands of shares and New Taiwan dollars):

	December 31, 2005			December 31, 2006		
	Number of Shares	Book Value NT\$	Market Price NT\$	Number of Shares	Book Value NT\$	Market Price NT\$
Common stock	16,476	798,663	1,315,408	16,805	798,662	1,142,744
GDR	4,695	<u>2,472,257</u>	<u>1,832,790</u>	4,788	<u>2,472,258</u>	<u>1,595,170</u>
		<u>3,270,920</u>	<u>3,148,198</u>		<u>3,270,920</u>	<u>2,737,914</u>

(c) Capital surplus

	December 31, 2005 NT\$	December 31, 2006 NT\$	US\$
Share premium:			
Paid-in capital in excess of par value	856,901	856,901	26,289
Surplus from merger	22,781,719	22,781,719	698,911
Premium on capital stock resulting from conversion of convertible bonds	4,552,585	4,552,585	139,667
Forfeited interest resulting from conversion of convertible bonds	1,006,210	1,006,210	30,869
Surplus related to the treasury stock transactions by subsidiary companies	101,316	194,556	5,969
Other:			
Surplus from long-term equity investments accounted for by the equity method	<u>1,253,402</u>	<u>555,049</u>	<u>17,028</u>
	<u>30,552,133</u>	<u>29,947,020</u>	<u>918,733</u>

According to the ROC Company Act, with the exception of capital surplus originating from long-term equity investments accounted for by the equity method, any realized capital surplus could be transferred to common stock as stock dividends after deducting accumulated deficit, if any. Realized capital surplus includes share premium and donations from shareholders. Distribution of stock dividends from realized capital surplus is subject to certain restrictions imposed by the governmental authorities.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)****(d) Legal reserve, unappropriated earnings, and dividend policy**

The Company's articles of incorporation stipulate that at least 10% annual net income after deducting accumulated deficit, if any, must be retained as legal reserve until such retention equals the amount of authorized common stock. In addition, a special reserve should be set up in accordance with SFB regulations. The remaining balance of annual net income, if any, can be distributed as follows:

- 5% to 10% as employee bonuses; employees may include subsidiaries' employees that meet certain criteria set by the board of directors;
- 1% as remuneration for directors and supervisors; and
- the remainder, after retaining a certain portion for business considerations, as dividends and bonuses for stockholders.

Since the Company operates in an industry experiencing rapid change and development, distribution of earnings shall be made in view of the year's earnings, the overall economic environment, the related laws and decrees, and the Company's long-term development and steady financial position. The Company has adopted a steady dividend policy, in which a cash dividend comprises at least 10% of the total dividend distributed.

According to the ROC Company Act, the legal reserve can be used to offset an accumulated deficit and may be distributed in the following manner: (i) when it reaches an amount equal to one-half of the paid-in capital, it can be transferred to common stock at the amount of one-half of legal reserve; and (ii) when it reaches an amount exceeding one-half of the authorized common stock, dividends and bonuses can be distributed from the excess portion of the legal reserve.

Beginning in 2000, pursuant to SFB regulations, an amount equal to the total amount of any deduction items of shareholders' equity shall be provided from the net income of the current year as a special reserve that cannot be distributed as dividend or bonus. Accordingly, such special reserve shall be adjusted to reflect the changes in the deduction items. Any reversal of the special reserve can be added back to unappropriated earnings for distribution of dividends or bonus. As of December 31, 2005 and 2006, the Company retained a special reserve of NT\$2,017,819 and NT\$283,921, respectively, to cover the amount by which treasury stock cost was below market value and other deduction items of stockholders' equity.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

The appropriation of 2004 and 2005 earnings was approved at the shareholders' meetings on June 14, 2005, and June 15, 2006, as follows:

	2004 NT\$	2005 NT\$
Dividend per share		
Cash	2.3	3.0
Stock	<u>0.6</u>	<u>0.2</u>
	<u>2.9</u>	<u>3.2</u>
Employee bonus–stock (par value)	355,490	374,546
Employee bonus–cash	88,872	374,546
Directors' and supervisors' remuneration	<u>55,545</u>	<u>93,637</u>
	<u>499,907</u>	<u>842,729</u>

The appropriation of earnings did not differ from the resolutions approved by the Company's directors.

Assuming the above employee bonus and directors' and supervisors' remuneration are paid in cash and expensed in the year when the earnings are recognized, the earnings per share, not computed retroactively, for 2004 and 2005 would be reduced from NT\$3.38 and NT\$3.83 to NT\$3.14 and NT\$3.45, respectively. Stock dividends distributed to employees represent 1.70% and 1.66% of the outstanding common shares as of December 31, 2004 and 2005, respectively.

Appropriation of 2006 employee bonus and directors' and supervisors' remuneration is subject to the Company's directors' and shareholders' resolutions. After the resolutions, related information can be obtained from the public information website.

(17) Earnings per common share ("EPS")

	2005		2006	
	Before income taxes NT\$	After income taxes NT\$	Before income taxes NT\$	After income taxes NT\$
Basic EPS:				
Net income	<u>9,650,156</u>	<u>8,477,502</u>	<u>11,774,747</u>	<u>10,218,242</u>
Weighted-average number of shares outstanding during the year (thousand shares)	<u>2,294,957</u>	<u>2,294,957</u>	<u>2,296,317</u>	<u>2,296,317</u>
Basic EPS (in dollars)	<u>4.21</u>	<u>3.69</u>	<u>5.13</u>	<u>4.45</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(18) Disclosure of financial instruments

- (a) As of December 31, 2005 and 2006, fair values of financial assets and liabilities of the Consolidated Companies were as follows:

The book value of short-term financial instruments is considered to be the fair value because of the short-term nature of these instruments, and the book value method is considered to be a reasonable basis to assess the fair value. Such method is applicable to cash and cash equivalents, notes and accounts receivable/payable, receivables from and payables to related parties, other receivables, royalties payable, and accrued expenses.

The estimated fair values and carrying amounts of all other financial assets and liabilities as of December 31, 2005 and 2006, were as follows:

	2005		2006		
	Carrying amount NT\$	Fair value NT\$	Carrying amount NT\$	Public quote price NT\$	Fair value Valuation amount NT\$
Non-derivative financial instruments					
Financial assets:					
Available-for-sale financial assets—current	6,160,138	10,546,378	13,805,760	13,805,760	-
Financial assets carried at cost	4,112,438	see below	4,837,842	see below	see below
Long-term equity investments under equity method					
- fair value available	10,037,726	18,755,267	5,048,610	10,312,471	-
- fair value not available	3,261,460	see below	1,564,852	see below	see below
Available-for-sale financial assets—noncurrent	194,349	234,454	2,384,234	2,384,234	-
Refundable deposits (classified as “other financial assets”)	501,042	501,042	813,807	-	813,807
Noncurrent receivables (classified as “other financial assets”)	486,991	486,991	480,537	-	480,537
Derivative financial instruments					
Financial assets:					
Financial assets at fair value through profit or loss—current	684,860	684,860	99,965	-	99,965
Hedging purpose derivative financial assets—current	66,062	66,062	66,541	-	66,541
Financial liabilities:					
Financial liabilities at fair value through profit or loss—current	-	-	1,202,186	-	1,202,186
Hedging purpose derivative financial liabilities—current	-	-	321,016	-	321,016

- (b) The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- (i) Available-for-sale financial assets—current and noncurrent

Publicly quoted market prices are used as fair value.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)**

(ii) Financial assets carried at cost

Financial assets carried at cost were privately held stock. The fair value of privately held stock was unable to be determined because it was not traded in the public market.

(iii) Long-term equity investments under equity method

The fair values of publicly traded stock is based on publicly quoted market prices. Most of the Consolidated Companies' long-term equity investments were privately held stock. The fair value of privately held stock was unable to be determined because it was not traded in the public market.

(iii) Refundable deposits (recorded as other financial assets — noncurrent)

Refundable deposits are for the operating needs of the consolidated entities. Since the collecting periods were undeterminable, fair market value cannot be estimated. Therefore, book values are used as fair market values.

(iv) Noncurrent receivables (recorded as other financial assets — noncurrent)

The fair values are their present value discounted at the market interest rate.

(v) Derivative financial instruments

The fair values of the Consolidated Companies' derivative financial instruments as of December 31, 2005, are based on quotations received from financial institutions; the fair values as of December 31, 2006, are estimated using the valuation method. The assumptions used should be the same as those used by financial market traders when quoting their prices, which are readily available to the Consolidated Companies.

(c) For the year ended December 31, 2006, the evaluation loss on financial assets and liabilities under an assessment method by the Consolidated Companies amounted to NT\$1,343,916.

(d) Disclosure of financial risks

(i) Market risk

Mutual funds and publicly traded stock were recorded by the Consolidated Companies as "available-for-sale financial assets" and were evaluated by fair value. Therefore, the Consolidated Companies were exposed to the risk of price fluctuation in the securities market.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)**

The Consolidated Companies entered into foreign currency forward contracts and foreign currency options to hedge exchange risk resulting from assets and liabilities denominated in foreign currency and cash flows resulting from anticipated transactions in foreign currency. The gain and loss from exchange rate fluctuation was offset by that from the hedged assets or liabilities. Furthermore, the length and amounts of the foreign exchange forward contracts and foreign currency options were in line with the payment date and anticipated cash outflows of the Consolidated Companies' foreign currency assets and liabilities. Therefore, the market risk related to the changes in exchange rates was not considered significant.

(ii) Credit risk

The Consolidated Companies' credit risk is mainly from potential breach of contract by the counter-party associated with cash, equity investment, and derivative transactions. In order to control its exposure to the credit risk of each financial institution, the Consolidated Companies usually deposit money with various financial institutions and hold long-term equity investments in the form of mutual funds and stocks issued by companies with high credit quality. As a result, the concentration of credit risks related to the Consolidated Companies' cash and long-term equity investments is not considered significant. Furthermore, the banks undertaking the derivative transactions are reputable financial institutions; therefore, the Consolidated Companies' exposure related to the potential default by those counter-parties is not considered significant.

(iii) Liquidity risk

The Consolidated Companies' capital and operating funds are sufficient to reimburse all obligations. Therefore, the Consolidated Companies did not have liquidity risk.

(iv) Cash flow risk related to the fluctuation of interest rates

The Consolidated Companies' short-term borrowings and long-term debt carried floating interest rates. As a result, the effective rate changes along with the fluctuation of the market interest rates and thereby influences the Consolidated Companies' future cash flow. If the market interest rate increases by 1%, the Consolidated Companies' future yearly cash outflow would increase by approximately NT\$47,400.

(e) Hedge strategy

The Consolidated Companies' assets and liabilities denominated in foreign currency may fluctuate along with the fluctuation of exchange rates. As a result, the Consolidated Companies entered into derivative contracts such as foreign exchange forward contracts and foreign currency options to hedge the exchange rate risk.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

The purpose of the Consolidated Companies' entering into foreign currency forward contracts and foreign currency options is to hedge the exchange rate risk resulting from assets and liabilities denominated in foreign currency and cash flows resulting from anticipated transactions in foreign currency. The length of the contracts is in line with the payment date and the anticipated cash outflows of the Consolidated Companies' assets and liabilities denominated in foreign currency. As a result, the Consolidated Companies settle their foreign currency assets and liabilities with contract obligations or rights at the maturity date.

5. Transactions with Related Parties

Name	Relationship with the Company
Wistron Corporation ("Wistron")	Investee of the Company, accounted for by equity method
Cowin Worldwide Corporation ("COWIN")	Subsidiary of Wistron
Wistron InfoComm (Philippines) Corporation ("WPH")	Subsidiary of Wistron
Wistron InfoComm Manufacturing (Kunshan) Co., Ltd. ("WEKS")	Subsidiary of Wistron
Wistron InfoComm (Kunshan) Co., Ltd. ("WKS")	Subsidiary of Wistron
Wistron InfoComm Technology (Kunshan) Co., Ltd. ("WIKS")	Subsidiary of Wistron
Bluechip Infotech Pty Ltd. ("SAL")	Investee of the Company, accounted for by equity method
e-Life Mall Corp. ("eLIFE")	Investee of the Company, accounted for by equity method
BenQ Corporation ("BenQ")	Investee of the Company, accounted for by equity method (Commencing from June 30, 2006, the Company had no significant influence over BenQ and AU, and as a result, BenQ and AU were reclassified as non-related parties.)
AU Optronics Corp. ("AU")	Investee of BenQ, accounted for by equity method
iD Softcapital Inc.	Its chairman is one of the Company's supervisors

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(a) Significant transactions with related parties as of and for the years ended December 31, 2005 and 2006, are summarized below:

(1) Net sales and related notes and accounts receivable

1. Net sales to:

	2005	2006	
	NT\$	NT\$	US\$
SAL	795,527	864,017	26,507
WEKS	246,288	800,817	24,568
eLIFE	788,251	701,226	21,513
COWIN	347,623	484,629	14,868
WIKS	136,861	257,763	7,908
WKS	227,902	186,761	5,729
Other	<u>418,215</u>	<u>446,140</u>	<u>13,687</u>
	<u>2,960,667</u>	<u>3,741,353</u>	<u>114,780</u>

Trading terms with related parties are not significantly different from the terms with third-party customers.

2. In 2005, the Consolidated Companies sold a parcel of land located in Aspire Industry Park to AU for NT\$2.8 billion. The gain on disposal amounted to NT\$480 million.

3. Notes and accounts receivable from:

	December 31, 2005	December 31, 2006	
	NT\$	NT\$	US\$
WEKS	5,442,639	244,308	7,495
eLIFE	134,121	156,988	4,816
COWIN	97,055	149,738	4,594
WIKS	62,384	122,012	3,743
WKS	63,061	78,165	2,398
SAL	87,083	73,020	2,240
WPH	37,028	64,837	1,989
Others	<u>117,026</u>	<u>51,882</u>	<u>1,592</u>
	<u>6,040,397</u>	<u>940,950</u>	<u>28,867</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(2) Purchases and related notes and accounts payable

1. Purchases from:

	2005 NT\$	2006 NT\$	US\$
Wistron	7,865,991	9,936,483	304,837
AU	8,999,415	4,067,105	124,773
Others	<u>1,165,267</u>	<u>101,491</u>	<u>3,114</u>
	<u>18,030,673</u>	<u>14,105,079</u>	<u>432,724</u>

Trading terms with related parties are not significantly different from the terms with third-party suppliers.

In 2005 and 2006, the Consolidated Companies sold raw material to Wistron or its foreign subsidiaries and purchased back the finished goods after being manufactured by them. To avoid overstating the revenues, sales of raw material to Wistron or its foreign subsidiaries amounting to NT\$21,382,152 and NT\$36,730,724 for the years ended December 31, 2005 and 2006, respectively, were excluded from the consolidated revenues. However, the outstanding receivables and payables resulting from the above-mentioned transactions cannot be offset due to lack of legally enforceable rights. As of December 31, 2005 and 2006, the related accounts receivable and payable amounted to NT\$5,254,206 and NT\$9,592, respectively.

2. Notes and accounts payable to:

	December 31, 2005 NT\$	December 31, 2006 NT\$	US\$
Wistron	6,339,952	787,654	24,164
AU	1,969,790	-	-
Others	<u>288,505</u>	<u>36,634</u>	<u>1,124</u>
	<u>8,598,247</u>	<u>824,288</u>	<u>25,288</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(3) Transfer and spin-off assets

On February 28, 2002, AI spun off its design, manufacturing and services business from its Acer brand business and transferred related operating assets and liabilities to Wistron. The receivables resulting from the deferred income tax assets spun off to Wistron amounted to NT\$687,867 and NT\$385,043 as of December 31, 2005 and 2006 respectively. When Spun off, the Company agreed with Wistron that Wistron is obligated to pay for the deferred income tax asset only when it is actually utilized. In 2006, The ROC income tax authorities examined and rejected Wistron's claim of investment credits from the spin-off in the income tax returns for 2002, 2003, and 2004. Wistron disagreed with the assessment and filed a request with the tax authorities for a recheck of its 2002, 2003 and 2004 income tax returns. To be conservative, the Company recognized income tax expense of NT\$875,802 based on total tax impact estimated and provided a valuation allowance of NT\$385,043 against the receivables as of December 31, 2006. The remaining balance of \$490,759 was recorded as other payables from related parties.

(4) Management service fees

In 2005 and 2006, the Company paid iD Soft Capital Inc. management service fees amounting to NT\$75,738 and NT\$78,500, respectively.

(5) Advances to/from related parties

The Consolidated Companies paid certain expenses on behalf of related parties. Additionally, related parties paid certain expenses and accounts payable on behalf of the Consolidated Companies. As of December 31, 2005 and 2006, the Consolidated Companies had aggregate receivables from related parties of NT\$36,635 and NT\$89,937, respectively, and payables to related parties of NT\$73,366 and NT\$573,586, respectively, resulting from these transactions.

(6) Receivables from and payables to related parties referred to above were as follows:

	December 31, 2005 NT\$	December 31, 2006 NT\$	US\$
Receivables:			
Notes and accounts receivable	6,040,397	940,950	28,867
Other receivables	36,635	89,937	2,759
Receivables resulting from assets spun off	687,867	385,043	11,813
Allowance for receivables resulting from assets spun off	-	(385,043)	(11,813)
	<u>6,764,899</u>	<u>1,030,887</u>	<u>31,626</u>
Payables:			
Notes and accounts payable	8,598,247	824,288	25,288
Other payables	73,366	573,586	17,597
	<u>8,671,613</u>	<u>1,397,874</u>	<u>42,885</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

6. Pledged Assets

Assets pledged for various purposes were as follows:

Pledged assets	Pledged to secure	Book value of pledged assets at December 31,		
		2005 NT\$	2006 NT\$	US\$
Cash in bank and time deposits	Deposits for contract bidding projects fulfillment	158,466	389,274	11,942
Accounts receivable	Stand-by letters of credit	394,921	601,548	18,455
Inventories	Stand-by letters of credit	517,859	259,043	7,947
Available-for-sale financial assets – current	Long-term and short-term debt	604,265	-	-
Property and equipment, and property not used in operations	Long-term and short-term debt	<u>2,210,692</u>	<u>2,199,370</u>	<u>67,474</u>
Total		<u>3,886,203</u>	<u>3,449,235</u>	<u>105,818</u>

As of December 31, 2005 and 2006, a portion of the above pledged time deposits amounting to NT\$140,040 and NT\$159,974, respectively, were classified as “other financial assets” in the accompanying consolidated balance sheets. The remaining balance was classified as “pledged time deposits”.

7. Commitments and Contingencies

(a) Royalties

The Company renewed its Patent Cross License agreement with IBM in October 2003. The license period is 5 years. The agreement mainly states that both parties have the right to make use of either party’s global technological patents to manufacture and sell personal computer products. The Company agrees to make fixed payments periodically to IBM, and the Company will not have any additional obligation for the use of IBM patents other than the fixed amounts of payments agreed upon.

In June 2004, the Company and Lucent Technologies Inc. extended the Patent Cross License agreement to December 31, 2007. During the aforementioned period, the Company only pays the amounts according to the contract when manufacturing and selling computer products for which Lucent holds related patents. No additional royalties are required. The essence of the license agreement authorizes both parties to use each other’s worldwide computer-related patents for manufacturing and selling personal computer products.

(b) Others

- (1) As of December 31, 2005 and 2006, the Company had provided outstanding stand-by letters of credit totaling NT\$134,160 and NT\$202,566, respectively, for bidding on sales contracts and for customs duty contract implementation.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

- (2) The Consolidated Companies have entered into several operating lease agreements for warehouses, land and buildings. Future minimum lease payments were as follows:

Year	NT\$	US\$
2007	224,169	6,877
2008	200,505	6,151
2009	161,630	4,959
2010	106,279	3,261
2011 and thereafter	<u>226,942</u>	<u>6,962</u>
	<u>919,525</u>	<u>28,210</u>

8. Significant Loss from Casualty: None

9. Subsequent Events

- (a) On December 31, 2006, the Company entered into an agreement with Nan Shan Life Insurance Company, Ltd. to sell its property not used in operations in NeiHu. The registration of property transfer was expected to be completed in the first quarter of 2007, with an estimated gain on disposal of approximately NT\$100,000.
- (b) In January 2007, the Company took part in HiTRUST.COM Inc.'s treasury stock purchase program and sold a portion of the shares held. The selling price amounted to NT\$652,702. The transaction has no significant impact on 2007 net income.

10. Other

- (a) Total personnel, depreciation and amortization expenses incurred for the years ended December 31, 2005 and 2006, were as follows:

	2005				2006			
	Operating expense	Reduction of investment income	Cost of revenues	Total	Operating expense	Reduction of investment income	Cost of revenues	Total
	NT\$	NT\$	NT\$	NT\$	NT\$	NT\$	NT\$	NT\$
Personnel:								
Salaries	6,323,981	32,539	-	6,356,520	6,594,509	12,022	-	6,606,531
Labor and health insurance	273,857	477	-	274,334	273,934	106	-	274,040
Pension	347,814	22,766	-	370,580	372,948	108	-	373,056
Other	233,785	14	-	233,799	503,248	-	-	503,248
Depreciation	925,084	532	50,732	976,348	815,698	240	25,200	841,138
Amortization	516,499	116	3,331	519,946	238,805	44	12,021	250,870

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

- (b) The Company's subsidiary TWP entered into an agreement with Giga Media to sell its online game businesses and operations to Giga Media Ltd. and Giga Media's affiliate. The selling price amounted to approximately NT\$1.54 billion, resulting in a gain (before income tax) on disposal of NT\$1.5 billion, which was classified as "other income" under non-operating income and gains. As of December 31, 2006, the receivables resulting from the disposal of businesses and operations amounted to NT\$162,700 and were recorded under "other receivables".

The carrying amounts of net assets that were decreased as a result of the above-mentioned transactions were as follows:

	NT\$	US\$
Accounts receivables	85,562	2,625
Accounts receivables from related parties	21,767	668
Other current assets	4,271	131
Property, plant and equipment	11,818	363
Other assets	2,935	90
Accounts payable	(818)	(25)
Accrued expenses and other current liabilities	<u>(88,417)</u>	<u>(2,713)</u>
	<u>37,118</u>	<u>1,139</u>

- (c) Reclassifications

Certain amounts in the consolidated financial statements as of and for the year ended December 31, 2005, have been reclassified to conform to the 2006 presentation for comparative purposes. These reclassifications do not significantly impact the presentation of the consolidated financial statements.

11. Segment Information

- (a) Industry segment

The main business of the Consolidated Companies is to sell "Acer" brand-name desktop PCs, Notebook PCs, and other related IT products, which represents a single industry.

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(b) Geographic information

Information by geographic area as of and the years ended December 31, 2005 and 2006, was as follows:

	2005					Consolidated NT\$
	Taiwan NT\$	North America NT\$	Europe NT\$	Asia NT\$	Eliminations NT\$	
Area income:						
Customers	82,646,021	37,202,548	162,313,255	46,573,875	-	328,735,699
Inter-company	<u>176,533,231</u>	<u>259,407</u>	<u>7,562,674</u>	<u>112,452</u>	<u>(184,467,764)</u>	-
	<u>259,179,252</u>	<u>37,461,955</u>	<u>169,875,929</u>	<u>46,686,327</u>	<u>(184,467,764)</u>	328,735,699
Investment income						1,373,113
Gain on disposal of investments						<u>5,716,103</u>
Total income						<u>335,824,915</u>
Area profit (loss) before income taxes	<u>(1,668,089)</u>	<u>14,695</u>	<u>6,426,204</u>	<u>538,403</u>	<u>134,082</u>	5,445,295
Net investment loss						(42,179)
Gain on disposal of investments, net						5,634,709
Interest expense						<u>(385,293)</u>
Consolidated income before income taxes						<u>10,652,532</u>
Area identifiable assets	<u>104,823,889</u>	<u>9,530,223</u>	<u>52,935,838</u>	<u>17,108,778</u>	<u>(26,422,588)</u>	157,976,140
Long-term investments						13,299,186
Goodwill						<u>306,616</u>
Total assets						<u>171,581,942</u>
Depreciation and amortization	<u>1,127,382</u>	<u>32,112</u>	<u>172,162</u>	<u>164,638</u>	<u>-</u>	<u>1,496,294</u>
Capital expenditures	<u>212,909</u>	<u>11,605</u>	<u>175,088</u>	<u>105,795</u>	<u>-</u>	<u>505,397</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

	2006					Consolidated NT\$
	Taiwan NT\$	North America NT\$	Europe NT\$	Asia NT\$	Eliminations NT\$	
Area income:						
Customers	77,991,430	57,488,711	184,892,473	63,887,884	-	384,260,498
Inter-company	<u>214,021,404</u>	<u>240,730</u>	<u>4,973,158</u>	<u>106,486</u>	<u>(219,341,778)</u>	-
	<u>292,012,834</u>	<u>57,729,441</u>	<u>189,865,631</u>	<u>63,994,370</u>	<u>(219,341,778)</u>	384,260,498
Investment income						1,049,743
Gain on disposal of investments						<u>5,660,889</u>
Total income						<u>390,971,130</u>
Area profit (loss) before income taxes	<u>1,765,124</u>	<u>73,789</u>	<u>4,863,002</u>	<u>1,588,700</u>	<u>(1,130)</u>	8,289,485
Net investment income						427,803
Gain on disposal of investments, net						5,619,929
Interest expense						<u>(547,191)</u>
Consolidated income before income taxes						<u>13,790,026</u>
Area identifiable assets	<u>109,840,228</u>	<u>15,352,531</u>	<u>85,595,843</u>	<u>22,695,598</u>	<u>(51,841,692)</u>	181,642,508
Long-term investments						6,613,462
Goodwill						<u>244,328</u>
Total assets						<u>188,500,298</u>
Depreciation and amortization	<u>1,077,609</u>	<u>-</u>	<u>9,089</u>	<u>5,310</u>	<u>-</u>	<u>1,092,008</u>
Capital expenditures	<u>823,146</u>	<u>34,826</u>	<u>203,169</u>	<u>144,058</u>	<u>-</u>	<u>1,205,199</u>

(c) Export sales

Export sales of the Company and its domestic subsidiaries for the years ended December 31, 2005 and 2006, were as follows:

Sales to:	2005	2006	
	NT\$	NT\$	US\$
North America	206,721	297,386	9,123
Europe	100,327	9,541	293
Other	<u>3,120,380</u>	<u>2,456,462</u>	<u>75,361</u>
	<u>3,427,428</u>	<u>2,763,389</u>	<u>84,777</u>

(Continued)

ACER INCORPORATED AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

(d) Major customers

Sales to individual customers comprising over 10% of the Consolidated Companies' revenues are summarized below:

	2005		2006		
	NT\$	Percentage	NT\$	US\$	Percentage
Customer A	<u>28,627,891</u>	<u>9%</u>	<u>47,790,111</u>	<u>1,466,134</u>	<u>13%</u>