

**INVENTEC CORPORATION**  
**FINANCIAL STATEMENTS**  
**SIX MONTHS ENDED JUNE 30, 2003 AND 2002**  
**AND**  
**INDEPENDENT AUDITORS' REPORT**

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**INVENTEC CORPORATION**  
**FINANCIAL STATEMENTS**  
**JUNE 30, 2003 AND 2002**

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## **Independent Auditors' Report**

Inventec Corporation:

We have audited the accompanying balance sheets of Inventec Corporation as of June 30, 2003 and 2002, and the related statements of income, changes in stockholders' equity, and cash flows for the six months then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As described in Note 4.d, as of June 30, 2003 and 2002, long-term equity investments of Inventec Corporation were \$9,150,369 thousand and \$9,688,997 thousand, respectively. Equity earnings related thereto for the six months ended June 30, 2003 and 2002, were \$551,841 thousand and \$468,321 thousand, respectively, which were recognized based upon the financial statements prepared by the investee companies and not audited in compliance with the audit procedures mentioned in the preceding paragraph.

In our opinion, except for the effects of any adjustments that might have emerged had the financial statements of investee companies been audited by independent accountants, the financial statements referred to above present fairly, in all material respects, the financial position of Inventec Corporation as of June 30, 2003 and 2002, and the results of its operations and its cash flows for the six months then ended in conformity with the "Rules Governing Preparation of Financial Statements by Securities Issuers" and generally accepted accounting principles of the Republic of China.

Taipei, Taiwan, R.O.C.  
July 31, 2003

The accompanying financial statements are intended only to present the financial position, results of operation and cash flows in accordance with the accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures, and practices to audit such financial statements are those generally accepted and applied in the Republic of China.

**INVENTEC CORPORATION**  
**BALANCE SHEETS**  
**June 30, 2003 and 2002**  
(New Taiwan Dollars in Thousands, Except for Share Data)

ASSETS	June 30, 2003		June 30, 2002	
	Amount	%	Amount	%
Current Assets				
Cash and cash equivalents (Notes 2 and 4)	\$ 6,023,172	14	\$ 9,765,920	25
Notes receivable (Note 2)				
Other customers	1,190	-	1,022	-
Related parties	984	-	4,315	-
Accounts receivable - less allowance for doubtful accounts (Notes 2 and 4)				
Other customers	6,843,568	16	3,311,417	9
Related parties	5,741,192	14	9,777,785	25
Other financial assets - current	6,104,090	15	194,132	-
Inventories, less allowance for inventory market decline and obsolescence (Notes 2 and 4)	1,885,282	5	2,843,225	7
Prepayments and other current assets	114,406	-	112,821	-
Deferred income tax assets (Notes 2 and 4)	392,355	1	438,447	1
	27,106,239	65	26,449,084	67
Long-term equity investments (Notes 2 and 4)				
Accounted for under the equity method	10,328,985	25	9,696,592	24
Accounted for under the cost method	1,574,802	4	180,202	2
	11,903,787	29	9,876,794	26
Other financial assets - non-current (Note 6)	60,498	-	81,444	-
Property, Plant, and Equipment (Notes 2 and 4)				
Land	788,870	2	1,035,730	3
Buildings	427,252	1	794,910	2
Machinery	906,773	2	1,050,432	3
Transportation equipment	24,458	-	25,278	-
Furniture and office facilities	913,699	2	769,365	2
Other equipment	220,297	1	415,640	1
Less: Accumulated depreciation	(1,601,474)	(4)	(1,644,173)	(4)
Construction in progress	3,394	-	30,577	-
Prepayment for equipment	2,630	-	3,310	-
	1,685,899	4	2,481,069	7
Other Assets				
Deferred debit - intercompany loss (Note 2)	194,663	-	194,663	-
Other assets (Notes 2 and 4)	819,701	2	55,918	-
	1,014,364	2	250,581	-
<b>TOTAL ASSETS</b>	<b>\$ 41,770,787</b>	<b>100</b>	<b>\$ 39,138,972</b>	<b>100</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
Current Liabilities				
Notes payable	\$ 729,856	2	\$ 1,449,059	4
Accounts payable				
Other customers	7,044,381	17	7,446,884	19
Related parties	4,732,839	11	1,803,620	4
Income tax payable	146,381	-	338,068	1
Accrued expenses	451,641	1	607,966	2
Advanced collection	47,110	-	46,558	-
Other current liabilities	1,357,012	3	1,141,378	3
Estimated warranty reserve (Note 2)	746,146	2	626,071	2
	15,255,366	36	13,459,604	35
Other Liabilities				
Accrued pension liabilities (Note 2)	183,964	-	430,118	1
Refundable deposits	-	-	4,023	-
Deferred income tax liabilities (Notes 2 and 4)	283,799	1	288,198	1
Deferred credit - intercompany profit (Notes 2)	255,180	1	199,618	1
Other liabilities	2,564	-	5,766	-
	725,507	2	927,723	3
<b>Total Liabilities</b>	<b>15,980,873</b>	<b>38</b>	<b>14,387,327</b>	<b>38</b>
Stockholders' Equity				
Capital stock, par value \$10 per share; authorized 2,000,000,000 shares, issued and outstanding 1,835,000,000 shares in June 30, 2003; authorized 2,000,000,000 shares, issued and outstanding 1,660,700,000 shares in June 30, 2002	18,350,000	44	16,607,000	41
Stock dividends to be distributed	1,910,000	5	1,743,000	4
Capital surplus (Note 2)				
Premium on stock issuance	447,723	1	447,723	2
Long-term equity investments	121,064	-	134,714	-
Others	177	-	177	-
Retained earnings:				
Legal reserve (Note 2)	2,910,055	7	2,575,062	7
Undistributed earnings (Note 2 and 4)	1,894,344	5	3,140,920	8
Cumulative translation adjustments (Note 2)	156,551	-	103,049	-
<b>Total Stockholders' Equity</b>	25,789,914	62	24,751,645	62
Commitments and Contingencies (Notes 2 and 7)				
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 41,770,787</b>	<b>100</b>	<b>\$ 39,138,972</b>	<b>100</b>

**The accompanying notes are an integral part of the financial statements.**  
**Please refer to Independent Auditors' Report dated July 31, 2003.**

**INVENTEC CORPORATION**  
**STATEMENTS OF INCOME**  
**Six Months Ended June 30, 2003 and 2002**  
**(New Taiwan Dollars in Thousands, Except for Share Data)**

	Six Months Ended June 30,			
	2003		2002	
	Amount	%	Amount	%
<b>Operating Revenues:</b>				
Gross sales (Note 2)	\$ 38,327,931	100	\$ 33,649,069	100
Technical services revenue (Note 4)	4,413	-	4,753	-
Net operating revenues	38,332,344	100	33,653,822	100
<b>Operating Costs:</b>				
Cost of sales	(35,487,821)	(92)	(30,694,589)	(91)
	2,844,523	8	2,959,233	9
Add: Unrealized gross profit, beginning of period	99,201	-	102,369	-
Less: Unrealized gross profit, end of period	(31,771)	-	(102,441)	-
Gross Margin	2,911,953	8	2,959,161	9
<b>Operating Expenses:</b>				
Selling expense	(1,225,871)	(3)	(871,802)	(2)
Administrative and general expense	(504,684)	(1)	(422,141)	(1)
Research and development expense	(652,764)	(2)	(431,815)	(1)
	(2,383,319)	(6)	(1,725,758)	(4)
Operating Income	528,634	2	1,233,403	5
<b>Non-Operating Income:</b>				
Interest income	52,397	-	120,738	-
Equity in earnings (Note 4)	549,967	1	468,321	1
Dividend income (Note 4)	600	-	6,000	-
Gain on disposition of property	14,348	-	27,850	-
Foreign exchange gain	14,030	-	-	-
Gain on inventory market recovery	-	-	73,043	-
Other income	229,819	1	558,395	2
	861,161	2	1,254,347	3
<b>Non-Operating Expenses:</b>				
Interest expense	(255)	-	(363)	-
Loss on disposition of properties	-	-	(17)	-
Foreign exchange loss	-	-	(572,166)	(2)
Loss on inventory devaluation and obsolescence	(1,073)	-	-	-
Other expenses	(20,568)	-	(289)	-
	(21,896)	-	(572,835)	(2)
Income before income tax	1,367,899	4	1,914,915	6
Income tax benefit (expense) (Note 4)	86,771	-	(226,497)	(1)
Net income	\$ 1,454,670	4	\$ 1,688,418	5
	Before Tax	After Tax	Before Tax	After Tax
Earnings per share (Notes 2 and 4)				
Basic	\$ 0.75	\$ 0.79	\$ 1.15	\$ 1.02
Earnings per share - retroactively adjusted				
Basic	\$ -	\$ -	\$ 1.04	\$ 0.92

**The accompanying notes are an integral part of the financial statements.**  
**Please refer to Independent Auditors' Report dated July 31, 2003.**

**INVENTEC CORPORATION**  
**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**Six Months Ended June 30, 2003 and 2002**  
**(New Taiwan Dollars in Thousands, Except for Share Data)**

	Capital Stock	Stock dividends to be distributed	Capital Surplus	Retained Earnings		Cumulative Translation Adjustments	Total
				Legal Reserve	Unappropriated Earnings		
Beginning balance, January 1, 2002	\$ 16,607,000	\$ -	\$ 806,677	\$ 2,193,313	\$ 4,227,410	\$ 196,571	\$ 24,030,971
2001 earnings distribution:							
Legal reserve	-	-	-	381,749	(381,749)	-	-
Compensation to directors and supervisors	-	-	-	-	(103,073)	-	(103,073)
Employee bonuses	-	-	-	-	(158,202)	-	(158,202)
Employee bonuses - stock	-	82,300	-	-	(82,300)	-	-
Stock dividends	-	1,411,595	-	-	(1,411,595)	-	-
Cash dividends	-	-	-	-	(687,930)	-	(687,930)
Capitalization of capital surplus	-	249,105	(249,105)	-	-	-	-
Net income for the six months ended June 30, 2002	-	-	-	-	1,688,418	-	1,688,418
Gain on disposal of property, plant, and equipment	-	-	(49,941)	-	49,941	-	-
Adjustment to net equity value due to change in ownership of investee companies	-	-	74,983	-	-	-	74,983
Translation adjustment to long-term equity investments (net of income tax of \$31,174)	-	-	-	-	-	(93,522)	(93,522)
Ending balance, June 30, 2002	<u>\$ 16,607,000</u>	<u>\$ 1,743,000</u>	<u>\$ 582,614</u>	<u>\$ 2,575,062</u>	<u>\$ 3,140,920</u>	<u>\$ 103,049</u>	<u>\$ 24,751,645</u>
Beginning balance, January 1, 2003	\$ 18,350,000	\$ -	\$ 568,964	\$ 2,575,062	\$ 3,828,661	\$ 220,647	\$ 25,543,334
2002 earnings distribution:							
Legal reserve	-	-	-	334,993	(334,993)	-	-
Compensation to directors and supervisors	-	-	-	-	(90,448)	-	(90,448)
Employee bonuses	-	-	-	-	(136,046)	-	(136,046)
Employee bonuses - stock	-	75,000	-	-	(75,000)	-	-
Stock dividends	-	1,835,000	-	-	(1,835,000)	-	-
Cash dividends	-	-	-	-	(917,500)	-	(917,500)
Net income for the six months ended June 30, 2003	-	-	-	-	1,454,670	-	1,454,670
Translation adjustment to long-term equity investments (net of income tax of \$21,365)	-	-	-	-	-	(64,096)	(64,096)
Ending balance, June 30, 2003	<u>\$ 18,350,000</u>	<u>\$ 1,910,000</u>	<u>\$ 568,964</u>	<u>\$ 2,910,055</u>	<u>\$ 1,894,344</u>	<u>\$ 156,551</u>	<u>\$ 25,789,914</u>

**The accompanying notes are an integral part of the financial statements.**  
**Please refer to Independent Auditors' Report dated July 31, 2003.**

**INVENTEC CORPORATION**  
**STATEMENTS OF CASH FLOWS**  
**Six Months Ended June 30, 2003 and 2002**  
**(New Taiwan Dollars in Thousands)**

	Six Months Ended June 30,	
	2003	2002
Cash flows from operating activities:		
Net income	\$ 1,454,670	\$ 1,688,418
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	145,505	155,705
Amortization	135,427	261,422
Gain on disposition of property, plant, and equipment, net	(5,981)	(22,556)
Gain on disposition of deferred assets	(1,585)	(158)
Loss on scrapping of property, plant, and equipment, net	-	93
Provision (reversal) for inventory devaluation	1,073	(73,043)
Foreign currency exchange loss (gain)	(12,497)	89,375
Allowance for doubtful accounts	47	14,826
Equity in earnings recognized under the equity method over cash dividends received	728	(430,903)
Estimated warranty reserve	240,592	40,630
Changes in assets and liabilities:		
Notes and accounts receivable	1,702,926	(1,180,917)
Other financial assets - current	(3,303,806)	(78,439)
Inventories	647,731	(577,598)
Prepayments and other current assets	(42,394)	(71,809)
Deferred income tax assets and liabilities	(205,668)	(102,010)
Notes and accounts payable	(2,094,039)	2,576,295
Income tax payable	146,381	77,316
Accrued expenses	(59,652)	(82,924)
Advanced collection	19,415	(19,530)
Other current liabilities	(21,954)	(66,508)
Deferred credits - intercompany profit	41,857	(6,404)
Accrued pension liabilities	24,229	35,043
Net cash provided by (used in) operating activities	<u>(1,186,995)</u>	<u>2,226,324</u>
Cash flows used in investing activities:		
Increase in long-term investments	(303,575)	(2,453,876)
Purchase of property and equipment	(87,534)	(58,376)
Purchase of deferred assets	(175,969)	(247,992)
Proceeds from disposition of property and equipment	18,794	38,716
Proceeds from disposition of deferred assets	3,441	485
Other financial assets - non-current	9,881	(8,000)
Decrease in other assets	5,153	28,756
Net cash used in investing activities	<u>(529,809)</u>	<u>(2,700,287)</u>
Cash flows from financing activities:		
Increase in other liabilities	1,561	231
Net cash provided by financing activities	<u>1,561</u>	<u>231</u>
Foreign exchange effects	12,497	(89,375)
Net decrease in cash and cash equivalents	(1,702,746)	(563,107)
Cash and cash equivalents, beginning of the period	7,725,918	10,329,027
Cash and cash equivalents, end of the period	<u>\$ 6,023,172</u>	<u>\$ 9,765,920</u>
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	<u>\$ 257</u>	<u>\$ 2,993</u>
Cash paid during the period for income tax	<u>\$ (27,484)</u>	<u>\$ 251,191</u>
Investing and financing activities with no effects on cash flows:		
Undistributed employee bonuses and compensation to directors and supervisors	<u>\$ 226,494</u>	<u>\$ 261,275</u>
Undistributed cash dividends	<u>\$ 917,500</u>	<u>\$ 687,930</u>
Purchase of property and equipment with cash and other payables:		
Increase in property and equipment	\$ 91,432	\$ 58,867
Add: Other payables - beginning of the period	5,044	3,230
Less: Other payables - end of the period	(8,942)	(3,721)
Cash paid	<u>\$ 87,534</u>	<u>\$ 58,376</u>

**The accompanying notes are an integral part of the financial statements.**  
**Please refer to Independent Auditors' Report dated July 31, 2003.**

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**Six Months Ended June 30, 2003 and 2002**  
**(New Taiwan Dollars in Thousands, Unless Otherwise Stated)**

**1. OVERVIEW**

The Company engages primarily in developing, manufacturing, processing and trading of computers, word processors and related products. Significant historical events are as follows:

1975- The Company was founded with a registered capital of \$1,000 to produce calculators and telephone sets.

1989- The Company started to manufacture laptops and word processors.

The Company invested in Besta Co., Ltd.

The Company commenced to manufacture a series of electronic dictionaries as well as language CDs.

1990- The Company built overseas manufacturing plants to manufacture telephone and facsimile machines through investing in Inventec Electronics (M) SDN. BHD.

1991- The Company invested in Inventec Electronics (Shanghai) Co., Ltd. through its investment in Inventec Corporation (Hong Kong) Co., Ltd. to expand software business.

1993- Mass production of PDAs commenced.

1994- The Company invested in Inventec Electronics (Nanking) Co., Ltd., Inventec Electronics (Beijing) Co., Ltd., Inventec Electronics (Beijing) Co., Ltd. and Inventec Electronics (Xi'an) Co., Ltd. for software production.

1995- Mass production of multi-function, multimedia Pentium-computers commenced and a site at Wu-Ku Industrial Park for plant expansion was purchased.

1996- Operation of the factory in Wu-Ku commenced.

A site at Lin-Ko Industrial Park was acquired by the Company for factory expansion and its construction was launched.

The Company's stock was listed in Taiwan Stock Exchange in November.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

1997- Operation of the factories in Lin-Ko Industrial Zone commenced.

Subsidiaries of the Company in Scotland, Singapore and the United States were registered and engaged in assembling and after-sales services.

1998-The Company established Inventec Holding (North America) Co., Ltd. for after-sale services of its U.S. subsidiaries.

-The Company purchased Ta-Shi plant in Taoyuan. Production of servers and desktops commenced.

1999-The Company sold its personal learning system department and related trademark, patents, and copyrights to the investee company Inventec Besta Co., Ltd.

-The Company sold its investment in Inventec Electronic (Xi'an) Co., Ltd. to its investee company Inventec Besta Co., Ltd.

-The Company bought a second factory at Wu-Ku Industrial Park for business in information appliance (IA).

-The Company established Inventec Multimedia and Telecom Corp. for multimedia products and communication related businesses.

-The Company established Inventec Micro-Electronics Corp. to manufacture telecommunication equipment.

-The Company established Inventec Online Co. for software development.

2000-The PDA division was transferred to Inventec Appliances Corp. and assets valuation was used as the basis of the Company's investment.

-The Company established Inventec Communication and Technology Co. for investment business.

-The Company sold its investments in Inventec Electronics (M) SDN. BHD. to the investee company Inventec Communication and Technology Co. to integrate operation and business.

-Investee companies Inventec Communication and Technology Co. and Inventec Multimedia and Telecom Co. merged to reinforce administrative efficiency, integrate resources, and reduce costs. Inventec Multimedia and Telecom Co. is the continuing company after the merger.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

-The Company invested in Inventec Corporation (Cayman) Co., Ltd. for further investment in Inventec Corporation (Shanghai) Co., Ltd. of which parts assembling is the major line of its business.

2001-The Company invested in Inventec Tomorrow Studio Corporation for editorial tasks of books and electronic publications and sales.

2002-Inventec Online Corp. and Inventec Appliances Corp. merged to integrate resources. Inventec Appliances Corp. is the continuing company after the merger.

2003-The Company sold its investment in Inventec Appliances (Shanghai) Co., Ltd. to Inventec Appliances Corp.

-The Company invested in Inventec Corporation (Cayman) Co., Ltd. For further investment in Inventec (Pudong) Corp. of which parts assembling is the major line of its business.

As of June 30, 2003, the average number of employees was 2,083.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Company's financial statements were prepared in accordance with the "Standards Governing the Compilation of Financial Statements of Security Issuers" and generally accepted accounting principles of the Republic of China. The financial statements are based on historical cost. Summary of significant accounting policies is as follows:

**a. Cash Equivalents**

Cash equivalents are Treasury bills, commercial paper, and banker's acceptances with maturities within three months. Commercial paper and banker's acceptances are stated at cost and valued by the specific identification method. On the balance sheet date, interest receivables are accrued on unsold investments.

**b. Notes and Accounts Receivable and Allowance for Doubtful Accounts**

Allowance for doubtful accounts is provided for by reviewing the balance of various receivables at period-end. Allowance for receivables outstanding beyond 1 year and of clients with financial difficulties is fully provided, net of likely collectible amount.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**c. Inventories and Allowance for Inventory Market Decline and Obsolescence**

Inventories are stated at cost on a perpetual inventory basis by the weighted-average method and valued at the lower of cost or market on the balance sheet date. Allowance for inventory market decline is provided for when the market value of inventories is lower than cost, and valuation is based on the total amount of inventories. Allowance for inventory obsolescence is provided for obsolete or slow-moving (over 6 months) items, net of estimated useful or salvage values.

**d. Long-Term Equity Investments**

Long-term equity investments where the Company cannot exercise significant influence are stated at cost. If an investee company is a listed company, an allowance for market decline is provided when market price is lower than cost, with unrealized market decline charged to stockholders' equity. For non-listed companies, should evidence suggest investment value impairment may be other than temporary and the possibility of recovery remote, investment loss is recognized currently with the restated book value as the new cost.

Long-term equity investments where the Company can exercise significant influence are accounted for under the equity method. Premium or discount on investments is amortized equally over 5 years. Exchange differences from translation of foreign-denominated financial statements at period-end are reflected as translation adjustment under stockholders' equity. If the fiscal year of an investee company is different from that of the Company, equity earnings of an investee company are recognized according to equivalent ownership at period-end. If the current audited financial statements are unavailable, gain and loss on investments are recognized in the following year by the current equivalent ownership of the investee company on the balance sheet date. Majority-owned investee companies are valued by the equity method when preparing interim financial statements.

Unrealized intercompany transactions are eliminated and recorded as deferred debits. Regardless of downstream or upstream transactions, unrealized intercompany gains and losses are eliminated in proportion to the shareholding ratio, except for in downstream transactions, where gain or loss must be fully eliminated when controlling interests exist.

Unrealized gains and losses resulting from transactions between investee companies are eliminated in proportion to shareholding ratio if controlling interests exist. Otherwise the unrealized gains or losses are eliminated according to the product of shareholding ratio.

Gains and losses resulted from transactions of depreciable assets are recognized ratably

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

over their economic lives, while those from other assets are recognized immediately.

Cost and gains and losses on disposition of long-term equity investments are determined by the weighted-average method. Capital surplus from disposition of such investments is reduced by the percentage sold, with gains and losses included in current earnings.

Long-term equity investments where the Company has controlling interest are accounted for under the equity method and consolidated financial statements are required according to rules set forth in the Statement of Financial Accounting Standards ("SFAS") and by the Securities and Futures Commission ("SFC") under the Ministry of Finance ("MOF"). Consolidation is not required when preparing interim financial statements.

**e. Property, Plant, Equipment and Depreciation**

Land is stated at cost. Depreciation is applied by the straight-line method with economic lives stipulated by the government plus 1 year's salvage value. Assets still in use after full depreciation may continue to be depreciated by estimated economic lives and salvage value. Economic lives of major property and equipment are the following:

Buildings	10 to 46 years
Machinery	2 to 13 years
Transportation equipment	4 to 6 years
Furniture and office facilities	3 to 18 years
Electric equipment	2 to 16 years
Renovation	2 to 15 years
Miscellaneous equipment	2 to 16 years

Non-operating properties are listed as other assets. Properties with no operating value are reclassified as other assets and carried at the lower of book or net realizable value, and their costs and accumulated depreciation shall offset each other, with difference reported as current loss.

**f. Deferred Expenses**

Telephone line charges and cost of power distributors are amortized equally over 5 years. Molds and tools are amortized equally over 12 months. Software costs of products such as practice-reading cards are amortized at the ratio of its current total production over total current and estimated future production. If unused for production for over six months, then the software will be fully reflected as other losses.

**g. Pension Plan**

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

The Company has a pension plan covering all regular employees, and pension payment is commensurate with years of service. The Company contributes annually to the pension fund and deposits in a government designated account. The pension fund is not reflected in the Company's financial statements. Effective 1995, the Company adopted SFAS No.18 and secured actuarial report on pension liabilities with December 31 as the measurement date. Provisions for pension expense commenced on January 1, 1996, and unrecognized net transition obligations are amortized equally over 15 years.

**h. Foreign Currency Translations**

Assets and liabilities of overseas subsidiaries are translated at the spot rate of the balance sheet date; stockholders' equity is translated by historical rate except for the beginning balance of retained earnings, where the spot rate at the beginning of the year is used. Income statement accounts are translated at the weighted-average rate during the year, with difference reflected as translation adjustments to stockholders' equity.

Foreign-denominated non-forward transactions are recorded at rates as transactions occur. Foreign exchange gain and loss on settlement of foreign-denominated assets and liabilities and those of balance-sheet-date adjustment to foreign-denominated assets and liabilities by the spot rates then are included in current earnings.

**i. Non-Trading Financial Derivatives**

According to the rule set forth by SFAS, hedging foreign exchange forward contracts are recorded at spot rates of the contract date and adjusted by the exchange rate at period-end, with exchange gain and loss included in current earnings. Difference between the contract and the spot rates is recognized ratably over the term of forward contracts. Forward contract receivables netting related payables are reflected as an asset or a liability.

Non-trading foreign currency options are not reflected in the balance sheet on the contract date. Upon settlement, exchange gain and loss are included in current earnings. Premium paid or collected on purchase or sale of foreign currency options is reflected as receivable or payable, and is ratably recognized over the contract term as current gain or loss.

Since there is no physical transfer of principals in interest rate swaps, only memorandum entries of notional principals are made for non-trading swaps. Interest receivables or payables on settlement or accrued on the balance sheet date will adjust foreign exchange gain and loss on the hedged assets or liabilities.

**j. Capital Surplus**

According to the Company Law, capital surplus is used exclusively to offset cumulative

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

losses and increase capital. If the Company revalues properties and uses capital surplus to offset cumulative losses, it must first be restored by future earnings before dividends or any other distribution can be made.

**k. Legal Reserve**

Legal reserve is used exclusively to offset cumulative losses or to increase capital. Capitalization of legal reserve is permitted only when it reaches 50% of the paid-in capital, and only 50% of it can be capitalized. It may not be used for any other purpose.

**l. Earnings Distribution and Dividends Policy**

The Company's Articles of Incorporation prescribe that after-tax earnings shall first offset cumulative losses, and 10% be appropriated as legal reserve. Special reserve may be set aside for operations or to meet regulations. 7% and 3% of the remainder are distributed as employee bonus and compensation for directors and supervisors, respectively. The rest is distributed per the proposal presented to annual stockholders' meeting by the Board of Directors.

In consideration of the Company's future funding needs and long-term budget planning, and in order to meet shareholders' demand of cash flow, annual cash dividends paid cannot be fewer than 10% of the total current dividends.

**m. Commitments and Contingencies**

If loss from a commitment or contingency is deemed highly likely and the amount can be reasonably estimated, then such loss is immediately recognized. Otherwise, only the nature of such loss is disclosed in notes to the financial statements.

**n. Revenue Recognition**

Revenue is recognized when title to the product and risk and benefits of ownership are transferred to the customer; otherwise recognition is deferred until conditions are met.

**o. Warranty Reserve**

An allowance is provided for products with warranty based on past warranty service cost, and the related liability is classified as current or non-current, depending on its nature.

**p. Classification of Capital and Operating Expenditures**

Expenditures that benefit the Company in future years are capitalized, while immaterial expenditures or those with no future benefits are treated as current expense or loss.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**q. Income Tax**

The Company adopted the SFAS No. 22, "Accounting for Income Taxes" to make inter- and intra-period income tax allocation. Tax effects of deductible temporary differences, unused investment tax credits, and operating loss carryforwards are treated as deferred tax assets, whereas those of taxable temporary differences are accounted for as deferred tax liabilities. A valuation allowance is provided for deferred tax assets by assessing whether it is more likely than not such assets will realize. Adjustments to prior years' earnings are reported under stockholders' equity rather than included in current earnings. Income tax expense and benefit from unearned gain and loss and changes in capital surplus are reported under respective accounts in net. Adjustments to prior years' income taxes are reflected as current income taxes.

The 10% surtax on undistributed earnings is reported as current expense on the date of the annual stockholder's meeting declaring distribution of earnings.

**r. Earnings per Share (EPS)**

EPS is based the weighted-average shares outstanding during the year. In the event of capital increase through capitalization of retained earnings or capital surplus, EPS is retroactively adjusted, regardless of the outstanding period in which the incremental shares are issued.

**3. REASONS FOR AND EFFECTS OF ACCOUNTING CHANGES: None.**

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**4. SUMMARY OF MAJOR ACCOUNTS**

**a. Cash and Cash Equivalents**

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Cash on hand	\$ 432	\$ 467
Checking accounts	11,275	3,831
Demand deposits	8,510	24,056
Time deposits	5,922,323	8,798,340
Foreign currency deposits	80,632	85,306
Cash equivalents	-	853,920
Total	<u>\$ 6,023,172</u>	<u>\$ 9,765,920</u>

**b. Accounts Receivable**

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Accounts receivable - other customers	\$ 6,845,855	\$ 3,323,894
Less: Allowance for doubtful accounts	<u>(2,287)</u>	<u>(12,477)</u>
Net book value	6,843,568	3,311,417
Accounts receivable - related parties	5,741,192	9,777,785
Total	<u>\$ 12,584,760</u>	<u>\$ 13,089,202</u>

**c. Inventories**

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Raw materials	\$ 1,046,895	\$ 2,006,875
Work in process	419,741	498,813
Finished goods	890,804	1,084,790
Supplies-in-transit	<u>1,575</u>	<u>79,846</u>
Subtotal	2,359,015	3,670,324
Less: Allowance for inventory market decline and obsolescence	<u>(473,733)</u>	<u>(827,099)</u>
Net	<u>\$ 1,885,282</u>	<u>\$ 2,843,225</u>
Insurance Coverage	<u>\$ 3,512,420</u>	<u>\$ 4,901,090</u>

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**d. Long-Term Equity Investments**

Name of Investee Company	June 30, 2003			June 30, 2002		
	Ownership	Book Value	Original Investment	Ownership	Book Value	Original Investment
<u>Accounted for under the equity method</u>						
Inventec Besta Co., Ltd.	38.69%	\$ 1,178,616	\$ 765,058	38.69%	\$ 1,171,405	\$ 765,058
Inventec Corporation (Hong Kong) Co., Ltd.	100.00%	335,516	8,705	100.00%	1,617,087	781,090
Inventec Corporation (Scotland) Co., Ltd.	100.00%	271,545	39,518	100.00%	209,685	39,518
Inventec Corporation (Singapore) Co., Ltd.	100.00%	6,849	6,888	100.00%	7,595	6,888
Inventec Holding (North America) Co., Ltd.	100.00%	404,729	159,003	100.00%	400,379	159,003
Inventec Multimedia and Telecom Corp.	59.71%	1,277,552	967,400	60.14%	1,205,540	967,400
Inventec Micro-Electronics Corp.	70.48%	423,025	401,625	70.48%	434,417	401,625
Inventec Online Corp.	-	-	-	69.17%	72,279	165,409
Inventec Appliances Corp.	95.03%	4,695,031	3,544,475	95.59%	3,886,172	3,379,066
Inventec Corporation (Cayman) Co., Ltd.	100.00%	1,538,001	1,632,423	100.00%	443,593	556,463
Inventec Tomorrow Studio Corp.	60.00%	198,121	298,800	60.00%	248,440	298,800
Subtotal		<u>10,328,985</u>			<u>9,696,592</u>	
<u>Accounted for under the cost method</u>						
WK Technology Fund IV	1.52%	40,000	<u>Market Price</u>	1.52%	40,000	<u>Market Price</u>
SINA.COM	0.78%	13,802	<u>\$ 22,507</u>	0.78%	13,802	<u>\$ 18,865</u>
Eastern Broadband	0.15%	100,000		0.15%	100,000	
Storage Bank Inc.	10.09%	26,400		10.09%	26,400	
E 28 Limited	-	<u>1,394,600</u>		-	<u>-</u>	
Subtotal		<u>1,574,802</u>			<u>180,202</u>	
Total		<u>\$11,903,787</u>			<u>\$ 9,876,794</u>	

For the six months ended June 30, 2003 and 2002, income and loss from investments in investee companies accounted for under the equity method in which the Company has controlling interest were as follows:

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

	Six Months Ended June 30,	
	2003	2002
Based on unaudited financial statements prepared by investee companies:		
Inventec Corporation (Hong Kong) Co., Ltd.	\$ (41,955)	\$ 198,930
Inventec Corporation (Scotland) Co., Ltd.	40,092	31,163
Inventec Micro-Electronics Corp.	4,683	16,489
Inventec Holding (North America) Co., Ltd.	22,415	97,484
Inventec Online Corp. (dissolved after merger)	-	19,048
Inventec Appliances Corp.	468,821	206,406
Inventec Corporation (Cayman) Co., Ltd.	52,152	(90,288)
Inventec Tomorrow Studio Corp.	(10,583)	(9,053)
Inventec Corporation (Singapore) Co., Ltd.	(222)	-
Inventec Besta Co., Ltd.	-	(10,040)
Inventec Multimedia and Telecom Corp.	16,438	8,182
Based on audited financial statements:		
Inventec Besta Co., Ltd.	(1,874)	-
Inventec Corporation (Singapore) Co., Ltd.	-	-
<b>Total</b>	<b>\$ 549,967</b>	<b>\$ 468,321</b>

Registered capital of the 100%-owned subsidiary Inventec Corporation (Hong Kong) Co., Ltd. is HK\$2,500 (US\$322), representing 2,500,000 shares. On January 2, 2003, the Company sold all shares of Inventec Appliances (Shanghai) Co., Ltd. originally held by Inventec Corporation (Hong Kong) Co., Ltd. to Inventec Appliance (Cayman) Holding Corp., an investee company of Inventec Appliances Corp for \$1,110,747, resulting in a gain of \$116,719. Recognition of the gain is deferred until the shares of Inventec Appliances (Shanghai) Co., Ltd. are sold to a non-related party. As of June 30, 2003, the Company received returned capital of US\$24,865 (Reflected as advance receipts for capital in Inventec Corporation (Hong Kong) Co., Ltd.'s accounts. Cash capitalization procedures have not been processed).

Effective March 1, 2001, the subsidiary Inventec Corporation (Singapore) Co., Ltd. temporarily ceased operations. Its registered capital was SG\$350 (US\$250), representing 350,000 shares with par value of SG\$1. The Company is entitled to 349,625 shares, and 375 shares are registered under individuals. Shareholding ratio was 100%.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

The 100%-owned subsidiary Inventec Corporation (Cayman) Co., Ltd. was founded in November 2000 with a registered capital of US\$6,500. In February and March 2003, and March 2002 the Company increased its investment by US\$31,000 and US\$5,000, and the investment were approved by Investment Commission's Letter Ruling No.(91)(2)091023283, (92)(2)091049980, and (90)(2)90025133.

The Company's investee, Inventec Appliances Corp. increased capital with cash in June 2002. Pursuant to the Company law, 10% of new shares were withheld for employee subscription. Consequently, shareholding ratio declined from 99.99% to 95.59%. In November 2002, Inventec Online Corp. merged with Inventec Appliances Corp. with Inventec Appliances Corp. as the surviving company. After the merger, the Company's ownership in Inventec Appliances Corp. decreased to 95.03%.

In October 2002, the Company purchased 40,000,000 shares of convertible preferred stock of E28 Limited for US\$40,000. The preferred shares pay a dividend of 4% per annum and the dividend is neither cumulative nor participating.

The fiscal year of Inventec Corporation (Singapore) Co., Ltd. ends on March 31 and those of Inventec Holding (North America) Co., Ltd. and Inventec Corporation (Scotland) Co., Ltd. end on September 30.

Cash dividends received from investee companies were as follows:

Name of investee company	Six Months Ended June 30,	
	2003	2002
Inventec Corporation (Hong Kong) Co., Ltd.	\$ 524,385	\$ -
Inventec Besta Co., Ltd.	12,270	16,358
Inventec Micro-Electronics Corp.	14,040	21,060
WK Technology Fund IV	600	6,000
	\$ 551,295	\$ 43,418

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**e. Property, Plant and Equipment**

June 30, 2003	Cost	Accumulated Depreciation	Net
Land	\$ 788,870	\$ -	\$ 788,870
Buildings	427,252	107,911	319,341
Machinery	906,773	673,137	233,636
Transportation equipment	24,458	22,758	1,700
Furniture and office facilities	913,699	627,370	286,329
Other equipment			
Electric equipment	79,495	59,231	20,264
Renovation	94,039	75,174	18,865
Miscellaneous equipment	46,763	35,893	10,870
Construction in progress	3,394	-	3,394
Prepayment for equipment	2,630	-	2,630
Total	<u>\$ 3,287,373</u>	<u>\$ 1,601,474</u>	<u>\$ 1,685,899</u>
<b>June 30, 2002</b>			
Land	\$ 1,035,730	\$ -	\$ 1,035,730
Buildings	794,910	133,130	661,780
Machinery	1,050,432	686,737	363,695
Transportation equipment	25,278	21,948	3,330
Furniture and office facilities	769,365	547,872	221,493
Other equipment			
Electric equipment	256,833	130,676	126,157
Renovation	109,114	89,008	20,106
Miscellaneous equipment	49,693	34,802	14,891
Construction in progress	30,577	-	30,577
Prepayment for equipment	3,310	-	3,310
Total	<u>\$ 4,125,242</u>	<u>\$ 1,644,173</u>	<u>\$ 2,481,069</u>

As of June 30, 2003 and 2002, fire and auto accident insurance coverage of the above property, plant, and equipment amounted to \$4,452,073 and \$4,139,225, respectively.

Interest capitalized for the six months ended June 30, 2003 and 2002, was \$0.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**f. Other Assets**

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Deferred charges	\$ 89,315	\$ 32,776
Temporary payments	3,995	9,695
Assets held for lease, less accumulated depreciation	3,457	3,534
Idle assets, less accumulated depreciation	699,302	889
Prepayments for molds and tools	23,632	9,024
Accounts overdue	24,828	605
Less: Allowance for doubtful accounts	(24,828)	(605)
Total	<u>\$ 819,701</u>	<u>\$ 55,918</u>

On May 18, 1998, the Company entered into a joint-construction contract with Hung Chang Construction Company (“Hung Chang”). The Company agreed to provide idle land and to negotiate with other landowners to demolish construction built thereupon. Hung Chang agreed to finance the planning, design, and construction of the new building. With respect to the ownership of land and the new building, it was agreed that the Company and other landowners would have 60% of the building in exchange for 40% of the land ownership. The construction commenced in June 2000 and completed in late September 2002. The building is reflected under idle assets.

In November 2002, due to a change in operation policy, operating activities at the plant and factories located in Lin-Kou Industrial Park were decreased. Related land and building were transferred from property, plant, and equipment to idle assets.

As of June 30, 2003 and 2002, insurance coverage of the above idle and rental assets amounted to \$76,816 and \$5,000, respectively.

**g. Capital Increase**

On May 30, 2003, pursuant to resolutions of the annual stockholders’ meeting, the Company capitalized earnings of \$1,835,000 and employee bonuses of \$75,000, and capital increase amounted to \$1,910,000 with July 21, 2003 as the record date. Total capital stock after the increase was \$20,260,000 and the Company has not completed relevant registration changes.

On May 30, 2002, pursuant to resolutions of the annual stockholders’ meeting, the Company capitalized earnings of \$1,411,595, capital surplus \$249,105 and employee bonuses of \$82,300, and capital increase amounted to \$1,743,000. Total capital stock after the increase was \$18,350,000 with July 16, 2002 as the record date. The Company has secured license after change in registration.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**h. Income Tax**

1. Deferred income tax assets and liabilities

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
a. Total deferred income tax assets	\$ 437,669	\$ 545,095
b. Total deferred income tax liabilities	(329,113)	(394,846)

	<u>June 30, 2003</u>		<u>June 30, 2002</u>	
	Amount	Income Tax Effect	Amount	Income Tax Effect
c. Temporary differences:				
- Recognition of unrealized exchange gain: deductible	\$ 75,186	\$ 18,796	\$ 300,617	\$ 75,154
- Recognition of inventory market decline and obsolescence: deductible	473,733	118,433	827,099	206,775
- Recognition of warranty expenses: deductible	746,146	186,537	626,071	156,518
- Recognition of loss on overseas investments: taxable	(361,741)	(90,435)	(161,832)	(40,458)
- Recognition of gain on investments: taxable	(716,692)	(179,173)	(1,183,716)	(295,929)
- Recognition of unrealized intercompany profits: taxable	(29,284)	(7,321)	(96,438)	(24,109)
- Cumulative translation adjustment to long-term investments: taxable	(208,735)	(52,184)	(137,398)	(34,350)
- Recognition of pension expense: deductible	181,255	45,314	426,591	106,648
- Unused balance of investment tax credits	-	68,589	-	-

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
2. Deferred income tax assets - current	\$ 392,355	\$ 438,447
Deferred income tax liabilities - current	-	-
Net	<u>\$ 392,355</u>	<u>\$ 438,447</u>
3. Deferred income tax assets- non-current	\$ 45,314	\$ 106,648
Deferred income tax liabilities- non-current	(329,113)	(394,846)
Net	<u>\$ (283,799)</u>	<u>\$ (288,198)</u>

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

4. Calculation of income tax expense:	Six Months Ended June 30,	
	2003	2002
Income tax calculated per statutory tax rate	\$ 341,965	\$ 478,718
Permanent differences	(120,266)	(60,833)
Temporary differences	137,079	102,010
5-year tax-exempt income	(55,984)	(52,039)
Investment tax credits	(151,397)	(116,722)
Income tax payable	151,397	351,134
Income tax separately levied	923	1,695
Adjustment to prior years' income tax	(33,423)	(24,322)
Unused balance of investment tax credits	(68,589)	-
Income tax effect due to temporary differences:		
Provision for inventory obsolescence and market decline	(268)	18,261
Provision (reversal)		
for loss on foreign investments, net	49,977	(15,274)
Reversal of provision for warranty reserve, net	(60,148)	(10,158)
Recognition of gain on investments	(112,976)	59,323
Reversal (recognition) of unrealized intercompany profit, net	(11,609)	387
Recognition of unrealized exchange gain	3,949	(145,774)
Recognition of pension expense	(6,004)	(8,775)
Income tax expense (benefit)	\$ (86,771)	\$ 226,497

5. The Company's tax returns through year 1997 have been assessed by the Tax Authority. Additional taxes for 1995, 1996, and 1997 and was \$8,555, \$26,455 and \$31,743, respectively, and the Company has petitioned for administrative relief.

6. Stockholder's Imputation Tax Credit Account ("ICA") and Tax Rate:

	June 30, 2003	June 30, 2002
Stockholder's imputation tax credit account	\$ 376,894	\$ 691,478

In 2003 and 2002, after filing the corporate income tax returns, the estimated and the actual imputation tax credit rate for earnings distributed to R.O.C. residents would approximately be 11.33% and 18.19%, respectively.

Information on unappropriated earnings:

Undistributed earnings:	June 30, 2003	June 30, 2002
Accumulated prior to 1997 and before	\$ 477,632	\$ 477,632
Accumulated after 1998	1,416,712	2,663,288
Total	\$ 1,894,344	\$ 3,140,920

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**i. Pension Plan**

The Company has a pension plan covering all employees, and payment is commensurate with years of service. 2 units are granted for each of the first 15 years of service, and 1 unit for each of the years thereafter, up to a maximum of 45 units. Any fraction of a year shorter than 6 months is counted as half a year and any fraction of a year longer than 6 months is counted as 1 year of service. Effective February 1987, the Company contributed to the pension fund deposited with Central Trust of China. As of June 30, 2003 and 2002, balance of the pension fund account was \$390,810 and \$464,979, respectively.

**j. Earnings per Share (EPS)**

Earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. As of June 30, 2003 and 2002, weighted-average number of common shares outstanding was 1,835,000,000 and 1,660,700,000. As of June 30, 2002, the number of outstanding shares retroactively adjusted was 1,835,000,000 due to stock dividends.

**l. Information on Financial Instruments**

**(1) Financial Derivatives:**

**(a) Amount of contracts and credit risk**

Financial Instrument	June 30, 2003		June 30, 2002	
	Contract	Credit	Contract	Credit
Forward contracts				
Non-trading options				
-call options	US\$ -	\$ -	US\$ 5,000	\$ -
-put options	US\$ -	\$ -	US\$ 5,000	\$ -
Non-trading foreign currency swaps	US\$ -	\$ -	US\$ 5,000	\$ -

The amount of credit risk is the sum of contracts with positive fair market value at balance sheet date after netting settlement of all contracts and represents the Company's possible loss in the event of default by counterparties.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**(b) Market Risk**

Derivatives held by the Company are exposed to market risk resulting from potential fluctuations in foreign exchange rates. Possible devaluation is offset by exchange gain on hedged foreign-denominated assets and liabilities.

**(c) Amount of Liquidity Risk, Cash Flow Risk, and Future Demand for Cash**

The Company uses its own funds to settle financial derivative contracts with banks.

**(2) Fair Value of Financial Instruments**

	June 30, 2003	
	Book Value	Fair Value
Financial Assets		
Book value equal to fair value	\$ 24,774,694	\$ 24,774,694
Long-term investments	11,903,788	12,255,061
Total financial assets	\$ 36,678,482	\$ 37,029,755
Financial Liabilities		
Book value equal to fair value	\$ 14,646,122	\$ 14,646,122
	June 30, 2002	
	Book Value	Fair Value
Financial Assets		
Book value equal to fair value	\$ 23,136,035	\$ 23,136,035
Long-term investments	9,876,794	9,893,877
Total financial assets	\$ 33,012,829	\$ 33,029,912
Financial Liabilities		
Book value equal to fair value	\$ 12,533,503	\$ 12,533,503

Method and assumptions used by the Company to evaluate the fair value of financial instruments are as follows:

- (a) The fair value of short-term financial instruments is determined by their face value on the balance sheet. Since such instruments will mature with short notice, the face value is a reasonable basis in establishing the fair value. The method is applicable to cash and cash equivalents, notes and accounts receivable, other current assets, short-term borrowings, notes and accounts payable, and other current liabilities.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

- (b) The book value of long-term investments is accounted for under the cost or the equity method based on audited or self-prepared financial statements of investee companies. Since there are no market quotes or reference reports for non-listed companies, fair value of these investments are determined by the net equity worth.
- (c) With respect to financial instruments such as refundable deposits that are indispensable guarantee for the ongoing operations of the Company, it is impossible to estimate the time necessary to accomplish exchange of assets. Consequently, the fair market value of such financial instruments cannot be established. The book value is used as the fair market value.
- (d) Fair value of non-trading foreign-denominated financial derivatives is determined by the amount the Company will pay or receive, assuming contract termination on the balance sheet date. In general, it includes unrealized gains and losses on currently unsettled contracts. There are reference reports issued by financial institutions for most of the non-trading financial derivatives held by the Company.

**(3) Financial Instruments with Off-Balance-Sheet Credit Risk:**

As of June 30, 2003 and 2002, guarantees provided by the Company for bank loans to related parties amounted to US\$113,000, GBP500 and US\$71,500, GBP500, respectively.

As of June 30, 2003 and 2002, promissory notes issued for bank loans amounted to \$6,058,543 and \$5,575,739, respectively.

**(4) Information on Concentration of Credit Risk:**

Group concentration of credit risk exist if the transacting party is an individual or a number of counterparties which engage in similar activities or activities in the same region or share other similar economic characteristics that would similarly affect their ability to meet contractual obligations with changes in economic or other conditions. As of June 30, 2003 and 2002, the Company's contracts with credit risk concentration were the following:

<u>Accounts receivable, net - by region</u>	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Domestic	\$ 1,306,702	\$ 560,093
Asia	2,037,216	3,276,796
Europe	4,032,702	5,244,831
America	5,139,721	3,962,325
Oceania	68,419	45,157
Total	<u>\$ 12,584,760</u>	<u>\$ 13,089,202</u>

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**5. RELATED PARTY TRANSACTIONS**

**A. Name of Related Party and Relationship with the Company:**

Name of Related Party	Relationship with the Company
Inventec Besta Co., Ltd.	An investee company accounted for under the equity method
Inventec Corporation (Scotland) Co., Ltd.	A subsidiary of the Company
Inventec Corporation (Singapore) Co., Ltd.	"
Inventec Multimedia and Telecom Corp.	"
Inventec Micro-Electronics Corp.	"
Inventec Appliances Corp.	"
Inventec Corporation (Cayman) Co., Ltd.	"
Inventec Corporation (Hong Kong) Co., Ltd.	"
Inventec Holding (North America) Co., Ltd.	"
Inventec Electronics (Beijing) Co., Ltd.	A subsidiary of Inventec Corporation (Hong Kong) Co., Ltd.
Inventec Electronics (Nanking) Co., Ltd.	"
Inventec Electronics (Tianjin) Co., Ltd.	"
Inventec Appliances (Shanghai) Co., Ltd.	A third-level subsidiary of Inventec Appliances Corp.
Inventec Corporation (Shanghai) Co., Ltd.	A subsidiary of Inventec Corporation (Cayman) Co., Ltd.
Inventec (Pudong) Corp.	"
Inventec Electronics (M) SDN. BHD.	A subsidiary of Inventec Multimedia and Telecom Corp.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**B. Significant Transactions with Related Parties:**

**i) Sales**

Related Party	Six Months Ended June 30,			
	2003		2002	
	Amount	% Net Sales	Amount	% Net Sales
Inventec Electronics (M) SDN. BHD	\$ 237,068	1%	\$ 293,798	1%
Inventec Corporation (Scotland) Co., Ltd.	6,429,349	17%	9,632,629	29%
Invertec Holding (North America) Co., Ltd.	5,619,461	14%	7,826,777	23%
Inventec Corporation (Hong Kong) Co., Ltd.	1,275,241	3%	3,162,360	9%
other	492	-	-	-
<b>Total</b>	<b>\$13,561,611</b>	<b>35%</b>	<b>\$20,915,564</b>	<b>62%</b>

Prices of sales of motherboards (reflected as inventory) to Inventec Electronics (M) SDN. BHD. are based on cost with collection terms varying between one and three months.

The Company sold work-in-process to the assembling department of Inventec Corporation (Scotland) Co., Ltd. and upon completion of assembling, finished products were sold to others. Prices of work-in-process are negotiated. Since Inventec Corporation (Scotland) is an overseas after-sales service and assembling center, no basis of price reference exists. Collection period is within two months.

Inventec Holding (North America) Co., Ltd. is an overseas warranty service and packaging center and prices of sales thereto are negotiated. Accordingly, no basis of price reference exists. Collection period depends on its collection from others and remittance and averages within three months.

Prices of raw materials sold to Inventec Corp. (H.K.) Co., Ltd. are the same as those with other clients. Collection period averages within two months.

As of June 30, 2003 and 2002, unrealized gross margin from sales to related parties was \$31,771 and \$102,441, respectively.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**ii) Warranty Services and Product Maintenance**

For the six months ended June 30, 2003 and 2002, payment to related parties for service and maintenance, after netting product warranty reserve, was the following:

<u>Related Party</u>	<u>Six Months Ended June 30,</u>	
	<u>2003</u>	<u>2002</u>
	<u>Amount</u>	<u>Amount</u>
Inventec Holding (North America) Co., Ltd.	\$ 164,212	\$ 110,358
Inventec Corporation (Scotland) Co., Ltd.	77,687	69,779
Total	<u>\$ 241,899</u>	<u>\$ 180,137</u>

**iii) Purchases**

<u>Related Party</u>	<u>Six Months Ended June 30,</u>			
	<u>2003</u>		<u>2002</u>	
	<u>Amount</u>	<u>% Net Purchase</u>	<u>Amount</u>	<u>% Net Purchase</u>
Inventec Electronics (M) SDN. BHD.	\$ 368,459	1%	\$ 1,248,857	6%
Inventec Holding (North America) Co., Ltd.	78,377	-	-	-
Inventec Corporation (Scotland) Co., Ltd.	163,053	-	-	-
Inventec Corporation (Hong Kong) Co., Ltd.	20,109,207	58%	2,216,467	11%
Others	7,320	-	178	-
	<u>\$ 20,726,416</u>	<u>59%</u>	<u>\$ 3,465,502</u>	<u>17%</u>

The Company purchased motherboards from Inventec Electronics (M) SDN. BHD. at an agreed-upon price. The payment term is approximately one to three months.

The Company purchased finished goods and work in process from Inventec Corporation (Hong Kong) Co., Ltd, at an agreed-upon price. The payment term is approximately two to three months.

The Company purchased supplies used for warranty service from Inventec Holding (North America) Co., Ltd. at an agreed-upon price. The payment term is within two months.

The Company purchased supplies used for warranty service from Inventec Corporation (Scotland) Co., Ltd. at an agreed-upon price. The payment term is

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

within two months.

**iv) Technical Service Revenue**

The Company entered into an agreement with Inventec Besta Co., Ltd., which would pay royalty to the Company for use of patents and copyrights in the manufacturing information and electronic-related products. Royalty is determined by sales volume.

The Company entered into an agreement with Inventec Tomorrow Studio Corp. in which the Company collects royalty through production, distribution, and sale of Dr. Eye 2002. Royalty is based on sales volume.

For the six months ended June 30, 2003 and 2002, royalty collected from Inventec Besta Co., Ltd. was \$247 and \$2,903, respectively.

For the six months ended June 30, 2003 and 2002, royalty collected from Inventec Tomorrow Studio Corp. for the right to sale computer software amounted to \$490 and \$1,850, respectively.

**v) Purchase of Software**

For the six months ended June 30, 2003 and 2002, cost of software purchased from Inventec Corp. (Hong Kong) Co., Ltd., reflected as deferred expenses, was \$101,652 and \$202,236, respectively. Prices were negotiated with payment terms of one to three months.

**vi) Others**

(1) In 1999, the Company sold properties, deferred assets, assets stated under expenses, and trademark to Inventec Besta Co., Ltd., resulting in a gain on property disposition of \$51,712 and other revenue of \$40,453. As of June 30, 2003 and 2002, unrealized gain on sale of properties to Inventec Besta Co., Ltd. was \$17,599 and \$233, respectively, with unrealized other revenue of \$4,652 and \$5,589, respectively.

(2) In 1999, the Company sold properties, deferred assets, and assets stated under expense to Inventec Multimedia & Telecom Corp., resulting in a gain on property disposition of \$295 and other revenue of \$5,088. As of June 30, 2003 and 2002, unrealized gain on sale of properties to Inventec Multimedia & Telecom Corp. was \$0 and \$38, respectively, and there was no unrealized other revenue.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

- (3) In 2000, the Company invested in Inventec Appliances Corp. with properties, deferred assets, and assets stated under expense, resulting in a gain on asset disposition of \$103,713 and other revenue of \$31,693. Sale of properties and deferred assets resulted in gain on property disposition of \$1,156 and other revenue of \$6,427. As of June 30, 2003 and 2002, unrealized gain on property sales was \$0 and \$73,566, respectively, and unrealized other revenue was \$0 and \$39 respectively.
- (4) For the six months ended June 30, 2003, the Company sold properties, deferred assets, and assets stated under expense to Inventec Corporation (Hong Kong) Co., Ltd. resulting in a gain on property disposition of \$27,122 and other revenue of \$3,409. As of June 30, 2003, unrealized gain on sale of properties \$18,390 and unrealized other revenue was \$2,007.
- (5) For the six months ended June 30, 2003 and 2002, general and administrative expenses collected from Inventec Appliances Corp., Inventec Micro-Electronic Corp., were \$20,136 and \$22,091, respectively, reflected as other revenue.
- (6) As of June 30, 2003, promissory notes issued to Inventec Application Corp. for the Company's participation in the Ministry of Economic Affairs "Mobile Terminal Application Platform" plan amounted to \$50,292.

**vii) Accounts Receivable (Payable)**

	June 30, 2003		June 30, 2002	
	Amount	%	Amount	%
Notes Receivable	\$ 984	45%	\$ 4,314	81%
Accounts Receivable:				
Inventec Holding (North America) Co., Ltd.	\$ 2,289,410	18%	\$ 2,891,510	22%
Inventec Corporation (Scotland) Co., Ltd.	2,741,586	22%	3,701,039	28%
Inventec Electronics (M) SDN. BHD	100,828	1%	184,082	2%
Inventec Corporation (Hong Kong) Co., Ltd.	609,102	5%	3,001,136	23%
Others	266	-	18	-
Total	\$ 5,741,192	46%	\$ 9,777,785	75%
Other Receivables	\$ 38,256	26%	\$ 89,298	92%
Other Current Assets				
Inventec Corporation (Hong Kong) Co., Ltd.	\$ 5,851,399	22%	\$ 11,864	52%
Others	2,399	-	-	-
Total	\$ 5,853,798	22%	\$ 11,864	52%

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

	June 30, 2003		June 30, 2002	
	Amount	%	Amount	%
Notes Payable	\$ 4,746	1%	\$ 15	-
Accounts Payable:				
Inventec Corporation (Hong Kong) Co., Ltd.	\$ 4,605,255	39%	\$ 1,568,433	17%
Inventec Electronics (M) SDN. BHD.	124,974	1%	230,447	2%
Others	2,610	-	4,740	-
Total Accounts Payable	<u>\$ 4,732,839</u>	<u>40%</u>	<u>\$ 1,803,620</u>	<u>19%</u>
Other Current Liabilities:				
Inventec Corporation (Hong Kong) Co., Ltd.	<u>\$ 102,358</u>	<u>23%</u>	<u>\$ 154,794</u>	<u>35%</u>

**viii) Endorsement Guarantees**

As of June 30, 2003 and 2002, endorsement guarantees provided to related parties for bank loans were as follows:

Related Party Guaranteed	Amount Guaranteed		Remarks
	June 30, 2003	June 30, 2002	
Inventec Corporation (Hong Kong) Co., Ltd.	US\$ 15,000	US\$ 30,000	Citibank, N.A.
Inventec Corporation (Cayman) Co., Ltd.	US\$ 30,000	US\$ -	"
Inventec Appliances (Shanghai) Co., Ltd.	US\$ 8,000	US\$ 14,500	Bank of America
Inventec Corporation (Shanghai) Co., Ltd.	US\$ 25,000	US\$ -	"
Inventec Electronics (Nanking) Co., Ltd.	US\$ 1,500	US\$ 1,500	"
Inventec Electronics (Tianjin) Co., Ltd.	US\$ 2,500	US\$ 2,500	"
Inventec Electronics (Beijing) Co., Ltd.	US\$ 1,000	US\$ 1,000	"
Inventec Corporation (Scotland) Co., Ltd.	US\$ 23,000	US\$ 20,000	Citibank, N.A.
"	GBP 500	GBP 500	Government of Scotland
Inventec Holding (North America) Co., Ltd.	US\$ 2,000	US\$ -	Bank of America
Inventec (Pudong) Corp.	<u>US\$ 5,000</u>	<u>US\$ 2,000</u>	"
Total	<u>US\$ 113,000</u>	<u>US\$ 71,500</u>	
	<u>GBP 500</u>	<u>GBP 500</u>	

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**6. PLEDGED ASSETS**

As of June 30, 2003 and 2002, following assets were pledged as collateral:

<u>Asset</u>	<u>June 30, 2003</u>	<u>June 30, 2002</u>	<u>Purpose of pledge</u>
Refundable deposits	<u>\$ 60,498</u>	<u>\$ 81,444</u>	Guarantees for foreign labor, customs duties, and property deposits.

**7. SIGNIFICANT COMMITMENTS AND CONTINGENCIES** (excluding related-party transactions):

1. As of June 30, 2003 and 2002, unused letters of credit amounted to US\$712, and US\$3,340, EUR107, respectively.
2. As of June 30, 2003, the Company filed documents to the Ministry of Economic Affairs to verify its qualification under "Operation Headquarters" regulations. which stipulates that income derived from provision of management services or R & D services to overseas affiliates and overseas investment income or gain from disposal of overseas investments are exempt from tax. Had tax credit been acquired during the first half of 2003, income tax benefit and earnings per share for the six months ended June 30, 2003 would have increased by \$131,096 and \$0.07, respectively.

**8. SIGNIFICANT CATASTROPHIC LOSSES:** None.

**9. SIGNIFICANT SUBSEQUENT EVENTS:** None.

**INVENTEC CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS (CONT'D)**

**10. OTHERS:**

- (1) Personnel, depreciation, and amortization expense incurred categorized as operating cost on expense are as follows:

Categorized as: Nature	Six months ended June 30, 2003			Six months ended June 30, 2002		
	Operating cost	Operating expense	Total	Operating cost	Operating expense	Total
Personnel expenses						
Salary expense	319,083	602,368	921,451	547,933	540,322	1,088,255
Health and labor insurance expense	21,656	29,656	51,312	37,174	23,049	60,223
Pension expense	10,923	28,838	39,761	28,256	27,847	56,103
Other expense	4,172	3,649	7,821	10,539	2,632	13,171
Depreciation expense	55,347	66,364	121,711	98,362	56,792	155,154
Amortization expense	12,641	37,048	49,689	47,866	304	48,170

- (2) In January 2002, Samsung Electronics Co., Ltd. (Samsung) named the Company and 10 other parties as defendants for patents infringement in United States District Court for the District of Texas. The plaintiff claimed that the defendants violated six of its U.S. patents. As of June 30, 2003, four of the six claims have been dropped by Samsung. Patents Nos. 5588054 and 5333273 are currently under trial. The Company has appointed a counsel for the litigation. In November 2002, the Magistrate Judge ruled that unless the Company and Samsung object within a stated period of time, the trial will be tried by a federal judge.
- (3) On May 30, 2003, the Company's shareholders meeting resolved to sale 105,515,000 shares of Inventec Appliances Corp. in order to meet the ownership diversification requirement for Inventec Appliances Corp's application for listed stocks. The shares were sold for \$28 per share, totaling \$2,954,420. The Company estimates the above transaction will be completed before August 2003.