

**Far EastOne Telecommunications Co., Ltd. and  
Subsidiaries**

**Consolidated Financial Statements as of  
September 30, 2004 and 2003  
Together with Independent Accountants' Review Report**

Readers are advised that the original version of these financial statements is in Chinese. If there is any conflict between these financial statements and the Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail.

**English Translation of a Report Originally Issued in Chinese**

**INDEPENDENT ACCOUNTANTS' REVIEW REPORT**

October 22, 2004

The Board of Directors and Stockholders  
Far EastTone Telecommunications Co., Ltd. and Subsidiaries

We have reviewed the accompanying consolidated balance sheets of Far EastTone Telecommunications Co., Ltd. ("the Company") and subsidiaries as of September 30, 2004 and 2003, and the related consolidated statements of income and cash flows for the nine months then ended, all expressed in New Taiwan dollars. These consolidated financial statements are the responsibility of the Company's and subsidiaries' management.

Except for the matter described in the next paragraph, we conducted our review in accordance with Statement on Auditing Standards No. 36—"Review of Financial Statement" in the Republic of China, which consist principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of China, the objective of which is the expression of an opinion regarding the consolidated financial statements taken as a whole. Accordingly, we do not express such an opinion.

We were unable to obtain reviewed financial statements supporting the Company's and subsidiaries' investments in certain equity-accounted investee companies stated at NT\$1,800,465 thousand as of September 30, 2004, the Company's equity in the losses of those companies of NT\$155,927 thousand, which were included in the consolidated net incomes for the nine months then ended as described in Note 7, and the related information of the Company's and subsidiaries' investments as described in Note 22 to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying values of the investments in the investee companies or the equity in their losses by other auditing procedures.

Based on our review, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain sufficient evidence regarding the investments in and equity in the losses of the investee companies and the related information of the Company's and subsidiaries' investments as described in the preceding paragraph, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the Republic of China.

#### Notice to Readers

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

English Translation of Financial Statements Originally Issued in Chinese

FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2004 AND 2003

(In Thousands of New Taiwan Dollars, Except Par Value)

(Reviewed, Not Audited)

ASSETS	2004		2003		LIABILITIES AND STOCKHOLDERS' EQUITY	2004		2003	
	Amount	%	Amount	%		Amount	%	Amount	%
<b>CURRENT ASSETS</b>					<b>CURRENT LIABILITIES</b>				
Cash and cash equivalents (Notes 2 and 5)	\$ 3,600,861	4	\$ 5,800,932	9	Short-term loans (Note 11)	\$ 1,200,000	1	\$ -	-
Short-term investments (Note 2)	290,000	-	-	-	Commercial paper payable (Note 12)	1,745,339	2	346,571	-
Accounts and notes receivable—net of allowance for doubtful accounts of \$1,500,775 in 2004 and \$547,550 in 2003 (Note 2)	6,645,681	7	3,820,200	6	Notes payable	41,163	-	25,480	-
Receivables from related parties (Notes 2 and 19)	60,098	-	92,809	-	Accounts payable	980,316	1	1,005,690	2
Inventories—net (Notes 2 and 6)	964,677	1	938,998	2	Payables to related parties (Note 19)	293,417	-	469,035	1
Prepaid expenses (Notes 2 and 19)	2,241,825	2	2,036,561	3	Income tax payable (Notes 2 and 18)	1,576,433	2	123,215	-
Deferred income tax assets—current (Notes 2 and 18)	1,268,896	1	525,781	1	Accrued expenses	4,749,481	5	2,416,376	4
Other current assets	189,220	-	64,104	-	Payables related to acquisition of properties	1,441,792	1	1,903,471	3
Total current assets	15,261,258	15	13,279,385	21	Guarantee deposits received—current	1,614,831	2	-	-
					Unearned revenues (Note 2)	2,587,107	2	2,205,121	3
<b>INVESTMENTS IN SHARES OF STOCK (Notes 2, 7 and 19)</b>					Current portion of long-term liabilities (Notes 2, 8, 13, 19 and 20)	8,225,991	8	616,000	1
Equity method	1,800,465	2	8,518	-	Other current liabilities (Notes 2 and 14)	417,510	-	186,412	-
Cost method	3,000	-	-	-	Total current liabilities	24,873,380	24	9,297,371	14
Prepayment for investments	45,000	-	40,000	-					
Total investments in shares of stock	1,848,465	2	48,518	-	<b>LONG-TERM LIABILITIES—Net of current portion (Notes 2, 8, 13 and 20)</b>				
					Long-term bonds payable	9,000,000	9	10,543,165	16
<b>PROPERTIES (Notes 2, 8, 19 and 20)</b>					Long-term debts payable	6,060,226	6	350,000	1
Cost					Long-term lease payable	88,500	-	-	-
Land	1,050,281	1	890,580	1	Total long-term liabilities	15,148,726	15	10,893,165	17
Buildings and equipment	2,078,425	2	1,457,533	2					
Operating equipment	86,917,135	83	47,632,215	74	<b>OTHER LIABILITIES</b>				
Computer equipment	10,825,075	10	6,054,834	9	Accrued pension cost (Notes 2 and 16)	217,238	-	159,605	-
Office equipment	792,982	1	771,829	1	Guarantee deposits received—noncurrent	89,909	-	1,668,493	3
Leasehold improvements	1,412,279	2	1,580,074	3	Minority interest	-	-	1,918,066	3
Miscellaneous equipment	297,215	-	54,834	-	Other	14,794	-	-	-
Total cost	103,373,392	99	58,441,899	90	Total other liabilities	321,941	-	3,746,164	6
Less—accumulated depreciation	44,947,703	43	22,597,529	35	Total liabilities	40,344,047	39	23,936,700	37
Construction in progress and advances related to acquisition of equipment	5,996,677	5	3,306,434	5					
Net properties	64,422,366	61	39,150,804	60	<b>STOCKHOLDERS' EQUITY</b>				
					Capital stocks—\$10 par value				
<b>INTANGIBLE ASSETS</b>					Authorized—4,200,000 thousand shares in 2004 and 3,360,000 thousand shares in 2003				
Goodwill—net (Notes 1 and 2)	11,271,785	11	-	-	Issued—3,763,151 thousand shares in 2004 and 2,697,786 thousand shares in 2003	37,631,514	36	26,977,860	42
3G concession (Notes 2 and 9)	10,169,000	9	10,169,000	16	Capital surplus				
Total intangible assets	21,440,785	20	10,169,000	16	Paid-in capital in excess of par value	4,694,535	4	5,944,514	9
					From business combination	8,482,381	8	-	-
<b>OTHER ASSETS</b>					From investments in shares of stock	-	-	29,086	-
Rental assets—net (Notes 2 and 10)	191,459	-	-	-	Total capital surplus	13,176,916	12	5,973,600	9
Refundable deposits (Note 19)	423,576	1	238,226	-	Retained earnings				
Deferred income tax assets—noncurrent (Notes 2 and 18)	1,015,769	1	1,713,006	3	Legal reserve	2,697,301	3	1,878,489	3
Miscellaneous (Note 2)	136,726	-	195,565	-	Unappropriated earnings	10,884,133	10	6,024,803	9
Total other assets	1,767,530	2	2,146,797	3	Total retained earnings	13,581,434	13	7,903,292	12
					Cumulative translation adjustments	6,493	-	3,052	-
					Total stockholders' equity	64,396,357	61	40,857,804	63
<b>TOTAL ASSETS</b>	<b>\$ 104,740,404</b>	<b>100</b>	<b>\$ 64,794,504</b>	<b>100</b>	<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 104,740,404</b>	<b>100</b>	<b>\$ 64,794,504</b>	<b>100</b>

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

(See Deloitte & Touche review report dated October 22, 2004)

**English Translation of Financial Statements Originally Issued in Chinese**

**FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003  
(In Thousands of New Taiwan Dollars, Except Amounts Per Share)  
(Reviewed, Not Audited)**

	<u>2004</u>		<u>2003</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
OPERATING REVENUES (Notes 2 and 19)				
Sales of cellular phone equipment and accessories—net	\$ 3,040,034	6	\$ 1,588,656	6
Service revenues	45,979,313	94	25,557,169	94
Other	<u>15,108</u>	<u>-</u>	<u>3,988</u>	<u>-</u>
Total operating revenues	<u>49,034,455</u>	<u>100</u>	<u>27,149,813</u>	<u>100</u>
OPERATING COSTS (Notes 2, 16, 17 and 19)				
Cost of sales	3,290,694	7	1,780,587	7
Cost of services	<u>20,226,267</u>	<u>41</u>	<u>11,747,379</u>	<u>43</u>
Total operating costs	<u>23,516,961</u>	<u>48</u>	<u>13,527,966</u>	<u>50</u>
GROSS PROFIT	<u>25,517,494</u>	<u>52</u>	<u>13,621,847</u>	<u>50</u>
OPERATING EXPENSES (Notes 2, 16, 17 and 19)				
Marketing	6,507,730	13	4,526,493	17
General and administrative	5,197,458	11	2,800,855	10
Research and development	<u>282,291</u>	<u>-</u>	<u>229,267</u>	<u>1</u>
Total operating expenses	<u>11,987,479</u>	<u>24</u>	<u>7,556,615</u>	<u>28</u>
OPERATING INCOME	<u>13,530,015</u>	<u>28</u>	<u>6,065,232</u>	<u>22</u>
NONOPERATING INCOME AND GAINS				
Gain from sale of non-performance account receivable	88,351	-	-	-
Interest	18,077	-	31,888	-
Gain from sale of short-term investments	9,579	-	-	-
Foreign exchange gains—net (Note 2)	-	-	45,710	1
Other	<u>67,284</u>	<u>-</u>	<u>30,913</u>	<u>-</u>
Total nonoperating income and gains	<u>183,291</u>	<u>-</u>	<u>108,511</u>	<u>1</u>
NONOPERATING EXPENSES AND LOSSES				
Interest (Notes 2, 8 and 22)	554,394	1	233,109	1
Provision for losses on properties not currently used in operations (Note 2)	275,625	1	-	-
Equity in investees' net losses (Notes 2 and 7)	155,927	-	1,778	-
Loss on disposal of properties—net (Note 2)	31,917	-	-	-

(Continued)

**English Translation of Financial Statements Originally Issued in Chinese**

	<b><u>2004</u></b>		<b><u>2003</u></b>	
	<b><u>Amount</u></b>	<b><u>%</u></b>	<b><u>Amount</u></b>	<b><u>%</u></b>
Foreign exchange losses (Note 2)	\$ 21,879	-	\$ -	-
Other (Note 17)	<u>68,189</u>	<u>-</u>	<u>2</u>	<u>-</u>
Total nonoperating expenses and losses	<u>1,107,931</u>	<u>2</u>	<u>234,889</u>	<u>1</u>
CONSOLIDATED INCOME BEFORE INCOME TAX EXPENSE (BENEFIT)	12,605,375	26	5,938,854	22
INCOME TAX EXPENSE (BENEFIT) (Notes 2 and 18)	<u>1,747,963</u>	<u>4</u>	<u>( 33,716)</u>	<u>-</u>
CONSOLIDATED INCOME BEFORE MINORITY INTEREST	10,857,412	22	5,972,570	22
MINORITY INTEREST	<u>-</u>	<u>-</u>	<u>43,138</u>	<u>-</u>
CONSOLIDATED NET INCOME	<u>\$10,857,412</u>	<u>22</u>	<u>\$ 6,015,708</u>	<u>22</u>
	<b><u>2004</u></b>		<b><u>2003</u></b>	
	<b><u>Income Before Income Tax</u></b>	<b><u>Net Income</u></b>	<b><u>Income Before Income Tax</u></b>	<b><u>Net Income</u></b>
CONSOLIDATED EARNINGS PER SHARE (Note 15)				
Primary	<u>\$3.38</u>	<u>\$2.91</u>	<u>\$2.02</u>	<u>\$2.03</u>
Diluted	<u>\$3.27</u>	<u>\$2.82</u>	<u>\$1.93</u>	<u>\$1.94</u>

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

(See Deloitte & Touche review report dated October 22, 2004)

(Concluded)

**English Translation of Financial Statements Originally Issued in Chinese**

**FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003**

**(In Thousands of New Taiwan Dollars)**

**(Reviewed, Not Audited)**

	<u>2004</u>	<u>2003</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Consolidated net income	\$ 10,857,412	\$ 6,015,708
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interest	-	( 43,138 )
Depreciation and amortization	9,324,727	5,272,260
Provision for doubtful accounts	1,191,725	297,694
Provision (reversal of allowance) for losses on inventories	3,999	( 1,284 )
Equity in investees' net losses	155,927	1,778
Losses (gains) on disposal of properties—net	31,917	( 9,529 )
Provision for loss on properties not currently used in operations	275,625	-
Accrued pension cost	47,960	28,475
Deferred income taxes	847,856	( 214,520 )
Interest premium on convertible bonds	30,047	23,915
Unrealized exchange losses (gains) on overseas convertible bonds	885	( 121,210 )
Other	7,513	30,722
Changes in operating assets and liabilities		
Decrease (increase) in		
Accounts and notes receivable	( 501,121 )	( 901,317 )
Receivables from related parties	( 12,573 )	( 84,671 )
Inventories	53,118	( 281,700 )
Prepaid expenses	( 76,205 )	( 310,655 )
Other current assets	( 788 )	56,486
Increase (decrease) in		
Notes payable	( 412,800 )	( 3,464 )
Accounts payable	( 293,961 )	416,345
Payables to related parties	66,883	( 191,194 )
Income tax payable	848,729	( 13,880 )
Accrued expenses	( 927,115 )	( 512,322 )
Unearned revenues	( 51,115 )	154,811
Other current liabilities	<u>19,163</u>	<u>( 12,737 )</u>
Net cash provided by operating activities	<u>21,487,808</u>	<u>9,596,573</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Decrease in short-term investments	3,103,647	-
Acquisition of investments in shares of stock	( 609,404 )	-
Prepayment for investments	( 45,000 )	( 40,000 )
Acquisition of properties	( 5,712,959 )	( 4,681,873 )
Proceeds from sale of properties	85,631	88,489
Return of the capital from the dissolved investee	488	-
Decrease (increase) in refundable deposits	( 7,045 )	135,053
Decrease (increase) in other assets	<u>10,317</u>	<u>( 66,235 )</u>
Net cash used in investing activities	<u>( 3,174,325 )</u>	<u>( 4,564,566 )</u>

(Continued)

**English Translation of Financial Statements Originally Issued in Chinese**

	<u>2004</u>	<u>2003</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Decrease in short-term loans	(\$ 1,050,000)	\$ -
Increase (decrease) in commercial paper payable	( 1,198,092)	346,571
Increase in long-term bonds payable	-	5,472,460
Increase in long-term debts	7,665,000	350,000
Decrease in long-term liabilities	( 17,251,606)	( 4,177,839)
Decrease in guarantee deposits received	( 552,772)	( 323,234)
Bonus paid to employees and directors	( 147,387)	( 154,666)
Cash dividends paid	( 4,748,620)	( 2,997,540)
Decrease in other liabilities	( 22,030)	-
Repurchase of treasury stock	( 3,334,798)	-
Cash consideration of the merger	( <u>11,698,461</u> )	<u>-</u>
Net cash used in financing activities	( <u>32,338,766</u> )	( <u>1,484,248</u> )
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>		
	( 14,025,283)	3,547,759
<b>CASH AND CASH EQUIVALENTS DUE TO MERGE WITH KG TELECOMMUNICATIONS CO., LTD.</b>		
	3,057,490	-
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>		
	<u>14,568,654</u>	<u>2,253,173</u>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>		
	<u>\$ 3,600,861</u>	<u>\$ 5,800,932</u>
<b>SUPPLEMENTARY INFORMATION</b>		
Interest paid (excluding capitalized interest)	<u>\$ 605,136</u>	<u>\$ 193,829</u>
Income tax paid	<u>\$ 53,456</u>	<u>\$ 194,687</u>
<b>NONCASH INVESTING AND FINANCING ACTIVITIES</b>		
Current portion of long-term liabilities	<u>\$ 8,225,991</u>	<u>\$ 616,000</u>
Reclassification of properties into rental assets	<u>\$ 192,908</u>	<u>\$ -</u>
Reclassification of properties into properties not currently used in operations	<u>\$ 190,000</u>	<u>\$ -</u>
Conversion of overseas convertible bonds into common stock and capital surplus	<u>\$ 908,182</u>	<u>\$ -</u>
<b>CASH PAID FOR ACQUISITION OF PROPERTIES</b>		
Increase in properties	\$ 3,879,551	\$ 4,465,166
Decrease in payables related to acquisition of properties	1,551,408	216,707
Decrease in obligations under capital lease	<u>282,000</u>	<u>-</u>
Actual cash paid for acquisition of properties	<u>\$ 5,712,959</u>	<u>\$ 4,681,873</u>
<b>PROCEEDS FROM DISPOSAL OF PROPERTIES</b>		
Total amount of properties sold	\$ 18,374	\$ 166,424
Increase in receivables from properties sold	( 1,747)	( 77,935)
Decrease in receivables from related parties	<u>69,004</u>	<u>-</u>
Actual cash received from disposal of properties	<u>\$ 85,631</u>	<u>\$ 88,489</u>

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

(See Deloitte & Touche review report dated October 22, 2004)

(Concluded)



## **FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (Amounts in Thousands of New Taiwan Dollars, Unless Otherwise Stated) (Reviewed, Not Audited)**

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#### **1. ORGANIZATION AND OPERATIONS**

Far EasTone Telecommunications Co., Ltd. (“Far EasTone”) was incorporated in the Republic of China on April 11, 1997 and began commercial operations on January 20, 1998. Far EasTone’s shares have been traded and listed on the ROC Over-the-Counter Securities Exchange (now known as GreTai Securities Market) since December 10, 2001. Far EasTone provides wireless communications, leased circuit, Internet and international simple resale (ISR) services and also sells cellular phone equipments and accessories.

Far Eastern Textile Co., Ltd. is the ultimate parent company of Far EasTone. In October 2003, the other principal stockholder, the AT&T Wireless Group and its affiliates, transferred to Far Eastern Textile Co., Ltd. and its affiliate (“Far Eastern Group”) all Far EasTone’s stock owned. As of September 30, 2004, Far Eastern Group directly or indirectly owns 53.03% of Far EasTone’s shares.

Far EasTone provides wireless communications services by geographical sector under two type I licenses—GSM900 for the northern region of Taiwan and GSM1800 for island-wide (“GSM” means global system for mobile communications) issued by the Directorate General of Telecommunications (the “DGT”) of the Republic of China (ROC). These licenses allow Far EasTone to provide services for 15 years from 1997, with an annual license fee at 2% of total wireless communications service revenues.

The DGT also issued to Far EasTone a type II license, allowing it to provide internet services for 10 years from 1999 for a fixed annual license fee based on the amount of Far EasTone’s paid-in capital. In addition, Far EasTone provides services under a type II-ISR license for 10 years from December 2001 and pays an annual license fee at 0.5% of ISR service revenues and is licensed to provide local/domestic long-distance land cable leased circuit services for 15 years from 2003 with an annual license fee at 1% of leased circuit service revenues.

On October 7, 2003, Far EasTone signed a definitive merger agreement with KG Telecommunication Co., Ltd. (the “former KGT”). The former KGT was incorporated in the Republic of China on June 27, 1997 and began commercial operations in January 1998. It provides wireless communications, leased-circuit services and also sells cellular phone units and accessories.

The former KGT provides wireless communications services under a type I license—GSM1800 for the northern region of Taiwan issued by the DGT. The license allows the former KGT to provide services for 15 years from 1997, with an annual license fee at 2% of total wireless communications service revenues. Moreover, the merger of former KGT with TUNTEX (with a license to provide mobile communications service under a type I license—GSM1800 for the central and southern region of Taiwan issued by the DGT) is effective January 1, 2000. Thus, the former KGT provided wireless communications services under a type I license—GSM1800 for island-wide. The DGT also issued the former KGT a type I license, allowing it to provide local/domestic long distance land cable leased-circuit services for 15 years from September 2000, with an annual license fee at 1% of leased-circuit service revenues.

The merger agreement with the former KGT provided for the transaction to occur in two steps (the “Combination”). To facilitate the combination with the former KGT, Far EasTone formed a new wholly owned subsidiary in September 2003 called Yuan Ho Telecommunications Co., Ltd. (“Yuan-Ho”), which also was a party to the merger agreement. Yuan-Ho engages in providing wireless communications and sale of telecommunications equipment. In connection with the first step of the Combination, Yuan-Ho issued 526,431 thousand shares for total proceeds of \$11,698,461.

In the first step of the transaction, the former KGT merged with and into Yuan-Ho with Yuan-Ho as the surviving company. The first step was completed and effective on January 1, 2004.

As consideration for this step of the transaction, the former KGT shareholders became entitled to receive cash of \$6.72, together with 0.46332 of one share of common stock of Yuan-Ho, for each former KGT share that they owned, representing aggregate consideration to all the former KGT shareholders of \$11,698,461 in cash and 806,567 thousand shares of common stock of Yuan-Ho. This merger consideration was held in escrow for the former KGT shareholders pending completion of the second step of the transaction. Subsequent to completion of the first step of the transaction, Yuan-Ho obtained approval from the Department of Commerce, Ministry of Economic Affairs (MOEA) to change its name to KG Telecommunications Co., Ltd. (“KG Telecom”) and the former KGT no longer existed as a corporate entity. In addition, the capital of KG Telecom increased to \$13,329,979 and the equity of KG Telecom owned by Far EasTone was temporarily diluted to 39.49%. The other principal shareholders of KG Telecom are the original shareholders of the former KGT and held 60.51% ownership as of January 1, 2004.

In the second step of the transaction, former KGT shareholders became entitled to receive one share of Far EasTone stock in exchange for each KG Telecom share owned, representing an aggregate of 806,567 thousand of Far EasTone shares in the amount of \$17,930,678. In order to satisfy this consideration to shareholders of KG Telecom except the shares Far EasTone owned, Far EasTone issued 693,523 thousand new shares and reissued the 113,044 thousand shares held as treasury stock. (Note 14) The share swap agreement was approved by the shareholders of the two companies on February 18, 2004 and by the OTC and SFC on March 29, 2004 and April 8, 2004, respectively. The second step of the transaction was completed on April 29, 2004.

Upon completion of the second step of the transaction, Far EasTone accounted for the merger with KG Telecom as a wholly-owned subsidiary. Far EasTone established control of KG Telecom as of January 1, 2004 as Far EasTone held the majority of the board seats of KG Telecom, significant consideration had been paid and other elements of control had been established. As such, Far EasTone recognized 100% of its investment income beginning January 1, 2004.

The transaction was accounted for as a purchase with a total purchase price of NT\$29,832,639 which includes Far EasTone common stock valued at NT\$17,930,678 based on the average closing prices for the trading day (September 29, 2003 to October 3, 2003) around the announcement date (October 7, 2003) of the Combination, a cash payment of \$11,698,461 and direct transaction costs \$203,500. The difference between the total purchase price and the fair value of net assets assumed from the former KGT is \$11,865,037 (included in goodwill) and is amortized using the straight-line method over 15 years.

	<b><u>Fair Value of Net Assets</u></b>
Cash and cash equivalents	\$ 3,057,490
Short-term investments—net	3,393,647
Accounts and notes receivables—net	3,601,008
Inventories—net	220,694
Prepaid expenses	409,319
Deferred income tax assets—current	806,277
Other current assets	111,668
Investments in shares of stock	1,273,517
Properties—net	30,061,042
Refundable deposits	174,795
Deferred expenses—net	112,693
Deferred income tax assets—noncurrent	119,616
Other assets	58,037
Short-term bank loan	( 2,150,000 )

(Continued)

	<b><u>Fair Value of Net Assets</u></b>
Commercial paper payable	(\$ 2,453,844)
Notes payable	( 423,293)
Accounts payable	( 231,071)
Income tax payable	( 703,621)
Accrued expenses	( 2,835,260)
Payables related to acquisition of properties	( 276,270)
Guarantee deposits—current	( 532,669)
Unearned revenues	( 778,534)
Current portion of long-term liabilities	( 3,822,170)
Other current liabilities	( 146,918)
Long-term liabilities	( 10,870,475)
Guarantee deposits—noncurrent	( 171,252)
Other liabilities	( <u>36,824</u> )
 Total fair value of net assets	 <u>\$17,967,602</u>

Yuan-Ze Telecommunications Co., Ltd. (Yuan-Ze) started preparing for its establishment on January 1, 2001 and was incorporated in the ROC on December 5, 2001 as Far EasTone's wholly owned subsidiary. Yuan-Ze received permission from the DGT to start its preparatory activities for the construction of 3G (third-generation wireless communications system) network on March 15, 2002. In March 2002, Yuan-Ze issued additional shares of stock of NT\$9,170,000 for cash and Far EasTone subscribed for a portion of these shares (aggregate par value of NT\$7,170,000), thus diluting its equity to 80.71%. For the purpose of integration of the telecommunications business and operational efficiency, Far EasTone bought all the other shares of Yuan-Ze from other stockholders for NT\$2,000,000 on December 16, 2003. Thus, Yuan-Ze became a wholly owned subsidiary of Far EasTone.

On December 22, 2003, the Board of Directors of both companies approved the merger of Far EasTone with Yuan-Ze, with Far EasTone as the surviving company. The proposed date for completion of the merger will be in 2005. Yuan-Ze engages in providing 3G wireless communications and sale of telecommunications equipment. As of September 30, 2004, Yuan-Ze was still in its development stage.

Far EasTone, Yuan-Ze and KG Telecom (the "Group") had 3,463 and 2,133 employees as of September 30, 2004 and 2003, respectively.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

These financial statements conform to the Guidelines Governing the Preparation of Financial Reports for Securities Issuers and accounting principles generally accepted in the ROC.

The Group uses reasonable estimates for allowance for doubtful accounts, allowance for losses on inventories, allowance for losses on properties not currently used in operations, depreciation and amortization, income taxes and pension cost. Because of the uncertainty of circumstances, however, estimates may differ from the actual outcome.

The significant accounting policies of the Group are summarized as follows:

### **Consolidation**

The consolidated financial statements include the accounts of Far EasTone and its direct and indirect subsidiaries with individual total assets or total operating revenues exceeding 10% of the unconsolidated total assets or operating revenues of Far EasTone. Other subsidiaries are also consolidated if their combined total assets or operating revenues exceeds 30% of the unconsolidated total assets or operating revenues of Far EasTone. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements as of and for the nine months ended September 30, 2004 include the accounts of Far EasTone, KG Telecom and Yuan-Ze. The consolidated financial statements as of and for the nine months ended September 30, 2003 include the accounts of Far EasTone, the former KGT and Yuan-Ze.

### **Current and Noncurrent Assets and Liabilities**

Current assets include non-restricted cash or cash equivalents as well as items expected to be converted into cash or used within one year. Current liabilities are obligations expected to be settled within one year. All other assets and liabilities are classified as noncurrent.

### **Cash Equivalents**

Bonds and commercial paper purchased under agreements to resell with original maturities of not more than three months are classified as cash equivalents.

### **Short-term Investments**

Short-term investments in mutual funds are carried at the lower of aggregate cost or market value. An allowance for loss is provided and charged to income for the current period when the aggregate carrying value of the investments exceeds the total market value. Any recovery of the market value to the extent of the original carrying value is recognized as income. Of the mutual funds, the market value are based on the net assets value as of the balance sheet date.

The costs of short-term investments sold are determined by the moving-weight-average method.

### **Allowance for Doubtful Accounts Receivable**

An allowance for doubtful accounts receivable is provided on the basis of the aging status and estimated collectibility of receivables from subscribers and other parties.

### **Inventories**

Inventories are stated at the lower of cost or market value (net realizable value). Cost is determined by the moving-weighted-average method.

### **Investments in Shares of Stock**

Investments in shares of stock in companies in which the Group owns at least 20% of investees' common stock or exercises significant influence over their operating and financial policy decisions are accounted for by the equity method. Under this method, the investment is initially carried at cost on the acquisition date. Any cash dividends received are recognized as a reduction in the carrying value of the investments. The investment carrying values are then adjusted proportionately to the Group's share in the investees' net income or net loss. The difference between the cost of the investment and the Group's equity in the investees' net assets is amortized over three to twenty years. If the current year's financial statements of

less than majority-owned investees are not timely available to the Group, the equity in the net income or net loss of these investees is recognized in the succeeding year on the basis of the financial statements of the previous year. If an investee issues additional shares and the Group acquires these shares at a percentage different from its current equity in the investee, the resulting increase in the Group's equity in its investee's net assets is credited to capital surplus. Any decrease in the Group's equity in the investees' net assets is debited to capital surplus. If capital surplus is not enough for debiting purposes, the difference is debited to unappropriated earnings.

Other investments are accounted for by the cost method. Such investments are carried at cost less an allowance for an other than temporary decline in the value of unlisted stock. These allowances are charged to current income. Cash dividends received are accounted for as dividend income.

Stock dividends received are accounted for only as an increase in the number of shares held but are not recognized as investment income. The carrying amount of each share is recalculated on the basis of the total number of shares, including the received stock dividend.

Costs of investments sold are determined by the moving-weighted-average method.

### **Properties and Rental Properties**

Properties and rental properties are stated at cost. Depreciation expense is computed using the straight-line method over the estimated useful lives of the assets. Major improvements as well as interest expense incurred during the construction period are capitalized, while maintenance and repairs are expensed currently. Properties still being used beyond their services life years are depreciated over their newly estimated service lives.

Equipment under capital leases and the related liability are stated at the lower of (1) the fair value of the equipment at the beginning of the lease or (2) the total present value of future lease payments and the bargain purchase option.

Useful lives are estimated as follows:

	<u>Useful Life Years</u>
Buildings	48-55
Building equipment	5-10
Operating equipment	5-15
Computer equipment	3-7
Office equipment	5-10
Leasehold improvements	3-5
Miscellaneous equipment	3-8

Upon retirement or other disposal (e.g., sale) of properties, the related cost and accumulated depreciation are removed from the accounts, and any resulting gain or loss is credited or charged to nonoperating income or expense.

### **Goodwill**

Goodwill derived from merging with the former KGT (Note 1) is amortized by the straight-line method over 15 years.

### **3G Concession**

The 3G concession will be amortized on a straight-line basis from the date the license granted through the date the license expires.

## **Deferred Charges**

Deferred charges (included in other assets—miscellaneous), which consist mainly of base station wiring, are amortized using the straight-line method over three to five years.

## **Properties not Currently Used in Operations**

Properties not currently used in operations (included in other assets—miscellaneous), such as telecommunications equipment, are stated at the lower of cost or net realizable value.

## **Revenue Recognition**

Revenue is recognized when the earnings process is completed or virtually complete and the revenue is realizable and measurable. The costs of providing services are recognized as incurred. Usage revenues (equal to excess of minutes of traffic included in the fixed monthly service fees) from wireless services, international simple resale services, internet and data services and interconnection calls, net of any applicable discount, are billed according to customers' usage and are recognized on the basis of minutes of traffic processed. Other revenues are recognized as follows: (a) fixed monthly service fees and leased-circuit service revenues are accrued each month; and (b) prepaid call and internet card services are recognized as income based upon customer usage.

The revenues from and expenses for the sale of cellular phone equipment and accessories are recognized when the products are delivered to and accepted by the customers as the related transaction is considered a separate earnings process from the sale of wireless services.

The amount received at the start of a bundle contract (which covers both the purchase price of a cellular phone unit and service fees for an equivalent number of minutes of traffic each month throughout the validity period of the contract) is deferred and recognized as revenue over the validity period of the contract using the straight-line method. If the sum of the cost of the cellular phone unit and the commission paid to the dealers (the "customer acquisition cost") exceeds the amount received at the beginning of the contract, the excess is charged to marketing expense. The portion of the customer acquisition cost equivalent to the amount received at the beginning of the contract is deferred and amortized as marketing expenses over the validity period of the contract using the straight-line method.

Operating revenues are measured at fair values based on the prices negotiated between the Group and the customers. Since the future values of operating revenues resulting from receivables within one year approximate the fair values of these receivables, the fair values are not recalculated based on the pro forma interest rate method.

## **Promotion Expenses**

Commissions and cellular phone equipment subsidy costs (other than those pertaining to the bundle contract mentioned above) related to the Group's promotions are treated as marketing expenses in the period when the service to a subscriber is activated.

## **Pension Costs**

Far EasTone and KG Telecom have a defined benefit pension plan for all regular employees. Benefits are based on the number of service years and basic pay on the final month before retirement. Yuan-Ze does not have a pension plan.

Pension costs are recognized on the basis of actuarial calculations. Unrecognized net transition obligations and unrecognized pension gains or losses are amortized using the straight-line method over 15 years and the average remaining service of employees, respectively.

## **Convertible Bonds**

Far EasTone issued overseas convertible bonds at par value and without any discount or premium. Far EasTone gave the bondholders the right to redeem the convertible bonds in cash at par value plus the interest-premium on a specific date. The interest-premium of puttable convertible bonds, which is the difference between the specified put price and the par value, is amortized using the interest method and is recognized as a liability over the period from the issuance date of the bonds to the expiry date of the put option. The direct and necessary costs (included in other assets—miscellaneous) of issuing convertible bonds is amortized using the straight-line method over the same period as interest-premium.

When the bondholder exercises the conversion option, Far EasTone uses the book-value approach. Far EasTone will write off the unamortized issuance costs, recognized interest-premium and par value of the convertible bonds. The amount of capital stock is valued as the net amount that is written-off, and the amount in excess of the par value of capital stock is recognized as additional paid-in capital.

## **Income Tax**

Deferred income tax assets are recognized for the tax effects of deductible temporary differences, unused operating loss carry forwards and unused investment tax credits, and deferred tax liabilities are recognized for the tax effects of taxable temporary differences. A valuation allowance is recognized for deferred income tax assets that are not certain to be realized. Deferred income tax assets and liabilities are classified as current or noncurrent on the basis of the classifications of the related assets and liabilities. A deferred asset or liability that cannot be related to an asset or a liability in the financial statements is classified as current or noncurrent according to the expected realization date of the temporary difference.

Deferred income tax liabilities derived from the temporary differences of carrying amounts and the tax base of long-term investments are not recognized if it is expected that the foreign subsidiary will not distribute its earnings in the future and the difference will be permanent.

The tax credits for certain purchase of telecommunications and other equipment, research and development expenses and personnel training expenses are accounted for as a reduction in the current period's income tax expense.

Adjustments of prior years' tax liabilities are added to, or deducted from, the current period's income tax expenses.

Income taxes (10%) on undistributed earnings since January 1, 1998 are recorded as expense in the year when the stockholders resolve to retain the earnings.

## **Foreign-currency Transactions**

Foreign-currency transactions (except derivative transactions) are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Gains or losses resulting from the application of different foreign exchange rates when foreign-currency assets and liabilities are settled, are credited or charged to income in the period of settlement.

On the balance sheet dates, the balances of foreign-currency denominated assets and liabilities are restated at the prevailing exchange rates, and the resulting differences are recorded as follows:

- a. Equity-accounted investments—as cumulative translation adjustments under stockholders' equity; and
- b. Other assets and liabilities—as credits or charges to income.

## Financial Derivatives

The notional amounts of interest rate swap agreements are not recognized in the financial statements because these agreements do not require the settlement of such notional amounts. On the balance sheet dates or settlement dates, the amounts receivable or payable under the agreements, which result from differences in interest rates, are accrued as interest income or interest expense of the hedged item.

Cross currency swap contracts, which are intended for hedging purposes, are recorded at the contract exchange rates on the starting dates of the contracts (the “starting dates”). The exchanged interest during the contract period, on an accrual basis, is recorded as an adjustment to the revenue or expense associated with the items being hedged.

Forward exchange contracts are entered into as hedges of foreign-currency commitments and are recorded in New Taiwan dollars as assets and/or liabilities using the spot rates on the starting dates. The premium or discount, which is the amount of the contract multiplied by the difference between the contracted forward rates and the spot rates on the starting dates, is deferred and then recognized as an adjustment to the commitment when the hedged transactions occur. However, if the contract amount exceeds the foreign-currency amount of the related commitment, the amortization of the premium or discount related to the excess is recognized as gain or loss in the current period.

On the balance sheet date, the gains or losses on the contracts, computed by multiplying the contract amount by the difference between the rates on the starting dates and the balance sheet dates (or the rates last used to measure a gain or loss on that contract for an earlier period), are recognized in the same way used for amortizing the premium or discount described above. Also, the receivables and payables related to the forward contracts are netted out, and the net amount is presented as an asset or a liability.

## Reclassifications

Certain accounts in the consolidated financial statements as of and for the nine months ended September 30, 2003 have been reclassified to conform to the presentation of consolidated financial statements as of and for the nine months ended September 30, 2004.

### 3. ELIMINATED MATERIAL INTERCOMPANY TRANSACTIONS

#### For the Nine Months Ended September 30, 2004

<u>Company</u>	<u>Eliminated Account</u>	<u>Amount</u>	<u>Parties</u>
Far EasTone	Receivables from related parties	\$ 397,448	KG Telecom
	Receivables from related parties	206,374	Yuan-Ze
	Payables to related parties	1,386	KG Telecom
	Service revenue	686,445	KG Telecom
	Cost of services	611,070	KG Telecom
	Marketing expenses	12,900	KG Telecom
	Management service revenue	46,890	KG Telecom
	Management service revenue	6,393	Yuan-Ze
	Nonoperating income—other	34,774	KG Telecom
	KG Telecom	Receivables from related parties	1,386
Receivables from related parties		4,071	Yuan-Ze
Payables to related parties		397,448	Far EasTone
Service revenue		611,070	Far EasTone
Cost of services		686,445	Far EasTone

(Continued)



<u>Company</u>	<u>Eliminated Account</u>	<u>Amount</u>	<u>Parties</u>
Yuan-Ze	Marketing expenses	\$ 34,774	Far EasTone
	Nonoperating income—other	12,900	Far EasTone
	General and administrative expenses	46,890	Far EasTone
	Payables to related parties	206,374	Far EasTone
	Payables to related parties	4,071	KG Telecom
	General and administrative expenses	6,393	Far EasTone

#### 4. PRO FORMA FINANCIAL INFORMATION

The following pro forma financial information presents the combined balance sheet and statement of income of Far EasTone, Yuan-Ze, and KG Telecom as of and for the nine months ended September 30, 2003. The pro forma financial information is presented to give effect to the Combination as if it had occurred on January 1, 2003.

(In Thousands, Except Per Share Data)

	<u>Amount</u>
Current assets	\$20,208,352
Properties-net	70,445,112
Current liabilities	25,176,985
Operating revenue	44,174,742
Depreciation	8,654,974
Amortization	697,677
Interest expense	781,162
EBITDA (operating income plus depreciation and amortization)	17,819,475
Income before income tax	7,888,285
Net income	7,465,949
EPS (based on weighted-average number of shares outstanding for 3,391,309 thousands)	2.20

The pro forma combined balance sheet and statement of income are presented for illustrative purposes only. This information is not necessarily indicative of the financial position and results of operations that might have occurred had the formation of KG Telecom and the above mentioned Combination occurred on January 1, 2003, nor is it necessarily indicative of future financial position or results of operations of Far EasTone and subsidiaries.

#### 5. CASH AND CASH EQUIVALENTS

	<u>September 30</u>	
	<u>2004</u>	<u>2003</u>
Cash		
Cash on hand	\$ 8,180	\$ 7,222
Checking and demand deposits	1,573,383	856,218
Time deposit—interest of 0.94% to 1.85% in 2004 and 0.97% to 1.09% in 2003	785,101	2,242,588
	<u>2,366,664</u>	<u>3,106,028</u>
Cash equivalents		
Commercial paper purchased under agreements to resell—interest of 0.985% to 1.000% in 2004 and 0.85% to 0.95% in 2003	1,234,197	2,694,904
	<u>\$ 3,600,861</u>	<u>\$ 5,800,932</u>

**6. INVENTORIES—NET**

	<u>September 30</u>	
	<u>2004</u>	<u>2003</u>
Cellular phone equipments	\$ 875,351	\$ 878,272
SIM cards	68,386	60,662
Cellular phone accessories	<u>43,182</u>	<u>7,481</u>
	986,919	946,415
Less—allowance for losses	<u>22,242</u>	<u>7,417</u>
	<u>\$ 964,677</u>	<u>\$ 938,998</u>

**7. INVESTMENTS IN SHARES OF STOCK**

	<u>September 30</u>			
	<u>2004</u>		<u>2003</u>	
	<u>Carrying</u>	<u>% of</u>	<u>Carrying</u>	<u>% of</u>
	<u>Value</u>	<u>Owner-</u>	<u>Value</u>	<u>Owner-</u>
		<u>ship</u>		<u>ship</u>
Equity method				
KGEx.com	\$ 902,149	50.27	\$ -	-
Far Eastern Electronic Toll Collection Co., Ltd.	455,340	45.00	-	-
KGT International Holdings	146,430	100.00	-	-
Far Eastern Info Service (Holding) Ltd.	95,337	100.00	-	-
KG Satellite	83,268	66.33	-	-
iScreen	69,071	40.00	-	-
E. World (Holdings) Ltd.	<u>48,870</u>	85.92	<u>8,518</u>	19.00
	<u>1,800,465</u>		<u>8,518</u>	
Cost method				
YesMobile Taiwan	<u>3,000</u>	0.50	-	-
Prepayment for investments				
Far Eastern Electronic Toll Collection Co., Ltd.	-		40,000	
Ding Ding Integrated Marketing Service Co., Ltd.— preparatory office	<u>45,000</u>		-	
	<u>45,000</u>		<u>40,000</u>	
	<u>\$ 1,848,465</u>		<u>\$ 48,518</u>	

The Taiwan Area National Freeway Bureau of the Ministry of Transportation and Communications (“MOTC”) has launched a project called “Privatized Establishment and Implementation of the Freeway Electronic Toll Collection Program”. To participate in this project, Far EasTone and third parties incorporated Far Eastern Electronic Toll Collection Co., Ltd. (“FETETC”). MOTC selected FETETC through public appraisal and signed the contract on April 27, 2004.

Originally, the investment in E. World (Holdings) is accounted for by the equity method since the combined equity interests of the Far Eastern Group in E. World (Holdings) allows Far EasTone to exercise significant influence on its operating and financial policy decisions. Far EasTone bought from the related parties amounting to \$41,788 in June 2004, as a result, the ownership was increased from 19.00% to 85.92%. Since the ownership of E. World (Holdings) exceeds 50%, the amounts recognized as equity in the net income or net loss of E. World (Holdings) were then based on net income or net loss in the current period.

The equities in net assets of the foregoing investments accounted for by the equity method are based on unreviewed financial statements as of September 30, 2003 except the investment in E. World (Holdings) Ltd., which is based on audited financial statements. For the nine months ended September 30, 2004 and 2003, the equity in investees’ net losses were \$155,927 and \$1,778, respectively.

## 8. PROPERTIES

- a. Accumulated depreciation consisted of:

	<u>September 30</u>	
	<u>2004</u>	<u>2003</u>
Buildings and equipment	\$ 334,626	\$ 145,247
Operating equipment	36,336,167	18,573,027
Computer equipment	6,808,974	2,797,941
Office equipment	538,843	420,897
Leasehold improvements	714,977	618,373
Miscellaneous equipment	<u>214,116</u>	<u>42,044</u>
	<u>\$44,947,703</u>	<u>\$22,597,529</u>

- b. Far EasTone leases internet equipment with software (included in operating equipment) under three years leases, with total lease payments of \$35,686. The lease agreements qualify as capital leases since (a) the present value in 2000 of the future lease payments under the agreement is more than 90% of the fair value of the leased assets, and (b) Far EasTone had the option to buy all the leased equipment at a bargain price of NT\$1.00 only.

Far EasTone bought the above internet equipment with software at the bargain price when the agreement expired in 2003.

Far EasTone and KG Telecom lease from Far Eastern International Leasing Corporation operating equipment, included in construction in progress at September 30, 2004 under a five years lease with annual lease payment of \$30,828. The fair value of the leased properties at the inception of the lease is \$147,500, and the total future lease payments amount to \$154,136. The lease agreements qualify as capital lease since (a) the present value of the future lease payments under the agreement exceeds 90% of the fair value of the leased assets, and (b) the lease term is equal to 75% or more of the estimated economic life of the leased assets. The details of the lease as of September 30, 2004 are as follows:

	<u>September 30,</u> <u>2004</u>
Total future lease payments	\$ 123,308
Less—imputed interest expense	<u>5,308</u>
	118,000
Less—current portion of lease payable (included in current portion of long-term liabilities)	<u>29,500</u>
Long-term lease payable	<u>\$ 88,500</u>

- c. Capitalized interest on properties was as follows:

	<u>Nine Months Ended</u> <u>September 30</u>	
	<u>2004</u>	<u>2003</u>
Total interest expense	\$ 627,637	\$ 311,032
Less—interest capitalized 1.33% to 4.24% in 2004 and 1.35% to 6.10% in 2003	<u>73,243</u>	<u>77,923</u>
Interest expense—net of amounts capitalized	<u>\$ 554,394</u>	<u>\$ 233,109</u>

## 9. 3G CONCESSION

Yuan-Ze paid guarantee deposits of \$1,000,000 to bid for the third-generation wireless communications concession (3G concession) in 2001. The guarantee deposits were treated as part of the 3G concession on March 11, 2002 when the bidding process for the 3G concession was completed. On March 15, 2002, Yuan-Ze received the 3G concession from the DGT. Yuan-Ze is then required to obtain a network construction permit from the DGT. Once the network construction is complete, it may apply for a 3G license from the MOTC. The 3G license is valid through December 31, 2018. Yuan-Ze will amortize the 3G concession on a straight-line basis from the date the license granted through the date the license expires.

## 10. RENTAL ASSETS—NET

**September 30,  
2004**

Cost	
Land	\$ 99,524
Buildings	<u>94,672</u>
	194,196
Less—accumulated depreciation	
Buildings	<u>2,737</u>
	<u>\$ 191,459</u>

Rental properties are offices which are intended to be used as operating premises for future business expansion. The rental agreements will expire at various dates through February 2013. Future rentals are summarized as follows:

<u>Period</u>	<u>Amount</u>
October 2004 to September 2005	\$ 11,719
October 2005 to September 2006	11,799
October 2006 to September 2007	11,974
October 2007 to September 2008	4,606
After October 2008	15,971

## 11. SHORT-TERM LOANS

Far EasTone took unsecured bank loans at interest of 1.2% to 1.3%. Outstanding unsecured bank loans were due and were fully repaid at various dates from October 1, 2004 through October 12, 2004.

## 12. COMMERCIAL PAPER PAYABLE

Far EasTone and Yuan-Ze issued commercial paper guaranteed by financial institutions. The obligations were discounted at the rate of 1.19% to 1.438%, and are due at various dates from October 22, 2004 through March 23, 2005. Yuan-Ze repaid partial of the loan amounting to \$250,000 on October 22, 2004.

### 13. LONG-TERM LIABILITIES

	<b>September 30, 2004</b>		
	<b><u>Due Within One Year</u></b>	<b><u>Due After One Year</u></b>	<b><u>Total</u></b>
<b>Bonds</b>			
Overseas unsecured convertible bonds—Far EasTone	\$ 3,008,929	\$ -	\$ 3,008,929
Interest premium—overseas unsecured convertible bonds—Far EasTone	48,807	-	48,807
Domestic secured bonds—Far EasTone	638,000	330,000	968,000
Domestic secured bonds—KG Telecom	1,020,000	-	1,020,000
Domestic unsecured bonds—1st—Far EasTone	-	4,200,000	4,200,000
Domestic unsecured bonds—2nd—Far EasTone	-	1,470,000	1,470,000
Domestic unsecured bonds—3rd—Far EasTone	-	3,000,000	3,000,000
	<u>4,715,736</u>	<u>9,000,000</u>	<u>13,715,736</u>
<b>Long-term debts</b>			
Commercial paper—KG Telecom	218,000	432,498	650,498
Unsecured bank loans—KG Telecom	-	1,000,000	1,000,000
Secured bank loans—KG Telecom	3,262,755	1,207,728	4,470,483
Secured bank loans—Yuan-Ze	-	3,420,000	3,420,000
	<u>3,480,755</u>	<u>6,060,226</u>	<u>9,540,981</u>
<b>Long-term lease payable</b>			
Far EasTone	14,750	44,250	59,000
KG Telecom	14,750	44,250	59,000
	<u>29,500</u>	<u>88,500</u>	<u>118,000</u>
	<u>\$ 8,225,991</u>	<u>\$ 15,148,726</u>	<u>\$ 23,374,717</u>

	<b>September 30, 2003</b>		
	<b><u>Due Within One Year</u></b>	<b><u>Due After One Year</u></b>	<b><u>Total</u></b>
<b>Bonds</b>			
Overseas unsecured convertible bonds—Far EasTone	\$ -	\$ 3,881,250	\$ 3,881,250
Interest premium—overseas unsecured convertible bonds—Far EasTone	-	23,915	23,915
Domestic secured bonds—Far EasTone	616,000	968,000	1,584,000
Domestic unsecured bonds—1st—Far EasTone	-	4,200,000	4,200,000
Domestic unsecured bonds—2nd—Far EasTone	-	1,470,000	1,470,000
	<u>616,000</u>	<u>10,543,165</u>	<u>11,159,165</u>
<b>Long-term debts</b>			
Secured bank loan—Yuan-Ze	-	350,000	350,000
	<u>\$ 616,000</u>	<u>\$ 10,893,165</u>	<u>\$ 11,509,165</u>

a. Overseas unsecured convertible bonds—Far EasTone

Five-year unsecured zero coupon convertible bonds, with total face value of US\$115,000 thousand, were issued on February 19, 2003. The bonds are listed on the Luxembourg Stock Exchange. The repayment or conversion terms of the bonds are as follows:

- 1) Far EasTone's redemption of the bonds upon maturity at 105.114% of their face value on February 19, 2008;
- 2) Redemption at the option of the bondholder at 102.015% of their face value on February 19, 2005;

- 3) The right of each bondholder to convert the bonds into shares or global depositary receipts between March 21, 2003 and January 20, 2008. The conversion price on September 30, 2003 was NT\$27.94, subject to adjustment for shares change.

As of September 30, 2004, convertible bonds amounting US\$26,450 thousand had been converted into 32,655 thousand shares of common stock (including 82 thousand units of Global Depositary Receipts representing 1,237 thousand shares of common stock).

- 4) Redemption at Far EasTone's option at a specific price under certain conditions, starting February 19, 2006.

b. Domestic secured bonds—Far EasTone

These are five-year secured domestic bonds issued at par value on November 30, 2000. The total face value of the bonds is \$2,200,000, with face value of \$1,000 and 5.06% interest, compounded semiannually. Starting on November 30, 2002 and every six months thereafter, Far EasTone should redeem the bonds for up to 14% to 15% of their face value.

c. Domestic secured bonds—KG Telecom

Five-year domestic secured bonds were issued at par value on August 4, 2000. The total face value of the bonds is \$3,000,000, with face value of \$1,000 and 5.37% interest. Starting on August 4, 2003 and every year thereafter, KG Telecom should redeem the bonds for up to 33% to 34% of their face value.

d. Domestic unsecured bonds—1st—Far EasTone

Five-year domestic unsecured bonds were issued at par value on February 19, 2002. The total face value of the bonds is \$4,200,000, with face value of \$1,000 at 3.4% annual interest. Redemption is at a percentage of the face amount of the bond, as follows: Type I bond—40% in February 2006 and 60% in February 2007; and Type II bond—60% in February 2006 and 40% in February 2007.

e. Domestic unsecured bonds—2nd—Far EasTone

These are five-year unsecured domestic bonds issued at par value on March 28, 2003. The total face value of the bonds is \$1,470,000, with a face value of \$1,000 and interest rate of 2.6% in the first year and 3.2% minus USD six-month LIBOR rate from the second year to maturity, payable semiannually. Far EasTone should redeem the full amount when the bonds become due in 2008.

f. Domestic unsecured bonds—3rd—Far EasTone

Three-year, four-year and five-year domestic unsecured bonds were issued at par value on December 12, 2003. The total face value of the bonds is \$3,000,000, with a face value of \$5,000 and annual interest rates of 1.83% (three-year bonds) and 1.92% (four-year bonds). The interest rate for five-year bonds is 5.2% minus USD six-month LIBOR rate if the LIBOR rate is greater than 1.05%; otherwise, the interest is at the LIBOR rate plus 1%, payable semi-annually. Far EasTone should redeem the full amount when the bonds become due in 2006, 2007 and 2008.

g. Commercial paper—KG Telecom

Under a revolving credit agreement, a consortium of banks has guaranteed the commercial paper of \$650,498 to be reissued until June 2007. The commercial paper bears variable interest rates of 1.53% to 1.896% as of September 30, 2004. Starting in 2002, the maximum amount of commercial paper that can be reissued under the agreement will be decreased by 14-15% every six months.

h. Unsecured bank loans—KG Telecom

KG Telecom had unsecured bank loans at an annual interest rate of 1.3% to 2.0%. The loan is guaranteed by a consortium of banks and the guarantee is effective until June 2006.

i. Secured bank loans—KG Telecom

- 1) KG Telecom obtained a loan, amounting to \$1,428,500, from a consortium of banks at 2.463% interest rate, payable quarterly. The loan is secured and payable, starting in August 2002 and every six months thereafter, at equal installments of the principal with the final payment due in August 2005.
- 2) KG Telecom obtained a loan, amounting to US\$7,816 (equivalent to \$265,588), from a consortium of banks at 2.517% interest rate, payable quarterly. The loan is secured and payable, starting in August 2002 and every six months thereafter, at equal installments of the principal with the final payment due in August 2005.
- 3) KG Telecom obtained a loan, amounting to US\$38,446 (equivalent to \$1,306,395), from a consortium of banks at 2.9704% interest rate, payable quarterly. The loan is secured and payable, starting in June 2003 and every six months thereafter, at equal installments of the principal with the final payment due in June 2007.
- 4) KG Telecom obtained a secured bank loan, amounting to \$120,000, at 2.5% interest rate, payable monthly. The loan is payable in installments for \$20,000 to \$60,000 starting in July 2000 with final payment due in April, 2005.
- 5) KG Telecom obtained a loan, amounting to \$1,350,000, from a consortium of banks at 2.305% interest rate, payable quarterly. The loan is secured and payable, starting in February, 2005 and every three months thereafter, at equal installments of the principal with the final payment due in November 2005.

j. Secured bank loans—Yuan-Ze

Yuan-Ze obtained a loan from a consortium of banks at 1.928% to 2.125% interest rate. The loan was due on January 28, 2004. The loan is guaranteed by a consortium of banks and the guarantee is effective until April 7, 2006.

k. Long-term lease payable:

Far EasTone and KG Telecom have entered into capital lease agreements for operating equipment (included in construction in progress at September 30, 2004) with Far Eastern International Leasing Corp. in July 2004. The annual lease payments amount to \$30,828 (Note 8).

## 14. STOCKHOLDERS' EQUITY

Under government regulations, capital surplus from equity-method investments cannot be used to offset a deficit or be capitalized. In addition, capital surplus (includes both paid-in capital in excess of par value and arising from business combination) may be used to offset a deficit or transferred to capital as stock dividend within prescribed limits only.

Far EasTone's Articles of Incorporation provide that, every year, 10% of net income less income tax and any accumulated deficit should be appropriated as legal reserve. In addition, if Far EasTone decides to distribute dividends, 2% of the balance should be appropriated as bonuses to employees, and 1% of the final balance should be appropriated as remuneration to directors and supervisors.

Under the ROC Company Law, legal reserve should be appropriated until the accumulated reserve equals the Far EasTone's paid-in capital. The reserve can only be used to offset a deficit, or when the reserve reaches 50% of Far EasTone's paid-in capital, up to 50% of the reserve can be distributed as stock dividend.

The cash dividends should be at least 10% of total dividends declared. The adjustment of this percentage may be approved by the stockholders depending on the cash requirement for any significant future capital expenditures.

These appropriations and other allocations of earnings should be resolved by the stockholders in the following year and given effect to in the financial statements of that year.

Under the integrated income tax system, noncorporate ROC-resident stockholders are allowed a tax credit for the income tax paid by Far EasTone on earnings generated from January 1, 1998. Under this system, Far EasTone maintains an imputation credit account (ICA) for the income tax and the tax credits allocated to each stockholder. The maximum credit available for allocation to each stockholder cannot exceed the balance shown in the ICA on the date of dividend distribution.

The appropriation and distribution of the 2003 and 2002 earnings were approved by the stockholders on June 30, 2004 and May 23, 2003, respectively.

	<u>Appropriation</u>		<u>Dividend Per Share</u> <u>(NT Dollars)</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Legal reserve	\$ 818,813	\$ 780,842		
Bonus to employees—cash	147,387	140,551		
Remuneration to directors and supervisors—cash	73,693	70,276		
Cash dividend	4,748,620	2,997,540	\$ 1.40	\$ 1.30
Stock dividend	1,560,261	3,896,802	0.46	1.69

Under the Enterprise Mergers and Acquisitions Law No. 12, Far EasTone entered into an agreement with a dissenting stockholder (Bai Yang Investment Co., Ltd) on April 16, 2004 to repurchase 113,044 thousand shares for \$3,334,798. The difference between the fair value and the repurchase price of the treasury stock of \$821,733 was recorded as a reduction to unappropriated earnings.

In order to satisfy the consideration to the stockholders of KG Telecom except the shares Far EasTone owned, Far EasTone issued 693,523 thousand new shares (included in capital stock and capital surplus—from business combination in the amount of \$6,935,232 and \$8,482,381, respectively, amounting to \$15,417,613) and reissued the 113,044 thousand shares held as treasury stock (Note 1).

The stockholders also approved the capitalization of unappropriated earnings of \$1,560,261 and paid-in capital in excess of par value of \$1,831,611 to issue additional shares amounting to \$3,391,872. The issuance of additional capital stock has registered with MOEA on September 30, 2004.

The details of Far EasTone's Global Depositary Receipts (GDRs) as of September 30, 2004 are as follows:

		<u>GDRs (in</u> <u>Thousand Units</u> <u>Units</u>	<u>Representing</u> <u>Common Stock</u> <u>(in Thousand</u> <u>Shares)</u>
Initial offering	a	\$ 10,000	\$ 150,000
Converted from overseas unsecured convertible bonds	b	82	1,237
Issued for capital increase	c	296	4,448
GDR's transferred to common stock		( <u>7,888</u> )	( <u>118,338</u> )
Outstanding issued		<u>\$ 2,490</u>	<u>\$ 37,347</u>



- a. On June 1, 2004, the Securities and Futures Bureau (SFB) approved Far EasTone's request to sell 150,000 thousand of Far EasTone's shares in the form of GDRs to foreign investors representing 10,000 thousand units of GDRs. One unit of GDR represents 15 shares of Far EasTone's common stock. The issuance of the GDRs was completed on June 17, 2004 and the GDRs were traded and listed on the Luxembourg Stock Exchange with a price of US\$13.219.
- b. On July 20, 2004, SFB approved Far EasTone's request to issue new common stock in the form of GDRs of US\$114,500 thousand to be used for the conversion of overseas convertible bonds. As of September 30, 2004, 82 thousand units of GDRs have been issued for the conversion of overseas unsecured convertible bonds representing Far EasTone's 1,237 thousand shares of common stock.
- c. Far EasTone has issued 296 thousand units of GDRs as a result of capital increase from capital surplus as well as retained earnings. Those GDRs represent 4,448 thousand shares of common stock.

The owners of GDRs have the same rights as stockholders except that the owners should exercise the following beneficial interests subject to its terms of the Deposit Agreements and relevant ROC laws and regulations through the Depositary Trust Company:

- a. Exercise voting rights;
- b. Transfer the GDRs; and
- c. Receive dividends and exercise preemptive rights or other rights and interests.

## 15. CONSOLIDATED EARNINGS PER SHARE

The information on consolidated earnings per share (EPS) calculation is as follows:

	<u>Amount (Numerator)</u>		<u>Capital Stock (Denominator) (in Thousand Shares)</u>	<u>Consolidated Earnings Per Share (NT\$)</u>	
	<u>Income Before Income Tax</u>	<u>Net Income</u>		<u>Income Before Tax</u>	<u>Net Income</u>
For the nine months ended <u>September 30, 2004</u>					
Consolidated primary EPS					
Consolidated net income	\$ 12,605,375	\$ 10,857,412	3,730,852	<u>\$3.38</u>	<u>\$2.91</u>
Effect of dilutive potential common stocks					
Convertible bonds	<u>67,531</u>	<u>65,166</u>	<u>141,811</u>		
Consolidated diluted EPS					
Consolidated net income including the effect of dilutive potential common stocks	<u>\$ 12,672,906</u>	<u>\$ 10,922,578</u>	<u>3,872,663</u>	<u>\$3.27</u>	<u>\$2.82</u>

(Continued)

	<u>Amount (Numerator)</u>		<u>Capital Stock (Denominator) (in Thousand Shares)</u>	<u>Consolidated Earnings Per Share (NT\$)</u>	
	<u>Income Before Income Tax</u>	<u>Net Income</u>		<u>Income Before Income Tax</u>	<u>Net Income</u>
For the nine months ended <u>September 30, 2003</u>					
Consolidated primary EPS					
Consolidated net income	\$ 5,981,992	\$ 6,015,708	2,967,565	<u>\$2.02</u>	<u>\$2.03</u>
Effect of dilutive potential common stocks					
Convertible bonds	( <u>66,573</u> )	( <u>66,948</u> )	<u>101,080</u>		
Consolidated diluted EPS					
Consolidated net income including the effect of dilutive potential common stocks	<u>\$ 5,915,419</u>	<u>\$ 5,948,760</u>	<u>3,068,645</u>	<u>\$1.93</u>	<u>\$1.94</u>

For the nine months ended September 30, 2003, consolidated EPS retroactively adjusted for the 2003 stock dividend declared in 2004 decreased from \$2.22 to \$2.02 (primary EPS) and from \$2.23 to \$2.03 (diluted EPS).

## 16. PENSION PLAN

Both Far EasTone and KG Telecom make a monthly contribution, at 2% of salaries and wages, to a pension fund (“the fund”) that is administered by a pension plan committee and deposited in the Committee’s name in the Central Trust of China. As of September 30, 2004, Yuan-Ze has no regular employees and pension plan.

Net pension costs of Far EasTone and KG Telecom were as follows:

	<u>Nine Months Ended September 30</u>	
	<u>2004</u>	<u>2003</u>
Actuarial net pension cost	\$ 79,814	\$ 52,093
Less: Included in properties	5,535	2,396
Included in receivables from related parties	<u>637</u>	<u>279</u>
Net pension cost (included in operating costs and expenses)	<u>\$ 73,642</u>	<u>\$ 49,418</u>

Far EasTone and KG Telecom’s contributions to the Fund were \$31,664 and \$22,930 for the nine months ended September 30, 2004 and 2003, respectively. Fund balances were \$276,871 and \$143,093 as of September 30, 2004 and 2003, respectively.

**17. EMPLOYEE, DEPRECIATION AND AMORTIZATION EXPENSES**

	<b>For the Nine Months Ended September 30, 2004</b>			
	<b>Operating Costs</b>	<b>Operating Expenses</b>	<b>Nonoperating Expenses and Losses</b>	<b>Total</b>
Employee expenses				
Salaries	\$ 374,896	\$ 1,563,964	\$ -	\$ 1,938,860
Insurance	24,984	92,914	-	117,898
Pension	15,388	58,254	-	73,642
Miscellaneous	12,846	135,525	-	148,371
Depreciation	7,476,422	1,171,258	1,449	8,649,129
Amortization	81,096	594,502	-	675,598
	<u>\$ 7,985,632</u>	<u>\$ 3,616,417</u>	<u>\$ 1,449</u>	<u>\$ 11,603,498</u>

	<b>For the Nine Months Ended September 30, 2003</b>			
	<b>Operating Costs</b>	<b>Operating Expenses</b>	<b>Nonoperating Expenses and Losses</b>	<b>Total</b>
Employee expenses				
Salaries	\$ 168,825	\$ 1,003,117	\$ -	\$ 1,171,942
Insurance	11,282	70,315	-	81,597
Pension	2,642	46,776	-	49,418
Miscellaneous	7,572	78,150	-	85,722
Depreciation	4,419,439	851,451	-	5,270,890
Amortization	-	1,370	-	1,370
	<u>\$ 4,609,760</u>	<u>\$ 2,051,179</u>	<u>\$ -</u>	<u>\$ 6,660,939</u>

**18. INCOME TAX**

- a. Reconciliation of income tax expense based on income before income tax at statutory income tax rates to income tax expense—current is as follows:

	<b>September 30</b>	
	<b>2004</b>	<b>2003</b>
Income tax expense computed at statutory tax rate (25%)	\$ 4,043,519	\$ 1,495,498
Add (deduct) tax effects of		
Permanent differences	( 672,614)	( 2,483)
Temporary differences	254,923	( 31,381)
Tax-exempt income	( 1,856,007)	( 1,095,296)
Unappropriated earnings tax (10%)	280,170	17,460
Investment tax credits	( 681,608)	( 258,599)
Income tax expense—current	<u>\$ 1,368,383</u>	<u>\$ 125,199</u>

As of September 30, 2004 and 2003, Yuan-Ze generated a net loss and had no taxable income.

The balances of income tax payable as of September 30, 2004 were net of the creditable income taxes of \$958 plus the accrual of income tax payable in the amount of \$209,008 for the years not yet examined and cleared by the tax authorities (refer to f.). The balance of income tax payable as of September 30, 2003 were net of the creditable income taxes of \$1,984.

Net operating income generated from the use of switches and cell sites acquired during the period April 1, 1997 to December 31, 1999 are exempt from income tax for the period January 1, 2000 to December 31, 2004.

Net operating income generated from the use of switches and cell sites acquired during the period January 1, 2000 to June 26, 2002 are exempt from income tax for the period June 26, 2002 to June 25, 2007.

b. Income tax expense (benefit) consisted of:

	<b>Nine Months Ended</b>	
	<b>September 30</b>	
	<b>2004</b>	<b>2003</b>
Income tax expense—current	\$ 1,368,383	\$ 125,199
Income tax benefit (expense)—deferred	340,560	( 164,521)
Prior year's adjustment	38,653	3,622
Income tax expense on income subjected to a separate rate of 20%	<u>367</u>	<u>1,984</u>
Income tax expense (benefit)	<u>\$ 1,747,963</u>	<u>( \$ 33,716)</u>

c. Deferred income taxes assets (liabilities) as of September 30, 2004 and 2003 consisted of:

	<b>September 30</b>	
	<b>2004</b>	<b>2003</b>
<u>Current</u>		
Provision for doubtful accounts	\$ 1,330,571	\$ 548,224
Investment tax credit	502,804	-
Provision for losses on inventories	5,561	1,839
Unrealized foreign exchange loss (gain)—net	13,531	( 25,537)
Employee welfare expense	-	1,125
Other	<u>1,867</u>	<u>130</u>
	1,854,334	525,781
Less—valuation allowance	<u>585,438</u>	<u>-</u>
	<u>\$ 1,268,896</u>	<u>\$ 525,781</u>
<u>Noncurrent</u>		
Investment tax credits	\$ 752,416	\$ 1,151,792
Depreciation resulting from the differences in estimated service lives of properties	504,078	411,090
Loss carryforwards	167,588	104,682
Accrued pension cost	54,255	40,600
Provision for losses on properties not currently used in operations	88,592	-
Accrued interest premium	12,202	6,108
Cumulative equity in the net loss of investee	8,559	103,160
Other	<u>7,553</u>	<u>331</u>
	1,595,243	1,817,763
Less—valuation allowance	<u>579,474</u>	<u>104,757</u>
	<u>\$ 1,015,769</u>	<u>\$ 1,713,006</u>

The tax rate used in calculating deferred income tax was 25%.

d. Integrated income tax information:

	<b>September 30</b>	
	<b>2004</b>	<b>2003</b>
Far EasTone	\$ 6,315	\$ 2,088
KG Telecom	\$ 483,466	\$ -
Yuan-Ze	\$ 138	\$ 2

The ratio of the ICA balance of Far EasTone on the dividend distribution date in 2004 and 2003 to the balance of the undistributed earnings as of December 31, 2003 and 2002 were 0.68% and 2.58%, respectively.

The estimated ratio of KG Telecom's ICA balance on the dividend distribution date in 2004 to the balance of the undistributed earnings as of December 31, 2003 was 24.93%.

Yuan-Ze has no appropriated earnings as of September 30, 2004. Therefore, the ICA balance of Yuan-Ze will be accumulated until a future date of dividend distribution.

The tax credits will be accumulated until the date of dividend distribution. Upon dividend distribution, the ratio of the imputed tax credits to unappropriated earnings based on the prevailing ICA balance will be used by Far EasTone and KG Telecom for allocating tax credits to each Far EasTone's and KG Telecom's stockholder.

e. Investment tax credits and loss carryforwards information:

The unused investment tax credits and loss carryforwards of the Group as of September 30, 2004 are summarized as follows:

Far EasTone

<u>Statutes</u>	<u>Items</u>	<b>Total Investment Tax Credits</b>	<b>Unused Investment Tax Credits</b>	<b>Year of Expiry</b>
Statute for Upgrading Industries	Purchase of automated equipment or technology	\$ 267,455	\$ 149,060	2005
		141,604	30,031	2006
		54,946	54,946	2007
		2,941	2,941	2008
Statute for Upgrading Industries	Research and development expenditures	699,533	502,803	2004
		587,938	43,592	2005
		304,206	39,661	2006
		28,866	28,866	2007
Statute for Upgrading Industries	Personnel training expenditures	38,545	38,545	2008
		19,629	19,629	2005
		12,038	12,038	2006
		3,273	3,273	2007
		<u>\$ 2,160,974</u>	<u>\$ 925,385</u>	

KG Telecom

<u>Statutes</u>	<u>Items</u>	<u>Total Investment Tax Credits</u>	<u>Unused Investment Tax Credits</u>	<u>Year of Expiry</u>
Statute for Upgrading Industries	Purchase of automated equipment or technology	\$ 564,651	\$ 173,435	2006
		<u>151,916</u>	<u>150,439</u>	2007
		<u>\$ 716,567</u>	<u>\$ 323,874</u>	

Yuan-Ze

<u>Statutes</u>	<u>Items</u>	<u>Total Investment Tax Credits</u>	<u>Unused Investment Tax Credits</u>	<u>Year of Expiry</u>
Statute for Upgrading Industries	Purchase of automated equipment or technology	<u>\$ 5,961</u>	<u>\$ 5,961</u>	2007

Year of ExpiryLoss Carryforwards

2006	\$ 36,132
2007	10,118
2008	76,396
2009	<u>44,942</u>
	<u>\$167,588</u>

## f. Income tax returns status:

Income tax returns through 1999 of Far EastTone had been examined and cleared by the tax authorities.

Income tax returns through 2002 of Yuan-Ze had been examined and cleared by the tax authorities.

Income tax returns through 1997 of KG Telecom had been examined and cleared by the tax authorities. In addition, tax authorities had examined and cleared KG Telecom's income tax returns for 1998 and 2001, however KG Telecom had appealed for re-examination of filing related to the amortization of goodwill resulting from merger with Tuntex and the dispute in the amount of investment tax credits. The outcome of this appeal is not yet finalized. KG Telecom had accrued income tax payable of \$209,008 for years not yet examined and cleared by tax authorities based on the foregoing examined results.

**19. RELATED-PARTY TRANSACTIONS**

The Group's related parties and relationship are as follows:

<u>Related Party</u>	<u>Nature of Relationship</u>
Yuan Ding Co. (YDC)	Same chairman
New Century InfoComm Tech Co., Ltd. (NCIC)	Same chairman
Far Eastern International Leasing Corp. (FEILC)	Supervisor of Far EastTone
Far Eastern Textile Ltd. (FETL)	Ultimate parent company
AT&T Wireless Service Inc. (AWS)	Parent company of a major stockholder and a related party until October 2003

(Continued)

<b>Related Party</b>	<b>Nature of Relationship</b>
AT&T Corp. (AT&T)	Parent company of AWS and a related party until October 2003
Far Eastern Telecom Engineering Corp. (FETEC)	Investee of YDC
Far Eastern Info Service (Holding) Ltd. (Bermuda)	Subsidiary of Far EasTone and a related party since September 2004
Far Eastern Technology Developmental Foundation (FETTDF)	Far EasTone's donation to the foundation's capital over one third
Far Eastern Resource Development Co., Ltd. (FETRD)	Same chairman
Far Eastern Department Stores Co., Ltd. (FEDS)	Same chairman
Asia Cement Co., Ltd. (ACC)	Same chairman
U-Ming Marine Transport Corp. (UMMT)	Same chairman
Far Eastern Polychem Industries Ltd. (FETPI)	Same ultimate parent company
Far Eastern Investment Holding Ltd. (Bermuda) (FETIH)	Same ultimate parent company
Oriental Industrial Holding Pte. Ltd. (Singapore) (OIHP)	Subsidiary of ACC
FEDS Development Ltd. (BVI) (FEDSD)	Subsidiary of FEDS
Yue-Tung Investment Corp. (YTI)	Subsidiary of UMMT
Far Eastern Technology Network Information Ltd. (Shanghai) (FETI)	Same ultimate parent company and a subsidiary of Far EasTone since September 2004
E. World (Holdings) Ltd. (E. World)	Subsidiary
Yuan Ding Investment Co., Ltd.	Same chairman
Far Eastern International Bank (FETIB)	Same chairman
Oriental Union Chemical Corporation	Same chairman
Far Eastern Geant Company Ltd.	Same chairman
E. World Ltd. (Taiwan)	Same chairman
Oriental Institute of Technology	Same chairman
Oriental Securities Co., Ltd.	Same ultimate parent company
Ding Ding Hotel Co., Ltd.	Same chairman
Liquid Air Far East Co., Ltd.	Its chairman is the relative of Far EasTone's chairman
Far Eastern Apparel Co., Ltd.	Same ultimate parent company
Yuan Ding Leasing Corp.	Same ultimate parent company
Far Eastern Electronic Toll Collection Co., Ltd. (FETETC)	Equity-method investee of Far EasTone
KGEx.com	Subsidiary of KG Telecom and a related party of Far EasTone since January 2004
KGT International Holdings	Subsidiary of KG Telecom and a related party of Far EasTone since January 2004
KG Satellite	Subsidiary of KG Telecom and a related party of Far EasTone since January 2004
Taipei Metro Properties Management	Same ultimate parent company
Yue Ding Industry Co., Ltd.	Director of Far EasTone
Yue-Li Investment Corporation	Director of Far EasTone
NTT DoCoMo Inc.	Its subsidiary is the director of Far EasTone
Far Eastern Y.Z. Hsu Science and Technology Memorial Foundation	Director of Far EasTone
Asia Investment Corporation	Supervisor of Far EasTone
Bai Yang Investment Co., Ltd.	Its chairman is the relative of Far EasTone's chairman
Ding Yuan International Investment Co., Ltd.	Same ultimate parent company

(Continued)

<u>Related Party</u>	<u>Nature of Relationship</u>
Kai Yuan International Investment Co., Ltd.	Same ultimate parent company
An Ho Garment Co., Ltd.	Same ultimate parent company
Yuan Tong Investment Co., Ltd.	Same ultimate parent company
Far Cheng Human Resources Consultant Corp. (FCHRC)	Same ultimate parent company

In addition to Notes 8 and 14, the significant transactions with the above parties are summarized as follows:

		<u>2004</u>		<u>2003</u>	
		<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
<u>During the nine-month period</u>					
Operating revenue					
NCIC	a.	\$ 821,046	2	\$ 476,588	2
KGEx.com	b.	250,338	1	-	-
Other	c.	<u>3,010</u>	<u>-</u>	<u>68</u>	<u>-</u>
		<u>\$ 1,074,394</u>	<u>3</u>	<u>\$ 476,656</u>	<u>2</u>
Operating costs and expenses					
Service cost					
KGEx.com	d.	\$ 28,847	-	\$ -	-
FETEC	e.	23,305	-	20,459	-
NCIC	b.	2,165	-	30,043	-
Other	z.	<u>228</u>	<u>-</u>	<u>-</u>	<u>-</u>
		<u>\$ 54,545</u>	<u>-</u>	<u>\$ 50,502</u>	<u>-</u>
Rental					
FEILC	f.	\$ 38,123	2	\$ 75,470	8
FETRD	g.	33,776	2	-	-
NCIC	h.	21,308	1	-	-
FETL	i.	3,618	-	36,546	4
Other	z.	<u>5,988</u>	<u>-</u>	<u>5,851</u>	<u>1</u>
		<u>\$ 102,813</u>	<u>5</u>	<u>\$ 117,867</u>	<u>13</u>
Management service fee					
AWS	j.	<u>\$ -</u>	<u>-</u>	<u>\$ 36,000</u>	<u>100</u>
Research and development expense					
FETTDF	k.	<u>\$ 12,188</u>	<u>75</u>	<u>\$ 11,867</u>	<u>55</u>
Service fee					
FETI	l.	\$ 97,552	48	\$ 42,602	22
FCHRC	m.	57,119	28	129,098	66
Others	z.	<u>6,952</u>	<u>3</u>	<u>-</u>	<u>-</u>
		<u>\$ 161,623</u>	<u>79</u>	<u>\$ 171,700</u>	<u>88</u>

(Continued)



		<u>2004</u>		<u>2003</u>	
		<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonoperating income and gains					
Management service revenue (included in other nonoperating income and gains)					
KGEx.com	n.	\$ 7,500	100	\$ -	-
Rental income (included in other nonoperating income and gains)					
NCIC	o.	\$ 1,836	24	\$ -	-
Gain on disposal of properties					
NCIC	p.	\$ 811	-	\$ 64,646	678
Other					
NCIC	p.	\$ -	-	\$ 7,400	24
Nonoperating expenses and losses					
Interest expense					
FETIB	q.	\$ 1,197	-	\$ -	-
Acquisition of investments in shares of stock					
FETPI	r.	\$ 92,616	15	\$ -	-
FETIH	s.	12,531	2	-	-
OIHP	s.	12,531	2	-	-
YTI	s.	12,531	2	-	-
FEDSD	s.	4,195	1	-	-
		\$ 134,404	22	\$ -	-
Acquisition of properties					
NCIC	t.	\$ 152,522	3	\$ -	-
FEILC	f.	147,500	3	1,532,506	35
FETEC	u.	32,368	-	60,184	1
		\$ 332,390	6	\$ 1,592,690	36
<u>At end of period</u>					
Receivables from related parties					
NCIC	b. and p.	\$ 19,794	33	\$ 77,416	83
KGEx.com	v.	19,791	33	-	-
FETETC	w.	7,096	12	-	-
FETI	l.	6,136	10	-	-
AWS	j.	-	-	15,393	17
Other	z.	7,281	12	-	-
		\$ 60,098	100	\$ 92,809	100

(Continued)

		<u>2004</u>		<u>2003</u>	
		<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Prepaid expenses					
FEILC	f.	\$ 6,736	1	\$ 794	-
NCIC	h.	2,358	-	-	-
YDC	x.	1,224	-	1,387	-
FETL	i.	553	-	558	-
Other	z.	<u>3,089</u>	<u>-</u>	<u>1,948</u>	<u>-</u>
		<u>\$ 13,960</u>	<u>1</u>	<u>\$ 4,687</u>	<u>-</u>
Deferred charge (included in other assets—miscellaneous)					
NTT DoCoMo Inc.	y.	<u>\$ 14,444</u>	<u>8</u>	<u>\$ -</u>	<u>-</u>
Refundable deposits					
FEILC	f.	\$ 4,590	1	\$ 6,839	3
NCIC	h.	1,769	-	-	-
YDC	x.	582	-	917	-
Other	z.	<u>255</u>	<u>-</u>	<u>244</u>	<u>-</u>
		<u>\$ 7,196</u>	<u>1</u>	<u>\$ 8,000</u>	<u>3</u>
Payables to related parties					
NCIC	b. and t.	\$ 212,276	72	\$ 107,485	23
FETEC	e. and u.	21,059	7	321,245	69
KGEx.com	d.	8,565	3	-	-
Other	z.	<u>51,517</u>	<u>18</u>	<u>40,305</u>	<u>8</u>
		<u>\$ 293,417</u>	<u>100</u>	<u>\$ 469,035</u>	<u>100</u>
Long-term debts payable—current portion					
FETIB	q.	<u>\$ 34,000</u>	<u>-</u>	<u>\$ -</u>	<u>-</u>
Long-term lease payable (includes current portion)					
FEILC	f.	<u>\$ 118,000</u>	<u>100</u>	<u>\$ -</u>	<u>-</u>

The descriptions of the transactions with related parties are as follows:

- a. Operating revenues (such as service revenue and revenues from sales of cellular phone equipments and accessories) from related parties are based on normal service rates, selling prices and collection terms.
- b. The transactions between Far EasTone, KG Telecom and NCIC consisted of sales to NCIC of cellular phone equipments and accessories and interconnection activities for NCIC's use of Far EasTone's and KG Telecom's network. The interconnection fees paid by Far EasTone and KG Telecom on its use of NCIC's fixed-line network and billing processing costs pertaining to the interconnection services provided by NCIC to Far EasTone and KG Telecom are included in service cost. The international direct dialing revenue collected by Far EasTone and KG Telecom for NCIC was treated as a reduction of service revenue and was included in payables to related parties.
- c. The transactions between Far EasTone, KG Telecom and KGEx.com are interconnection activities for KGEx.com's use of Far EasTone's and KG Telecom's network.

- d. KG Telecom signed a network maintenance contract with KGEx.com for maintaining KG Telecom's telecommunications network and backbone network facilities. In addition, Far EasTone and KG Telecom paid the interconnection fees to KGEx.com for their use of KGEx.com's network.
- e. Far EasTone and KG Telecom signed a network maintenance contract with FETEC for maintaining their telecommunications network and backbone network facilities.
- f. Under operating lease agreements, Far EasTone rented from FEILC the following: (a) its office spaces in Neihu, Tainan and Kaohsiung from February 2000 to April 2003; (b) the land and mobile switch centers located in Neihu, Taichung and Xinzhu, from November 1999 to June 2005; and (c) vehicles.

When the contracts expire, Far EasTone may either renew the contracts or buy the buildings or land at the following prices:

	<u>Purchase Price</u>
Neihu switch center	\$ 130,000
Taichung land for switch center	106,050
Tainan office space	78,000
Kaohsiung office space	45,900
Xinzhu land for switch center	120,000

The lease contract on the office spaces in Neihu expired in April 2003. The board of directors approved the purchase of the land and buildings in Neihu for use as Far EasTone's headquarters on February 26, 2003. The purchase amounted to \$1,532,382 (without sales tax) was determined based on the appraisal report from real estate brokers. The title to the land and buildings was transferred to Far EasTone by the end of April 2003.

Far EasTone and KG Telecom lease from FEILC operating equipment, included in construction in progress at September 30, 2004, under a five years lease from July 2004 to June 2009, with annual lease payment of \$30,828. The fair value of the leased properties at the inception of the lease is \$147,500, and the total future lease payments amount to \$154,136 (Note 8).

- g. Far EasTone leases from FETRD several parcels of the land and building spaces under contracts with term from September 2003 to November 2013. The properties are located in Yatung street and Renai Street in Panchao City; and Wuku in Taipei County and other locations in Taiwan.
- h. Far EasTone leases from NCIC telecommunications network and office spaces in Neihu under contracts with term from September 2003 to September 2008.
- i. Far EasTone leases from FETL several parcels of the land and building spaces under contracts with term from July 1997 to November 2014. The properties are located in Yuantung Street in Chungli and other locations in Taiwan.
- j. Far EasTone signed a service agreement with AWS in January 1997 for AWS to provide consulting services on the construction of a wireless network and business operations. The service charges were based on the actual expenses incurred by the AWS consultants and are net of any withholding taxes paid by Far EasTone.
- k. FETTDF researches telecommunication technology and provides training programs for Far EasTone.
- l. Far EasTone signed a service agreement with FETI in 2003. The service charges were based on the services provided by FETI as agreed with Far EasTone. The advances to FETI were treated as receivables from related parties and were collected at various times based on the cash balances of FETI.

- m. The Group has contracts with FCHRC for manpower dispatching service. The service charges were based upon the services provided by FCHRC for temporary or specific personnel supplies.
- n. Far EasTone provides management services to KGEx.com for its daily operating expenditures.
- o. Far EasTone leases its HUB spaces to NCIC, the lease agreement will expire in March 2005.
- p. The advances for the construction and joint use of telecommunications network and backbone network facilities between Far EasTone and NCIC and receivables from sales of properties to NCIC were included in receivables from related parties. The proceeds and gains from disposal of properties for the nine months ended September 30, 2004 are \$8,011 and \$811, respectively.

Far EasTone sold HUB and related operating equipment located in Tai-Ping, Taichung County to NCIC in 2003. The selling price of the HUB and related operating equipment was \$154,805 with a related service charge of \$7,770, including sales tax. For the nine months ended September 30, 2003, the gain on disposal of properties and service charge for the management of the building was \$64,646 and \$7,400, respectively, which was recorded as nonoperating income as net gains from disposal of properties.

- q. KG Telecom obtained a syndicated loan from a consortium of banks with interest payable quarterly. A portion of the outstanding loans is drawn from FETIB, amounting to \$34,000. The loan is secured and payable every six months at equal installments of the principal with the final payment due in August 2005.

In addition, FETIB provides a guarantee for payment of KG Telecom's long-term bonds amounting to \$30,600.

- r. Far EasTone bought 100% ownership of Far Eastern Info Service (Holding) Ltd. in the amount of \$92,616 on August 30, 2004. As a result, Far EasTone gained 100% ownership of FETI indirectly.
- s. Far EasTone bought 4,685 thousand shares in the amount of \$41,788 representing ownership of 66.92% of E. World Holdings from FEITH, OIHP, FEDSD and YTI (Note 7).
- t. Far EasTone bought NCIC's telecommunications network and backbone network facilities.
- u. Far EasTone has contracts with FETEC for the construction of telecommunications network and backbone network facilities.
- v. Far EasTone and KG Telecom gave advances to KGEx.com for its daily operating expenditures and will be collected at various times based on the cash balances of KGEx.com.
- w. Far EasTone gives advances to FETETC for its daily operating expenditures during its development stage. The advances will be collected at various times based on the cash balances of FETETC.
- x. The Group leased certain floors at The Mall for the period September 1999 to December 2005 from YDC.
- y. In order to promote I-Mode services in Taiwan, KG Telecom has entered into an agreement (I-Mode Technical Assistance and License Agreement) with NTT DoCoMo Inc. According to this agreement, KG Telecom shall pay NTT DoCoMo Inc. the initial payment and the running royalty that will be paid at the percentage of the related revenue of KG Telecom.
- z. Accounts of other related parties are less than 5% of the respective accounts.

All the above rental rates and terms are comparable to leases with third parties.

## 20. ASSETS PLEDGED OR MORTGAGED

The assets pledged or mortgaged are used as collateral for customs duties, long-term and short-term debts and bonds as follows:

	<u>September 30</u>	
	<u>2004</u>	<u>2003</u>
Time deposits (included in other assets—miscellaneous)	\$ 7,881	\$ -
Properties—net	<u>25,275,917</u>	<u>4,865,170</u>
	<u>\$25,283,798</u>	<u>\$ 4,865,170</u>

## 21. COMMITMENTS AS OF SEPTEMBER 30, 2004

The Group has the following significant commitments:

- a. The Group has outstanding contracts to acquire properties for \$3,522,093.
- b. Far EasTone's outstanding letters of credit amounted to ¥ 400,536 thousand (equivalent to \$122,684) and US\$1,870 thousand (equivalent to \$63,526).
- c. The rentals of land, buildings and cell sites of the Group for the next five years are summarized as follows:

<u>Period</u>	<u>Amount</u>
October 1, 2004 to September 30, 2005	\$ 2,523,645
October 1, 2005 to September 30, 2006	2,621,646
October 1, 2006 to September 30, 2007	2,723,478
October 1, 2007 to September 30, 2008	2,829,293
October 1, 2008 to September 30, 2009	2,939,246

## 22. ADDITIONAL DISCLOSURES

A. Important transactions and B. Related information of the Group's investees.

- a. Financing provided: None
- b. Endorsement/guarantee provided: None
- c. Marketable securities and investments in shares of stock held: Schedule A
- d. Marketable securities acquired and disposed of at costs or prices of at least NT\$100 million or 20% of the paid-in capital: Schedule B
- e. Acquisition of individual real estate at costs of at least NT\$100 million or 20% of the paid-in capital: None
- f. Disposal of individual real estate at prices of at least NT\$100 million or 20% of the paid-in capital: None
- g. Total purchase from or sale to related parties amounting to at least NT\$100 million or 20% of the paid-in capital: Schedule C

- h. Receivables from related parties amounting to at least NT\$100 million or 20% of the paid-in capital: Schedule D
- i. Names, locations, and related information of investees on which Far EasTone exercises significant influence: Schedule E
- j. Derivative financial instruments

Far EasTone and KG Telecom used certain derivative financial instruments to hedge overall fluctuations on interest rates and exchange rate for the nine months ended September 30, 2004 and 2003. All these transactions are for nontrading purposes. Yuan-Ze did not enter into any derivative financial instrument contracts for the nine months ended September 30, 2004 and 2003.

The information on derivative financial instrument contracts entered into by the Group are as follows:

1) Open contracts and credit risk

<u>Type of Transaction</u>	<u>September 30, 2004</u>						<u>Credit Risk</u>
	<u>Notional Amount</u>	<u>Fixed Rate</u>	<u>Market Rate</u>	<u>Settlement Date</u>	<u>Maturity Date</u>		
Interest rate swap— Far EasTone	\$2,670,000	1.25%-1.95%	1.03%-3.41%	Every 6 months	March 28, 2008— December 19, 2008		\$ -
Interest rate swap— KG Telecom	1,000,000	3.38%-5.45%	1.04%-1.69%	Every 3 months	November 22, 2004 —May 20, 2005		-

<u>Type of Transaction</u>	<u>September 30, 2003</u>						<u>Credit Risk</u>
	<u>Notional Amount</u>	<u>Fixed Rate</u>	<u>Market Rate</u>	<u>Settlement Date</u>	<u>Maturity Date</u>		
Interest rate swap— Far EasTone	\$1,470,000	1.25%	2.60%	Every 6 months	March 28, 2008— April 3, 2008		\$ -

<u>Type of Transaction</u>	<u>September 30, 2004</u>			
	<u>Notional Amount</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Credit Risk</u>
Cross currency swap—KG Telecom	US\$ 46,656 thousand	\$ -	(\$ 2,481)	\$ 315

The related gains of Far EasTone on these swap contracts for the nine months ended September 30, 2004 and 2003 were \$26,436 and \$3,411, respectively, recorded as a reduction of interest expenses.

The related losses of KG Telecom on these interest rate swap and cross currency swap contracts for the nine months ended September 30, 2004 was NT\$48,901, recorded as interest expenses.

There was no outstanding forward contract as of September 30, 2004 and 2003, respectively.

In 2004 and 2002, Far EasTone placed an order for cellular phones amounting to ¥ 374,560 thousands and ¥ 1,444,814 thousands, respectively. To hedge the effect of exchange rate fluctuations on these commitments, Far EasTone entered into Japanese yen forward contracts. The forward contracts were due on August 18, 2004 and January 6, 2003, respectively, and the realized gains of \$1,695 and \$4,103 were recognized as reduction of inventory.

Far EasTone and KG Telecom are exposed to credit risk if counter-parties default on their contractual obligations. To manage this risk, Far EasTone and KG Telecom transacts only with selected financial institutions with good credit ratings. Thus, management does not anticipate any material losses resulting from defaults.

2) Market risk

Far EasTone and KG Telecom entered into interest rate swap and cross currency swap contracts to hedge the effect of foreign currency fluctuations on its obligations with floating interest rates. The contracts are settled at net amounts. Therefore, the market risk is not material.

Far EasTone entered into forward exchange contracts to hedge the effect of exchange rate fluctuations on firm commitments. Therefore, the market risk is not material.

3) Liquidity risk, cash-flow risk and future cash demand

The interest rate swap contracts are settled at net amounts, and the expected cash demand is not significant. The forward exchange rates are determined in advance and no additional material cash is required. Due to the simultaneous cash inflow and outflow generated from cross currency swap contracts, the aggregated outcome of net cash flow is expected to be insignificant. Management believes that Far EasTone and KG Telecom have sufficient operating capital to meet cash demand.

4) The purpose of derivative financial instruments held or issued/the strategies to meet the purpose

Far EasTone and KG Telecom use certain derivative financial instruments for nontrading purposes. The interest rate swap contracts are for hedging overall fluctuations on interest rates. The swap involves Far EasTone's and KG Telecom's paying interests at a fixed rate and receiving interests based on market rates. Far EasTone and KG Telecom entered into forward exchange contracts to hedge the effects of exchange rate fluctuations on firm commitments. The cross currency swap contracts are for hedging overall fluctuations on interest rates and exchange rates from foreign currency obligations with floating rates. The overall purpose of these contracts is to hedge Far EasTone's and KG Telecom's exposure to cash flow risk. Far EasTone and KG Telecom periodically evaluates the effectiveness of the instruments.

5) The fair values of financial instruments were estimated as follows:

	September 30			
	2004		2003	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<u>Nonderivative financial instruments</u>				
Financial assets				
Cash and cash equivalents	\$ 3,600,861	\$ 3,600,861	\$ 5,800,932	\$ 5,800,932
Short-term investments	290,000	290,000	-	-
Notes and accounts receivable—net	6,645,681	6,645,681	3,820,200	3,820,200
Receivables from related parties	60,098	60,098	92,809	92,809
Investments in shares of stock	1,848,465	1,848,465	48,518	48,518
Refundable deposits	423,576	422,662	238,226	238,011

(Continued)

	September 30			
	2004		2003	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Pledged time deposits (included in other assets—miscellaneous)	\$ 7,881	\$ 7,881	\$ -	\$ -
Financial liabilities				
Short-term loans	1,200,000	1,200,000	-	-
Commercial paper payable	1,745,339	1,745,339	346,571	346,571
Notes payable	41,163	41,163	25,480	25,480
Accounts payable	980,316	980,316	1,005,690	1,005,690
Payables to related parties	293,417	293,417	469,035	469,035
Payables related to acquisition of properties	1,441,792	1,441,792	1,903,471	1,903,471
Long-term liabilities (including current portion)	23,374,717	23,584,452	11,509,165	11,716,615
Guarantee deposits received (including noncurrent portion)	1,704,740	1,704,740	1,668,493	1,668,493
<u>Derivative financial instruments</u>				
Interest rate swap—FET	-	( 37,330)	-	14,924
Interest rate swap—KG Telecom	-	( 20,392)	-	-
Cross currency swap—KG Telecom	-	( 2,481)	-	-

The bases used for estimating the fair values of financial instruments were as follows:

- a) The carrying values of cash and cash equivalents, notes and accounts receivable, receivables from related parties, pledged time deposits, short-term loans, notes payable, accounts payable, payables to related parties and payables related to acquisition of properties are recorded at their carrying values due to the short maturity of these instruments.
- b) The fair values of investments in shares of stock are recorded at market prices or, if market prices are unavailable, on the equity in the investee's net assets.
- c) Long-term liabilities—market prices or, if market prices are unavailable, upon present value of expected cash outflows, which is discounted at the interest rates for bank loans with similar maturity date.
- d) Refundable deposits and guarantee deposits received—present values of future payments or receipts.
- e) Fair values of derivative financial instruments—quoted market prices obtained from foreign banks.

#### C. Investment in Mainland China:

- a. Investee company name, the description of the primary business activity and products, issued capital, nature of the relationship, capital inflow or outflow, ownership interest, gain or loss on investment, amounts received on investment, and the limitation on investment: Schedule F;
- 2) Significant direct or indirect transactions with the investee company, prices, payment terms, and unrealized gain or loss: Note 19.



FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES

MARKETABLE SECURITIES HELD

SEPTEMBER 30, 2004

(Amounts in Thousands of New Taiwan Dollars, Unless Otherwise Specified)

Company Name	Type and Name of Securities	Relationship with the Company	Financial Statement Account	September 30, 2004				Note
				Shares	Carrying Value	Percentage of Ownership (%)	Market Value or Net Asset Value	
Far Eastone Telecommunications Co., Ltd.	<u>Stocks</u>							
	KG Telecommunications Co., Ltd.	Equity-method investee.	Investments in shares of stock	1,332,997,916	\$ 33,201,314	100.00	\$ 33,201,314	Notes A and E
	Yuan-Ze Telecommunications Co., Ltd.	Equity-method investee	Investments in shares of stock	1,037,000,000	9,688,304	100.00	9,688,304	Notes A and E
	Far Eastern Electronic Toll Collection Co., Ltd.	Equity-method investee	Investments in shares of stock	54,000,000	455,340	45.00	455,340	Note B
	E. World (Holdings) Ltd.	Equity-method investee.	Investments in shares of stock	6,014,622	48,870	85.92	48,870	Note B
Far Eastern Info Service (Holding) Ltd.		Equity-method investee.	Investments in shares of stock	1,200	95,337	100.00	95,337	Note B
E. World (Holdings) Ltd.	<u>Stocks</u>							
	E. World Ltd.	Equity-method investee	Investments in shares of stock	19,349,994	US\$ 552,000	99.99	US\$ 552,000	Note B
	Ideaculture Limited (Cayman)	-	Investments in shares of stock	1,195,141	US\$ 431,000	17.96	US\$ 143,000	Note D
Far Eastern Info Service (Holding) Ltd.	<u>Share certificates</u>							
	Far Eastn Technology Network Information Limited Company (Shanghai)	Equity-method investee	Investments in shares of stock	-	US\$ 1,968,000	100.00	US\$ 1,968,000	Note B
KG Telecommunications Co., Ltd.	<u>Stocks</u>							
	KGEx.com	Equity-method investee	Investments in shares of stock	175,931,000	902,149	50.27	902,149	Note B
	KGT International Holdings	Equity-method investee	Investments in shares of stock	50,000	146,430	100.00	146,430	Note B
	KG Satellite	Equity-method investee	Investments in shares of stock	9,950,000	83,268	66.33	83,268	Note B
	iScreen	Equity-method investee	Investments in shares of stock	4,000,000	69,071	40.00	69,071	Note B
YesMobile (Taiwan)		-	Investments in shares of stock	100,000	3,000	0.50	3,000	Note B
Far Eastern Alliance Taiwan Bond Fund	<u>Mutual funds</u>							
		-	Short-term investments	27,573,879.00	290,000	-	290,000	Note C
KGT International Holdings	<u>Stocks</u>							
	KGEx.com	Equity-method investee	Investments in shares of stock	16,051,000	US\$ 3,735,000	4.59	US\$ 3,735,000	Note B
KGEx.com	<u>Mutual funds</u>							
	Invesco Bond Fund	-	Short-term investments	2,425,199.91	35,000	-	35,039	Note C
	Sheng Hua 1699 Bond Fund	-	Short-term investments	720,290.45	8,565	-	8,674	Note C
KG Satellite	<u>Mutual funds</u>							
	Phoenix Fund	-	Short-term investments	1,399,492.00	20,225	-	20,472	Note C
	PCA Bond Fund	-	Short-term investments	217,068.70	3,241	-	3,279	Note C
	Central Diamond Bond Fund	-	Short-term investments	7,995,521.37	88,061	-	89,083	Note C

Note A. Calculation was based on reviewed financial statements as of September 30, 2004.

Note B. Calculation was based on unreviewed financial statements as of September 30, 2004.

Note C. Open-ended mutual funds was calculated by net asset value of mutual funds as of September 30, 2004.

Note D. Calculation was based on the most current audited financial statements.

Note E. All balances have been eliminated in consolidation.

FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES

MARKETABLE SECURITIES ACQUIRED AND DISPOSED OF AT COSTS OR PRICES OF AT LEAST \$100 MILLION OR 20% OF THE PAID-IN CAPITAL FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004  
(Amounts in Thousands of New Taiwan Dollars)

Company Name	Marketable Securities	Account	Related Party	Nature of Relationship	Beginning Balance		Acquired		Disposed			The Change due to Equity Method	Ending Balance		
					Share/Units	Amount	Share/Units	Amount	Share/Units	Price	Costs		Gain or Loss	Share/Units	Amount
Far Eastone Telecommunications Co., Ltd.	KG Telecommunications Co., Ltd. (Note E)	Equity-method investee	Original stockholders of KG Telecom Issuance of stock by cash	-	526,430,771.00	\$ 11,698,382	806,567,145 (Note D)	\$ 17,930,678 (Note D)	-	\$ -	\$ -	\$ -	\$ 3,572,254 (Note B)	1,332,997,916.00	\$ 33,201,314
	Far Eastern Electronic Toll Collection Co., Ltd.	Equity-method investee		-	6,500,000.00	65,000	47,500,000	475,000	-	-	-	( 84,660) (Note C)	-	54,000,000.00	455,340
KG Telecommunications Co., Ltd. (Note A)	Fuhwa Bond Fund	Short-term investments	-	-	8,276,487.41	101,313	-	-	8,276,487.41	101,752	101,313	439	-	-	-
	Sheng Hua 1699 Bond Fund	Short-term investments	-	-	28,193,838.32	335,263	-	-	28,193,838.32	336,616	335,263	1,353	-	-	-
	Sheng Hua 5599 Bond Fund	Short-term investments	-	-	27,259,695.01	292,862	-	-	27,259,695.01	293,494	292,862	632	-	-	-
	Entrust Kirin Bond Fund	Short-term investments	-	-	24,112,994.10	255,463	-	-	24,112,994.10	256,642	255,463	1,179	-	-	-
	Phoenix Fund	Short-term investments	-	-	52,414,671.20	756,895	-	-	52,414,671.20	759,803	756,895	2,908	-	-	-
	PCA Bond Fund	Short-term investments	-	-	17,673,057.10	263,885	-	-	17,673,057.10	264,260	263,885	375	-	-	-
	President Home Run Bond Fund	Short-term investments	-	-	9,818,196.30	132,159	-	-	9,818,196.30	132,351	132,159	192	-	-	-
	United Bond Fund	Short-term investments	-	-	11,773,049.24	147,593	-	-	11,773,049.24	147,687	147,593	94	-	-	-
	Truswell Bond Fund	Short-term investments	-	-	16,337,600.20	200,000	-	-	16,337,600.20	200,714	200,000	714	-	-	-
	Invesco GP Aggressive Income Fund	Short-term investments	-	-	10,510,341.13	115,223	-	-	10,510,341.13	115,490	115,223	267	-	-	-
	Grand Cathay Bond Fund	Short-term investments	-	-	13,666,157.20	170,000	-	-	13,666,157.20	170,069	170,000	69	-	-	-
	TA Chong Bond Fund	Short-term investments	-	-	12,012,974.00	150,000	-	-	12,012,974.00	150,067	150,000	67	-	-	-
	TA Chong Gallop Bond Fund	Short-term investments	-	-	19,154,886.40	200,000	-	-	19,154,886.40	200,090	200,000	90	-	-	-
	The First Global Investment Trust Duo Li Bond Fund	Short-term investments	-	-	421,785.10	6,740	6,255,473.50	100,000	6,677,258.60	106,865	106,740	125	-	-	-
	Fuh-Hwa Bond Fund	Short-term investments	-	-	12,150,254.50	154,518	-	-	12,150,254.50	155,336	154,518	818	-	-	-
	Far Eastern Alliance Taiwan Bond Fund	Short-term investments	-	-	-	-	27,573,879.00	290,000	-	-	-	-	-	27,573,879.00	290,000
KGEx.Com (Note A)	Sheng Hua 1699 Bond Fund	Short-term investments	-	-	10,178,000.94	121,022	-	-	9,457,710.49	113,000	112,457	543	-	720,290.45	8,565

Note A: The beginning balance was carried from KG Telecom's accounts balances due to the combination with KG Telecom.

Note B: Including investment gain of \$3,568,706 and cumulative translation adjustments of \$3,548 under equity method.

Note C: Investment loss under equity method.

Note D: Acquisition from the combination with KG Telecom (Note 1).

Note E: All the carrying values of investment in shares of stock, investment income (loss) and the investees' net assets have been eliminated in consolidation.

**FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES**

**TOTAL PURCHASE FROM OR SALE TO RELATED PARTIES AMOUNTING TO AT LEAST \$100 MILLION OR 20% OF THE PAID-IN CAPITAL  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004**

(Amounts in Thousands of New Taiwan Dollars)

Purchase (Sale) of Goods	Related Party	Nature of Relationship	Transaction Details				Abnormal Transaction		Notes/Accounts Receivable or (Payable)		
			Purchase/Sale	Amount	% to Total	Payment Terms	Unit Price	Payment Terms	Ending Balance	% to Total	
Far EasTone Telecommunications Co., Ltd.	KG Telecommunications Co., Ltd. (Note C)	Subsidiary of Far EasTone	Service revenue	(\$ 686,445)	( 4%)	30 days	-	-	Accounts receivable (Note A)	\$37,076	6%
			Cost of services	611,070	4%	30 days	-	-	Accounts payable (Note A)	\$ -	-
KG Telecommunications Co., Ltd.	New Century InfoComm Tech Co., Ltd.	Same chairman	Service revenue	( 483,552)	( 1%)	30 days	-	-	Accounts receivable (Note B)	\$ 9,977	2%
									Accounts payable (Note B)	(\$32,702)	(13%)
KG Telecommunications Co., Ltd.	KGEx.com	Subsidiary of KG Telecom	Service revenue	( 177,261)	( 1%)	30 days	-	-	Accounts receivable	\$10,900	58%
									Accounts receivable (Note B)	-	-
	New Century InfoComm Tech Co., Ltd.	Same chairman	Service revenue	( 337,494)	( 2%)	30 days	-	-	Accounts payable (Note B)	(\$14,941)	(3%)

Note A: Service revenue and cost of services between Far EasTone and KG Telecom were settled at net amounts and was included in receivables from related parties.

Note B: All revenues and costs were settled at full amount except interconnection revenues and costs and were included in receivables from related parties and payables to related parties, respectively.

Note C: All the service revenue, cost of services and receivables from related parties have been eliminated in consolidation.

**FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES**

**RECEIVABLES FROM RELATED PARTIES AMOUNTING TO AT LEAST NT\$100 MILLION OR 20% OF THE PAID-IN CAPITAL**

**SEPTEMBER 30, 2004**

**(Amounts in Thousands of New Taiwan Dollars)**

Company Name	Related Party	Nature of Relationship	Ending Balance (Note)	Turnover Rate	Overdue		Amounts Received in Subsequent Period	Allowance for Bad Debts
					Amount	Action Taken		
Far EasTone Telecommunications Co., Ltd.	KG Telecommunications Co., Ltd.	Subsidiary	\$397,448	(Note A)	\$ -	-	\$ -	\$ -
	Yuan-Ze Telecommunications Co., Ltd.	Subsidiary	206,374	(Note A)	-	-	-	-

Note A: The turnover rate is unavailable because receivables from related parties were mainly due to the advances in operating expenditures to related parties.

Note B: All receivables from related parties have been eliminated in consolidation.

FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES

NAMES, LOCATIONS, AND OTHER INFORMATION OF INVESTEEES ON WHICH THE GROUP EXERCISES SIGNIFICANT INFLUENCE

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004

(Amounts in Thousands of New Taiwan Dollars, Unless Otherwise Specified)

Investor Company	Investee Company	Location	Main Businesses and Products	Original Investment Amount		Balance as of September 30, 2004			Net Gain (Loss) of the Investee	Equity in Net Gain (Loss)	Note
				September 30, 2004	December 31, 2003	Shares	Percentage of Ownership (%)	Carrying Value			
Far EasTone Telecommunications Co., Ltd.	KG Telecommunications Co., Ltd.	Taiwan	Wireless telecommunications services and the wholesale/retail sale of telecom equipment	\$ 29,629,139	\$ 11,698,461	1,332,997,916	100.00	\$ 33,201,314	\$ 3,568,706	\$ 3,568,706	Notes A, B and I
	Yuan-Ze Telecommunications Co., Ltd.	Taiwan	Wireless telecommunications services and the wholesale/retail sale of telecom equipment	10,370,000	10,370,000	1,037,000,000	100.00	9,688,304	( 179,959 )	( 181,784 )	Notes A, B and I
	Far Eastern Electronic Toll Collection Co., Ltd.	Taiwan	Electronic toll collection service	540,000	65,000	54,000,000	45.00	455,340	( 188,133 )	( 84,660 )	Notes C and D
	E. World (Holdings) Ltd.	British Cayman Islands	Investment	82,883	41,095	6,014,622	85.92	48,870	( 213 )	( 1,328 )	Notes A and E
	Far Eastern Info Service (Holding) Ltd.	British Bermuda Islands	Investment	92,616	-	1,200	100.00	95,337	17,851	2,721	Notes D and F
KG Telecommunications Co., Ltd. (Note H)	KGEx.com	Taiwan	Type II telecommunications service	1,759,310	1,759,310	175,931,000	50.27	902,149	( 240,708 )		Notes D and F
	KGT International Holdings	British Virgin Islands	Investment	93,976	93,976	50,000	100.00	146,430	( 32,255 )		Notes D and F
	KG Satellite (KGS)	Taiwan	Type I telecommunications services	99,500	99,500	9,950,000	66.33	83,268	( 3,757 )		Notes D and F
	iScreen	Taiwan	Information service	100,000	100,000	4,000,000	40.00	69,071	( 14,602 )		Notes D and G
KGT International Holdings (Note H)	KGEx.com	Taiwan	Type II telecommunications service	US\$4,822,000	US\$4,687,000	16,051,000	4.59	US\$3,735,000	( 240,708 )		Notes D and F
E. World (Holdings) Ltd.	E. World Ltd.	Taiwan	Sale of cellular phone equipments and accessories	193,500	193,500	19,349,994	99.99	US\$ 552,000	( 30 )		Notes D and F
Far Eastern Info Service (Holding) Ltd.	Far Eastern Technology Network Information Ltd. Company (Shanghai)	Shanghai	Computer software, data processing and network information providing services	US\$2,500,000	-	-	100.00	US\$1,968,000	17,851		Notes D and F

- Note:
- A. Subsidiary of Far EasTone.
  - B. Calculation was based on reviewed financial statements as of September 30, 2004.
  - C. Equity-method investee of Far EasTone.
  - D. Calculation was based on unreviewed financial statements as of September 30, 2004.
  - E. The equity in net gain (loss) was used to be recognized in the succeeding year because the audited financial statements of the investee were not timely available. However, the equity in net gain (loss) has been recognized at the same period since the percentage of ownership exceeded 50% in June 2004. Therefore, calculation was based on audited financial statements in 2003 and unaudited ones for the period ended September 30, 2004.
  - F. Subsidiary of KG Telecom.
  - G. Equity-method investee of KG Telecom.
  - H. The original investment amounts were equal to those of KG Telecom's account balances as of December 31, 2003 due to the combination with KG Telecom in 2004.
  - I. All the carrying values of investment in shares of stock, investment income (loss) and the investees' net assets have been eliminated in consolidation.

FAR EASTONE TELECOMMUNICATIONS CO., LTD. AND SUBSIDIARIES

INVESTMENT IN MAINLAND CHINA  
 FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004  
 (Amounts in Thousand New Taiwan Dollars, Unless Otherwise Specified)

Investee Company Name	Main Businesses and Products	Total Amount of Paid-in Capital	Investment Type (e.g., Direct or Indirect)	Accumulated Outflow of Investment from Taiwan as of Jan. 1, 2004	Investment Flows		Accumulated Outflow of Investment from Taiwan as of Sep. 30, 2004	% Ownership of Direct or Indirect Investment	Investment Gain (Loss)	Carrying Value as of Sep. 30, 2004	Accumulated Inward Remittance of Earnings as of Sep. 30, 2004	Accumulated Investment in Mainland China as of Sep. 30, 2004	Investment Amounts Authorized by Investment Commission, MOEA	Upper Limit on Investment
					Outflow	Inflow								
Far Eastern Technology Network Information Limited Company (Shanghai)	Computer software, data processing and network information providing services	\$84,950 (US\$2,500,000)	Note B	\$ -	\$92,616	\$ -	\$92,616	100%	\$2,721	\$66,873 (US\$1,968,000)	\$ -	\$92,616	\$92,616	\$25,758,543 (Note C)

Note A: Calculation of investment gain (loss) was based on unreviewed financial statement as of September 30, 2004.

Note B: Far EasTone made the investment through existing company registered in 3rd region.

Note C: Equal to 40% of Far EasTone's net asset value.