Notes to the Consolidated Financial Statements

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

1. Organization and Principal Activities

Semiconductor Manufacturing International Corporation was incorporated under the laws of the Cayman Islands on April 3, 2000 and its subsidiaries as of December 31, 2006 include the following:

Name of company	Place and date of incorporation/ establishment	Attributable equity interest held	Principal activity
Garrison Consultants Limited ("Garrison")	Samoa April 5, 2000	100%	Provision of consultancy services
Better Way Enterprises Limited ("Better Way")	Samoa April 5, 2000	100%	Provision of marketing related activities
Semiconductor Manufacturing International (Shanghai) Corporation ("SMIS")*#	The People's Republic of China (the "PRC") December 21, 2000	100%	Manufacturing and trading of semiconductor products
SMIC, Americas	United States of America June 22, 2001	100%	Provision of marketing related activities
Semiconductor Manufacturing International (Beijing) Corporation ("SMIB")*	The PRC July 25, 2002	100%	Manufacturing and trading of semiconductor products
SMIC Japan Corporation	Japan October 8, 2002	100%	Provision of marketing related activities
SMIC Europe S.R.L	Italy July 3, 2003	100%	Provision of marketing related activities
SMIC Commercial Shanghai Limited Company (formerly SMIC Consulting Corporation)*	The PRC September 30, 2003	100%	Operation of a convenience store
Semiconductor Manufacturing International (Tianjin) Corporation ("SMIT")*#	The PRC, November 3, 2003	100%	Manufacturing and trading of semiconductor products
Semiconductor Manufacturing International (AT) Corporation ("AT")	Cayman Islands July 26, 2004	56.67%	Investment holding
Semiconductor Manufacturing International (Chengdu) Corporation ("SMICD")*	The PRC August 16, 2004	56.67%	Manufacturing and trading of semiconductor products
Semiconductor Manufacturing International (Solar Cell) Corporation ("Solar Cell")	Cayman Island June 30, 2005	100%	Investment holding
SMIC Energy Technology (Shanghai) Corporation ("Energy Science")*#	The PRC September 9, 2005	100%	Manufacturing and trading of solar cell related semiconductor products
SMIC (Chengdu) Development Corporation*#	The PRC December 29, 2005	100%	Construction, operation, management of SMICD's and quarter, schools, living and supermarket
Magnificent Tower Limited	British Virgin Islands, January 5, 2006	100%	Investment holding

* Companies registered as wholly foreign-owned enterprises in the PRC.

\# For identification purposes only

1. Organization and Principal Activities (Continued)

Semiconductor Manufacturing International Corporation and its subsidiaries (hereinafter collectively referred to as the "Company" or "SMIC") are mainly engaged in the computer-aided design, manufacturing, packaging, testing and trading of integrated circuits and other semiconductor services, and manufacturing design of semiconductor masks.

In 2004, the Company incorporated AT and SMICD, a wholly owned subsidiary of AT. In 2005, AT issued redeemable convertible preference shares to a third party for cash consideration of US$39 million, representing 43.33% equity interest of AT.

2. Reclassifications of Certain Accounts

(a) In 2005, the Company has reclassified the amortization of share-based compensation in the same lines as cash compensation paid to the same employees in accordance with SAB 107, Share-Based Payment. The comparative figures of the prior years have been reclassified to conform to this presentation.

(b) Commencing with the first quarter ended March 31, 2005, the Company reclassified the amortization expenses related to acquired intangible assets into a separate line item. The comparative figures of the prior years have been reclassified to conform to this presentation.

3. Summary of Significant Accounting Policies

(a) Basis of presentation

The consolidated financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

(b) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its majority owned subsidiaries. All inter-company transactions and balances have been eliminated upon consolidation. Minority interest is recorded as a reduction of the reported income or expense unless the amount would result in a reduction of expense for which the minority partner would not be responsible.

(c) Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenue and expenses in the financial statements and accompanying notes. Significant accounting estimates reflected in the Company's financial statements include valuation allowance for deferred tax assets, allowance for doubtful accounts, inventory valuation, useful lives and commencement of productive use for plant and equipment and acquired intangible assets, impairment on long-lived assets, accruals for sales adjustments, other liabilities, contingencies and share-based compensation expenses.

3. Summary of Significant Accounting Policies (Continued)

(d) Certain significant risks and uncertainties

The Company participates in a dynamic high technology industry and believes that changes in any of the following areas could have a material adverse effect on the Company's future financial position, results of operations, or cash flows: changes in the overall demand for semiconductor manufacturing services; competitive pressures due to excess capacity or price reductions; advances and trends in new technologies and industry standards; changes in key suppliers; changes in certain strategic relationships or customer relationships; regulatory or other factors; risks associated with the ability to obtain necessary raw materials; and risks associated with the Company's ability to attract and retain employees necessary to support its growth.

(e) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and highly liquid investments which are unrestricted as to withdrawal or use, and which have maturities of three months or less when purchased.

(f) Investments

Short-term investments consisting primarily of mutual funds, corporate notes and corporate bonds are classified either as available for sale or trading securities.

Available for sale securities have been recorded at fair market value. Unrealized gains and losses are recorded as accumulated other comprehensive income (loss). Unrealized losses, which are deemed other than temporary, are recorded in the statement of operations as other expenses. The unrealized gains and losses are reclassified to earnings once the available-for-sale investments are settled.

Trading securities are recorded at fair value with unrealized gains and losses classified as earnings.

Debt securities with original maturities greater than one year are classified as long-term investments held to maturity.

(g) Concentration of credit risk

Financial instruments that potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents, shot-term investments, accounts receivable and receivable for sale of manufacturing equipments. The Company places its cash and cash equivalents with reputable financial institutions.

The Company conducts credit evaluations of customers and generally does not require collateral or other security from its customers. The Company establishes an allowance for doubtful accounts based upon estimates, factors surrounding the credit risk of specific customers and other information.

(h) Inventories

Inventories are stated at the lower of cost (weighted average) or market. Cost comprises direct materials and where applicable, direct labors costs and those overheads that have been incurred in bringing the inventories to their present location and condition.

Adjustments are recorded to write down the cost of obsolete and excess inventory to the estimated market value based on historical and forecast demand. In 2006, 2005 and 2004, inventory was written down by US$16,106,471, US$13,808,698 and US$10,506,374, respectively, to reflect the lower of coat or market.

(In U.S. dollars, except where otherwise stated)

3. Summary of Significant Accounting Policies (Continued)

(i) Land use rights, net

Land use rights are recorded at cost less accumulated amortization. Amortization is provided over the term of the land use right agreement on a straight-line basis over the term of the agreements, which range from 50 to 70 years.

(j) Plant and equipment, net

Plant and equipment are carried at cost less accumulated depreciation and are depreciated on a straight-line basis over the following estimated useful lives:

Buildings	25 years
Facility, machinery and equipment	10 years
Manufacturing machinery and equipment	5 years
Furniture and office equipment	3-5 years
Transportation equipment	5 years

The Company constructs certain of its plant and equipment. In addition to costs under the construction contracts, external costs directly related to the construction of such facilities, including duties and tariffs, equipment installation and shipping costs, are capitalized. Depreciation is recorded at the time assets are ready for their intended use.

(k) Acquired intangible assets

Acquired intangible assets, which consist primarily of technology, licenses and patents, are carried at cost less accumulated amortization and impairment. Amortization is computed using the straight-line method over the expected useful lives of the assets of 5 to 10 years. The Company has determined that its intangible assets were not impaired at December 31, 2006. The Company had no goodwill as of December 31, 2006, 2005 and 2004.

(l) Impairment of long-lived assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable. When these events occur, the Company measures impairment by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flow is less than the carrying amount of the assets, the Company would recognize an impairment loss based on the fair value of the assets.

(m) Revenue recognition

The Company manufactures semiconductor wafers for its customers based on the customers' designs and specifications pursuant to manufacturing agreements and/or purchase orders. The Company also sells certain semiconductor standard products to customers. The Company recognizes revenue to customers upon shipment and title transfer. The Company also provides certain services, such as mask making, testing and probing, and revenue is recognized when the services are completed.

(In U.S. dollars, except where otherwise stated)

3. Summary of Significant Accounting Policies (Continued)

(m) Revenue recognition (Continued)

Customers have the rights of return within one year pursuant to warranty and sales return provisions, which has been minimal. The Company typically performs tests of its products prior to shipment to identify yield rate per wafer. Occasionally, product tests performed after shipment identify yields below the level agreed with the customer. In those circumstances, the customer arrangement may provide for a reduction to the price paid by the customer or for its costs to ship replacement products to the customer. The Company estimates the amount of sales returns and the cost of replacement products based on the historical trend of returns and warranty replacements relative to sales as well as a consideration of any current information regarding specific known product defects at customers that may exceed historical trends.

(n) Capitalization of interest

Interest incurred on funds used to construct plant and equipment during the active construction period is capitalized, net of government subsidies received. The interest capitalized is determined by applying the borrowing interest rate to the average amount of accumulated capital expenditures for the assets under construction during the period. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful life of the assets. Capitalized interest of US$4,798,002, US$7,617,123 and US$7,531,038, net of government subsidies of US$22,396,613, US$3,990,606 and US$nil in 2006, 2005 and 2004, respectively, has been added to the cost of the underlying assets during the year and is amortized over the respective useful life of the assets.

	For the year ended December 31		
	2006	2005	2004
Total actual interest expense	**$ 78,120,699**	$ 50,392,052	$ 21,228,932
Less: Government subsidy	**22,396,613**	3,990,606	–
Less: Capitalized interest	**4,798,002**	7,617,123	7,531,038
Net interest expense	**$ 50,926,084**	$ 38,784,323	$ 13,697,894

(o) Government subsidies

The Company receives government subsidies in the following five forms:

(1) *Reimbursement of certain interest costs incurred on borrowings*

The Company received government subsidies of US$13,878,353, US$12,390,652 and US$nil in 2006, 2005 and 2004, respectively, which were calculated based on the interest expense on the Company's budgeted borrowings. The Company recorded government subsidies as a reduction of interest expense.

(2) *Value added tax refunds*

The Company received subsidies of US$82,960, US$3,747,951 and US$1,949,265 in 2006, 2005 and 2004, respectively, for value added taxes paid by the Company in respect of export sales of semiconductor products. The value added tax refunds have been recorded as a reduction of the cost of sales.

(3) *Sales tax refunds*

The Company received sales tax refunds of US$97,079, US$609,461 and US$573,992 in 2006, 2005 and 2004, respectively, which were recorded as an offset of the general and administrative expenses.

3. Summary of Significant Accounting Policies (Continued)

(o) Government subsidies (Continued)

(4) Government awards

The Company received government awards of US$11,886,551 and US$3,270,242 in the form of reimbursement of certain expenses in 2006 and 2005, respectively. Accordingly these awards were recorded as reduction of expenses.

The Company received US$1,449,888 in 2004 in recognition of the Company's efforts to attract and retain talents with overseas experience in the high technology industry. The government recognition awards were recorded as other income in 2004 since the Company was awarded for its overall effort in attraction and retention of such talents but not for specific projects.

(5) Government subsidy for fab construction

Certain local governments provided subsidies to encourage the Company to participate and manage new plants relating to the integrated circuit industry.

The Company received a subsidy of US$2,208,758 in 2006 as reimbursement of land use right payment, which has been used to offset the cost of the land use right.

The Company received a subsidy of US$18,538,886 in 2005, which was used to offset the account of plant and equipment as they were strictly related to the construction of an assembly and testing plant.

(p) Research and development costs

Research and development costs are expensed as incurred.

(q) Start-up costs

In accordance with Statement of Position No. 98-5, "Reporting on the costs of start-up activities," the Company expenses all costs incurred in connection with start-up activities, including preproduction costs associated with new manufacturing facilities and costs incurred with the formation of the Company such as organization costs. Preproduction costs including the design, formulation and testing of new products or process alternatives are included in research and development expenses. Preproduction costs including facility and employee costs incurred in connection with constructing new manufacturing plants are included in general and administrative expenses.

3. Summary of Significant Accounting Policies (Continued)

(r) Foreign currency translation

The United States dollar ("US dollar"), the currency in which a substantial portion of the Company's transactions are denominated, is used as the functional and reporting currency of the Company. Monetary assets and liabilities denominated in currencies other than the US dollar are translated into US dollar at the rates of exchange ruling at the balance sheet date. Transactions in currencies other than the US dollar during the year are converted into the US dollar at the applicable rates of exchange prevailing on the day transactions occurred. Transaction gains and losses are recognized in the statements of operations.

The financial records of certain of the Company's subsidiaries are maintained in local currencies other than the US dollar, such as Japanese Yen, which are their functional currencies. Assets and liabilities are translated at the exchange rates at the balance sheet date, equity accounts are translated at historical exchange rates and revenues, expenses, gains and losses are translated using the average rate for the year. Translation adjustments are reported as cumulative translation adjustments and are shown as a separate component of other comprehensive income (loss) in the statement of stockholders' equity.

(s) Income taxes

Deferred income taxes are recognized for temporary differences between the tax bases of assets and liabilities and their reported amount in the financial statements, net operating loss carry forwards and credits by applying enacted statutory tax rates applicable to future years. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Current income taxes are provided for in accordance with the laws of the relevant taxing authorities.

(t) Comprehensive income (loss)

Comprehensive income (loss) includes such items as foreign currency translation adjustments and unrealized gains/ losses on short-term investments. Comprehensive income (loss) is reported in the statement of stockholders' equity.

(u) Fair value of financial instruments

Financial instruments include cash and cash equivalents, short-term investments, short-term borrowings, promissory note, long-term payables relating to license agreements, long-term debt, accounts payables, accounts receivables and receivables for sale of equipments. The carrying values of cash and cash equivalents, short-term investments and short-term borrowings approximate their fair values based on quoted market values or due to their short-term maturities. The carrying value of long-term payables relating to license agreements, long-term debt and payables approximates fair value due to variable interest rates that approximate market rates.

3. Summary of Significant Accounting Policies (Continued)

(v) Share-based compensation

The Company grants stock options to its employees and certain non-employees. Prior to January 1, 2006, the Company accounted for share-based compensation in accordance with Accounting Principles Board Opinion No. 25, ("APB 25"), "Accounting for Stock Issued to Employees," and related interpretations. The Company also followed the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation", as amended by SFAS 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." As a result, no expense was recognized for options to purchase the Company's ordinary shares that were granted with an exercise price equal to fair market value at the day of the grant prior to January 1, 2006. Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), ("SFAS 123(R)") "Share-Based Payment," which establishes accounting for equity instruments exchanged for services.

Under the provisions of SFAS 123(R), share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant). The Company elected to adopt the modified prospective transition method as provided by SFAS 123(R) and, accordingly, financial statement amounts for the prior periods presented in this report have not been restated to reflect the fair value method of expensing share-based compensation.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company recognized a benefit of US$5.2 million as a result of the cumulative effect of a change in accounting principle, in relating to the forfeiture rate applied on the unvested portion of the stock options. Basic and diluted net loss per share for the year ended December 31, 2006 would have been US$0.0025.

The Company's total actual share-based compensation expense for the year ended December 31, 2006, 2005 and 2004 was US$23,506,847 and US$25,735,849 and US$27,011,078, respectively.

(In U.S. dollars, except where otherwise stated)

3. Summary of Significant Accounting Policies (Continued)

(v) Share-based compensation (Continued)

Had compensation cost for options granted to employees under the Company's stock option plans been determined based on the fair value at the grant date, as prescribed in SFAS No. 123, for the periods prior to January 1, 2006, the Company's pro forma loss would have been as follows:

	Year ended December 31,	
	2005	2004
(Loss) income attributable to holders of ordinary shares	$ (114,774,827)	$ 77,363,770
Add: Stock compensation as reported	25,735,849	27,011,078
Less: Stock compensation determined using the fair value method	(32,997,627)	(37,486,703)
Pro forma (loss) income attributable to holders of ordinary shares	$ (122,036,605)	$ 66,888,145
(Loss) income per share:		
Basic – pro forma	$ (0.01)	$ 0.00
Diluted – pro forma	$ (0.01)	$ 0.00
Basic – as reported	$ (0.01)	$ 0.01
Diluted – as reported	$ (0.01)	$ 0.00

The weighted-average grant-date fair value of options granted during the year 2006, 2005 and 2004 was US$0.05, US$0.05 and US$0.17, respectively.

The fair value of each option and share grant are estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2006	2005	2004
Average risk-free rate of return	**4.72%**	4.16%	2.64%
Weighted average expected term	**2-4 years**	1-4 years	0.5-4 years
Volatility rate	**32.69%**	30.39%	52.45%
Expected dividend	**–**	–	–

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

3. Summary of Significant Accounting Policies (Continued)

(w) Derivative financial instruments

The Company's primary objective for holding derivative financial instruments is to manage currency and interest rate risks. The Company records derivative instruments as assets or liabilities, measured at fair value. The recognition of gains or losses resulting from changes in the values of those derivative instruments is based on the use of each derivative instrument and whether it qualifies for hedge accounting.

The Company has the following notional amount of derivative instruments:

	December 31, 2006	2005	2004
Forward foreign exchange contracts	**$ 35,660,177**	$ 245,622,512	$ 61,034,335
Interest rate swap contracts	**265,947,874**	340,000,000	–
	$ 301,608,051	$ 585,622,512	$ 61,034,335

The Company purchases foreign-currency forward exchange contracts with contract terms expiring within one year to protect against the adverse effect that exchange rate fluctuations may have on foreign-currency denominated purchase activities, principally the Reminbi, the Japanese Yen and the European Euro. The foreign-currency forward exchange contracts do not qualify for hedge accounting. In 2006, 2005 and 2004, gains and losses on the foreign currency forward exchange contracts were recognized in the statement of operations. Notional amounts are stated in the US dollar equivalents at spot exchange rates at the respective dates.

Settlement currency	Notional amount	US dollar equivalents
As of December 31, 2006		
Japanese Yen	**4,235,537,500**	**$ 35,660,177**
As of December 31, 2005		
Japanese Yen	22,097,665,000	$ 188,659,310
European Euro	47,900,000	56,881,250
Renminbi	661,400	81,952
		$ 245,622,512
As of December 31, 2004		
Japanese Yen	2,915,714,899	$ 28,111,405
European Euro	20,042,037	27,313,288
USD	46,428,200	5,609,642
		$ 61,034,335

(In U.S. dollars, except where otherwise stated)

3. Summary of Significant Accounting Policies (Continued)

(w) Derivative financial instruments (Continued)

In 2006 and 2005, the Company entered into various interest rates swap contracts to protect against volatility of future cash flows caused by the changes in interest rates associated with the outstanding debts. The interest rate swap contracts do not qualify for hedge accounting. In 2006 and 2005, hedging gains or losses on the interest rate swap contracts were recognized in the statement of operations. As of December 31, 2006 and 2005, the Company had outstanding interest rate swap contracts with notional amounts of US$250,000,000 and US$340,000,000, respectively.

In addition to the abovementioned interest rate swap contracts, in 2006, the Company entered into a cross-currency interest rate swap agreement to protect against volatility of future cash flows caused by the changes in both interest rate and exchange rate associated with the outstanding long-term debts that are denominated in a currency other than US dollar. The cross-currency interest rate swap agreement does not qualify for hedge accounting. In 2006, hedging gains or losses on the interest rate swap contracts were recognized in the statement of operations. As of December 31, 2006, the Company had outstanding cross-currency interest rate swap contracts with notional amounts of US$15,947,874.

The fair values of each derivative instrument are as follows:

	December 31		
	2006	2005	2004
Forward foreign exchange contracts	**$ (2,694,415)**	$ (2,607,714)	$ (283,344)
Interest rate swap contracts	**(5,317,837)**	(1,270,811)	–
	$ (8,012,252)	$ (3,878,525)	$ (283,344)

As of December 31, 2006, 2005 and 2004, the fair value of these derivative instruments was recorded in accrued expenses and other current liabilities, with the change of fair value of forward foreign exchange contracts recorded as part of other income (expense), the change of fair value of interest rate swap contract and cross currency interest rate swap contracts recorded as part of interest expense.

3. Summary of Significant Accounting Policies (Continued)

(x) Recently issued accounting standards

In February 2006, FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statement No. 133 and 140," which simplifies accounting for certain hybrid financial instruments by permitting fair value re-measurement for any hybrid instrument that contains an embedded derivative that otherwise would require bifurcation and eliminates a restriction on the passive derivative instruments acquired, issued or subject to re-measurement (new basis) event occurring after the beginning of an entity's fiscal year that begins after September 15, 2006. The Company is currently evaluating the impact of SFAS No. 155 on its consolidated financial statements.

In June 2006, FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109 (FIN 48)." This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and the measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. Earlier application is encouraged. The Company is currently evaluating the impact, if any, of FIN 48 on its consolidated financial statements.

In September 2006, FASB issued SFAS No.157, "Fair Value Measurements", which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurement. This Statement clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged. The Company is currently evaluating the impact, if any, of SFAS157 on its consolidated financial statements.

In June 2006, the Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That is Gross Versus Net Presentation)" ("EITF 06-3"). The scope of EITF 06-3 includes sales, use, value added and some excise taxes that are assessed by a governmental authority on specific revenue-producing transactions between a seller and customer. EITF 06-3 states that a company should disclose its accounting policy (i.e. gross or net presentation) regarding the presentation of taxes within its scope, and if significant, these disclosures should be applied retrospectively to the financial statements for all periods presented. EITF 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. The Company is currently evaluating the impact, if any, of this statement on its consolidated financial statements and related disclosures.

3. Summary of Significant Accounting Policies (Continued)

(y) Income (loss) per share

Basic income (loss) per share is computed by dividing income (loss) attributable to holders of ordinary shares by the weighted average number of ordinary shares outstanding (excluding shares subject to repurchase) for the year. Diluted income (loss) per ordinary share reflects the potential dilution that could occur if securities or other contracts to issue ordinary shares were exercised or converted into ordinary shares. Ordinary share equivalents are excluded from the computation in loss periods as their effects would be antidilutive.

(z) Share split

On March 18, 2004, the Company effected a 10-for-1 share split immediately after the conversion of preference shares into ordinary shares. All share information relating to ordinary shares of the Company in the accompanying financial statements, including the conversion price relating to such ordinary shares and stock options, have been adjusted retroactively, which gives effect to the share split.

4. Motorola Asset Purchase and License Agreements

On September 23, 2003, the Company entered into an agreement to acquire certain assets and assume certain obligations from Motorola, Inc. ("Motorola") and Motorola (China) Electronics Limited ("MCEL"), a wholly owned subsidiary of Motorola in exchange for 82,857,143 Series D convertible preference shares convertible into ordinary shares at a conversion price of US$0.2087 per share and a warrant to purchase 8,285,714 Series D convertible preference shares for US$0.01 per share (the "Asset Purchase"). In addition, the Company issued 8,571,429 Series D convertible preference shares convertible into ordinary shares at a conversion price of US$0.2087 per share and a warrant to purchase 857,143 Series D convertible preference shares for US$0.01 per share in exchange for US$30,000,000. The Company and Motorola completed the Asset Purchase on January 16, 2004.

In conjunction with the Asset Purchase, the Company and Motorola entered into an agreement to license certain technology and intellectual property. In exchange for these licenses, the Company agreed to issue Motorola an aggregate of 11,428,571 Series D convertible preference shares convertible into ordinary shares at a conversion price of US$0.2087 per share and a warrant to purchase 1,142,857 Series D convertible preference shares for US$0.01 per share. On December 5, 2003, the Company partially closed this license agreement with Motorola and issued to Motorola 7,142,857 Series D convertible preference shares and a warrant to purchase 714,286 Series D convertible preference shares at US$0.01 per share. On January 16, 2004, the Company closed the license agreement with Motorola and issued to Motorola 4,285,714 series D convertible preference share and a warrant to purchase 428,571 Series D convertible preference shares at US$0.01 per share.

5. Accounts Receivable, Net of Allowances

The Company determines credit terms for each customer on a case by case basis, based on its assessment of such customer's financial standing and business potential with the Company.

In addition, for certain customers with long-established relationship and good past repayment histories, a longer credit period may be granted.

(In U.S. dollars, except where otherwise stated)

5. Accounts Receivable, Net of Allowances (Continued)

An aging analysis of trade debtors is as follows:

	2006	2005	2004
Current	**$ 213,539,198**	$ 192,303,054	$ 148,502,815
Overdue:			
Within 30 days	**31,611,729**	38,017,540	15,901,323
Between 31 to 60 days	**5,879,705**	2,528,249	2,656,964
Over 60 days	**1,154,343**	8,485,071	2,127,185
	$ 252,184,975	$ 241,333,914	$ 169,188,287
Net of Allowance for doubtful accounts	**$ (4,048,845)**	$ (1,091,340)	$ (1,105,165)

The change in the allowance for doubtful accounts is as follows:

	2006	2005	2004
Balance, beginning of year	**$ 1,091,340**	$ 1,105,165	$ 114,473
Provision for the year	**2,957,505**	–	990,692
Reversal in the year	**–**	(13,825)	–
Balance, end of year	**$ 4,048,845**	$ 1,091,340	$ 1,105,165

6. Investments

Available-for-sale security

The following is a summary of short-term available-for-sale listed securities:

	December 31, 2006			
	Cost	**Gross unrealized gains**	**Gross unrealized losses**	**Fair value**
Mutual fund	**$ 52,866,825**	**$ 0**	**$ –**	**$ 52,866,825**

	December 31, 2005			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Commercial paper	$ 3,482,033	$ 9,450	$ –	$ 3,491,483
Mutual fund	10,283,573	20,803	–	10,304,376
	$ 13,765,606	$ 30,253	$ –	$ 13,795,859

(In U.S. dollars, except where otherwise stated)

6. Investments (Continued)

	December 31, 2004			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Corporate note	$ 10,000,000	$ –	$ –	$ 10,000,000
Mutual fund	10,277,379	86,805	–	10,364,184
	$ 20,277,379	$ 86,805	$ –	$ 20,364,184

Trading security

As of December 31, 2006, the Company also held certain trading securities with costs of US$5,000,000 and fair value of US$5,083,778.

7. Inventories

	2006	2005	2004
Raw materials	**$ 89,431,781**	$ 55,697,982	$ 39,336,929
Work in progress	**150,506,509**	115,210,052	83,953,481
Finished goods	**35,240,662**	20,329,602	20,727,442
	$ 275,178,952	$ 191,237,636	$ 144,017,852

8. Assets Held for Sale

Assets held for sale represent residential real estate that the Company has constructed for its employees. In 2004, the Company had sold residential real estate with a carrying value of US$12,089,113 to employees for US$12,778,062, which resulted in a gain on disposition of US$688,949. The Company has reclassified the majority of the unsold residential real estate units of US$18,670,278 to land use rights, plant and equipment and recorded a cumulative adjustment for depreciation expense of US$1,155,623, representing depreciation that would have been recognized had the unsold real estate units been continuously classified as land use rights, plant and equipment. The remaining balance of assets held for sale as of December 31, 2004 was US$1,831,972, representing 44 sets of the residential real estate units.

In 2005, the Company sold residential real estate units with a carrying value of US$1,679,818 for US$2,322,409, which resulted in a gain on disposal of US$642,591. Meanwhile, the Company has reclassified the remaining unsold real estate units of US$152,154 to land use rights, plant and equipment. Accordingly, the Company recorded a cumulative adjustment for depreciation expense of US$7,352, representing depreciation that would have been recognized had the unsold real estate units been continuously classified as land use rights, plant and equipment. No residential real estate was classified as assets held for sale as of December 31, 2005.

In 2006, the Company decided to offer employees additional residual real estate, and classified the US$17,097,675 carrying value as assets held for sale. Meanwhile, the Company sold residential real estate units with a carrying value of US$7,676,946 for US$8,934,560, which resulted in a gain on disposal of US$1,257,614. The remaining balances of assets held for sale as of December 31, 2006 was US$9,420,729, representing 213 sets of residential real estate units.

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

9. Land Use Rights, Net

	2006	2005	2004
Land use rights (50 – 70 years)	**$ 42,485,856**	$ 38,504,311	$ 42,412,453
Less: accumulated amortization	**(4,162,523)**	(3,736,793)	(3,214,679)
	$ 38,323,333	$ 34,767,518	$ 39,197,774

10. Plant and Equipment, Net

	2006	2005	2004
Buildings	**$ 269,721,109**	$ 212,205,753	$ 203,375,644
Facility, machinery and equipment	**435,112,058**	382,928,570	339,852,626
Manufacturing machinery and equipment	**4,539,566,491**	3,810,671,778	2,838,231,084
Furniture and office equipment	**61,979,029**	75,696,024	51,932,370
Transportation equipment	**1,666,185**	1,581,493	1,324,144
	5,308,044,872	4,483,083,618	3,434,715,868
Less: accumulated depreciation and amortization	**(2,314,667,455)**	(1,515,923,860)	(772,416,194)
Construction in progress	**251,023,405**	318,471,373	649,624,925
	$ 3,244,400,822	$ 3,285,631,131	$ 3,311,924,599

In 2006, the Company sold plant, equipment and other fixed assets with a carrying value of US$34,231,116 for US$77,353,045, which resulted in a gain on disposal of US$43,121,929.

The plant and equipment were sold to a government-owned foundry based in Chengdu, Sichuan province, to which SMIC is also contracted to provide management services.

11. Acquired Intangible Assets, Net

	2006	2005 (As Restated, see Note 31)	2004 (As Restated, see Note 31)
Cost:			
Technology	**$ 20,256,328**	$ 17,406,681	$ 15,674,853
Licenses	**49,308,145**	36,739,470	12,768,057
Patent licenses	**65,297,639**	65,297,639	67,122,391
	$ 134,862,112	$ 119,443,790	$ 95,565,301
Accumulated Amortization:			
Technology	**(13,712,517)**	(9,065,285)	(5,232,801)
Licenses	**(12,135,592)**	(5,618,381)	(1,702,470)
Patent licenses	**(37,321,505)**	(24,092,387)	(10,894,731)
	(63,169,614)	(38,776,053)	(17,830,002)
Acquired intangible assets, net	**$ 71,692,498**	$ 80,667,737	$ 77,735,299

11. Acquired Intangible Assets, Net (Continued)

2006

The Company entered into several technology, patent and license agreements with third parties whereby the Company purchased intangible assets for US$15,418,322.

2005

In addition, the Company entered into several technology, patent, and license agreements with third parties whereby the Company purchased licenses for US$23,878,489.

2004

The Company issued 4,285,714 Series D convertible preference shares and a warrant to purchase 428,571 Series D convertible preference shares at US$0.01 per share in exchange for certain licenses from Motorola, which was valued at US$15,000,000 (see Note 4).

The Company issued 914,285 Series D convertible preference shares to a strategic technology partner in exchange for certain software licenses, which was valued at US$5,060,256.

The Company entered into various other license agreements with third parties whereby the Company purchased licenses for US$28,217,249.

All acquired technology intangible assets are generally amortized over a period of 5 years. Occasionally, licenses for advanced technologies are amortized over longer periods up to 10 years. The Company recorded amortization expense of US$24,393,561, US$20,946,051 (As Restated, See Note 31) and US$14,368,025 in 2006, 2005 and 2004 respectively. The Company will record amortization expenses related to the acquired intangible assets of US$23,291,713, US$19,194,945, US$8,864,510, US$3,106,196, and US$366,459 for 2007, 2008, 2009, 2010 and 2011 respectively.

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

12. Equity Investment

	December 31, 2006	
	Carrying Amount	**% of Ownership**
Toppan SMIC Electronics (Shanghai) Co., Ltd.	**$ 13,619,643**	**30**

On July 6, 2004, the Company and Toppan Printing Co., Ltd ("Toppan") entered into an agreement to form Toppan SMIC Electronics (Shanghai) Co., Ltd. ("Toppan SMIC") in Shanghai, to manufacture on-chip color filters and micro lenses for CMOS image sensors.

In 2005, the Company injected cash of US$19,200,000 into Toppan SMIC, representing its 30% ownership. In 2006 and 2005, the Company recorded US$4,201,247 and US$1,379,110, respectively, as its share of the net loss of the equity investment. As of December 31, 2006, the share of net loss of the equity investment balance to be carried forward amounted to US$5,580,357.

13. Accounts Payable

An aging analysis of the accounts payable is as follows:

	2006	2005	2004
Current	**$ 238,864,239**	$ 209,142,167	$ 307,396,991
Overdue:			
Within 30 days	**43,364,820**	22,479,945	38,803,625
Between 31 to 60 days	**9,594,873**	4,593,542	4,351,844
Over 60 days	**17,305,267**	26,102,778	13,781,153
	$ 309,129,199	$ 262,318,432	$ 364,333,613

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

14. Promissory Note

In 2005, the Company reached a settlement and license agreement with TSMC as detailed in Note 11 and Note 24. Under this agreement, the Company issued thirteen non-interest bearing promissory notes with an aggregate amount of US$175,000,000 as the settlement consideration. The Company has recorded a discount of US$17,030,709 for the imputed interest on the notes, which was calculated using an effective interest rate of 3.45% and has been recorded as a reduction of the face amounts of the promissory notes. The Company repaid US$30,000,000 and US$30,000,000 in 2006 and 2005 respectively, and the outstanding promissory notes are as follows:

	December 31, 2006	
Maturity	**Face value**	**Discounted value**
2007	**$ 30,000,000**	**$ 29,242,001**
2008	**30,000,000**	**28,259,668**
2009	**30,000,000**	**27,310,335**
2010	**25,000,000**	**22,031,654**
	115,000,000	**106,843,658**
Less: Current portion of promissory notes	**30,000,000**	**29,242,001**
Long-term portion of promissory notes	**$ 85,000,000**	**$ 77,601,657**

	December 31, 2005	
Maturity	Face value	Discounted value
2006	$ 30,000,000	$ 29,242,001
2007	30,000,000	28,259,668
2008	30,000,000	27,310,335
2009	30,000,000	26,392,893
2010	25,000,000	21,291,540
	145,000,000	132,496,437
Less: Current portion of promissory notes	30,000,000	29,242,001
Long-term portion of promissory notes	$ 115,000,000	$ 103,254,436

The promissory note was interest free, and the present value was discounted using the weighted-average of the Company's borrowing rate.

In 2006 and 2005, the Company recorded interest expense of US$4,347,221 and US$4,527,146 respectively, relating to the amortization of the discount.

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

15. Indebtedness

Short-term and long-term debts are as follows:

	2006	2005	2004
Short-term borrowings from commercial banks (a)	**$ 71,000,000**	$ 265,481,082	$ 91,000,000
Long-term debt by contracts (b):			
Shanghai phase I USD syndicate loan	**$ –**	$ 259,200,000	$ 432,000,000
Shanghai phase I RMB syndicate loan	**–**	–	47,966,446
Shanghai phase II USD syndicate loan	**–**	256,481,965	256,482,000
Shanghai new USD syndicate loan	**274,420,000**	–	–
Beijing USD syndicate loan	**600,000,000**	224,955,000	–
EUR syndicate loan	**15,947,873**	–	–
	$ 890,367,873	$ 740,636,965	$ 736,448,446
Long-term debt by repayment schedule:			
2005	**$ –**	$ –	$ 191,986,372
2006	**–**	246,080,580	265,267,355
2007	**170,796,968**	197,173,071	169,273,861
2008	**290,446,968**	148,265,571	73,280,572
2009	**290,446,968**	111,625,243	36,640,286
2010	**138,676,969**	37,492,500	–
	890,367,873	740,636,965	736,448,446
Less: current maturities of long-term debt	**170,796,968**	246,080,580	191,986,372
Non-current maturities of long-term debt	**$ 719,570,905**	$ 494,556,385	$ 544,462,074

(a) **Short-term borrowings from commercial banks**

As of December 31, 2004, the Company had seven short-term credit agreements that provided total credit facilities up to US$253,000,000 on a revolving credit basis. As of December 31, 2004, the Company had drawn down US$91,000,000 under these credit agreements and US$162,000,000 is available for future borrowings. The outstanding borrowings under the credit agreements were unsecured. The interest expense incurred in 2004 was US$360,071. The interest rate on the loan ranged from 1.77% to 3.57% in 2004.

As of December 31, 2005, the Company had fifteen short-term credit agreements that provided total credit facilities up to approximately US$431 million on a revolving credit basis. As of December 31, 2005, the Company had drawn down approximately US$265 million under these credit agreements and approximately US$166 million is available for future borrowings. The outstanding borrowings under the credit agreements are unsecured. The interest expense incurred in 2005 was US$8,987,676. The interest rate on the loan ranged from 2.99% to 5.73% in 2005.

15. Indebtedness (Continued)

(a) Short-term borrowings from commercial bank (Continued)

As of December 31, 2006, the Company had fifteen short-term credit agreements that provided total credit facilities up to US$474 million on a revolving credit basis. As of December 31, 2006, the Company had drawn down US$71 million under these credit agreements and US$403 million is available for future borrowings. The outstanding borrowings under the credit agreements are unsecured. The interest expense incurred in 2006 was US$8,471,823. The interest rate on the loan ranged from 3.62% to 6.52% in 2006.

(b) Long-term debt

Shanghai Phase I USD syndicate loan

In December 2001, the SMIS entered into a long-term debt agreement with a syndicate of financial institutions based in the P.R.C. for US$432,000,000. The withdrawal period of the facility was 18 months starting from the loan agreement date. As of December 31, 2004, SMIS had fully utilized the loan amount. The interest payment is due on a semi-annual basis. The principal amount is repayable starting from March 2005 in five semi-annual installments of US$86,400,000. In 2006, the interest rate on the loan ranged from 6.16% to 7.05%. As of December 31, 2006, the borrowing was fully repaid by draw down of the new syndicate loan as detailed below. The interest expense incurred in 2006, 2005 and 2004 was US$6,587,140, US$16,499,858 and US$14,014,698, respectively, of which US$783,538, US$3,631,872 and US$6,396,254 was capitalized as additions to assets under construction in 2006, 2005 and 2004, respectively.

Shanghai Phase I RMB syndicate loan

SMIS had a RMB denominated line of credit of RMB 396,960,000 (approximately US$48 million) in 2001, with the same financial institutions. As of December 31, 2004, SMIS had fully drawn down on the line of credit. The interest rate for the loan was calculated based on the basic rate of a five-year term loan published by the People's Bank of China. The annual interest rate on the loan ranged from 5.02% to 5.27% in 2005. The interest expense incurred in 2005 and 2004 was US$1,649,858 and US$2,451,885, respectively, of which US$362,172 and US$1,134,784 was capitalized as additions to assets under construction in 2005 and 2004, respectively. As of December 31, 2006 and 2005, the borrowing was fully repaid.

Shanghai Phase II USD syndicate loan

In January 2004, the SMIS entered into the second phase long-term facility arrangement for US$256,481,965 with the same financial institutions. As of December 31, 2005 and 2004, SMIS had fully utilized the loan. The interest payment is due on a semi-annual basis. The principal amount is repayable starting from March 2006 in seven semi-annual installments of US$36,640,286. In 2006, the interest rate on the loan ranged from 6.16% to 7.05%. The interest expense incurred in 2006, 2005 and 2004 was US$7,185,813, US$12,470,302 and US$3,890,105, of which US$854,749, US$2,743,173 and $nil was capitalized as additions to assets under construction in 2006, 2005 and 2004, respectively. As of December 31, 2006, the borrowing was fully repaid by draw down of the new syndicate loan as detailed below.

In connection with the second phase long-term facility arrangement, SMIS has a RMB denominated line of credit of RMB 235,678,000 (US$28,476,030). As of December 31, 2004, SMIS had no borrowings on this line of credit. In 2005, SMIS fully utilized the facility and then repaid in full prior to December 31, 2005. The interest expense incurred in 2005 was US$25,625.

15. Indebtedness (Continued)

(b) Long-term debt (Continued)

Shanghai New USD syndicate loan

In June, 2006, SMIS entered into a new long-term facility agreement with the aggregate principal amount of US$600,000,000, with a consortium of international and PRC banks. Of this principal amount, US$393,000,000 was used to repay the principal amount outstanding under SMIS's phase I and phase II bank facilities. The remaining principal amount will be used to finance future expansion and general corporate requirement for SMIS. The remaining facility balance is available for drawdown until December 2007. As of December 31, 2006, SMIS had drawn down US$393,000,000 from this facility. The principle amount is repayable starting from December 2006 in ten semi-annual installments. In December 2006, SMIS had repaid the first installment of US$23,580,000 according to the repayment schedule and had repaid an additional US$95,000,000. As of December 31, 2006, the remaining balance of this borrowing is US$274,420,000. In 2006, the interest rate on the loan ranged from 6.46% to 6.72%. The interest expense incurred in 2006 was US$13,522,886, of which US$1,624,224 was capitalized as additions to assets under construction in 2006.

The total outstanding balance of SMIS's long-term debt is collateralized by certain plant and equipment at the original cost of US$1,899 million as of December 31, 2006. The registration of the mortgage was in process as of December 31, 2006.

Beijing USD syndicate loan

In May 2005, SMIB entered into a five-year loan facility in the aggregate principal amount of US$600,000,000, with a syndicate of financial institutions based in the PRC. This five-year bank loan was used to expand the capacity of SMIB's fabs. The withdrawal period of the facility was twelve months from date of signing the agreement. As of December 31, 2006 and 2005, the outstanding balance was US$600,000,000 and US$224,955,000, respectively, on this loan facility. The principal amount is repayable starting from December 2007 in six equal semi-annual installments. In 2006, the interest rate range on the loan ranged from 6.26% to 7.17%. The interest expense incurred in 2006 and 2005 was US$28,525,628 and US$3,991,080, of which US$450,516 and US$879,906 was capitalized as additions to assets under construction in 2006 and 2005 respectively.

The total outstanding balance of Beijing USD syndicate loan is collateralized by certain plant and equipment at the original cost of US$1,058 million as of December 31, 2006.

EUR syndicate loan

On December 15, 2005, the Company entered into a long-term loan facility agreement in the aggregate principal amount of EUR85 million with a syndicate of banks and ABN Amro Bank N.V. Commerz Bank (Nederland) N.V. as the leading bank. The proceeds from the facility were used to purchase lithography equipment to support the expansion of the Company's manufacturing facilities. The drawdown period of the facility ends on the earlier of (i) twenty months after the agreement sign off date or (ii) the date which the loans have been fully drawn down. Each drawdown made under the facility shall be repaid in full by the Company in ten equal semi-annual instalments starting from May 6, 2006. In 2006, SMIT had drawn down EUR15,122,775, which was equal to US$19,934,841, and repaid the first two installments with an aggregated amount of EUR3,024,555, which was equal to US$3,986,968.. As of December 31, 2006, the remaining balance is EUR12,098,220, with the US dollar equivalent of US$15,947,873. In 2006, the interest rate loan ranged from 3.41% to 3.95%. The interest expense incurred in 2006 was US$279,908, of which US$65,072 was capitalized as additions to assets under construction in 2006.

The total outstanding balance of the facility is collateralized by certain plant and equipment at the original cost of EUR17.8 million as of December 31, 2006.

The long-term debt arrangements contain financial covenants as defined in the loan agreements. The Company met these covenants as of December 31, 2006.

(In U.S. dollars, except where otherwise stated)

16. Long-term Payables Relating to License Agreements

The Company entered into several license agreements for acquired intangible assets to be settled by installment payments. Installments payable under the agreements as of December 31, 2006 and 2005 are as follows:

	December 31, 2006	
Maturity	**Face value**	**Discounted value**
2007	**$ 13,000,000**	**$ 12,690,471**
2008	**10,000,000**	**9,322,990**
2009	**8,500,000**	**7,669,960**
	31,500,000	**29,683,421**
Less: Current portion of long-term payables	**13,000,000**	**12,690,471**
Long-term portion of long-term payables	**$ 18,500,000**	**$ 16,992,950**

	December 31, 2005	
Maturity	Face value	Discounted value
2006	$ 7,000,000	$ 6,791,990
2007	9,000,000	8,381,854
2008	10,000,000	8,941,284
2009	8,500,000	7,363,260
	34,500,000	31,478,388
Less: Current portion of long-term payables	7,000,000	6,791,990
Long-term portion of long-term payables	$ 27,500,000	$ 24,686,398

These long-term payables were interest free, and the present value was discounted using the weighted-average of the Company's borrowing rate.

The current portion of other long-term payables is recorded as part of "accrued expenses and other current liabilities" in the balance sheet.

In 2006 and 2005, the Company recorded interest expense of US$1,355,386 and US$868,032 relating to the amortization of the discount.

(In U.S. dollars, except where otherwise stated)

17. Income Taxes

The Company is a tax exempted company incorporated in the Cayman Islands. The subsidiaries incorporated in the PRC are governed by the Income Tax Law of the PRC Concerning Foreign Investment and Foreign Enterprises and various local income tax laws (the "Income Tax Laws"). Pursuant to the relevant regulation and upon approval by the governmental agency, the Company's Shanghai, Beijing and Tianjin subsidiaries are entitled to a full exemption from Foreign Enterprise Income Tax ("FEIT") for five years starting with the first year of positive accumulated earnings and a 50% reduction for the following five years. SMIC Shanghai is in the third year of receiving exemption from FEIT. While as of December 31, 2006, SMIC Beijing and Tianjin are still in a cumulative operating loss.

According to PRC tax regulations, the Company's Chengdu subsidiary is entitled to a full exemption from FEIT for two years starting with the first year of positive accumulated earnings and a 50% reduction for the following three years. Up to December 31, 2006, Chengdu subsidiary is still in the process of applying for the tax holiday. As of December 31, 2006, the Chengdu subsidiary is still in a cumulative operating loss.

The Company's other subsidiaries are subject to respective local country's income tax law, including those of Japan, the United States of America and Europe. In 2006, 2005 and 2004, the Company's US subsidiary had recorded current income tax expense of US$31,030, US$223,846 and US$186,044, respectively. In 2006, 2005 and 2004, the Company's Europe subsidiary had recorded current income tax expense of US$112,671, US$46,981 and US$nil, respectively. The Company had minimal taxable income in Japan.

As part of the process of preparing financial statements, the Company is required to estimate its income taxes in each of the jurisdictions in which it operates. The Company accounts for income taxes by the liability method. Under this method, deferred income taxes are recognized for tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end, based on enacted laws and statutory tax rates applicable for the difference that are expected to affect taxable income. Valuation allowances are provided if based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

The provision for income taxes by location of the tax jurisdiction for the year ended December 31, 2006, 2005 and 2004 are as follows:

		December 31	
	2006	2005	2004
Domestic			
– Current	**$ 4,542**	$ 14,040	$ –
– Deferred	**(25,075,987)**	–	–
Foreign			
– Current	**$ 143,701**	$ 270,827	$ 186,044
– Deferred	**–**	–	–
	$ (24,927,744)	$ 284,867	$ 186,044

(In U.S. dollars, except where otherwise stated)

17. Income Taxes (Continued)

Temporary differences and carry forwards that give rise to deferred tax assets and liabilities are as follows:

	2006	2005	2004
Deferred tax assets:			
Allowances and reserves	**$ 1,962,410**	$ 1,682,244	$ 967,968
Start-up costs	**958,105**	1,844,170	2,566,628
Net operating loss carry forwards	**5,201,545**	5,172,687	–
Unrealized exchange loss	**47,860**	295,646	–
Depreciation of fixed assets	**33,715,867**	–	–
Subsidy on long lived assets	**295,654**	–	–
Accrued sales return	**137,719**	23,764	–
Total deferred tax assets	**$ 42,319,160**	$ 9,018,511	$ 3,534,596
Deferred tax liability:			
Capitalized interest	**$ (210,913)**	$ (113,490)	$ (92,032)
Unrealized exchange gain	**–**	–	(9,937)
Valuation allowance	**(17,032,260)**	(8,905,021)	(3,432,627)
Net deferred tax assets – non-current	**$ (25,075,987)**	$ –	$ –

As a result of strategic tax planning that became effective in 2006, a temporary difference between the tax and book bases of certain assets was created. Under FAS109 (Accounting for Income Taxes), the Company recognized a deferred tax asset of US$33.7 million and assessed a valuation allowance of US$8.4 million. Accordingly, an income tax benefit of US$25.3 million was recorded in 2006.

In 2006, the Company also recognized a deferred tax liability of US$0.2 million, which was relating to the timing differences generated from capitalized interest.

As of December 31, 2006, the Company's Shanghai, Beijing, Tianjin and Chengdu subsidiaries have net operating losses carried forward of US$334.4 million, of which US$32.2 million, US$129.7 million and US$172.5 million will expire in 2009, 2010 and 2011.

(In U.S. dollars, except where otherwise stated)

17. Income Taxes (Continued)

Reconciliation between the total income tax expense computed by applying the application enterprise income tax rate 15% to the income before income taxes and minority interest in the consolidated statements of operations were as follows:

	2006	2005	2004
Applicable enterprise income tax rate	**15.0%**	15.0%	15.0%
Expenses not deductible for tax purpose	**3.1%**	(1.4%)	0.2%
Effect of tax holiday and tax concession	**25.0%**	12.0%	(39.4%)
Expense (credit) to be recognized in future periods	**29.3%**	(5.2%)	6.6%
Changes in valuation allowances	**(11.9%)**	(4.9%)	3.7%
Effect of different tax rate of subsidiaries operating in other jurisdictions	**(24.9%)**	(15.8%)	14.1%
Effective tax rate	**35.6%**	(0.3%)	0.2%

18. Capital Stock

In 2004, the Company issued:

(1) 95,714,286 Series D convertible preference shares and a warrant to purchase 9,571,429 Series D convertible preference shares to acquire certain assets and assume certain obligations from Motorola with a fair value of US$335,843,804. The accounting treatment requires a beneficial conversion feature on the Series D convertible preference shares to be calculated. The consideration received in the Series D offering was first allocated between the convertible instrument and the Series D warrant on a relative fair value basis. A calculation was then performed to determine the difference between the effective conversion price and the fair market value of the ordinary shares at the commitment date resulting in the recognition of a deemed dividend of US$18,839,426.

(2) 914,285 Series D convertible preference shares to acquire certain software licenses with a fair value of US$5,060,256 from a strategic technology partner. (see Note 11)

(3) 750,000 Series B convertible preference shares to a strategic partner with a fair value of US$2,739,853. (see Note 11)

(4) 12,343 Series B convertible preference shares to a service provider which was valued at US$45,090.

(5) 3,030,303,000 ordinary shares in connection with the Initial Public Offering (the “IPO”)

(6) 136,640 ordinary shares to a service provider with a fair value of US$17,965.

(7) 23,957,830 ordinary shares to a supplier in exchange for certain equipment with a fair value of US$5,222,180. (see Note 11)

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

19. Stock Options and Warrants

The Company's employee stock option plans (the "Plans") allow the Company to offer a variety of incentive awards to employees, consultants or external service advisors of the Company. In 2004, the Company adopted the 2004 Stock Option Plan ("2004 Option Plan") whereby the Company grants stock options to attract, retain and motivate employees, directors and service providers. Following the completion of the IPO, the Company began issuing stock options solely through the 2004 Option Plan. Options to purchase 1,317,000,000 ordinary shares are authorized under the 2004 Option Plan. Under the terms of the 2004 Option Plan options are granted at the fair market value of the Company's ordinary shares and expire 10 years from the date of grant and vest over a requisite service period of 4 years. Any compensation expense is recognized on a straight-line basis over the employee service period. As of December 31, 2006, options to purchase 510,225,118 ordinary shares were outstanding, and options to purchase 806,274,882 ordinary shares were available for future grants.

In 2001, the Company adopted the 2001 Stock Option Plan ("2001 Option Plan"). Options to purchase 998,675,840 ordinary shares and 536,566,500 of Series A convertible preference shares are authorized under the 2001 Option Plan. Options to purchase Series A convertible preference shares were converted into options to purchase ordinary shares immediately prior to the completion of the IPO. Under the terms of the plans, options are generally granted at prices equal to the fair market value as estimated by the Board of Directors, expire 10 years from the date of grant and vest over a requisite service period of 4 years. Following the IPO, the Company no longer issues stock options under the 2001 plan. As of December 31, 2006, options to purchase 487,799,975 ordinary shares were outstanding, and options to purchase 368,139,728 ordinary shares were available for future grant.

A summary of the stock option activity is as follows:

	Ordinary shares			Weighted Average	
	Number of options		Weighted average exercise price	Remaining Contractual Term	Aggregated Intrinsic Value
Options outstanding at					
December 31, 2005	1,045,963,402	$	0.13		
Granted	165,863,560	$	0.14		
Exercised	(95,328,832)	$	0.04		
Cancelled	(118,473,037)	$	0.17		
Options outstanding at					
December 31, 2006	**998,025,093**	**$**	**0.14**	**7.43**	**46,407,772**
Vested or expected to vest at					
December 31, 2006	**830,627,032**	**$**	**0.13**	**7.27**	**37,243,894**
Exercisable at					
December 31, 2006	**421,826,973**	**$**	**0.12**	**6.31**	**24,277,264**

The total intrinsic value of option exercised in the year ended December 31, 2006, 2005 and 2004 was US$5,240,221, US$2,725,661 and US$885,504, respectively.

(In U.S. dollars, except where otherwise stated)

19. Stock Options and Warrants (Continued)

Certain options were granted to non-employees that resulted in a share-based compensation expense of US$584,283, US$828,498 and US$765,557 in 2006, 2005 and 2004, respectively.

Restricted share units

In January 2004, the Company adopted the 2004 Equity Incentive Plan ("2004 EIP") whereby the Company provided additional incentives to the Company's employees, directors and external consultants through the issuance of restricted shares, restricted share units and stock appreciation rights to the participants at the discretion of the Board of Directors. Under the 2004 EIP, the Company was authorized to issue up to 2.5% of the issued and outstanding ordinary shares immediately following the closing of its initial public offering in March 2004, which were 455,409,330 ordinary shares. As of December 31, 2006, 140,295,146 restricted share units were outstanding and 249,481,557 ordinary shares were available for future grant through the issuance of restricted shares, restricted share units and stock appreciation rights. The RSUs vest over a requisite service period of four years and expire 10 years from the date of grant. Any compensation expense is recognized on a straight-line basis over the employee service period.

A summary of restricted share units activities is as follows:

	Restricted share units			Weighted Average	
	Number of share units		Weighted average fair value	Remaining Contractual Term	Aggregated Fair Value
Outstanding at					
December 31, 2005	189,739,191	$	0.14		
Granted	16,058,864	$	0.13		
Exercised	(38,041,285)	$	0.12		
Cancelled	(27,461,624)	$	0.13		
Outstanding at					
December 31, 2006	**140,295,146**	**$**	**0.14**	**8.47**	**19,574,050**
Vested or expected to vest at					
December 31, 2006	**49,555,883**	**$**	**0.12**	**8.52**	**5,998,033**
Exercisable at					
December 31, 2006	**272,500**	**$**	**0.15**	**8.84**	**40,880**

Pursuant to the 2004 EIP, the Company granted 16,058,864, 122,418,740 and 118,190,824 restricted share units in 2006, 2005 and 2004, respectively, most of which vest over a period of 4 years. The fair value of the restricted share units at the date of grant was US$2,055,597, US$23,348,378 and US$26,001,981 in 2006, 2005 and 2004, respectively, which is expensed over the vesting period. As a result, the Company has recorded a compensation expense of US$5,452,148, US$7,051,688 and US$3,080,312 in 2006, 2005 and 2004 respectively.

(In U.S. dollars, except where otherwise stated)

19. Stock Options and Warrants (Continued)

Unrecognized compensation cost related to non-vested share-based compensation

As of December 31, 2006, there was US$32,406,172 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2001 Stock Option Plan, Stock Option Plan and 2004 EIP. The cost is expected to be recognized over a weighted-average period of 1.14 years.

Notes receivable from employees

At December 31, 2005 and 2004, the Company had notes receivable from employees related to the early exercise of employee stock options in the aggregate amount of US$nil and US$391,375, respectively. In 2005, the Company fully collected US$391,375 through the repayment of notes receivable by certain employees and the sale of the notes receivable to a third party bank. The notes are full recourse and are secured by the underlying ordinary shares and preference shares. The notes are due at various dates from year 2006 to 2008 and payable at varying rates from 3.02% to 4.28% per annum.

In 2006, 2005 and 2004, the notes earned interest in the aggregate amount of US$nil, US$40,238 and US$641,173, respectively.

As of December 31, 2006, 2005 and 2004 the Company had the following shares subject to repurchase:

	2006	2005	2004
Ordinary shares	**16,498,871**	35,964,021	203,973,224

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

20. Reconciliation of Basic and Diluted (Loss) Income per Share

The following table sets forth the computation of basic and diluted (loss) income per share for the years indicated:

	2006	2005	2004
(Loss) income attributable to holders of ordinary shares	**$ (44,109,078)**	$ (114,774,827)	$ 77,363,770
Less: Cumulative effect of a change in accounting principle	**(5,153,986)**	–	–
(Loss) income before cumulative effect of a change in accounting principle	**(49,263,064)**	(114,774,827)	77,363,770
Basic and diluted:			
Weighted average ordinary shares outstanding	**18,361,910,033**	18,264,791,383	14,441,917,246
Less: Weighted average ordinary shares outstanding subject to repurchase	**(27,411,110)**	(80,362,128)	(242,753,729)
Weighted average shares used in computing basic income per share	**18,334,498,923**	18,184,429,255	14,199,163,517
Effect of dilutive securities:			
Weighted average preference shares outstanding	**–**	–	3,070,765,738
Weighted average ordinary shares outstanding subject to repurchase	**–**	–	242,753,729
Warrants	**–**	–	102,323,432
Stock options	**–**	–	264,409,484
Restricted shares units	**–**	–	54,977,166
Weighted average shares used in computing diluted income per share	**18,334,498,923**	18,184,429,255	17,934,393,066
On the basis of income per share before cumulative effect of a change in accounting principle, basic	**$ (0.00)**	$ (0.01)	$ 0.01
On the basis of income per share before cumulative effect of a change in accounting principle, diluted	**$ (0.00)**	$ (0.01)	$ 0.00
Cumulative effect of a change in accounting principle per share, basic	**$ 0.00**	$ –	$ –
Cumulative effect of a change in accounting principle per share, diluted	**$ 0.00**	$ –	$ –
Basic (loss) income per share	**$ (0.00)**	$ (0.01)	$ 0.01
Diluted (loss) income per share	**$ (0.00)**	$ (0.01)	$ 0.00

(In U.S. dollars, except where otherwise stated)

20. Reconciliation of Basic and Diluted (Loss) Income per Share (Continued)

Ordinary share equivalents of warrant and stock options are calculated using the treasury stock method. Under the treasury stock method, the proceeds from the assumed conversion of options and warrants are used to repurchase outstanding ordinary shares using the average fair value for the periods.

As of December 31, 2006 and 2005, the Company had 223,818,877 and 306,419,133, respectively, ordinary share equivalents outstanding, that could have potentially diluted loss per share in the future, but which were excluded in the computation of diluted loss per share in 2006 and 2005, as their effect would have been antidilutive due to the net loss reported in such period.

As of December 31, 2004, the Company had 75,769,953 ordinary share equivalents outstanding that could have potentially diluted income per share in the future, but which were excluded in the computation of diluted income per share in 2004, as their exercise prices were above the average market values in that year.

The following table sets forth the securities comprising of these antidilutive ordinary share equivalents for the years indicated:

	December 31		
	2006	2005	2004
Warrants to purchase ordinary shares	**–**	–	9,584,403
Outstanding options to purchase ordinary shares	**62,339,207**	177,325,981	66,185,550
Outstanding unvested restricted share units to purchase ordinary shares	**161,479,670**	129,093,152	–
	223,818,877	306,419,133	75,769,953

(In U.S. dollars, except where otherwise stated)

21. Commitments

(a) Purchase commitments

As of December 31, 2006 the Company had the following commitments to purchase machinery, equipment and construction obligations. The machinery and equipment is scheduled to be delivered at the Company's facility by December 31, 2007.

Facility construction	$	75,101,000
Machinery and equipment		536,442,000
	$	611,543,000

(b) Investment commitments

As of December 31, 2006, the Company had an outstanding commitment of US$29,260,000 in a 56.67% owned subsidiary. The Company expects to pay this amount in 2007.

(c) Royalties

Beginning in 2002, the Company has entered into several license and technology agreements with third parties. The terms of the contracts range from 3 to 10 years. The Company is subject to royalty payments based on a certain percentage of product sales, using the third parties' technology or license. In 2006, 2005 and 2004, the Company incurred royalty expense of US$7,724,704, US$8,710,935 and US$6,258,709, respectively, which is included as part of cost of sales in the statement of operations.

Beginning in 2003, the Company has entered into several license agreements with third parties where the Company provides access to certain licensed technology. The Company will receive royalty payments based on a certain percentage of product sales using the Company's licensed technology. In 2006, 2005 and 2004, the Company earned royalty income of US$1,384,137, US$705,217 and US$336,216, respectively, which was included as part of sales in the statement of operations.

(d) Operating lease as lessor

The Company owns apartment facilities that are leased to the Company's employees at negotiated prices. The apartment rental agreement is renewed on an annual basis. The Company also leases office space to non-related third parties. Office lease agreements are renewed on an annual basis as well. The total amount of rental income recorded in 2006, 2005 and 2004 was US$6,142,692, US$6,952,946 and US$1,740,283, respectively.

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

21. Commitments (Continued)

(e) Operating lease as lessee

The Company has various operating leases including land use rights under non-cancellable leases expiring at various times through 2053. Future minimum lease payments under these leases as of December 31, 2006 are as follows:

Year ending		
2007	$	377,612
2008		162,757
2009		90,628
2010		61,500
2011		61,500
Thereafter		2,706,006
	$	3,460,003

22. Segment and Geographic Information

The Company is engaged principally in the computer-aided design, manufacturing and trading of integrated circuits. In accordance with SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information,” the Company’s chief operating decision maker has been identified as the Chief Executive Officer, who reviews consolidated results of manufacturing operations when making decisions about allocating resources and assessing performance of the Company. The Company believes it operates in one segment, and all financial segment information required by SFAS No. 131 can be found in the consolidated financial statements.

	2006	2005	2004
Total sales:			
United States	**$ 602,506,213**	$ 478,162,160	$ 391,433,443
Europe	**440,327,872**	316,576,024	125,596,424
Asia Pacific (Excluding Japan and Taiwan)	**168,607,598**	175,846,284	201,881,809
Taiwan	**153,057,616**	138,153,755	120,652,255
Japan	**100,823,568**	62,580,512	135,100,765
	$ 1,465,322,867	$ 1,171,318,735	$ 974,664,696

Revenue is attributed to countries based on headquarter of operation.

Substantially all of the Company’s long lived assets are located in the PRC.

(In U.S. dollars, except where otherwise stated)

23. Significant Customers

The following table summarizes net revenue and accounts receivable for customers which accounted for 10% or more of our accounts receivable and net sales:

	Net revenue Year ended December 31,			Accounts receivable December 31,		
	2006	2005	2004	**2006**	2005	2004
A	**28%**	26%	11%	**29%**	32%	15%
B	**17%**	15%	13%	**14%**	17%	8%
C	**8%**	9%	10%	**8%**	6%	6%
D	**2%**	8%	12%	**–%**	6%	7%
E	**4%**	7%	6%	**7%**	7%	15%
F	**3%**	5%	13%	**3%**	3%	10%
G	**1%**	2%	4%	**1%**	2%	12%

24. Litigation

Overview of TSMC Litigation:

Beginning in December 2003 through August 2004, the Company became subject to several lawsuits brought by Taiwan Semiconductor Manufacturing Company, Limited ("TSMC") relating to alleged infringement of certain patents and misappropriation of alleged trade secrets relating to methods for conducting semiconductor fab operations and manufacturing integrated circuits.

On January 31, 2005, the Company entered into a settlement agreement, without admission of liability, which provided for the dismissal of all pending legal actions without prejudice between the two companies (the "Settlement Agreement"). The terms of the Settlement Agreement also included:

1) The Company and TSMC agreed to cross-license each other's patent portfolio for all semiconductor device products, effective from January 2005 through December 2010.

2) TSMC covenanted not to sue the Company for trade secret misappropriation as alleged in TSMC's legal actions as it related to 0.15μm and larger processes subject to certain conditions ("TSMC Covenant"). The TSMC Covenant did not cover 0.13μm and smaller technologies after 6 months following execution of the Settlement Agreement (July, 31, 2005). Excluding the 0.13μm and smaller technologies, the TSMC Covenant remains in effect indefinitely, terminable upon a breach by the Company.

3) The Company is required to deposit certain Company materials relating to 0.13μm and smaller technologies into an escrow account until December 31, 2006 or under certain circumstances for a longer period of time.

4) The Company agreed to pay TSMC an aggregate of US$175 million in installments of US$30 million for each of the first five years and US$25 million in the sixth year.

Accounting under the Settlement Agreement:

In accounting for the Settlement Agreement, the Company determined that there were several components of the Settlement Agreement – settlement of litigation, covenant not to sue, patents licensed by us to TSMC and the use of TSMC's patent license portfolio both prior and subsequent to the settlement date.

The Company does not believe that the settlement of litigation, covenant not to sue or patents licensed by us to TSMC qualify as accounting elements. In regard to the settlement of litigation, the Company cites the following:

- The settlement agreement reached between TSMC and SMIC clearly stated that there was no admission of liability by either party;
- The settlement agreement required all parties to bear their own legal costs;

24. Litigation (Continued)

Accounting under the Settlement Agreement: *(Continued)*

- There were no other damages associated with the Settlement Agreement;
- There was a provision in the Settlement Agreement for a grace period to resolve any misappropriation issues had they existed;
- Albeit a complaint had been filed by TSMC on trade secret infringement, TSMC has never identified which trade secrets it claimed were being infringed upon by the Company;
- The Settlement Agreement was concluded when the litigation process was still at a relatively early stage and the outcome of the litigation was therefore highly uncertain.

The TSMC covenant not to sue for alleged trade secrets misappropriation does not qualify as a separable asset in accordance with either SFAS 141 or SFAS 142 as TSMC had never specified the exact trade secrets that it claimed were misappropriated, the Company's belief that TSMC's trade secrets may be obtained within the marketplace by other legal means and the Company never obtained the legal right to use TSMC's trade secrets.

In addition, the Company did not attribute any value to the patents licensed to TSMC under the Settlement Agreement due to the limited number of patents held by the Company at the time of the Settlement Agreement.

As a result, the Company determined that only the use of TSMC's patent license portfolio prior and subsequent to the settlement date were considered elements of an arrangement for accounting purposes. In attributing value to these two elements, the Company first discounted the payment terms of the US$175 million settlement amount using an annual 3.4464% interest rate to arrive at a net present value of US$158 million. This amount was then allocated to the pre-and post-settlement periods based on relative fair value, as further described below.

Based on this approach, US$16.7 million was allocated to the pre-settlement period, reflecting the amount that the Company would have paid for use of the patent license portfolio prior to the date of the Settlement Agreement. The remaining US$141.3 million, representing the relative fair value of the licensed patent license portfolio, was recorded on the Company's consolidated balance sheets as a deferred cost and is being amortized over a six-year period, which represents the life of the licensed patent license portfolio. The amortization of the deferred cost is included as a component of cost of sales in the consolidated statements of operations.

Valuation of Deferred Cost:

The fair value of the patent license portfolio was calculated by applying the estimated royalty rate to the specific revenue generated and expected to be generated from the specific products associated with the patent license portfolio.

The selected royalty rate was based on the review of median and mean royalty rates for the following categories of licensing arrangements:

a) Existing third-party license agreements with SMIC;

b) The analysis of comparable industry royalty rates related to semiconductor chip/integrated circuit (“IC”) related technology; and

c) The analysis of comparable industry royalty rates related to semiconductor fabrication.

On an annualized basis, the amounts allocated to past periods was lower than that allocated to future periods as the Company assumed increases in revenues relating to the specific products associated with the patent license portfolio.

As the total estimated fair value of the patent license portfolio exceeded the present value of the settlement amount, the Company allocated the present value of the settlement amount based on the relative fair value of the amounts calculated prior and subsequent to the settlement date.

24. Litigation (Continued)

Recent TSMC Legal Developments:

On August 25, 2006, TSMC filed a lawsuit against the Company and certain subsidiaries (SMIC (Shanghai), SMIC (Beijing) and SMIC (Americas) in the Superior Court of the State of California, County of Alameda for alleged breach of the Settlement Agreement, alleged breach of promissory notes and alleged trade secret misappropriation by the Company. TSMC seeks, among other things, damages, injunctive relief, attorneys' fees, and the acceleration of the remaining payments outstanding under the Settlement Agreement.

In the present litigation, TSMC alleges that the Company has incorporated TSMC trade secrets in the manufacture of the Company's 0.13 micron or smaller process products. TSMC further alleges that as a result of this claimed breach, TSMC's patent license is terminated and the covenant not to sue is no longer in effect with respect to the Company's larger process products.

The Company has vigorously denied all allegations of misappropriation. Moreover, TSMC has not yet proven, nor produced evidence of, any misappropriation by the Company. At present, the claims rest as unproven allegations, denied by the Company. The Court has made no finding that TSMC's claims are valid, nor has it set a trial date.

On September 13, 2006, the Company announced that in addition to filing a response strongly denying the allegations of TSMC in the United States lawsuit, it filed on September 12, 2006, a cross-complaint against TSMC seeking, among other things, damages for TSMC's breach of contract and breach of implied covenant of good faith and fair dealing.

On November 16, 2006, the High Court in Beijing, the People's Republic of China, accepted the filing of a complaint by the Company and its wholly-owned subsidiaries, SMIC (Shanghai) and SMIC (Beijing), regarding the unfair competition arising from the breach of bona fide (i.e. integrity, good faith) principle and commercial defamation by TSMC ("PRC Complaint"). In the PRC Complaint, the Company is seeking, among other things, an injunction to stop TSMC's infringing acts, public apology from TSMC to the Company and compensation from TSMC to the Company, including profits gained by TSMC from their infringing acts.

Under the provisions of SFAS 144, the Company is required to make a determination as to whether or not this pending litigation represents an event that requires a further analysis of whether the patent license portfolio has been impaired. We believe that the lawsuit is at a very early stage and we are still evaluating whether or not the litigation represents such an event. The Company expects further information to become available to us which will aid us in making a determination. The outcome of any impairment analysis performed under SFAS 144 might result in a material impact to our financial position and results of operations. Because the case is in its early stages, the Company is unable to evaluate the likelihood of an unfavourable outcome or to estimate the amount or range of potential loss.

25. Retirement Benefit

The Company's local Chinese employees are entitled to a retirement benefit based on their basic salary upon retirement and their length of service in accordance with a state-managed pension plan. The PRC government is responsible for the pension liability to these retired staff. The Company is required to make contributions to the state-managed retirement plan equivalent to 20-22.5% of the monthly basic salary of current employees. Employees are required to make contributions equivalent to 6%-8% of their basic salary. The employer's contribution of such an arrangement was approximately US$5,452,660, US$4,128,059 and US$2,502,521 for the years ended December 31, 2006, 2005 and 2004, respectively. The retirement benefits do not apply to expatriate employees.

26. Distribution of Profits

As stipulated by the relevant laws and regulations applicable to China's foreign investment enterprise, the Company's PRC subsidiaries are required to make appropriations from net income as determined under accounting principles generally accepted in the PRC ("PRC GAAP") to non distributable reserves which include a general reserve, an enterprise expansion reserve and a staff welfare and bonus reserve. Wholly-owned PRC subsidiaries are not required to make appropriations to the enterprise expansion reserve but appropriations to the general reserve are required to be made at not less than 10% of the profit after tax as determined under PRC GAAP. The staff welfare and bonus reserve is determined by the board of directors.

The general reserve is used to offset future extraordinary losses. The subsidiaries may, upon a resolution passed by the stockholders, convert the general reserve into capital. The staff welfare and bonus reserve is used for the collective welfare of the employee of the subsidiaries. The enterprise expansion reserve is for the expansion of the subsidiaries' operations and can be converted to capital subject to approval by the relevant authorities. These reserves represent appropriations of the retained earnings determined in accordance with Chinese law. Appropriations to general reserve by the Company's PRC subsidiaries were US$11,956,185, US$10,432,239 and US$12,655,906 in 2006, 2005 and 2004, respectively.

(In U.S. dollars, except where otherwise stated)

27. Components of loss (income) from operations

	2006	2005	2004
Loss (income) from operations is arrived at after charging (crediting):			
Auditors' remuneration	$ 1,577,928	$ 1,121,131	$ 695,990
Depreciation and amortization	919,038,915	768,586,770	455,947,253
Amortization of land use rights	577,578	885,083	1,013,269
Foreign currency exchange loss (gain)	3,939,745	(5,198,253)	1,446,113
(Income) loss on disposal of plant and equipment	(43,121,929)	–	–
(Reversal of) bad debt expense	2,957,505	(13,825)	990,692
Inventory write-down	2,297,773	3,088,238	10,506,374
Staff costs inclusive of directors' remuneration	$ 108,742,094	$ 102,163,244	$ 88,417,658

28. Directors' Remuneration and Five Highest Paid Individuals

Directors

Details of emoluments paid by the Company to the directors of the Company in 2006, 2005 and 2004 are as follows:

	Richard Chang	Kawanishi Tsuyoshi	Wang Yang Yuan	Hsu Ta-Lin	Lip-Bu Tan	Henry Shaw	Fang Yao	Jou Yen-Pong	Albert Y.C.	Lai Xing Cai	Jiang Shang zhou	Total
2006												
Salaries and other benefits	**192,727**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**192,727**
Stock option benefits	**156,241**	**12,951**	**12,951**	**12,951**	**12,951**	**12,951**	**-**	**-**	**37,742**	**-**	**-**	**258,736**
Total emoluments	**348,968**	**12,951**	**12,951**	**12,951**	**12,951**	**12,951**	**-**	**-**	**37,742**	**-**	**-**	**451,463**
2005												
Salaries and other benefits	190,724	–	–	–	–	–	–	–	–	–	–	190,724
Stock option benefits	97,664	49,026	8,608	8,608	8,608	8,608	–	8,608	–	–	–	189,730
Total emoluments	288,388	49,026	8,608	8,608	8,608	8,608	–	8,608	–	–	–	380,454
2004												
Salaries and other benefits	190,343	–	–	–	–	–	–	–	–	–	–	190,343
Stock option benefits	–	221,464	–	–	–	–	–	–	–	–	–	221,464
Total emoluments	190,343	221,464	–	–	–	–	–	–	–	–	–	411,807

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

28. Directors' Remuneration and Five Highest Paid Individuals (Continued)

The emoluments of the directors were within the following bands:

	2006 Number of directors	2005 Number of directors	2004 Number of directors
HK$nil to HK$1,000,000 ($128,620)	**10**	7	6
HK$1,000,001 ($128,620) to HK$1,500,000 ($192,930)	**–**	–	1
HK$1,500,001 ($192,930) to HK$2,000,000 ($257,240)	**–**	–	1
HK$2,000,001 ($257,240) to HK$2,500,000 ($321,550)	**–**	1	–
HK$2,500,001 ($321,550) to HK$3,000,000 ($385,860)	**1**	–	–

The Company granted 3,500,000, 15,000,000 and 5,100,000 options to purchase ordinary shares of the Company to the directors in 2006, 2005 and 2004, respectively. During the year ended December 31, 2006, nil stock options were exercised and 500,000 stock options were cancelled.

The Company granted 500,000, nil and 2,000,000 restricted share units to purchase ordinary shares of the Company to the directors in 2006, 2005 and 2004, respectively. During the year ended December 31, 2006, 1,000,000 restricted share units were exercised and nil restricted share units were cancelled.

In 2006, 2005 and 2004, no emoluments were paid by the Company to any of the directors as an inducement to join or upon joining the Company or as compensation for loss of office. In 2005, one director has declined an option to purchase 500,000 Ordinary Shares which the Board granted in November 2004. In 2006, two directors have declined an option to purchase 500,000 Ordinary Shares for each director which the Board granted in September 2006.

Five highest paid employees' emoluments

Of the five individuals with the highest emoluments in the Group, one (2005: one; 2004: one) is director of the Company whose emoluments is included in the disclosure above. The emoluments of the remaining four in 2006, 2005 and 2004 are as follows:

	2006	2005	2004
Salaries and other benefits	**$ 518,198**	$ 513,570	$ 430,144
Bonus	**233,662**	92,455	105,665
Stock option benefits	**268,528**	325,880	620,060
Total emoluments	**$ 1,020,388**	$ 931,905	$ 1,155,869

The bonus is determined on the basis of the basic salary and the performance of the Company and the individual.

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

28. Directors' Remuneration and Five Highest Paid Individuals (Continued)

Their emoluments were within the following bands:

	2006 Number of individuals	2005 Number of individuals	2004 Number of individuals
HK$nil to HK$1,000,000 ($128,620)	**–**	–	–
HK$1,000,001 ($128,620) to HK$1,500,000 ($192,930)	**–**	–	3
HK$1,500,001 ($192,930) to HK$2,000,000 ($257,240)	**3**	3	–
HK$2,000,001 ($257,240) to HK$2,500,000 ($321,550)	**1**	1	–
HK$4,500,001 ($578,790) to HK$5,000,000 (643,100)	**–**	–	1

29. Dividend

Deemed dividend represents beneficial conversion feature relating to the preferential price of certain convertible equity instrument investor receives when the effective conversion price of the equity instruments is lower than the fair market value of the common stock to which the convertible equity instrument would have converted at the date of issuance. Accordingly, deemed dividend on preference shares represents the price difference between the effective conversion price of the convertible equity instrument and the ordinary share.

Other than the deemed dividend on preference shares as described above, no dividend has been paid or declared by the Company in 2006, 2005 and 2004.

30. Differences between US GAAP and International Financial Reporting Standards

The consolidated financial statements are prepared in accordance with US GAAP, which differ in certain significant respects from International Financial Reporting Standards ("IFRS"). The significant difference relates principally to share-based payments to employees and non-employees, presentation of minority interest, convertible financial instruments and assets held for sale.

(i) In respect of accounting treatment for stock option, IFRS 2, "Share Based Payment", was issued to specify recognition, measurement and disclosure for equity compensation. IFRS 2 requires all share-based payment to be recognized in the financial statements using a fair value measurement basis. An expense should be recognised when good or services received are consumed. IFRS 2 was effective for periods beginning on or after January 1, 2005.

Under US GAAP, prior to the adoption of the SFAS 123(R), the Company can account for stock-based compensation issued to employees using one of the two following methods,

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

30. Differences between US GAAP and International Financial Reporting Standards (Continued)

(a) Intrinsic value based method

Under the intrinsic value based method, compensation expense is the excess, if any, of the fair value of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period.

(b) Fair value based method

For stock options, fair value is determined using an option pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option and the annual rate of quarterly dividends.

Under either approach compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period.

The Company has adopted the intrinsic value method of accounting for its stock options to employees in 2005 and 2004 and the share-based compensation recorded by the Company was US$25,735,849 and US$27,011,078, respectively. The fair value of the stock options is presented for disclosure purpose (see Note 3(v)).

Had the Company prepared the financial statements under IFRS, the Company would have adopted IFRS 2 retrospectively for the fiscal year began on January 1, 2005 and compensation expenses on share-based payments to employees would be calculated using fair value based method for the years prior to January 1, 2006. The additional share-based compensation under fair value method was US$7,261,778 and US$10,475,625, respectively, for year ended December 31, 2005 and 2004.

Meanwhile, the Company would not recognize the share-based payment in relating to the unvested portion since the adoption of IFRS 2.

Effective January 1, 2006, the Company adopted the provision of SFAS 123(R), "Share-Based Payment". Under the provisions of SFAS 123(R), share-based compensation cost is measured at the grant date, based on the fair value of the award. The measurement of share-based compensation has no longer significant difference from IFRS 2.

(ii) Under IFRS, minority interest should be presented in equity section while under US GAAP minority interest should be presented outside of equity, between liability and equity.

Under IFRS, the portion of profit and loss attributable to the minority interest and to the parent entity is separately disclosed on the face of the income statement. While under US GAAP, amounts attributable to the minority interest are presented as a component of net income or loss.

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

30. Differences between US GAAP and International Financial Reporting Standards (Continued)

(iii) IFRS requires an issuer of convertible debt instrument to classify and recognize separately the instrument's liability and equity elements. Under IAS 32, which has been effective for annual periods beginning on or after January 1, 2005, an issuer of such instrument creates a financial liability (a contractual arrangement to deliver cash or other financial assets) and has issued an equity instrument (a call option granting the holder the right to convert into preferred stock of the issuer). Under US GAAP, the entire instruments are classified as liability. The convertible debt instrument was issued in exchange for plant and equipment. Accordingly, adjustments are made to discount on the convertible promissory note, cost of plant and equipment and to stockholder's equity. In January 2004, the Company redeemed the convertible promissory note in cash. The increment in the costs allocated to plant and equipment was fully amortized in 2004.

(iv) Under US GAAP, beneficial conversion feature refers to the preferential price of certain convertible equity instruments an investor receives when the effective conversion price of the equity instruments in lower than the fair market value of the common stock to which the convertible equity instrument is convertible into at the date of issuance. US GAAP requires the recognition of the difference between the effective conversion price of the convertible equity instrument and the fair market value of the common stock as a deemed dividend.

Under IFRS, this deemed dividend is not required to be recorded.

(v) Prior to the issuance of IFRS 5, plant and equipment is initially measured at cost under IFRS. Under a cost model, plant and equipment are accounted for at cost less accumulated depreciation and accumulated impairment losses. Plant and equipment will continue to be depreciated even though the Company has determined that it will be disposed of within specified period.

Under US GAAP, a long-lived asset (disposal group) to be sold is classified as held for sale in the period in which certain specified criteria are met. A long-lived asset (disposal group) classified as held for sale is measured at the lower of its carrying amount or fair value less cost to sell and is not depreciated (amortized) while it is classified as held for sale. A long-lived asset that is reclassified as held and used shall be measured individually at the lower of its (a) carrying amount before the asset (disposal group) was classified as held for sale, adjusted for any depreciation (amortization) expense that would have been recognized had the asset (disposal group) been continuously classified as held and used, or (b) fair value at the date of the subsequent decision not to sell.

In 2004, International Accounting Standards Board issued IFRS 5 "Non-current Assets Held for Sale and Discontinued Operation". Pursuant to IFRS 5, assets or disposal groups that are classified as held for sale are carried at the lower of carrying amount and fair value less costs to sell and are not depreciated. IFRS 5 should be applied prospectively for annual periods beginning on or after January 1, 2005. The Company early adopted IFRS 5 and the accumulated difference between IFRS and US GAAP was reversed in 2004.

(In U.S. dollars, except where otherwise stated)

30. Differences between US GAAP and International Financial Reporting Standards (Continued)

(vi) Under IFRS, leases of land and buildings are classified as operating or finance leases in the same way as leases of other assets. However, a characteristic of land is that it normally has an indefinite economic life and, if title is not expected to pass to the leasee by the end of the lease term, the leasee normally does not receive substantially all of the risks and rewards incidental to ownership, in which case the lease of land will be an operating lease. A payment made on entering into or acquiring a leasehold that is accounted for as an operating lease represents prepaid lease prepayments that are amortized over the lease term in accordance with the pattern of benefits provided. For balance sheet presentation, the prepayment of land use rights should be disclosed as current and non-current.

Under US GAAP, land use rights are also accounted as an operating lease and represent prepaid lease payments that are amortized over the lease term in accordance with the pattern of benefits provided. Current and non-current asset reclassification is not required under US GAAP.

The adjustments necessary to restate net (loss) income attributable to holders of ordinary shares and stockholders' equity in accordance with IFRS are shown in the tables set out below.

	2006	2005 (As Restated, see Note 31)	2004 (As Restated, see Note 31)
Net (loss) income attributable to holders of ordinary shares as reported under US GAAP	**$ (44,109,078)**	$ (114,774,827)	$ 77,363,770
IFRS adjustments:			
i) Recognizing an expense for share-based payment	**–**	(7,261,778)	(10,475,625)
i) Reverse of cumulative effect of a change in accounting principal	**(5,153,986)**	–	–
iii) Depreciation of incremental costs allocated to plant and equipment	**–**	–	(124,944)
iv) Deemed dividend	**–**	–	18,839,426
v) Depreciation related to reclassification of unsold assets held for sale	**–**	–	674,117
Net (loss) income attributable to holders of ordinary shares under IFRS	**$ (49,263,064)**	$ (122,036,605)	$ 86,276,744
Net (loss) income per share under IFRS	**$ (0.00)**	$ (0.01)	$ 0.01
Stockholders' equity as reported under US GAAP	**$ 3,007,419,918**	$ 3,029,316,155	$ 3,115,942,285
ii) Presentation of minority interest	**38,800,666**	38,781,863	–
iii) Depreciation of incremental costs allocated to plant and equipment	**–**	–	(124,944)
iii) Accumulated amortization of discount on promissory notes	**–**	–	124,944
Stockholders' equity under IFRS	**$ 3,046,220,584**	$ 3,068,098,018	$ 3,115,942,285

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

30. Differences between US GAAP and International Financial Reporting Standards (Continued)

	2006	2005 (As Restated, see Note 31)	2004 (As Restated, see Note 31)
Land use rights, net – current portion			
as reported under US GAAP	**–**	–	–
IFRS adjustment			
vi) Current portion adjustment for land use right	**712,521**	650,581	522,114
Under IFRS	**712,521**	650,581	522,114
Land use rights, net			
As reported	**38,323,333**	34,767,518	39,197,774
IFRS adjustments			
vi) Current portion adjustment for land use right	**(712,521)**	(650,581)	(522,114)
Under IFRS	**37,610,812**	34,116,937	38,675,660
Plant and equipment, net			
as reported under US GAAP	**3,244,400,822**	3,285,631,131	3,311,924,599
IFRS adjustments			
iii) Depreciation of incremental costs allocated to plant and equipment	**–**	–	(124,944)
iii) Incremental costs allocated to plant and equipment	**–**	–	124,944
Under IFRS	**3,244,400,822**	3,285,631,131	3,311,924,599

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

30. Differences between US GAAP and International Financial Reporting Standards (Continued)

	2006	2005 (As Restated, see Note 31)	2004 (As Restated, see Note 31)
Additional paid-in capital			
as reported under US GAAP	**3,288,733,078**	3,291,407,448	3,289,724,885
IFRS adjustments			
i) Recognizing an expense for share-based payment	**–**	(17,620,141)	–
i) Retrospective adjustment on adoption of IFRS 2	**30,388,316**	23,126,538	(28,051,137)
i) Reverse of cumulative effect of a change in accounting principal	**5,153,986**	–	–
iv) Deemed dividend	**–**	–	(18,839,426)
iv) Carry forward prior year's adjustment on deemed dividend	**(55,956,051)**	(55,956,051)	(37,116,625)
Under IFRS	**$ 3,268,319,329**	$ 3,240,957,794	$ 3,205,717,697
Share-based compensation			
as reported under US GAAP	**–**	(24,881,919)	(51,177,675)
IFRS adjustments			
i) Recognizing an expense for share-based payment	**–**	24,881,919	–
i) Retrospective adjustment on adoption of IFRS 2	**–**	–	51,177,675
Under IFRS	**$ –**	$ –	$ –
Accumulated deficit			
as reported under US GAAP	**(288,810,490)**	(244,701,412)	(129,926,585)
IFRS adjustments			
i) Additional share-based compensation under IFRS 2	**–**	(7,261,778)	(10,475,625)
i) Carried over impact under IFRS 2	**(17,737,403)**	(10,475,625)	–
i) Impact on the adoption of IFRS 2	**(12,650,913)**	(12,650,913)	(12,650,913)
i) Reverse of cumulative effect of a change in accounting principal	**(5,153,986)**	–	–
iii) Accumulated amortization of discount on promissory notes	**–**	–	(124,944)
iii) Depreciation of incremental costs allocated to plant and equipment	**–**	–	124,944
iv) Deemed dividend	**–**	–	18,839,426
iv) Carry forward prior year's adjustment on deemed dividend	**55,956,051**	55,956,051	37,116,625
Under IFRS	**$ (268,396,741)**	$ (219,133,677)	$ (97,097,072)
Cost of sales			
as reported under US GAAP	**$ 1,338,155,004**	$ 1,105,133,544	$ 716,225,372
IFRS adjustments			
i) Recognizing an expense for share-based payment	**–**	3,366,722	–
i) Retrospective adjustment on adoption of IFRS 2	**–**	–	4,496,905
Under IFRS	**$ 1,338,155,004**	$ 1,108,500,266	$ 702,722,277

(In U.S. dollars, except where otherwise stated)

30. Differences between US GAAP and International Financial Reporting Standards (Continued)

	2006	2005 (As Restated, see Note 31)	2004 (As Restated, see Note 31)
Operating expenses			
as reported under US GAAP	**141,037,963**	153,225,353	169,598,058
IFRS adjustments			
i) Recognizing an expense for share-based payment	**–**	3,895,056	–
i) Retrospective adjustment on adoption of IFRS 2	**–**	–	5,978,720
Under IFRS	**$ 141,037,963**	$ 157,120,409	$ 175,576,778
Other income, net			
as reported under US GAAP	**(56,100,658)**	(26,321,705)	7,547,974
IFRS adjustments			
v) Depreciation related to reclassification of unsold assets held for sale	**–**	–	674,117
Under IFRS	**$ (56,100,658)**	$ (26,321,705)	$ 8,222,091

In addition to the above, there are also other differences between US GAAP and IFRS relevant to the accounting policies of the Company. These differences have not led to any material differences in 2006, 2005 and 2004, and details of which are set out as below:

(a) Inventory valuation

Inventories are carried at cost under both US GAAP and IFRS. However, if there is evidence that the net realisable value of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical obsolescence, changes in price levels, or other causes, the difference should be recognized as a loss of the current period. This is generally accomplished by stating such goods at a lower level commonly known as “market”.

Under US GAAP, a write-down of inventories to the lower of cost or market at the close of a fiscal period creates a new cost basis that subsequently cannot be reversed based on changes in underlying facts and circumstances. Market under US GAAP is the lower of the replacement cost and net realizable value minus normal profit margin.

Under IFRS, a write-down of inventories to the lower of cost or market at the close of a fiscal period is a valuation allowance that can be subsequently reversed if the underlying facts and circumstances changes. Market under IFRS is net realizable value.

No significant GAAP difference was noted in 2006, 2005 and 2004.

30. Differences between US GAAP and International Financial Reporting Standards (Continued)

(b) Deferred income taxes

Deferred tax liabilities and assets are recognized for the estimated future tax effects of all temporary differences between the financial statements carrying amounts of assets and liabilities and their respective tax bases under both US GAAP and IFRS.

Under IFRS, a deferred tax asset is recognized to the extent that it is probable that future profits will be available to offset the deductible temporary differences or carry forward of unused tax losses and unused tax credits. Under US GAAP, all deferred tax assets are recognized, subject to a valuation allowance, to the extent that it is "more likely than not" that some portion or all of the deferred tax assets will not be realized. "More likely than not" is defined as a likelihood of more than 50%.

With respect to the measurement of the deferred tax, IFRS requires recognition of the effects of a change in tax laws or rates when the change is "substantively enacted". US GAAP requires measurement using tax laws and rates enacted at the balance sheet date.

Under US GAAP, deferred tax liabilities and assets are classified as current or non-current based on the classification of the related asset or liability for financial reporting. Under IFRS, deferred tax assets and liabilities are always classified as non-current.

No significant GAAP difference was noted in 2006, 2005 and 2004.

(c) Segment reporting

Under IFRS, a listed enterprise is required to determine its primary and secondary segments on the basis of lines of business and geographical areas, and to disclose results, assets and liabilities and certain other prescribed information for each segments. The determination of primary and secondary segment is based on the dominant source of the enterprise's business risks and returns. Accounting policies adopted for preparing and presenting the financial statements of the Company should also be adopted in reporting the segmental results and assets. The business segment is considered as the primary segment for the Company. Meanwhile, the Management believes the risk and return shall be similar among its different geographical segments.

Under US GAAP, a public business enterprise is required to report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. US GAAP also permits the use of the accounting polices used for internal reporting purposes that are not necessarily consistent with the accounting policies used in consolidated financial statements.

No significant difference on reportable segment was noted.

30. Differences between US GAAP and International Financial Reporting Standards (Continued)

(d) Borrowing costs

IFRS and US GAAP requires capitalization of borrowing costs for those borrowings that are directly attributable to acquisition, construction or production of assets that necessarily take a substantial period of time to get ready for their intended use or sale. The amount to be capitalized is the borrowing cost which could theoretically have been avoided if the expenditure on the qualifying asset were not made. Under IFRS, borrowing costs are defined as interest and any other costs incurred by an enterprise in connection with the borrowing of funds, while under the US GAAP, borrowing costs are defined as interest only.

Under IFRS, to the extent that funds are borrowed specifically for the purpose of obtaining a qualified asset, the amount of borrowing costs eligible for capitalization is determined as the actual borrowing costs incurred on the borrowing during the period less any investment income on the temporary investment of those borrowing. The amount of borrowing costs to be capitalized under US GAAP is based solely on actual interest incurred related to actual expenditure incurred.

No significant GAAP difference was noted in 2006, 2005 and 2004.

(e) Impairment of asset

IFRS requires an enterprise to evaluate at each balance sheet date whether there is any indication that a long-lived asset may be impaired. If any such indication exists, an enterprise should estimate the recoverable amount of the long-lived asset. Recoverable amount is the higher of a long-lived asset's net selling price and its value is use. Value in use is measured on a discounted present value basis. An impairment loss is recognized for the excess of the carrying amount of such assets over their recoverable amounts. A reversal of previous provision of impairment is allowed to the extent of the loss previously recognised as expense in the income statement.

Under US GAAP, long-lived assets and certain identifiable intangibles (excluding goodwill) held and used by an entity are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of a long-lived asset and certain identifiable intangibles (excluding goodwill) may not be recoverable. An impairment loss is recognized if the expected future cash flows (undiscounted) are less than the carrying amount of the assets. The impairment loss is measured based on the fair value of the long-lived assets and certain identifiable intangibles (excluding goodwill). Subsequent reversal of the loss is prohibited. Long-lived assets and certain identifiable intangibles (excluding goodwill) to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

The Company had no impairment loss under either US GAAP or IFRS in 2006, 2005 and 2004.

30. Differences between US GAAP and International Financial Reporting Standards

(Continued)

(f) Research and development costs

IFRS requires the classification of the costs associated with the creation of intangible assets by research phase and development phase. Costs in the research phase must always be expensed. Costs in the development phase are expensed unless the entity can demonstrate all of the following:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use or sell it;
- its ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- its ability to measure the expenditure attributable to the intangible asset during the development phase.

Under US GAAP, research and development costs are expensed as incurred except for:

- those incurred on behalf of other parties under contractual arrangements;
- those that are unique for enterprises in the extractive industries;
- certain costs incurred internally in creating a computer software product to be sold, leased or otherwise marketed, whose technological feasibility is established, i.e. upon completion of a detailed program design or, in its absence, upon completion of a working model; and
- certain costs related to the computer software developed or obtained for internal use.

The general requirement to write off expenditure on research and development as incurred is extended to research and development acquired in a business combination.

No significant difference was noted in 2006, 2005 and 2004.

(g) Statements of cash flows

There are no material differences on statements of cash flows between US GAAP and IFRS. Under the US GAAP, interest received and paid must be classified as an operating activity. Under IFRS, interest received and paid may be classified as an operating, investing, or financing activity.

31. Re-statement

As a result of review of the accounting treatment for the Settlement Agreement reached with TSMC on January 31, 2005 (See note 24), the Company determined that errors were made in the identification and classification of the components of settlement payment. The Company previously recorded US$23.2 million of the settlement amount as an expense in 2004 and US$134.8 million of intangible assets associated with the patent license portfolio and covenant not to sue. The Company determined that the payment was made solely for the right to use the licensed patent license portfolio both prior and subsequent to the settlement date.

The TSMC covenant not to sue for alleged trade secrets misappropriation does not qualify as a separable asset in accordance with either SFAS 141 or SFAS 142 as TSMC had never specified the exact trade secrets that it claimed were misappropriated, the Company's belief that TSMC's trade secrets may be obtained within the marketplace by other legal means and the Company never obtained the legal right to use TSMC's trade secrets. As a result, the Company has determined that no value should have been allocated to the covenant not to sue.

(In U.S. dollars, except where otherwise stated)

31. Re-statement (Continued)

This determination impacted the allocation of the settlement amount to its various components, which resulted in the Company decreasing the amount of expense recognized in its 2004 financial statements from US$23.2 million to US$16.7 million in 2004 and increased the deferred cost associated with the patent license portfolio from US$134.8 million to US$141.3 million. This correction also affected the amount of expense recorded in periods subsequent to the settlement date given the higher asset value being recorded and the shorter amortization period of the patent license portfolio as compared to the covenant not to sue.

In addition, the Company corrected the classification of the payment for the patent license portfolio from an intangible asset to a deferred cost and has also reclassified the amortization of the deferred asset from amortization of intangibles to a component of cost of sales. The effects of correcting these errors is shown below:

Consolidated Balance Sheets

	As of December 31,			
	2005		2004	
	As Previously Reported	As restated	As Previously Reported	As restated
Acquired intangible assets, net	$ 195,178,898	$ 80,667,737		
Deferred cost	–	117,728,792		
Total assets	4,583,415,731	4,586,633,362		
Accrued expense and other current liabilities			82,857,551	76,399,187
Total current liabilities			730,329,536	723,871,172
Total liabilities			1,274,791,610	1,268,333,246
Accumulated deficit	(247,919,043)	(244,701,412)	(136,384,949)	(129,926,585)
Total stockholders equity	3,026,098,524	3,029,316,155	3,109,483,921	3,115,942,285
Total liabilities and stockholders equity	4,583,415,731	4,586,633,362		

Consolidated Statements of Operations

	As of December 31,			
	2005		2004	
	As Previously Reported	As restated	As Previously Reported	As restated
Sales	1,171,318,735	1,171,318,735		
Cost of sales	1,081,587,786	1,105,133,544		
Gross Profit	89,730,949	66,185,191		
Operating expenses:				
Litigation settlement			23,153,105	16,694,741
Amortization of intangible assets	41,251,077	20,946,052		
Total operating expenses	173,530,378	153,225,353	176,056,422	169,598,058
Income (loss) from operations	(83,799,429)	(87,040,162)	82,382,902	88,841,266
(Loss) income before income tax	(110,121,134)	(113,361,867)	89,930,876	96,389,240
Net (loss) income before cumulative effect of a change in accounting principle	(111,534,094)	(114,774,827)	89,744,832	96,203,196
Net income (loss)	(111,534,094)	(114,774,827)	89,744,832	96,203,196
Net income (loss) loss attributable to common stockholders	(111,534,094)	(114,774,827)	70,905,406	77,363,770
Income (loss) per share, basic	$ (0.01)	$ (0.01)	$ 0.00	$ 0.01
Income (loss) per share, diluted	$ (0.01)	$ (0.01)	$ 0.00	$ 0.00

For the years ended December 31, 2006, 2005 and 2004
(In U.S. dollars, except where otherwise stated)

31. Re-statement (Continued)

Consolidated Statements of Cash Flows

	2005		2004	
	As Previously Reported	As restated	As Previously Reported	As restated
(Loss) income attributable to holders of ordinary shares	(111,534,094)	(114,774,827)	70,905,406	77,363,770
Net (loss) income	(111,534,094)	(114,774,827)	89,774,832	96,203,196
Depreciation and amortization	745,926,095	769,471,853		
Amortization of intangible assets	41,251,077	20,946,052		
Accrued expenses and other current liabilities			32,115,883	25,657,519

32. Subsequent Events

On April 10, 2007, Cension Semiconductor Manufacturing Corporation (“Cension”) entered into an Asset Purchase Agreement (the “Agreement”) with Elpida Memory, Inc. (“Elpida”), a Japan based memory chip manufacturer, for the purchase of Elpida’s 200mm wafer processing equipment currently located in Hiroshima, Japan for the total price of US$320 million. The Company has the contract to manage Cension’s 200-millimeter fab in Chengdu.

As part of the Agreement, the Company will provide a corporate guarantee for a maximum guarantee liability of US$163.2 million on behalf of Cension in favor of Elpida. The Company’s guarantee liability will terminate upon full payment of the purchase price by Cension to Elpida. In return for providing the above corporate guarantee, the Company would receive a guarantee fee from Cension.

In conjunction with the Agreement, the Company will be entitled to the net profit (loss) associated with the production in Hiroshima during the transitional period (estimated to be no longer than 24 months) when the equipment acquired by Cension is being relocated in stages from Hiroshima to Chengdu.