FLIGHT SAFETY TECHNOLOGIES INC
Form 10QSB
April 14, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**
**FORM 10-QSB**

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For The Quarterly Period Ended February 28, 2006

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 000-33305

FLIGHT SAFETY TECHNOLOGIES, INC.

(Exact name of small business issuer as specified in its charter)

| Nevada | 95-4863690 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

28 Cottrell Street, Mystic, Connecticut 06355

(Address of principal executive offices)

(860) 245-0191

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

The number of shares of common stock outstanding as of April 10, 2006 was 8,215,210 shares.

Transitional Small Business Disclosure Format: Yes o No x

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

FLIGHT SAFETY TECHNOLOGIES, INC.

**Balance Sheets**
**as of**
**February 28, 2006 and May 31, 2005**
**Unaudited**

| | February 28, 2006 | May 31, 2005 |
|---|---|---|
| Assets | | |
| Current assets: | | |

| | | | | |
|---|---|---|---|---|
| Cash | $ | 309,323 | $ | 494,837 |
| Contract receivables | | 286,699 | | 415,617 |
| Investments held to maturity | | 4,299,292 | | 4,033,759 |
| Investments available for sale at fair value | | 2,296,042 | | 2,860,233 |
| Inventory | | 108,044 | | 108,044 |
| Other current assets | | 256,969 | | 51,721 |
| Total current assets | | 7,556,369 | | 7,964,211 |
| | | | | |
| Property and equipment, net of accumulated depreciation of $402,458 and $328,608 | | 196,048 | | 208,562 |
| | | | | |
| Other Assets: | | | | |
| Intangible assets, net of accumulated amortization of $60,352 and $ 47,377 | | 223,231 | | 180,562 |
| Investments held to maturity | | --- | | 500,002 |
| Other receivables | | 217,974 | | 330,010 |
| Total Other Assets | | 441,205 | | 1,010,574 |
| Total Assets | $ | 8,193,622 | $ | 9,183,347 |
| | | | | |
| Liabilities and Stockholders' Equity | | | | |
| Current liabilities: | | | | |
| Accounts payable | $ | 744,760 | $ | 589,313 |
| Accrued expenses | | 171,547 | | 180,340 |
| Total current liabilities | | 916,307 | | 769,653 |
| Stockholders' equity: | | | | |

| | | |
|---|---|---|
| Preferred Stock, $0.001 par value, 5,000,000 shares authorized, none issued and outstanding | --- | --- |
| Common stock, $0.001 par value, 50,000,000 shares authorized, 8,331,510 shares issued and outstanding | 8,332 | 8,331 |
| Additional paid-in-capital | 13,070,192 | 13,069,863 |
| Treasury Stock, 116,300 shares at cost | (199,827) | (199,827) |
| Accumulated other comprehensive loss | (57,339) | (164,023) |
| Unearned stock compensation | --- | (4,769) |
| Accumulated deficit | (5,544,043) | (4,295,881) |
| Total stockholders' equity | 7,277,315 | 8,413,694 |
| | $ 8,193,622 | $ 9,183,347 |

**Total Liabilities and Stockholders' Equity**

The accompanying notes are an integral part of these financial statements



FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Operations and Other Comprehensive Income (Loss)
For the Three and Nine Month Periods Ended February 28, 2006 and February 28, 2005
Unaudited

| | Three **Months 2006** | Three **Months 2005** | Nine Months 2006 | Nine Months 2005 |
|---|---|---|---|---|
| Contract Revenues | $ 914,268 | $ 631,197 | $ 3,652,238 | 2,505,138 |

| | | | | |
|---|---|---|---|---|
| Cost of Revenues | 469,332 | 370,154 | 2,171,700 | 1,673,542 |
| Gross Profit | 444,936 | 261,043 | 1,480,538 | 831,596 |
| Operating Expenses: | | | | |
| Research and development | 175,018 | 163,661 | 853,198 | 348,308 |
| Selling, general and administrative | 686,816 | 528,699 | 1,812,297 | 1,477,925 |
| Depreciation and amortization | 24,015 | 29,465 | 86,825 | 88,395 |
| Total operating expenses | 885,849 | 721,825 | 2,752,320 | 1,914,628 |
| Loss from Operations | (440,913) | (460,782) | (1,271,782) | (1,083,032) |
| Other Income (Expense) | | | | |
| Interest income | 83,051 | 54,561 | 213,095 | 156,458 |
| Loss on investments available for sale | -- | -- | (170,875) | -- |
| Loss before provision for income taxes | (357,862) | (406,221) | (1,229,562) | (926,574) |
| Provision for income taxes | 6,200 | 6,915 | 18,600 | 20,745 |
| Net Loss | (364,062) | (413,136) | (1,248,162) | (947,319) |
| Other Comprehensive Income (Loss) | | | | |
| Unrealized gains (loss) on investments | (1,348) | 26,783 | (64,191) | 3,814 |
| Less reclassification adjustment for loss included in net income | -- | -- | 170,875 | -- |
| Comprehensive Loss | $(365,410) | $(386,353) | $(1,141,478) | (943,505) |
| Net Loss Per Share | | | | |
| Basic and diluted | $ (.04) | $ (.05) | $ (.15) | $ (.12) |
| Weighted Average Number of Shares Outstanding | | | | |

| Basic and diluted | 8,215,210 | 8,215,110 | 8,215,143 | 8,218,925 |
|---|---|---|---|---|

The accompanying notes are an integral part of these financial statements



FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Changes in Stockholders Equity
For the Nine Months Ended February 28, 2006 and February 28, 2005
Unaudited

| | Common Stock Shares | Common Stock Amount | Additional Paid - In Capital | Treasury Stock | Accumulated Other Comp. loss | Unearned Stock Compensation | Accumulated Deficit | Stockholders Equity |
|---|---|---|---|---|---|---|---|---|
| Balance at May 31, 2004 | 8,331,410 | $ 8,331 | 13,105,863 | $ --- | $ (119,501) | $ (150,733) | $ (2,884,237) | $ 9,959 |
| Unearned stock compensation | -- | -- | -- | -- | -- | 47,223 | -- | 47 |
| Other Comprehensive Income (Loss) | -- | -- | -- | -- | 3,814 | -- | -- | 3 |
| Purchase of treasury stock | -- | -- | -- | (199,827) | -- | -- | -- | (199, |
| Net Loss | -- | -- | -- | -- | -- | -- | (947,319) | (947, |
| Balance at | | | | | | | | |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| February 28, 2005 | 8,331,410 | $ | 8,331 | $ | 13,105,863 | $ (199,827) | $ (115,687) | $ (108,510) | $ (3,831,556) | $ | 8,863 |
| Balance at May 31, 2005 | 8,331,410 | $ | 8,331 | $ | 13,069,863 | $ (199,827) | $ (164,023) | $ (4,769) | $ (4,295,881) | $ | 8,413 |
| Amortization of unearned stock comp. | -- | | -- | | -- | -- | -- | 4,769 | -- | | 4 |
| Warrants Exercised | 100 | | 1 | | 329 | -- | -- | -- | -- | | |
| Other comprehensive income (loss) | -- | | -- | | -- | -- | 106,684 | -- | -- | | 106 |
| Net loss | -- | | -- | | -- | -- | -- | -- | (1,248,162) | | (1,248, |
| Balance at February 28, 2006 | 8,331,510 | $ | 8,332 | $ | 13,070,192 | $ (199,827) | $ (57,339) | $ -- | $ (5,544,043) | $ | 7,277 |

The accompanying notes are an integral part of these financial statements

FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Cash Flow
For the Nine Months Ended February 28, 2006 and February 28, 2005
Unaudited

| | For the Nine Months Ended February 28, | |
|---|---|---|
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net loss | $(1,248,162) | $ (947,319) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 86,825 | 88,395 |
| Non-cash compensation - common stock | 4,769 | 47,223 |
| Loss on investment available for sale | 170,875 | -- |
| Accretion of investment discounts | (83,587) | -- |
| Changes in operating assets and liabilities: | | |
| Decrease in contract receivables | 128,918 | 254,999 |
| (Increase) decrease in other receivables | 112,036 | (235,195) |
| Increase in inventory | -- | (108,044) |

| | | |
|---|---|---|
| Increase in other current assets and other assets | (205,248) | (3,180) |
| Increase (decrease) in accounts payable and accrued expense | 146,654 | (238,650) |
| Net cash used in operating activities | (886,920) | (1,141,771) |
| Cash flows from investing activities: | | |
| Purchase of held to maturity securities | (12,621,944) | (6,047,160) |
| Proceeds from maturity of held to maturity securities | 12,940,000 | 7,023,709 |
| Proceeds from available for sale securities | 500,000 | -- |
| Purchase of available for sale securities | -- | (525,000) |
| Purchases of property and equipment | (61,336) | (58,548) |
| Payments for patents | (55,644) | (27,233) |
| Net cash provided by investing activities | 701,076 | 365,768 |
| Cash flows from financing activities: | | |
| Purchase of treasury stock | -- | (199,827) |
| Proceeds from warrants exercised | 330 | -- |
| Net cash provided by (used in) financing activities | 330 | (199,827) |
| Net decrease in cash and cash equivalents | (185,514) | (975,830) |
| Cash and cash equivalents at beginning of period | 494,837 | 1,180,863 |
| Cash and cash equivalents at end of period | $ 309,323 | $ 205,033 |

The accompanying notes are an integral part of these financial statements

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FLIGHT SAFETY TECHNOLOGIES, INC.

Notes To The Financial Statements
(Unaudited)
For The Three and Nine Months Ended February 28, 2006 and February 28, 2005

Note 1. Summary of Significant Accounting Policies

:

Basis of Presentation

These interim financial statements for the three and nine months ended February 28, 2006 and February 28, 2005, included herein, have been prepared, without audit, pursuant to the rules and regulations of the SEC. Results for the three and nine months ended February 28, 2006 and February 28, 2005 are not necessarily indicative of results for the entire year. In the opinion of management, all adjustments, consisting of normal recurring adjustments, which are necessary for a fair statement of operating results for the interim period have been made. These financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with our financial statements and related footnotes for the years ended May 31, 2005 and May 31, 2004 which are included in our annual report on Form 10-KSB filed on August 26, 2005.

Certain reclassifications have been made to the prior period financial statements to conform to current period presentation with no effect to the Company's reported net loss.

Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and the reported amounts of revenue and expenses during the reporting period. Material estimates that are particularly susceptible to significant change in the near term relate to the carrying values of investments, inventory, other receivables, and patents. Actual results could differ from those estimates.

Stock-Based Compensation

The Company accounts for its stock-based compensation using the intrinsic value method provided for under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations for stock options issued to employees and directors. Under APB 25, compensation expense is recognized over the vesting period to the extent that the fair market value of the underlying stock exceeds the exercise price of the employee stock award on the date of grant. Stock options issued under our stock option plans generally have no intrinsic value at the grant date, and under APB 25 no compensation cost is recognized for them. Statement of

Financial Accounting Standards ("SFAS") No. 123,



Accounting for Stock-Based Compensation, establishes a fair-value-based method of accounting for stock-based compensation plans. The Company has adopted the disclosure-only alternative under SFAS No. 123, which requires the disclosure of the pro forma effects on net loss and net loss per share as if the fair value accounting prescribed by SFAS No. 123 had been adopted.

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | February 28, 2006 | February 28, 2005 | February 28, 2006 | February 28, 2005 |
| Net (loss) as reported | $<364,062> | $<413,136> | $<1,248,162> | $<947,319> |
| Add: stock-based employee compensation expense included in net income | $ -- | $15,741 | $ 4,769 | $ 47,223 |
| Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards | $<175,746> | $<35,798> | $ <239,476> | $ <71,988> |
| Pro forma net (loss) | $<539,808> | $<433,193> | $ <1,482,869> | $ <972,084> |
| Earnings per share: | | | | |
| Basic and diluted - as reported | $ <.04> | $<.05> | $ <.15> | $ <.12> |
| Basic and diluted - pro forma | $ <.07> | $<.05> | $ <.18> | $ <.12> |

The fair value of each option grant is estimated as of the grant date using the Black-Scholes option pricing model. The following weighted average assumptions were used to value options granted in the Quarter ended February 28, 2006:

| | |
|---|---|
| Risk-free interest rate | 4.50% |
| Expected dividend yield | None |
| Expected life of options | 10 years |

| | |
|---|---|
| Expected volatility | 72% |
| Weighted-average grant-date fair value | $1.67 |



In December 2004, the Financial Accounting Standards Board issued SFAS No. 123(R), "Share-Based Payment, an Amendment of FASB Statements No. 123 and 95." SFAS No. 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services or incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments. SFAS No. 123(R) requires public entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions) and recognize the cost over the period during which an employee is required to provide service in exchange for the award. Adoption requires a modified prospective application whereby compensation expense is recognized on or after the required effective date for the portion of the outstanding awards for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards, calculated on a basis consistent with the SFAS No. 123 pro forma disclosures. The Company will adopt SFAS No. 123 (R) on its effective date, commencing with the quarter beginning June 1, 2006. Actual expense recorded related to these options would be reduced by future forfeitures.

Earnings Per Share

Basic loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. For the three and nine month periods ended February 28, 2006 and February 28, 2005, the effect of stock options and warrants was anti-dilutive; therefore, they were not included in the computation of diluted loss per share. The number of shares issuable upon the exercise of outstanding stock options and warrants that were excluded from the computation as their effect would be anti-dilutive were 3,805,300 and 3,073,327 as of February 28, 2006 and February 28, 2005, respectively.

Cash and Cash Equivalents

Cash represents cash on hand of $286,217 in checking accounts and $23,106 in money market accounts as of February 28, 2006. Money market accounts earn interest at approximately 1.25% (per annum).

Inventory

Inventory represents purchasing of long lead SOCRATES® system components to further expand to a thirty-two beam system. Inventory is accounted for at lower of cost or market and on the first-in first-out basis.

Revenue and Cost Recognition

Our contracts with the United States government are cost-reimbursable contracts that provide for a fixed profit percentage applied to our actual costs to complete the work. These contracts are subject to audit and adjustment by our government customer, and are subject to cost limitations as provided by the contract.



For these contracts, fee revenue is recorded at the time services are performed based upon actual project costs incurred and include a reimbursement for general, administrative, and overhead costs and the base fee. The general, administrative, and overhead costs are estimated periodically in accordance with government contract accounting regulations and may change based on actual costs incurred subject to approval. Revenue may be adjusted for our estimate of costs that may be categorized as disputed or unallowable as a result of cost overruns or the government audit process.

Contracting costs include all direct material, labor and subcontracting costs. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions and estimated profitability and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Revenue related to claims is recorded at the lesser of actual costs incurred or the amount expected to realized.

Intangible Assets

Intangible assets consist of patent costs. Amortization expense for the nine months ended February 28, 2006 and February 28, 2005 was $12,975 and $8,823 respectively. Amortization expense on average for the next five years is currently expected to be approximately $18,000.

Note 2. Equity Transactions:

During the nine months ended February 28, 2006, there was an issuance of common stock for 100 shares as the result of the exercise of warrants at $3.30 per share for a total of $330. The total shares issued as of February 28, 2006 were 8,331,510.

During the period from June 2, 2004 to June 17, 2004, we purchased 116,300 shares of our common stock at an average price of $1.71 for a total price of $199,827. The repurchase was authorized in a stock repurchase plan approved by our Board of Directors. Of the 8,331,510 shares of common stock issued to date, 8,215,210 are outstanding as of February 28, 2006.

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Note 3. Investments in Marketable Securities:

A summary of investments as of February 28, 2006 is as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Fair Value |
|---|---|---|---|---|
| Available for Sale | | | | |
| Mutual bond funds | $2,353,381 | $ -- | $ (57,339) | $2,296,042 |
| Held to Maturity | | | | |
| Corporate bonds | $3,799,290 | $ -- | $ -- | $3,799,290 |
| U.S. Government securities | 500,002 | -- | (7,657) | 492,345 |
| | $4,299,292 | $ -- | $ (7,657) | $4,291,635 |

Contractual maturities of held-to-maturity securities at February 28, 2006 are as follows:

Carrying Amount

| | |
|---|---|
| Due in one year or less | $4,299,292 |
| Due in one year or more | -- |
| | $4,299,292 |

In the quarter ended August 31, 2005, the Company recognized an impairment loss of $170,875 related to investments in a mutual bond fund. Despite the narrowing of the gap between the yield on the ten year Treasury note and the Consumer Price Index, the price of the investment did not improve as we had expected. The Company considered the severity and duration of these impairments and determined that they were other than temporary, and therefore, recorded the impairment loss.

For the quarter ended February 28, 2006 the Company reported an unrealized loss of $57,339 related to investments available for sale. The net asset value of the underlying mutual bond fund during the second and third quarter did not result in a significant loss as compared to the first quarter. The approximate net asset value of our investment was $876,773 during our quarter ended February 28, 2006 compared to $910,397 during the quarter ended November 30, 2005. The Company has considered the severity and duration of this impairment and considers it to be temporary and anticipates recovery during the quarters ending August 31, 2006 and November 30, 2006.



Note 4. Stock Options:

Options may be granted from time to time for shares of common stock as determined by the Board of Directors, subject to any applicable shareholder approval requirements. The stock options granted to date vest over a period of 36 months. The options are exercisable up to ten years from the date of vesting.

On June 23, 2005, 150,000 options were granted to an employee and on December 14, 2005 1,253,600 options were granted to employees, Officers and Directors with an exercise price of $3.50, vesting over a 36 month period and are exercisable up to ten years from the date of grant. A summary of our outstanding stock options for the period ended February 28, 2006 is as follows:

| | Options Outstanding | Weighted Average Exercise Price |
|---|---|---|
| Balance, May 31, 2005 | 969,621 | $ 4.92 |
| Expired | (487,121) | $ 6.00 |
| Granted | 1,403,600 | $ 3.50 |
| Exercised | -- | -- |
| Balance, February 28, 2006 | 1,886,100 | $ 3.58 |

The following table summarizes information regarding options outstanding and options exercisable at February 28, 2006:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Exercise Price | Number of Options | Weighted Average Remaining Contractual Life | Weight Average Exercise Price | Number of Options Exercisable | Weighted Average Exercise Price |
| $6.00 | 62,500 | .89 | $6.00 | 62,500 | $6.00 |
| $3.50 | 1,823,600 | 9.67 | $3.50 | 579,650 | $3.50 |
| | 1,886,100 | 9.65 | $3.66 | 642,150 | $3.63 |

Note 5. Warrants:

We have 1,919,200 warrants outstanding as of February 28, 2006. These warrants are comprised of 1,514,200 warrants with an exercise price of $3.30, 270,000 with an exercise price of $3.60, and 135,000 warrants with an exercise price of $5.40 which were issued as part of a public offering that expire January 29, 2009.

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Note 6. Other Receivables:

Other receivables include retained fees on Government contracts which represent up to a 15% payment hold back against billable fees and differences in actual and provisional overhead and general administrative rates which we expect are recoverable. We do not expect to receive payments for these other receivables in the next year and consider this account a long term asset. The summary below compares the balances for other receivables as of February 28, 2006 and May 31, 2005.

| | February 28, 2006 | May 31, 2005 |
|---|---|---|
| Retained Fee | | |
| Phase III Socrates | $ 78,368 | $ 39,010 |
| Phase IV Socrates | 15,087 | -- |
| Recoverable Rate difference | | |
| Phase III and IV Socrates | 124,519 | 291,000 |
| Total | $ 217,974 | $ 330,010 |

Other receivables includes recoverable rate differences resulting from the difference between the current overhead and general and administrative rates compared to our provisional rates, which has created a difference of $124,519 for the nine months ended February 28, 2006. We consider the recoverable rate difference as of February 28, 2006 to be a timing difference which we expect to be $0 by the end of our fiscal year May 31, 2006. The recoverable rate difference as of May 31, 2005 of $291,000 was billed to and paid by the DOT/VOLPE Center during the quarter ending November 30, 2005.

Note 7. Other Current Assets :

As of February 28, 2006, other current assets were $256,969 compared to $51,721 as of May 31, 2005. This net increase of $205,248 is primarily due to prepaid legal fees of $202,929. This amount represents the legal fees, over and above our Director's and Officer's (D&O) Liability insurance deductible of $200,000, for the preparation of the motion to dismiss a class action suit brought against the Company and certain Directors on July 14, 2004. After our D&O Insurance Carrier has reviewed and approved these charges, we expect our insurance company will reimburse us for a substantial portion of legal fees above the deductible.



Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Cautionary Statement Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995:

Except for the historical information presented in this document, the matters discussed in this quarterly report on Form 10-QSB for the three and nine month period ending February 28, 2006 or otherwise incorporated by reference into this document, contain "forward-looking statements" (as such term is defined in the Private Securities Litigation Reform Act of 1995). These statements are identified by the use of forward-looking terminology such as "believes", "plans", "intend", "scheduled", "potential", "continue", "estimates", "hopes", "goal", "objective", expects", "may", "will", "should" or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. The safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, apply to forward-looking statements made by us. We caution you that no statements contained in this Form 10-QSB should be construed as a guarantee or assurance of future performance or results. These forward-looking statements involve risks and uncertainties, which include risks and uncertainties associated with, among other things, the outcome of an informal inquiry by the SEC that appears to be in connection with certain analysts reports about us and our press releases, the outcome of pending class action litigation alleging violations of federal securities laws, whether the government will implement Wake Vortex Advisory System at all or with the inclusion of a SOCRATES® wake

vortex sensor, the impact of competitive products and pricing, limited visibility into future product demand, slower economic growth generally, difficulties inherent in the development of complex technology, new products sufficiency, availability of capital to fund operations, research and development, fluctuations in operating results, and these and other risks are discussed in the "Known Trends, Risks and Uncertainties" section Management's Discussion and Analysis of Financial Conditions and Results of Operations of this Form 10-QSB. The actual results that we achieve may differ materially from any forward-looking statements due to such risks and uncertainties. These forward-looking statements are based on current expectations, and, except as required by law, we assume no obligation to update this information whether as a result of new information, future events or otherwise. Readers are urged to carefully review and consider the various disclosures made by us in this Form 10-QSB and in our other reports filed with the Securities and Exchange Commission that attempt to advise interested parties of the risks and factors that may affect our business.



Overview

Our current operations have been funded substantially by U.S. Congressional appropriations resulting in four successive sole source contracts with agencies of the federal government for research, development, and testing of our SOCRATES® wake vortex sensor and related work pertaining to a wake vortex advisory system, sometimes referred to as WVAS, that National Aeronautics and Space Administration (NASA) is developing. We estimate the appropriations to the Federal Aviation Administration (FAA) totaled approximately $9.6 million in U.S. fiscal years ending September 30, 1997 through September 30, 2000 for research and development of our SOCRATES® wake vortex sensor; and appropriations to NASA for research and development of our SOCRATES® wake vortex sensor totaled approximately $18.5 million in U.S. fiscal years ending September 30, 2001 through September 30, 2005. To date the total government appropriations for SOCRATES® and WVAS is approximately $28.1 million. From these amounts, we have received four contracts aggregating approximately $19.8 million in funding. As of February 28, 2006, we have recognized an aggregate of approximately $18.3 million of contract revenue with $0.3 million in contract receivable as of February 28, 2006. Our current SOCRATES® government contract backlog is approximately $1.5 million. The balance of the government appropriations from 1997 to 2005 of approximately $8.3 million has funded the FAA and NASA program management and technical participation in the development of our SOCRATES® wake vortex sensor and WVAS.

We have entered into these contracts with the Volpe National Transportation Systems Center of the U.S. Department of Transportation (Volpe). Volpe funds our contracts when, as, and if it and other sponsoring federal agencies approve a statement of work and specific task orders under the statement of work. When funded, we invoice the federal government monthly based on our direct costs, including overhead and general and administrative plus a fixed fee for that month and typically receive payment by electronic wire transfer within two weeks of invoicing. Certain costs, such as lobbying, product development, and business development expenses that are not allowable under these contracts, research and development costs we incur over certain cost caps set by the U.S. government, costs incurred while our contracts are not funded, or costs deemed unreasonable, and hence unrecoverable, by the government are not reimbursable under our government contracts and have been funded primarily by proceeds of our equity offerings. All of our government contracts and funding are subject to the requirements of the Federal Acquisition Regulations.

On September 25, 2005, we received our fourth successive contract from Volpe in the aggregate amount of approximately $9.9 million to continue research, development and testing of our SOCRATES® technology. The initial task order funding under this new contract provided approximately $1.7 million and was dated September 25, 2005. On January 27, 2006 we received our second task order under this new contract which provided approximately $1.4 million of new funding.



The federal budget for U.S. FY 2006 does not contain any further stipulated earmarks for testing and development of SOCRATES®-based technology. We are continuing to explore additional funding from potential sources in the NASA and/or U.S. DOT budgets for U.S. FY 2007 and beyond.

The table below represents the U.S. Government funding to date for our four SOCRATES® contracts.

| SOCRATES® Phase | Contract Number | Contract Funding | Period of Performance |
|---|---|---|---|
| I | DTRS-57-97-C-00042 | $3,019,355 | From June 1, 1997<br>To July 31, 1999 |
| II | DTRS-57-99-D-00074 | $6,062,948 | From August 27, 1999<br>To December 31, 2003 |
| III | DTRS-57-03-D-30024 | $7,634,616 | From November 1, 2003<br>To October 15, 2005 |
| IV | DTRT-57-05-D-30115<br>Task Order No: T0001 | $1,695,029 | From September 15, 2005<br>To Present |
| | DTRT-57-05-D-30115 | | From January 27, 2006 |

| | | | |
|---|---|---|---|
| Task Order No: T0002 | $1,409,025 | To | Present |
| Total contract funding to date | $19,820,973 | | |

Our ability to generate additional revenue under our Phase IV contract after we have expended the current task order funding of $1,409,025, which is expected to support the current level of effort through approximately July 31, 2006, is subject to further U.S. Government funding and the issuance of additional task orders. The Phase IV contract was awarded on Sept. 25, 2005 for $9,815,140 and can be funded with new task orders which generally require less administrative effort than a new contract award, if additional funding is available under this contract. We believe the federal government has indicated a long-term interest in the development of a wake vortex avoidance system and our SOCRATES® wake vortex sensor for potential inclusion in such a system. However, there is currently $0 for further Research and Development of SOCRATES® Technology or WVAS in the current federal budget for its fiscal year 2006 budget. We are pursuing other sources of funding but can make no assurances of whether or when we will obtain additional funding for SOCRATES®. Our inability to obtain or delay in contract funding from the federal government could delay achievement of our profitability, if any, create a substantial strain on our liquidity, resources and product development, and have a material adverse effect on the progress of our research and development and our financial condition.



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From June 1, 1997, to the present we have advanced the SOCRATES® concept through various research and development milestones and now have a (16) beam SOCRATES® sensor installed at Denver International Airport where we anticipate the sensor will undergo further testing. Our current contract Task Order No. T0002 statement of work includes system engineering and concept of operations for a functional emulation of a WVAS and preparation for additional field testing. During the next New Years Eve holiday period there was a break-in and vandalism at our SOCRATES® sensor test site at Denver International Airport. A number of items were stolen from the SOCRATES® sensor van as well as from the U.S. Department of Transportation Volpe trailer on site. Damage to SOCRATES® sensor optoelectronics also occurred as a result of fire retardant chemicals being sprayed by the perpetrators. We have insurance coverage for the damage but our test schedules have been delayed.

We also are pursuing development of an airborne collision and ground proximity warning system we refer to as UNICORN™. We believe that UNICORN™ may have application to unmanned air vehicles operated for a variety of private and governmental purposes. As of February 28, 2006 the cumulative research and development expense for UNICORN™ is approximately $1,270,000. During August 2005 we tested a UNICORN™ prototype antenna in a proof-of-principle test. The data collected from this test is currently being analyzed and we currently are reviewing and considering how best to proceed with assessing marketing and partnering opportunities for UNICORN™.

During the past fiscal year, we also began the exploratory development of a third major technology initiative called TIICM™ (Tactical Integrated Illuminating Countermeasure) in conjunction with Sanders Design International (SDI), a New Hampshire company. TIICM™ is intended to provide a low cost yet highly effective shield of protection for airliners against the threat of certain terrorist-launched missiles. In April 2004, we executed a ten year Teaming Agreement with SDI under which we would be the prime contractor on development of countermeasure technologies to protect aircraft from shoulder-fired missiles. As of February 28, 2006 our cumulative independent research and development expense for TIICM™ is approximately $495,000. We have entered into additional arrangements with SDI pursuant to which we have applied for a new patent on TIICM™ with SDI and would have joint ownership of any resulting patent. We have also been working on TIICM™ with Analogic Corporation located in Peabody, Massachusetts. Analogic had entered into a prior licensing arrangement with SDI. We are in discussions with

Analogic with regard to restructuring the business relationships between Analogic, SDI and Flight Safety Technologies, Inc. There can be no assurance that these discussions will result in a successful restructuring. In the Department of Homeland Security budget for U.S. Fiscal Year 2006, Congress added $10 Million for the investigation of emerging technology for the protection of civil aircraft against terrorist missile threats. We expect that there may be an opportunity to compete for a portion of these funds in the third to fourth quarter of calendar 2006. There can be no assurance that any new patents on TIICM™ will be issued, or that we will derive any revenue or profit from TIICM™, nor any expectation that we will receive any government or commercial funding for TIICM™.



We have experienced significant losses since our inception. The loss for the nine months ended February 28, 2006 was $1,248,162. Losses for our two fiscal years ending May 31, 2005 and 2004 were $1,411,644 and $424,214, respectively. The net loss for our fiscal year ended May 31, 2004 was caused primarily by two factors: (1) rate ceilings during the first six months, and (2) unallowable expenses under our government contract. The loss for the fiscal year ending May 31, 2005 was caused by: (1) unallowable expenses, (2) expenses during a partially unfunded period, and (3) unrecoverable expenses. The loss for the nine months ended February 28, 2006 were caused by (1) unallowable expenses, (2) unrecoverable expenses, and (3) corporate research and development expenses. The unrecoverable expense category represents general and administrative expenses, primarily legal expenses and independent research and development expense which we believe are necessary but are significantly higher compared to prior years and may be considered unreasonable by the Defense Contract Audit Agency for a company our size.

Our Phase III and Phase IV government contracts do not include rate ceilings. If the government deems our allowable expenses to be reasonable, of which there can be no assurance, the absence of rate ceilings should eliminate or reduce a significant source of losses in previous years. We will continue to incur certain unallowable expenses or allowable expenses the government deems unreasonable. We also remain subject to the risk of further delay, reduction or elimination in federal contract funding. However, it is our view that the elimination of rate ceilings is a significant improvement to our historical contract terms.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based on our financial statements that have been prepared according to accounting principles generally accepted in the United States of America. In preparing these financial statements, we are required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. We evaluate these estimates on an on-going basis. We base these estimates on historical experiences and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. Our management has discussed these estimates and assumptions with our finance and audit committee. At this point in our operations, subjective judgments do not have a material impact on our financial statements except as discussed in the next paragraph.

Federal Acquisitions Regulations require that, among other things, our reimbursable costs are reasonable. We have analyzed our actual overhead rate and general administrative rate for the nine months ended February 28, 2006. We believe all component costs have been ordinary and necessary but that government auditors may consider our

independent research and development expense for UNICORN™ technology, as of the nine months ended February 28, 2006



unreasonable for a company our size. For rate setting purposes, we have excluded $430,000 for potential unrecoverable research and development and certain other general and administrative expenses for the nine months ending February 28, 2006. Since there is a degree of subjectivity in the judgment of what levels of cost are reasonable, we can make no assurance that the government will not require further adjustments.

Our financial statements and notes thereto include an item for "Other Receivables" that is described therein. Other receivables includes recoverable rate differences resulting from the difference between the current general and administrative rate compared to our provisional rate, which has created a difference of $124,519 as of February 28, 2006. We believe that this current difference is a timing issue and expect it to be $0 by the end of our fiscal year 2006.

As of the end of our fiscal year May 31, 2005 there was $291,000 in other receivable for recoverable rate difference. During our second quarter ended November 30, 2005 $214,326 was billed to the government. The balance of the rate difference of $76,674 was received from funds remaining in our third contract after the contract was completed. We have received full payment from the government for the $291,000 of previously reported other receivable.

Results of Operations

For the three and nine months ended February 28, 2006 and February 28, 2005.

Revenues

. To date, our revenues have consisted almost entirely of revenues earned from our four successive SOCRATES® wake vortex sensor research and development contracts with the federal government.

Contract revenue for the three and nine months ended February 28, 2006 were $914,268 and $3,652,238, respectively, compared to $631,197 and $2,505,138, respectively, for the three and nine months ended February 28, 2005. The $1,147,100 increase for the nine months ended February 28, 2006 compared to the same period of the prior year was due to the increased subcontractor, direct labor and consultant cost to test the 16 beam SOCRATES® system during the three months ended November 30, 2005 at Denver International Airport.

Costs of Revenues

. Subcontractor, consultant and direct labor expenses comprise our costs of revenues. Costs of revenue for the three and nine months ended February 28, 2006 were $469,332 and $2,171,700 or 51.3% and 59.5% respectively, compared to $370,154 and $1,673,542 or 58.6% and 66.8% respectively for the three and nine month periods ending February 28, 2005. The increase in cost of revenues is primarily due to increased cost to test the 16 beam SOCRATES® system in September and October 2005 at Denver International Airport. The decrease in the percent to revenue for the three and nine months ended February 28, 2006 compared to the same periods ended February 28, 2005 is primarily due to decreased subcontractor and consultant expenses.

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When our government contract is funded, charges to direct costs do not generally negatively impact our operating results because each contract covers its own direct costs. However, during periods when our government contract is not funded or if the actual direct cost of a specific task order exceeds its budgeted funding and the government is not willing to reallocate direct costs between task orders, any such costs we may incur are not reimbursable and must be funded from our own resources.

Research and Development

. Our research and development expense for the three and nine months ended February 28, 2006 were $175,018 and $853,198 respectively, compared to $163,661 and $348,308 for the three and nine month period ended February 28, 2005. The increase in research and development expenses of $504,889 for the nine months was primarily due to the increase of approximately $435,000 for project TIICM™ (Tactical Integrated Illumination Countermeasure) compared to $0 for the nine months ended February 28, 2005. The balance of the increase of approximately $70,000 is due to increased cost for testing our UNICORN prototype system in August 2005.

*Operating Expenses*. Government contractors are required to categorize operating expenses as overhead expenses or general and administrative expenses. These two indirect "cost pools" are then divided by their appropriate "direct cost base" combinations of direct contract cost, which determines the contractors overhead and general and administrative rates. These rates, for our first two government contracts, were subject to ceilings.

Our third and fourth contracts are not limited by rate ceilings. Instead, we submit our proposal for provisional billing rates to the government for approval. Provisional rates are based on forecasted allowable direct and indirect costs. As part of the audit procedure by the D.C.A.A. proposed and actual expenses for each fiscal year are reviewed for allowability and reasonableness in accordance with the Federal Acquisitions Regulations (FAR). On October 31, 2005 our provisional rates for fiscal year ending May 31, 2006 were audited and approved by the defense contract audit agency (D.C.A.A.) and the DOT/VOLPE Center. In addition, our actual rates based on actual allowable costs incurred, for our fiscal year ended May 31, 2005 were also approved.

Our un-reimbursable non-contract costs include: 1) expenses considered unallowable per Federal Acquisition Regulations (FAR), such as lobbying, stock based compensation and company car expense, 2) over ceiling expenses, 3) expenses incurred during periods without government contracto., Ltd., Asia Pacific Telecom Co. Ltd., Taiwan Star Cellular Corporation, Ambit Microsystems Corporation and us. The 4G license is valid until the end of year 2030. Furthermore, according to the press release announced by the NCC on March 31, 2014, the ROC government plans to release the 2600MHz spectrum band for 4G mobile services through a bidding process. We plan to participate in the bidding process to acquire the spectrum band in order to remain competitive. If we are unable to successfully maintain the rights to use the frequency spectrum that we need for our future business operations, our business prospects and future results of operations may be adversely affected, and as a result may lead to a material impact on our business revenues.

***Increasing market competition may adversely affect our growth and profitability by causing us to lose customers, charge lower tariffs or spend more on marketing.***

Mobile service providers in Taiwan have been offering 3G mobile services for several years. Smart phones with mobile data packages have become popular in recent years. To attract more mobile data users, the major three mobile operators, including us, have adopted comparable promotion packages to attract and maintain customers. Apart from the 3G services, we also aim to begin providing 4G services in July 2014. There are a total of six players in Taiwan that are nominated to provide 4G services, which may increase the level of competition in the 4G services market compared to the 3G services market. We cannot assure you that the intensified market competition will not affect our growth and profitability.

We also face increased broadband competition from cable operators. Cable operators have been using low-priced internet access packages to attract new customers in specific areas and buildings in Taiwan. They have also been upgrading their networks to DOCSIS 3.0 in order to provide higher speed internet access. DOCSIS refers to Data Over Cable Service Interface Specification, which is an international telecommunications standard that permits the addition of high-speed data transfer to an existing cable TV system. To counter these developments, we keep migrating more of our ADSL customers to FTTx services and to provide even higher speed fiber to the home, or FTTH access. The government has mandated the digitization of cable television networks by 2014. In addition, the NCC relaxed the zoning restrictions on service areas for cable operators on July 27, 2012, while cable operators remain subject to the restriction that the market share of any single cable operator cannot exceed 33%. This change will allow cable operators to provide digital cable services throughout Taiwan, including high definition cable TV with more channels as well as high speed cable modem services. As of now, it is still uncertain whether we will be deemed a cable operator and subject to the 33% market share restriction. As a result, we could face increased competition for our broadband access services and multimedia on demand, or MOD, IPTV services. If we are unable to compete successfully with the cable operators for broadband access services and MOD businesses, our results of operations could be impacted.

Many of our competitors are in alliances with leading international telecommunications service providers and have access to financial and other resources or technologies that may not be available to us. Moreover, if the government continues to liberalize the telecommunications market, such as through the issuance of new licenses or establishment of additional networks, our market position and competitiveness could be materially and adversely affected. We cannot guarantee that our measures to address competition will be effective, and therefore our business, financial condition and results of operations may be adversely affected by our competition.

Increasing competition may also cause the rate of our customer growth to reverse or decline, bring about further decreases in tariff rates and necessitate increases in our selling and promotional expenses. Any of these developments could adversely affect our business, financial condition and results of operations.

***Our ability to deliver services may be disrupted due to a systems failure, shutdown in our networks, earthquakes or other natural disasters.***

Taiwan is susceptible to earthquakes and typhoons. However, we do not carry insurance to cover damage caused by earthquakes, typhoons or other natural disasters or any resulting business interruption. Our services are

currently carried through our fixed and mobile communications networks, as well as through our transmission networks consisting of optical fiber cable, microwave, submarine cable and satellite transmission links, which could be vulnerable to damage or interruptions in operations due to natural disasters. For example, in 2013, losses on property, plant and equipment arising from natural disasters such as earthquakes and typhoons were approximately NT$5.3 million (US$0.2 million) as recorded in other income and expenses. The occurrence of natural disasters could impact our ability to deliver services and have a negative effect on our results of operations. Furthermore, we might also be liable for losses claimed from our customers that were incurred from our failure to deliver our services. These potential liabilities could also have a material adverse effect on our results of operations.

***We are subject to litigation that could expose us to substantial liabilities.***

We are from time to time involved in litigation, arbitration or administrative proceedings in the ordinary course of our business. See Item 4. Information on the Company B. Business Overview Legal Proceedings .

We cannot predict the outcome of these proceedings, and we cannot assure you that if a judgment is rendered against us in any or all of these proceedings, our financial condition and results of operations would not be materially and adversely affected.

***We depend on select personnel and could be affected by the loss of their services.***

We depend on the continued service of our executive officers and skilled technical and other personnel. Our business could suffer if we lose the services of any of these personnel and cannot adequately replace them. In particular, we are not insured against the loss of any of our personnel. We may not be able to retain our present personnel or attract additional qualified personnel as and when needed. Moreover, we may be required to increase substantially the number of these employees in connection with any expansion, and there is intense competition for experienced personnel in the Taiwan telecommunications industry. The major three mobile network operators in Taiwan, including us, are expanding their retail stores and may increase the number of their employees as part of this expansion. We cannot assure you that we will be able to successfully attract and retain new employees for the expansion of our retail stores. In addition, we may need to increase employee compensation levels in order to attract and retain personnel. We cannot assure you that the loss of the services of any of these personnel would not disrupt our business and operations and materially and adversely affect the quality of our services and harm our reputation.

***We may not realize the benefits we expect from our investments, and this may materially and adversely affect our business, financial condition, results of operations and prospects.***

We have made significant capital investments in our network infrastructure and information technology systems to provide the services we offer. In 2013, we made capital expenditures in our domestic fixed communications of NT$20.4 billion (US$682.6 million), our mobile communications business of NT$9.2 billion (US$309.9 million), our internet business of NT$4.6 billion (US$154.9 million), our international fixed communications business of NT$1.6 billion (US$52.3 million) and our other businesses of NT$0.6 billion (US$19.9 million), respectively. In order to continue to develop our business and offer new and more sophisticated services, we intend to continue to invest in these areas as well as new technologies. The launch of new and commercially viable products and services is important to the success of our business. We expect to continue making substantial capital expenditures to further develop our range of services and products. Commercial acceptance by consumers of the new and more sophisticated services we offer may not occur at the rate or level expected, and we may not be able to successfully adapt these services to effectively and economically meet our customers demand, thus impairing expected return from our investments.

We cannot assure you that services enabled by the new technologies we are implementing, such as Heterogeneous or Marco/Micro/Pico/Femto/BBU+RRH mobile technology, will be accepted by the public to the

extent required to generate an acceptable rate of return. In addition, we could face the risk of unforeseen complications in the deployment of these new services and technologies, and we cannot assure you that we will not exceed our estimate of the necessary capital expenditure to offer such services. New services and technologies may not be developed and/or deployed according to expected schedules or may not achieve commercial acceptance or be cost effective. The failure of any of our services to achieve commercial acceptance could result in additional capital expenditures or a reduction in profitability to the extent we are required under applicable accounting standards to recognize a charge for impairment of assets. Any such charge could materially and adversely affect our financial condition and results of operations.

In 2012, we determined that parts of our investment properties were impaired and recognized an impairment loss of NT$1,261 million. In 2013, based on the evaluation of fair value, some impaired investment properties were recoverable, and we reversed the impairment losses of NT$246 million (US$8.2 million). In 2013, we also recognized impairment losses of NT$254 million (US$8.5 million) and NT$18 million (US$0.6 million) for telecommunication and miscellaneous equipment and intangible assets, respectively.

We cannot assure you that we will be able to continue to maintain control of and consolidate the results of operations of our minority-owned subsidiary. For example, we consolidate the results of operations of our subsidiary, Senao International Co., Ltd., or Senao, because we have secured four out of seven seats on the board of directors of Senao through the support of large beneficial shareholders of Senao. Please refer to note 3 and note 15 of our consolidated financial statements included elsewhere in this annual report for details of the relationship between Senao and its parent companies. We cannot assure you that we will be able to continue maintaining control over the board of directors of Senao. If we lose control of our minority-owned subsidiary, we will no longer be able to consolidate the results of operations of such subsidiary, which could adversely affect our consolidated results of operations and ability to meet the operating results guidance that we have projected.

We may also from time to time make equity investments in companies, but we cannot assure you of their profitability. We cannot assure you that losses related to our equity investments will not have a material adverse effect on our financial condition or results of operations. In 2013, we evaluated and concluded that certain investments were impaired, and as a result we recognized an impairment loss of NT$66 million (US$2.2 million) for available-for-sale financial assets due to the decline in fair value owing to adverse changes in industry conditions and operating performance that were below expectations. We may be required to record additional impairment charges in future periods, which may have a material adverse effect on our financial condition and future results of operations.

***Changes in technology may render our current technologies obsolete or require us to obtain licenses for introducing new services or make substantial capital investments, financing for which may not be available to us on favorable commercial terms or at all.***

The Taiwan telecommunications industry has been characterized by rapid increases in the diversity and sophistication of the technologies and services offered. As a result, we expect that we will need to constantly upgrade our telecommunications technologies and services in order to respond to competitive industry conditions and customer requirements. Developments of new technologies have rendered some less advanced technologies unpopular or obsolete. If we fail to develop, or obtain timely access to, new technologies and equipment, or if we fail to obtain the necessary licenses to provide services using these new technologies, we may lose our customers and market share and become less profitable.

In addition, the cost of implementing new technologies, upgrading our networks or expanding capacity could be significant. In particular, we have made and will continue to make substantial capital expenditures in the near future in order to effectively respond to technological changes, such as the continued expansion of our fiber optic networks and

High Speed Packet Access, or HSPA, and HSPA+, and Dual carrier HSPA+ mobile network. Furthermore, the spectrum to operate 4G mobile services was awarded on October 30, 2013. Therefore, we will devote additional capital expenditure to build our 4G mobile services network based on Long Term Evolution, or

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LTE, technology. In addition, to meet the increasingly robust high-bandwidth requirements of digital convergence services, we will expand construction of fiber optic networks, including passive optical networks, or PONs, and optical distribution networks, or ODNs. To the extent these expenditures exceed our cash resources, we will be required to seek additional debt or equity financing. Our ability to obtain additional financing on favorable commercial terms will depend on a number of factors. These factors include our financial condition, results of operations, cash flows and the prevailing market conditions in the domestic and international telecommunications industry, the cost of financing and conditions in the financial markets, and the issuance of relevant government and other regulatory approvals. Any inability to obtain funding for our capital expenditures on commercially acceptable terms could jeopardize our expansion plans and materially and adversely affect our business prospects and future results of operations.

***If new technologies adopted by us do not perform as expected, or if we are unable to effectively deliver new services based on these technologies in a commercially viable manner, our revenue growth and profitability will decline.***

We are constantly evaluating new growth opportunities in the broader telecommunications industry. Some of these opportunities involve new services for which there are no proven markets, and may not develop as expected. Our ability to deploy and deliver these services will depend, in many instances, on new but unproven technologies. These new technologies may not perform as expected or generate an acceptable rate of return. In addition, we may not be able to successfully develop new technologies to effectively and economically deliver these services, or be able to compete successfully in the delivery of telecommunications services based on new technologies. Furthermore, the success of our mobile data services is substantially dependent on the availability of mobile data applications and devices that are being developed by third-party developers. These applications or devices may not be sufficiently developed to support the deployment of our mobile data services. If we are unable to deliver commercially viable services based on the new technologies that we adopt, our financial condition and results of operations may be materially and adversely affected.

***As an internet service provider, we may not be able to protect our customers and their information from cyber attacks, nor protect our services from disruptions due to cyber security breaches.***

As an internet service provider, our system is susceptible to cyber security risks, including hijack attacks, phishing attacks, hacker s intrusions to steal customer s information and distributed denial-of-service (DDoS) attacks. Our online services such as e-bills and multiple payment options through the internet are also vulnerable to cyber attacks. These attacks may disrupt our services and cause leakage of our customers personal information, which may result in significant damage and material adverse effect to our customers and our operations. We cannot assure you that our data protection measures are sufficient to prevent any data leakage or disruption of our service due to cyber attacks. We may suffer negative consequences, such as remedial costs, increased cyber security protection costs, lost revenues, litigation and reputational damage due to cyber attacks.

***Our largest stockholder may take actions that conflict with our public stockholders best interests.***

As of December 31, 2013, our largest shareholder, the government of the Republic of China, through the Ministry of Transportation and Communications, owned approximately 35.29% of our outstanding common shares. Accordingly, the government, through its control over our board, as all non-independent board members were appointed by the Ministry of Transportation and Communications, may continue to have the ability to control our business, including matters relating to:

any sale of all or substantially all of our assets;

the approval of our annual operation and projects budget;

the composition of our senior management;

the timing and distribution of dividends;

the election of a majority of our directors; and

our business activities and direction.

We cannot assure you that our largest shareholder will not take actions that impair our ability to conduct our business competitively or conflict with the best interests of our public stockholders.

***Actual or perceived health risks related to mobile handsets and base stations could lead to decreased mobile service usage and difficulties in increasing network coverage and could expose us to potential liability.***

According to some published reports, the electromagnetic signals from mobile handsets and cellular base stations may pose health risks or interfere with the operation of electronic equipment. Although the findings of those reports are disputed, actual or perceived risks of using mobile communications devices or of cellular base stations could have a material adverse effect on mobile service providers, including us. For example, our customer base could be reduced, our customers may reduce their usage of our mobile services, we could encounter difficulties in obtaining sites for additional cellular base stations required to expand our network coverage or we may be requested to reduce the number of existing cellular base stations. As a result, our mobile services business may generate less revenue and our financial condition and results of operations may be materially and adversely affected. In addition, we could be exposed to potential liability for any health problems caused by mobile handsets and base stations.

***Investor confidence in us may be adversely impacted if we or our independent registered public accountants are unable to attest to or express an unqualified opinion on the effectiveness of our internal control over financial reporting.***

We are subject to the reporting requirements of the SEC. The SEC, as directed by Section 404 of the U.S. Sarbanes-Oxley Act of 2002, adopted rules requiring U.S. public companies to include a report of management on our internal control over financial reporting in their annual reports that contain an assessment by management of the effectiveness of our internal control over financial reporting. The effectiveness of our internal control over financial reporting has been audited by Deloitte & Touche, an independent registered public accounting firm, which has also audited our consolidated financial statements for the year ended December 31, 2013. Deloitte & Touche has issued an attestation report on the effectiveness of our internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). See Item 15. Controls and Procedures Attestation Report of the Registered Public Accounting Firm .

While the management report included in this annual report concluded that our internal control over financial reporting was effective, we cannot assure you that our management will be able to conclude that our internal control over financial reporting is effective in future years. If in future years we fail to maintain effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act, we could suffer a loss of investor confidence in the reliability of our consolidated financial statements, which in turn could negatively impact the trading price of our ADSs, and could result in lawsuits being filed against us by our stockholders or otherwise harm our reputation.

***If we fail to maintain a good relationship with our labor union, work stoppages or labor unrest could occur and the quality of our services as well as our reputation could suffer.***

In accordance with the articles of association of Chunghwa Telecom Workers Union, besides the chief manager of each department, most of our employees are members of our principal labor union, the Chunghwa Telecom Workers Union. Since our incorporation in 1996, we have experienced disputes with our labor union on such issues as employee benefits and retirement benefits in connection with our privatization as well as the right to protest. Despite

having taken measures to improve relations, increase cooperation and ensure mutual benefit with our labor union, such as increasing channels of communications by holding periodic labor resource

review meetings and guaranteeing a labor union seat on our board of directors, we cannot assure you that we will be able to maintain a good relationship with our labor union. Any deterioration in our relationship with our labor union could result in work stoppages, strikes or threats to take such an action, which could disrupt our business and operations, materially and adversely affect the quality of our services and harm our reputation.

***Any further economic downturn or decline in the growth of the population in Taiwan may materially and adversely affect our financial condition, results of operations and prospects.***

We conduct most of our operations and generate most of our revenues in Taiwan. As a result, any decline in the Taiwan economy or a decline in the growth of the population in Taiwan may materially and adversely affect our financial condition, results of operations and prospects. For example, the global slowdown in technology expenditures has from time to time adversely affected the Taiwan economy, which is highly dependent on the technology industry. There is considerable uncertainty over the long-term effects of the expansionary monetary and fiscal policies that have been adopted by the central banks and financial authorities of some of the world s leading economies. There have also been concerns over unrest in the Middle East, Africa and Ukraine, which has resulted in higher oil prices and significant market volatility.

As our business is significantly dependent on economic growth, any uncertainty or further deterioration in economic conditions could have a material adverse effect on our financial condition and results of operations. We cannot assure you that economic conditions in Taiwan will continue to improve in the future or that our business and operations will not be materially and adversely affected by deterioration in the Taiwan economy.

***We face substantial political risks associated with doing business in Taiwan, particularly due to domestic political events and the tense relationship between the Republic of China and the People s Republic of China, which could adversely affect our financial condition and results of operations.***

Our principal executive offices and substantially all of our assets are located in Taiwan, and substantially all of our revenues are derived from our operations in Taiwan. Accordingly, our business, financial condition and results of operations and the market price of our common shares and the ADSs may be affected by changes in Republic of China governmental policies, taxation, inflation or interest rates and by social instability and diplomatic and social developments in or affecting Taiwan which are outside of our control. Taiwan has a unique international political status. Since 1949, Taiwan and the Chinese mainland have been separately governed. The People s Republic of China, or PRC, claims that it is the sole government in China and that Taiwan is part of China. Although significant economic and cultural relations have been established between the Republic of China and the PRC, such as the engagement of the Economic Cooperation Framework Agreement, or ECFA, in 2010, relations may become strained again. In June 2013, the ROC government and the PRC government entered into the Cross-Strait Agreement on Trade in Services pursuant to the ECFA. According to this agreement, both parties agreed to certain concessions on the telecommunication industries. As of March 31, 2014, the Cross-Strait Agreement on Trade in Services has not yet been ratified by the Legislation Yuan of Taiwan. If the agreement is unable to be ratified by the Legislation Yuan, our business operations in the PRC and our results of operation may be adversely affected. In addition, the PRC government has refused to renounce the use of military force to gain control over Taiwan. Past developments in relations between the Republic of China and the PRC have on occasion depressed the market prices of the securities of companies in the Republic of China. Relations between the Republic of China and the PRC and other factors affecting military, political or economic conditions in Taiwan could materially and adversely affect our financial condition and results of operations, as well as the market price and the liquidity of our securities. In addition, the complexities of the relationship between the ROC and PRC require companies involved in cross-strait business operations to carefully monitor their actions and manage their relationships with both ROC and PRC governments. In the past, companies in the ROC, including us, have received minor sanctions such as travel restrictions or minor monetary fines by the ROC

and/or PRC governments. We cannot assure you that we will be able to successfully manage our relationships with the ROC and PRC governments for our cross-strait business operations, which could have an adverse effect on our ability to expand our business and conduct cross-strait business operations.

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***Any future outbreak of contagious diseases may materially and adversely affect our business and operations, as well as our financial condition and results of operations.***

Any future outbreak of contagious diseases, such as severe acute respiratory syndrome or avian influenza, may disrupt our ability to adequately staff our business and may generally disrupt our operations. If any of our employees is suspected of having contracted any contagious disease, we may under certain circumstances be required to quarantine such employees and the affected areas of our premises. As a result, we may have to temporarily suspend part or all of our operations. Furthermore, any future outbreak may restrict the level of economic activity in affected regions, including Taiwan, which may adversely affect our business and prospects. As a result, we cannot assure you that any future outbreak of contagious diseases would not have a material adverse effect on our financial condition and results of operations.

***Stockholders may have more difficulty protecting their interests under the laws of the Republic of China than they would under the laws of the United States.***

Our corporate affairs are governed by our articles of incorporation, the Telecommunications Act, and by the laws governing corporations incorporated in the Republic of China. In addition, our corporate affairs may remain governed by the Statute of Chunghwa Telecom Co., Ltd. See Extensive regulation of our industry may limit our flexibility to respond to market conditions and competition, and our business may suffer . The rights of stockholders and the responsibilities of management and the members of the board of directors of Taiwan companies are different from those applicable to a corporation incorporated in the United States. For example, controlling or major stockholders of Taiwan companies do not owe fiduciary duties to minority stockholders. As a result, holders of our common shares and ADSs may have more difficulties in protecting their interests in connection with actions taken by our management or members of our board of directors than they would as public stockholders of a United States corporation.

***Our actual financial results may differ materially from our published guidance.***

Prior to 2013, we used to voluntarily publish our operating results guidance on an annual basis in accordance with ROC GAAP. Beginning in 2013, we continued to voluntarily publish our operating results guidance on an annual basis in accordance with Taiwan IFRSs. We may from time to time update our operating results guidance after evaluating the effects of any changes to the estimates and assumptions that we used to calculate our projections of our operating results. Our projections are based on a number of estimates and assumptions that are inherently subject to significant uncertainties and contingencies, including the risk factors described in this annual report. In particular, our projections are forward-looking statements that are necessarily speculative in nature, and it can be expected that one or more of the estimates on which the projections were based will not materialize or will vary significantly from actual results, and such variances will likely increase over time.

***Our results of operations and financial condition upon the adoption of Taiwan IFRSs may differ materially from our reported results of operations and financial condition under IFRSs.***

We have historically presented our consolidated financial statements, including our consolidated financial statements for the year ended December 31, 2012, in accordance with ROC GAAP for purposes of our filings with the TWSE, with reconciliation of net income and balance sheet differences of our consolidated financial statements to U.S. GAAP for certain filings with the SEC. Effective January 1, 2013, companies listed on the TWSE, including us, must report their financial statements under Taiwan IFRSs. Accordingly, we have adopted Taiwan IFRSs for reporting in the ROC our annual consolidated financial statements beginning in 2013 and our interim quarterly unaudited consolidated financial statements beginning in the first quarter of 2013. While we have adopted Taiwan IFRSs for ROC reporting purposes, we adopt IFRSs for certain filings with the SEC, including our annual reports on Form 20-F for the year

ended December 31, 2013 and thereafter. Following our adoption of IFRSs for the SEC filing purposes, we are no longer required to provide any reconciliation of our

consolidated financial statements with U.S. GAAP. For more details, see Item 3. Key Information A. Selected Financial Data for the description about the adoption of new financial reporting standards.

Taiwan IFRSs differs from IFRSs in certain significant respects, including to the extent that any new or amended standards or interpretations applicable under IFRSs may not be timely endorsed by the FSC. Furthermore, the dividends for 2013 that are expected to be declared at our 2014 annual general stockholders meeting will be calculated based on Taiwan IFRSs. It is difficult for us to evaluate the precise impact of the adoption of Taiwan IFRSs and IFRSs on our financial statements, because the FSC may issue new rules governing the adoption of Taiwan IFRSs and as other laws and regulations may be amended with the adoption of Taiwan IFRSs.

**Risks Relating to Ownership of Our ADSs and Common Shares**

***The value of your investment may be reduced by future sales of our ADSs or common shares by us, by the government of the Republic of China or by other stockholders.***

The government may continue to sell our common shares. Sales of substantial amounts of ADSs or common shares by the government or any other stockholder in the public market, or the perception that future sales may occur, could depress the prevailing market price of our ADSs and common shares.

***The market value of your investment may fluctuate due to the volatility of, and government intervention in, the Taiwan securities market.***

Our common shares are traded on the Taiwan Stock Exchange, or TWSE, which has a smaller market capitalization and is more volatile than the securities markets in the United States and many European countries. The market value of our ADSs may fluctuate in response to the fluctuation of the trading price of our common shares on the TWSE. The TWSE has experienced substantial fluctuations in the prices and trading volumes of listed securities, and there are currently limits on the range of daily price movements. During 2013, the TWSE Index peaked at 8,623.43 on December 30, 2013, and reached a low of 7,616.64 on January 17, 2013. On April 21, 2014, the TWSE Index closed at 8,951.19. The TWSE has experienced certain problems, including market manipulation, insider trading and payment defaults. The recurrence of these or similar problems could have a material adverse effect on the market price and liquidity of the securities of Taiwan companies, including our ADSs and common shares, in both the domestic and the international markets.

In response to declines and volatility in the securities markets in Taiwan, the government of the Republic of China formed the National Financial Stabilization Fund to support these markets through open market purchases of shares in Taiwan companies from time to time. The details of the transactions of the National Financial Stabilization Fund have not been made public. In addition, the government s Labor Insurance Fund and other funds associated with the government have in the past purchased, and may from time to time purchase, shares of Taiwan companies listed on the TWSE or other markets. As a result of these activities, the market price of common shares of Taiwan companies may have been and may currently be higher than the prices that would otherwise prevail in the open market. Market intervention by government entities, or the perception that such activity is taking place, may take place or has ceased, may cause sudden movements in the market prices of the securities of Taiwan companies, which may affect the market price and liquidity of our common shares and ADSs.

***We may be sanctioned or lose our licenses for violations of limits on foreign ownership of our common shares, and these limits may materially and adversely affect our ability to obtain financing.***

The laws of the Republic of China limit foreign ownership of our common shares. Prior to March 1, 2006, the Ministry of Transportation and Communications, as the competent authority under the Telecommunications Act, had the power to prescribe the limits on foreign ownership of our common shares. After the formation of the NCC on March 1, 2006, the NCC replaced the Ministry of Transportation and Communications as the competent

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authority under the Telecommunications Act pursuant to the National Communications commission Organization Law, or the Organization Law. The NCC and the Ministry of Transportation and Communications reached an agreement on foreign ownership of Chunghwa Telecom. An announcement issued by the Ministry of Transportation and Communications on December 28, 2007 stipulated that direct holdings by foreign investors in Chunghwa Telecom cannot exceed 49% of our outstanding share capital and the total direct and indirect holdings by foreign investors cannot exceed 55% of our outstanding share capital. As of April 21, 2014, foreign direct holdings of our outstanding share capital is at 14.66%. If we fail to comply with the applicable foreign ownership limitations, our licenses to operate some of our businesses could be revoked. Moreover, we cannot predict the manner in which the NCC will exercise its authority over us, or whether NCC will lower the foreign ownership cap at any time.

If we are deemed to be in violation of our foreign ownership limitations, any consequences arising from such violation may materially and adversely affect us. Moreover, since we are unable to control ownership of our common shares or ADSs representing our common shares, and because we have no ability to stop transfers among stockholders, or force particular stockholders to sell their shares, we may be subject to monetary fine or lose our licenses through no fault of our own. In that event, our business could be disrupted, our reputation could be damaged and the market price of our ADSs and common shares could decline. These limitations may also materially and adversely affect our ability to obtain adequate financing to fund our future capital requirements or to obtain strategic partners, and alternate forms of financing may not be available on terms favorable to us or at all.

***Restrictions on the ability to deposit our common shares into our ADS program may adversely affect the liquidity and price of the ADSs.***

The ability to deposit shares into our ADS program is restricted by Republic of China law, under which no person or entity, including you and us, may deposit our common shares into our ADS program unless the Securities and Futures Bureau has not objected within a prescribed period following the filing with it of an application to do so, except for the deposit of the common shares into our ADS program and for the issuance of additional ADSs in connection with:

- distribution of share dividends or free distribution of our common shares;

- exercise of preemptive rights of ADS holders applicable to the common shares evidenced by our ADSs in the event of capital increases for cash; or

- purchases of our common shares in the domestic market in Taiwan by the investor directly or through the depositary and delivery of such shares or delivery of our common shares held by such investors to the custodian for deposit into our ADS program, subject to the following conditions: (a) the depositary may accept deposit of those shares and issue the corresponding number of ADSs with regard to such deposits only if the total number of ADSs outstanding after the deposit does not exceed the number of ADSs previously approved by the Securities and Futures Bureau, plus any ADSs issued pursuant to the events described above; and (b) this deposit may only be made to the extent previously issued ADSs have been cancelled.

As a result of the limited ability to deposit common shares into our ADS program, the prevailing market price of our ADSs on the New York Stock Exchange may differ from the prevailing market price of the equivalent number of our common shares on the TWSE.

***You will be more restricted in your ability to exercise voting rights than the holders of our common shares, which may diminish your influence over our corporate affairs and may reduce the value of your ADSs.***

Holders of American depositary receipts evidencing our ADSs may exercise voting rights with respect to the common shares represented by these ADSs only in accordance with the provisions of our deposit agreement. The

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deposit agreement provides that, upon receipt of notice of any meeting of holders of our common shares, the depositary bank will, as soon as practicable thereafter if requested by us in writing, mail to ADS holders the notice of the meeting sent by us, voting instruction forms and a statement as to the manner in which instructions may be given by the holders.

Generally, ADS holders will not be able to exercise voting rights attached to the underlying securities on an individual basis. Under the deposit agreement, the voting rights attached to the underlying securities must be exercised as to all matters subject to a vote of stockholders collectively in the same manner, except in the case of an election of directors. The election of our directors is by means of cumulative voting. In the event the depositary does not receive voting instructions from ADS holders in accordance with the deposit agreement, our chairman or his or her designee will be entitled to vote the common shares represented by the ADSs in the manner he or she deems appropriate at his or her discretion, which may not be in your interest.

***Your right to participate in any future rights offerings may be limited, which may cause dilution to your holdings.***

We may from time to time distribute rights to our stockholders, including rights to acquire our securities. Under the deposit agreement, the depositary will not offer you those rights unless the distribution to ADS holders of both the rights and any related securities are either registered under the U.S. Securities Act of 1933, as amended, or the Securities Act, or exempt from registration under the Securities Act. We are under no obligation to file a registration statement with respect to any such rights or securities or to endeavor to cause such a registration statement to be declared effective. Moreover, we may not be able to establish an exemption from registration under the Securities Act. Accordingly, you may be unable to participate in our rights offerings and may experience dilution in your holdings.

If the depositary is unable to sell rights that are not exercised or not distributed or if the sale is not lawful or reasonably practicable, it will allow the rights to lapse, in which case you will receive no value for these rights.

***Changes in exchange controls that restrict your ability to convert proceeds received from your ownership of ADSs may have an adverse effect on the value of your investment.***

Your ability to convert proceeds received from your ownership of ADSs depends on existing and future exchange control regulations of the Republic of China. Under the current laws of the Republic of China, an ADS holder or the depositary, without obtaining further approvals from the Central Bank of the Republic of China (Taiwan) or any other governmental authority or agency of the Republic of China, may convert NT dollars into other currencies, including U.S. dollars, in respect of:

- the proceeds of the sale of common shares represented by ADSs or received as share dividends with respect to the common shares and deposited into the depositary receipt facility; and
- any cash dividends or distributions received from the common shares represented by ADSs.

In addition, the depositary may also convert into NT dollars incoming payments for purchases of common shares for deposit in the depositary receipt facility against the creation of additional ADSs. If you withdraw the common shares underlying your ADSs and become a holder of our common shares, you may convert into NT dollars subscription payments for rights offerings. The depositary may be required to obtain foreign exchange approval from the Central Bank of the Republic of China (Taiwan) on a payment-by-payment basis for conversion from NT dollars into foreign currencies of the proceeds from the sale of subscription rights of new common shares. Although it is expected that the

Central Bank of the Republic of China (Taiwan) will grant approval as a routine matter, required approvals may not be obtained in a timely manner, or at all.

Under the Republic of China Foreign Exchange Control Law, the Executive Yuan of the Republic of China may, without prior notice but subject to subsequent legislative approval rendered within ten days from such

imposition, impose foreign exchange controls or other restrictions in the event of, among other things, a material change in domestic or international economic conditions which might threaten the stability of the domestic economy in Taiwan.

***You are required to register with the Taiwan Stock Exchange and appoint several local agents in Taiwan if you withdraw common shares from our ADS facility and become our stockholder, which may make your ownership burdensome.***

If you are a non-Republic of China person and wish to withdraw common shares represented by your ADSs from our ADS facility and hold those common shares, you are required under the current laws and regulations of the Republic of China to appoint an agent, also referred to as a tax guarantor, in the Republic of China for filing tax returns and making tax payments. A tax guarantor must meet certain qualifications set by the Ministry of Finance of the Republic of China and, upon appointment, becomes a guarantor of your Republic of China tax obligations. If you wish to repatriate profits derived from the sale of withdrawn common shares or cash dividends or interest on funds derived from the withdrawn common shares, you will be required to submit evidence of your appointment of a tax guarantor and the approval of the appointment by the Republic of China tax authorities. You may not be able to appoint and obtain approval for a tax guarantor in a timely manner.

In addition, under the current laws of the Republic of China, you will be required to be registered as a foreign investor with the TWSE for making investments in the Republic of China securities market prior to your withdrawal and holding of common shares represented by the ADSs. You will be required to appoint a local agent in Taiwan to, among other things, open a securities trading account with a local securities brokerage firm and a bank account to remit funds, exercise stockholders rights and perform other functions as holders of ADSs may designate. You must also appoint a local bank to act as custodian for handling confirmation and settlement of trades, safekeeping of securities and cash proceeds and reporting and declaration of information. Without the relevant registration and appointment of the local agent and custodian and the opening of a securities trading account and bank account, you will not be able to hold, subsequently sell or otherwise transfer our common shares withdrawn from the ADS facilities on the TWSE.

## ITEM 4. INFORMATION ON THE COMPANY

### A. History and Development of the Company

Our legal and commercial name is Chunghwa Telecom Co., Ltd. We were officially established on July 1, 1996 as part of the privatization efforts by the government of the Republic of China and operate under the Statute of Chunghwa Telecom Co., Ltd. Prior to our formation, we were operating as a business unit of the Directorate General of Telecommunications. The common shares of the Company have been listed on the TWSE under the number 2412 since October 2000 and its ADSs have been listed on the New York Stock Exchange under the symbol CHT since July 2003. In August 2005, we became a privatized company as the ownership by the government of the Republic of China was reduced to less than 50%. Today, we are the largest full telecommunication service provider in Taiwan. Our principal executive offices are located at 21-3 Hsinyi Road, Section 1, Taipei, Taiwan, Republic of China, and our telephone number is (886) 2-2344-5488. Our website address is http://www.cht.com.tw. The information on our website does not form a part of this annual report. Our agent for service of process in the United States is CT Corporation System, 111 Eighth Avenue, New York, NY 10011.

We are the largest telecommunications service provider in Taiwan and one of the largest in Asia in terms of revenue. As an integrated telecommunications service provider, our principal services include:

domestic fixed communications services, including local and domestic long distance telephone services, broadband access services, local and domestic long distance leased line services, Wi-Fi services, MOD services, domestic data services and other domestic services;

- mobile communications services, including mobile services, sales of mobile handsets and tablets and other mobile services;

- internet services, including HiNet, our internet service, internet value-added services, data communication services, internet data center services, and other internet services;

- international fixed communications services, including international long distance telephone services, international leased line services, international data services, satellite services and other international services; and

- other services, including non-telecom services.

In addition to these traditional telecommunication services, we also focus on selected ICT services and advanced development, such as cloud computing.

For each of our key services, we enjoy leading positions across a number of areas in terms of both revenues and customers:

- we are Taiwan s largest fixed communications services provider as well as Taiwan s largest mobile communications service provider;

- we are Taiwan s largest broadband access provider; and

- we are Taiwan s largest internet service provider.

In 2013, our revenues were NT$228.0 billion (US$7.6 billion), our consolidated net income was NT$42.6 billion (US$1.4 billion) and our basic earnings per share was NT$5.35 (US$0.18).

In 2013, we made capital expenditures totaling NT$36.4 billion (US$1.2 billion), of which 56% was related to our domestic fixed communications business, 25% was related to our mobile communications business, 13% was related to our internet business, 4% was related to our international fixed communications business and 2% was related to our other businesses. See Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources Capital Expenditures for a detailed discussion of our capital expenditures.

**Competitive Strengths**

We believe that we are well positioned to take advantage of the increasing opportunities in the telecommunications market in Taiwan as new technologies evolve. In particular, we have maintained our leading market share in mobile communications and internet services. Furthermore, we have enjoyed greater flexibility in making purchasing and other business decisions after we were privatized in August 2005.

We believe that further deregulation and market liberalization will continue to drive the growth of the overall market for telecommunications services in Taiwan, as well as the development of new products and services. We expect to

benefit from additional opportunities as the telecommunications market in Taiwan continues to grow.

We believe that our primary competitive strengths are:

our broad customer base in Taiwan;

our position as an integrated, full-service telecommunications provider in Taiwan; and

our capital resources and technology, which we believe we can build on to expand our leading position in the mobile communications and internet services markets, including through our continued construction of our existing 3G/HSPA/ HSPA+/Dual cell HSPA+ mobile network, our expansion of FTTx broadband access services, IP-based MOD services, fixed-line/mobile value added and cloud

computing related services, and our construction of a 4G LTE, or Long-Term Evolution, mobile network using the spectrum that was granted in October 2013 with the largest amount of 4G frequency spectrum allocation out of all of the mobile network operators in Taiwan.

***We have a broad customer base in Taiwan.***

We are the largest telecommunications service provider in Taiwan with a broad customer base across all of our service offerings. Despite deregulation and an increase in competition in the Taiwanese telecommunications industry, we have maintained a market leading position in our primary service offerings of fixed communications, mobile communications and internet services. We believe our broad customer base in each of our service offerings grants us a distinct competitive advantage to maintain our existing customers and attract new customers and increases the chance of success for the launch and popularization of new products. As the telecommunications industry continues its trend of converging fixed communications, mobile communications and internet services, we believe that our comprehensive service offerings place us in a strong position to offer converged products and services to our customers.

***We are an integrated full-service telecommunications provider in Taiwan.***

We are the largest telecommunications service provider in Taiwan with a leading position in fixed communications services, mobile communications services and internet services.

*Broad range of communications products and services*. We believe that our ability to provide an attractive and comprehensive range of telecommunications services positions us to provide bundled and value-added services to our business and residential customers. In addition, we are able to offer innovative integrated services and tariff packages to meet the specific needs of our customers.

*Broad network coverage*. The breadth of our network and our ownership of the last-mile infrastructure in Taiwan, which comprises the connection between the local telephone service provider s switching centers to the end-users buildings or homes, provides us with access to existing and potential customers and creates a platform for expanding our services. In order to provide higher bandwidth services for our customers, we have been constructing our FTTx network since 2003. We have successfully migrated many of our customers from lower-speed to higher-speed internet access services and upgraded ADSL subscribers to FTTx, which offers even higher speeds by using fiber optic technology. The number of our FTTx subscribers has exceeded that of our ADSL subscribers since 2011. As of December 31, 2013, network coverage of FTTx with speeds of 60 Mbps and 100 Mbps was approximately 91.6% and 86.4%, respectively. In addition, our mobile communications network provides nationwide coverage. Our large cellular spectrum allocation together with our extensive network coverage positions us well for the continued expansion of our mobile services in Taiwan. We are also continuing to build our Wi-Fi network to offload 3G capacity in residential areas and public areas where subscriber density and usage is high, such as urban areas, airports and convenience stores.

*Brand awareness, distribution channels and customer service*. Our principal brands Chunghwa Telecom, emome and HiNet have a reputation for quality and reliability. We serve our large and well-established customer base through our extensive customer service network in Taiwan, including 17 operations offices, 431 service centers, 271 exclusive service stores and six customer service call centers. We are continuing to expand and transform our retail stores while increasing the number of our service centers throughout Taiwan. We also offer comprehensive and high-quality point of sale and after sale services in our service centers, stores and over the internet. Our extensive sales and distribution channels help us attract additional customers and develop new business opportunities. In 2013, we also obtained several domestic and international awards which recognized our service quality, corporate governance and our fulfillment of corporate social responsibility. In the Reader s Digest Trusted Brands Awards, we have stood out and

won the Platinum Award of Telecom Company in Taiwan for ten consecutive years since 2004. We were also awarded the Excellence in Corporate Social Responsibility Award by the Common Wealth Magazine and were ranked $A^{++}$ in Transparency and Information

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Disclosure by the Taiwan Securities and Futures Institute in 2013. In addition, we received the Bronze Class Sustainability Award by RobecoSAM in January 2014.

*Operational expertise*. Our management and employees have extensive operating experience and technical knowledge, which we believe cannot be easily replicated by competitors. We also believe we will continue to attract and retain high quality employees.

*Comprehensive customer billing infrastructure*. As Taiwan s leading telecommunications services provider, we have extensive resources and infrastructure relating to billing services. We intend to continue taking advantage of this unique attribute by offering bill collection services to internet content providers and other entities that lack the necessary resources and infrastructure for effective customer billing.

***We have the capital resources and technology to enhance our leading position in the growing mobile communications and internet services markets.***

*Enhancing position in our leading markets*. We expect our mobile value-added service, fixed broadband value-added and ICT services to continue to be the key drivers of our future growth. With our leading market share, we enjoy substantial economies of scale in equipment procurement as well as the marketing of our products and services.

*Strong capital structure*. We believe we have great financial resources in Taiwan. Our low debt-to-equity capital structure, together with our strong operating cash flows, provides us with the flexibility and resources to invest in capital intensive and growing businesses. In particular, we continue to invest in broadband internet protocol networks, fiber-optic networks, and 3G/HSPA, HSPA+, Dual carrier HSPA+ mobile communications networks and services. We will continue to make investments in or to acquire other companies which provide complementary telecommunications and internet-related services to further expand our business and offer new products and services.

*Advanced network technology*. In 2013, we upgraded our FTTx access networks to FTTH access networks, aiming at promoting our broadband services from megabit connectivity to gigabit connectivity and strengthening our leading position in bandwidth services in our industry. We have also upgraded our 3G network to HSPA and HSPA+, and Dual carrier HSPA+. We are currently deploying our 4G network, and we believe that we have the potential to be the first-to-market to launch and offer high speed 4G services over LTE technology. Our investment in network infrastructure places us in a position to capture a significant share of the internet and high-speed data transmission market.

*Research and development expertise*. As of March 31, 2014, we employ over 2,546 research professionals and engineers whose principal focus is to develop advanced network services and operation support systems and to build selected core technologies. In 2013, our research and development expenses accounted for 1.6% of our revenues. We believe our focus on research and development will allow us to efficiently develop and deploy new technologies and services ahead of our competitors.

**Business Strategies**

Taiwan has one of the highest fixed-line penetration rates in Asia and has also experienced rapid adoption of wireless communications and internet services, including broadband access services. We believe that telecommunications services will evolve over the coming years, driven by a number of technological innovations, including cloud computing, mobile value-added services and Internet of Things, or IoT. We also believe that the convergence trend of communications technologies will provide a significant competitive advantage to integrated telecommunications service providers that are able to design and construct sophisticated and scalable networks capable of serving as a

common platform for a broad range of services.

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Our key strategic objectives are to maintain our position as a leading integrated telecommunications services provider in Taiwan and to enhance our leadership position in growing markets, such as the mobile services and internet services markets, including fixed-line and mobile data services and value-added services. By leveraging our solid customer base, expanded network capacity and enhanced network capability, we plan to further enhance our fixed and mobile value-added services, or VAS, offerings and promotion. We have also introduced new ICT services as well as cloud computing services by leveraging enterprise high speed broadband demand to offer VAS and explore emerging service.

Consistent with our strategic objectives, we have developed the following business strategies:

***Focus on our core strengths while expanding our scope of services to capture new growth opportunities***

Our core strengths are the management of telecommunication networks and the provision of services over these networks. We currently operate several networks linked by a core backbone infrastructure consisting of public switched telephone, cellular, ADSL, FTTx and internet protocol networks. Our strategy for each network differs depending on the market dynamics and future growth prospects of services delivered over these networks. In general, we endeavor to maintain our strong market position in each of our business lines and seek to expand the scope of our business beyond network services by offering value-added services to generate growth and new opportunities.

*Fixed communications*: Our strategy is to maintain our position as the market leader in domestic fixed communications. We aggressively introduced new technology and equipment of our fixed network to improve operational efficiency and facilitate business transformation. In the meantime, we also provide MOD, cloud-based multi-screen services and IoT services including Intelligent Energy Network, or iEN, street surveillance services to improve customers digital life. We expect that these initiatives will enhance customers loyalty and generate more revenues.

*Broadband services*: We strive to maintain our broadband market share. Therefore, we are continuing the build-out of our FTTx infrastructure. We expect that we will be able to offer broadband services with speeds of 100 Mbps to 90% of households in the ROC by the end of 2014. As more customers within our current coverage area subscribe for 100 Mbps broadband services or FTTH services, we will still need to incur additional capital expenditures to deploy such services from the cross-connection boxes to each customer s premises. In addition, we plan to incur additional capital expenditures to further construct our FTTH infrastructure to expand our coverage area throughout the ROC. We believe these efforts will help us maintain our competitive advantage for broadband services. A high quality broadband network is also essential for our high-definition MOD services.

We provide ADSL and FTTx services to 4.6 million customers, which represented approximately 77.7% of Taiwan s fixed-line broadband customers by the end of 2013. Approximately 64.9% of our broadband customers were using FTTx services as of December 31, 2013.

We typically realize higher average revenue per user, or ARPU, for our FTTx internet services, and we continue to offer various incentives for our ADSL customers to upgrade to FTTx services. In 2013, FTTx revenue reached 79.5% of our total broadband revenue.

*Mobile Communications*: We currently offer our mobile services via both 2G and 3G networks. We obtained the 4G spectrum in October 2013, and we are currently deploying our 4G network. We believe we have the potential to be the first-to-market to launch and offer high speed 4G services over LTE technology in July 2014. For 3G, wideband code

division multiple access, or WCDMA, is adopted. In order to meet the demand from our customers for high-speed mobile data access, we upgraded our 3G mobile service to High-Speed Packet Access, or HSPA technology on September 12, 2006 and to HSPA+ services in 2010. The prevalence of smart devices, such as smart phones and tablet PCs that utilize large amounts of mobile data, has become a challenge for all mobile operators. We are continuing to develop HetNet to meet such demand. HetNet incorporates

macrocells for large area coverage, and small cells including micro cells, pico cells, femtocells and Wi-Fi to increase our data capacity. Our strategy for mobile service includes the following initiatives:

Further introducing mid- to low-tier smartphones to expand our mobile internet subscriber base;

Accelerating the migration of 2G customers to 3G network by offering various mobile handsets combined with attractive value-added services and product packages;

Expanding our HSPA+/Dual carrier HSPA+ coverage and enhancing the base station bandwidth to attract more mobile internet customers;

Constructing more Wi-Fi hotspots to offer wireless internet access service and to offload 3G data traffic; in particular, we plan to construct over 50,000 Wi-Fi hotspots by the end of 2014;

Enabling 3G/Wi-Fi auto-authentication to enhance customer experience; and

Accelerating LTE network construction to launch 4G services in July 2014.

*Internet services*: Our strategy for internet services is to continue to build on the success of our HiNet internet services and enhance our internet value-added services.

We are developing new media to provide both higher-speed access as well as attractive content to our customers. We are also continually enhancing our internet value-added services, such as online games, internet music, internet banking and internet protocol video services, including hiChannel, an internet platform where customers can view videos and multimedia content. In addition, to cater to customers increasing demand for e-commerce payment systems, we are also developing a platform to support multiple payment interfaces including mobile payment and third-party payment.

*Emerging services*: Our emerging services include ICT, cloud computing and integrated services. We have been providing ICT services since 2009, including iEN, and Intelligent Transportation System, or ITS, services. Our experience with ICT services positions us well to develop and offer cloud computing services, and we anticipate that cloud computing services could become an important area of growth for telecom operators in the near future. We started to offer hicloud Compute as a Service, or CaaS and provide customers 24-hour installation services in 2010. We started to offer hicloud Mall in 2011, which allows Independent Software Vendors, or ISV to offer their application software in the hicloud Mall for sale. We also introduced cloud-based multi-screen services, named Hami$^{+}$, providing music, video, news, e-book, weather, travel information, personal cloud and payment services. The integration of platform and network enables our customers to use and purchase the service through their PCs, MOD, tablet PCs and smart phones, and satisfies users needs to utilize those services anytime, anywhere with any device. For enterprise customers, we introduced hicloud Virtual Private Cloud, or VPC to facilitate the establishment of the dedicated cloud data center for centralized control of computing resource, storage services, network services and information security total solutions. We also introduced the hicloud box$^{e}$ to provide data storage and file sharing

services, which helps enterprise customers reduce storage costs while providing a platform to share resources in a protected environment. In 2013, we launched hicloud platform service, or hicloud PaaS, and hicloud S3 service, or hicloud S3:

hicloud PaaS is a cloud innovation platform that integrates six cloud-based components, including communications, information, marketing, digital contents, IoT, and information security, for developers to create various kind of cloud applications in a developing environment with three major programming languages: Java, .Net and PHP. In addition, hicloud PaaS innovation platform is connected to our hicloud Mall, and all cloud applications developed on the platform could be sold at our hicloud Mall; and

hicloud S3 is a cost-effective cloud-based storage service. Enterprises can lease cloud space to support their daily operation and therefore lower their storage cost. hicloud S3 also has HA, or High-Availability, operation system which provides stringent information security to reduce risks of losing information and leaking information.

We are continuing to expand the scope and variety of our integrated services to create more value for our customers. For example, we intend to develop an OTT platform and build relationships with content providers and service providers to offer attractive content and services over the platform.

***Emphasize quality of service and customer satisfaction***

Quality of service is critical in attracting and retaining customers and enhancing our long-term profitability. In order to continually enhance and improve the quality of our services, we have, in addition to the quality assurance function of our regular operating units, established a number of dedicated task forces to monitor our network performance. Our senior management sets our quality evaluation criteria and regularly reviews the quality of our performance.

In order to ensure that our quality of service will translate into strong customer loyalty, we plan to continue to focus on and invest in the provision of a full range of services that emphasize customer care from the point of sale onward. For example, we have extended the focus of our corporate customer services from major accounts to include small and medium-sized enterprises and in January 2007 established our Enterprise Business Group. As of December 31, 2013, our Enterprise Business Group was staffed by 396 professionals and offered packaged and customized services, customer-oriented solutions and integrated information and communications services. We have completed the integration of our call centers, all of which can now be reached by calling a single number 123 . We offer 24-hour customer service, including the handling of service and billing inquiries with the assistance of an Interactive Voice Response, or IVR, system. To improve the quality of our customer services, we implemented a customer relationship management system, which encompasses, among other things, a customer complaint system, a business information database for the use of our call centers, and a data mining system to enhance our sales and market analysis efforts.

In addition, we own hundreds of physical service stores, and we will continue to renovate our traditional service stores to enhance user experience. Please refer to Competitive Strengths We are an integrated full-service telecommunications provider in Taiwan for a discussion of our distribution channels.

***Improve operational efficiency and cost structure***

We have historically been focused, and will continue to focus, on cost control, particularly in the areas of network efficiencies and personnel costs. We expect to be able to further improve our operational efficiency and cost structure by migrating to more advanced networks and sophisticated operational support systems, and efficiently managing our workforce.

*Capital expenditures*. Our long-term goal is to optimize our capital expenditures by focusing on investing in innovative products and services with attractive return profiles. To catch up with the fast evolution of digital devices and network applications, we continue the construction of our fiber-based fixed-line and mobile network to increase the network bandwidth and enhance operational efficiencies. In particular, we plan to accelerate LTE network construction to launch 4G services in July 2014, and construct high capacity Wi-Fi/Fiber-Wireless networks to offload mobile network traffic and upgrade network equipment to improve operational efficiency and reduce operating cost. For example, we have focused on redesigning optical distribution networks, consolidating aggregate networks, simplifying network layers, centralizing network planning and equipment procurement, designing Single Radio Access Networks, developing remote automatic operations, administration, maintenance and provisioning systems and following precision construction policy to enhance equipment utilization rate and improve management efficiency.

*Personnel costs*. We seek to improve our operational efficiency by reducing our personnel costs. For example, we offered voluntary retirement programs once each year since 2005, which resulted in reductions of 6,426 employees in total as of December 31, 2013. We also hired more than 3,999 new employees after our privatization in August 2005.

Since then, we continued to align our organizational structure by integrating

various operating units and departments. We will also continue to reallocate our personnel from traditional fixed-line services to our growing businesses and to our marketing and enterprise customer services departments. On January 30, 2013, we set up a human resource company, Honghwa Human Resources Co., Ltd., in order to save on personnel expenses as well as to provide our customers with better installation services and services in our retail stores. We plan to gradually restructure the personnel of our customer services departments to use personnel provided by Honghwa Human Resources Co., Ltd.

***Expand our business through alliances, acquisitions and investments***

We plan to expand our business in high-growth areas, such as interactive multimedia broadband services, content delivery services and value-added services, through alliances, acquisitions and investments. We believe that our experience, operational scale and large customer base make us an attractive ally for other service providers.

*Alliances*. We have formed and will continue to pursue alliances with information content providers, multimedia service platform providers, customer premises equipment providers, internet portal operators, and information and communication technology solutions partners to diversify our business operations and enhance our service offerings. In January 2013, we signed a memorandum of understanding with Wiwynn Corporation. We aim to cooperate with Wiwynn Corporation by combining its hardware solution with our cloud technology to jointly provide customers plug-and-play appliance and explore domestic and overseas computing business opportunities. We also aim to develop the city of industry technology intelligence. In December 2013, we formed the Taiwan Intelligent Aerotropolis Association, an association that focuses on the research, development and application of telecommunication and aerotropolis technology, together with other telecommunication enterprises and equipment suppliers. The formation of the association has strengthened our leading position in the industry and further supplemented our capability to develop smart city and aerotropolis products and services. On January 17, 2014, we entered into a memorandum of understanding with Delta Electronics, Inc., under which both parties agree to coordinate and to develop environmentally friendly solutions for energy saving in telecommunications industry. See B. Business Overview Mobile Communications Business Mobile Services for a discussion of our alliance on mobile services.

*Acquisition and Investments*. We have focused our acquisition strategy on making acquisitions of companies that we believe to be complementary to our long-term strategic goals. In addition, after our privatization, we have focused our investment strategy on the development of new businesses and the enhancement of our operation efficiency. Recently we have entered into the following notable transactions:

In March 2011, we established a wholly owned subsidiary Chunghwa Telecom (China) Co., Ltd., which engages mainly in providing services of planning, design, and integration of information systems.

In May 2011, we established a wholly owned subsidiary Chunghwa Telecom Vietnam Co., Ltd. in Vietnam, which engages mainly in providing International Private Leased Circuit, or IPLC, and iEN, services to Taiwanese enterprises in Vietnam.

In May 2011, we, together with President Chain Store Corporation and EasyCard Corporation, established Dian Zuan Integrating Marketing Co., Ltd., or DZIM. As of December 31, 2013, we owned 13% of DZIM. DZIM engages mainly in information technology services and general advertising services.

In July 2011, we established Chunghwa Sochamp Technology Inc., which mainly engages in license plate recognition systems. As of December 31, 2013, we owned 51% of Chunghwa Sochamp Technology Inc.

In August 2011, we and United Daily News established a joint venture, Smartfun Digital Co., Ltd., which mainly engages in sales of educational software and providing digital parenting education. As of December 31, 2013, we owned 65% of Smartfun Digital Co., Ltd.

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In September 2011, we invested in Huada Digital Corporation and owned 50% of this company as of December 31, 2013. Huada Digital Corporation mainly engages in providing software services.

In February 2012, we subscribed for shares of China Airlines Ltd. in an equity offering and became a 5.07% stockholder of China Airlines Ltd. We expect to leverage China Airlines Ltd. s expertise and operational experience within the tourism and transportation industries to develop relevant ICT services, including intelligent tourism and transportation cloud services. We have developed a tourism cloud platform to provide travel information and products as well as physical and virtual channels to facilitate the operation of different parties in the tourism industry.

In November 2012, we established Hua-Xiong Information Technology (China) Co., Ltd., which mainly engages in providing intelligent systems and energy saving systems and services for buildings. As of December 31, 2013, we owned 51% of Hua-Xiong Information Technology (China) Co., Ltd.

In January 2013, we set up a human resource company, Honghwa Human Resources Co., Ltd., in order to save on personnel expenses as well as to provide our customers with better installation services and services in our retail stores.

In November 2013, Taiwan Mobile Corporation, Asia Pacific Telecom, Vibo Telecom, EasyCard Corporation, Far Eastone Telecommunications and us established the Alliance Digital Technology Co., Ltd., or ADT, which mainly engages in the development of mobile payments and information processing services. We owned a 19% equity interest in ADT and had one seat out of five seats on the board of directors of ADT as of December 31, 2013.

In February 2014, we, together with Benefit One Asia Ptd. Ltd., established Chunghwa Benefit One Co., Ltd., or Chunghwa Benefit One, and we owned a 50% equity interest in Chunghwa Benefit One. Chunghwa Benefit One mainly engages in providing an e-commerce platform for enterprises to provide employee benefits.

Please also see notes 3 and 16 to our consolidated financial statements included elsewhere in this annual report for our current strategic investments.

Going forward, we may consider making other equity investments and acquisitions that we believe are complementary to our business and strategic goals. Our future investment will be aimed at expanding our business scale and scope, making better use of our research and development resources and operational experience and increasing our revenues through investing in core telecom businesses as well as value-added services. We expect to target the markets of our overseas investments from Southeast Asia to China while carefully evaluating the risks involved.

***Maintain focus on maximizing stockholder value***

We are committed to maximizing stockholder value and we intend to maintain our high dividend payout policy. Following our privatization, we have more flexibility to implement capital management initiatives, including possible repurchases of our outstanding common shares and increases in our leverage through debt financing We bought back 121,075,000 common shares between August 29, 2007 and October 25, 2007 and cancelled those shares on December 29, 2007 and February 21, 2008, respectively.

We continued our capital reduction plan from 2007 to 2010. We effected the last capital reduction plan in 2010 by reducing 20% capital stock in the amount of NT$19.4 billion. The cash payment of NT$19.4 billion was made on January 25, 2011 to our stockholders.

Under the Company Act of the ROC, companies are allowed to distribute special cash dividend from capital surplus. At our annual general stockholders meeting held on June 25, 2013, our stockholders approved the distribution of NT$5.6 billion from capital surplus, and such amount was subsequently paid in August 2013. See

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Item 5. Operating and Financial Review and Prospects Overview Effect of adopting Taiwan-IFRSs on our dividends and employee bonuses.

**B. Business Overview**

**Our Principal Lines of Business**

Our core business segments are our domestic fixed communications business, mobile communications business, internet business and international fixed communications business. The selected financial data for the years ended December 31, 2012 and 2013 have been prepared and presented in accordance with IFRSs as issued by the International Accounting Standards Board.

**Domestic Fixed Communications Business**

The provision of domestic fixed communications services is one of our principal business activities. Our domestic fixed communications business includes local and domestic long distance telephone services, broadband access services, local and domestic long distance leased line services, multimedia on demand services, and other domestic services including ICT, corporate solution services, cloud computing services. We are the largest provider of local and domestic long distance telephone services in Taiwan. We also provide interconnection with our fixed-line network to other mobile and fixed-line operators. Our revenues from domestic fixed communications services were NT$76.1 billion or 34.4% of our revenues in 2012 and NT$73.5 billion (US$2,465.5 million) or 32.2% of our revenues in 2013. In general, we expect that revenues from our domestic fixed communications business as a percentage of our total revenues will continue to decline primarily due to mobile and VoIP substitution.

***Local Telephone***

The following table sets forth our revenues from local telephone services for the periods indicated.

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2012 | 2013 | |
| | NT$ | NT$ | US$ |
| | (in billions) | | (in millions) |
| Local telephone revenues: | | | |
| Usage | 20.1 | 17.9 | 599.0 |
| Subscription | 16.4 | 16.4 | 550.5 |
| Interconnection | 1.2 | 1.0 | 34.7 |
| Pay telephone | 0.4 | 0.3 | 11.0 |
| Other | 2.8 | 2.2 | 72.7 |
| Total | 40.9 | 37.8 | 1,267.9 |

We provide local telephone services to approximately 11.6 million customers in Taiwan. Our fixed-line network reaches virtually all homes and businesses in Taiwan. Revenues from local telephone services comprised 18.5% and 16.6% of our total revenues in 2012 and 2013, respectively. Approximately 73.9% of our local telephone customers as of December 31, 2013 were residential customers. We are currently the leader of the local telephone service market, with an average market share of approximately 95.0% and 94.6% in 2012 and 2013, respectively.

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The following table sets forth information with respect to our local telephone customers and penetration rates as of the dates indicated.

| | As of December 31 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| | (in thousands, except percentages and per household data) | | |
| Taiwan population[(1)] | 23,225 | 23,316 | 23,374 |
| Fixed line customers: | | | |
| Residential | 8,948 | 8,728 | 8,555 |
| Business | 3,133 | 3,061 | 3,017 |
| Total | 12,081 | 11,790 | 11,572 |
| Growth rate (compared to the same period in the prior year) | (1.8)% | (2.4)% | (1.8)% |
| Penetration rate (as a percentage of the population) | 52.0% | 50.6% | 49.5% |
| Lines in service per household | 1.11 | 1.07 | 1.03 |

(1) Data from the Department of Population, Ministry of the Interior, Republic of China.

With the continued development of mobile technologies and the disconnection of additional lines for dial-up services, demand for local customer lines has been declining. The number of fixed-line customers decreased by 2.4% in 2012 compared to 2011 and 1.8% in 2013 compared to 2012. We attribute the decrease in fixed-line customers to a general industry-wide trend of migrating from fixed-line services to mobile and internet telephony services. In adherence to a ruling by the Supreme Administrative Court, starting from September 2011, we no longer require our broadband service subscribers to apply for our fixed-line services. We also allow our existing broadband subscribers to unsubscribe their fixed-line service. The foregoing factors also caused the decrease in our fixed-line customers.

The following table sets forth information with respect to local telephone usage for the periods indicated.

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| | (in millions, except percentages) | | |
| Minutes from local calls[(1)(2)] | 15,569 | 14,368 | 12,942 |
| Growth rate (compared to the same period in the prior year) | 13.9% | (7.7)% | (9.9)% |

(1) Includes minutes from local calls made on pay telephones. It also includes minutes from fixed line-to-mobile calls due to the change in policy starting from 2011.

(2) Calls to our HiNet internet service, which are recorded as part of our internet services, are not included in our local call minutes or revenues.

Minutes from local calls increased in 2011 due to the inclusion of minutes from fixed-line-to-mobile calls in this category starting from 2011 as a result of the NCC s change in policy for collecting the tariffs of fixed-to-mobile phone

calls by our fixed communications business. Minutes from local calls decreased in 2012 and 2013 due to the impact of mobile substitution and increased use of VoIP applications.

We charge our local telephone service customers a monthly fee and a usage fee. We also charge separate fees for some value-added services. The monthly fees for our primary tariff plans are NT$70 with a deductible on usage fees of NT$25 for residential customers and NT$295 for business customers. Our primary peak time usage fee is NT$1.6 for three minutes or NT$2.7 for ten minutes, depending on the tariff plan selected by the customer, and our off-peak usage fee is NT$1.0 for ten minutes. Our usage fees are the same for residential and business customers.

The following table sets forth information with respect to the average local telephone usage charge per minute for the periods indicated.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| Average local telephone usage fee (per minute) | 1.41 | 1.39 |
| Growth rate (compared to the same period in the prior year) | 3.7% | (1.4)% |

Average per minute usage charges increased 3.7% to NT$1.41 in 2012, and we attribute this increase to the fact that users with lower average tariffs switched to using VoIP telephony services to a greater extent than users with higher average tariffs. However, average per minute usage charges decreased 1.4% to NT$1.39 in 2013, mainly due to more users switching to use mobile phones and VoIP telephony services, which also led to the decreases in total revenue derived from local telephone. Part of our competitive strategy is to offer customers innovative products and services intended to both secure customer loyalty and enhance revenues. In particular, our value-added services are designed to increase our call revenues by increasing the number of calls our customers make and by receiving fees for usage of the value-added services. These services include call waiting, caller identification, call forwarding, three-party calls, ring back tone and voicemail.

*Domestic Long Distance Telephone*

We provide domestic long distance telephone services in Taiwan. Total revenues from domestic long distance telephone services were NT$3.8 billion representing 1.7% of our total revenues in 2012 and NT$3.5 billion (US$0.1 billion) representing 1.5% of our total revenue in 2013. This decrease was mainly due to the increased use of mobile services and VoIP applications. Our average market share in the domestic long distance market was approximately 74.1%, 75.4% and 76.6% in 2011, 2012 and 2013, respectively.

The following table sets forth information with respect to usage of our domestic long distance telephone services for the periods indicated.

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| | (in millions, except percentages) | | |
| Domestic long distance telephone service usage (minutes) | 3,202 | 3,354 | 3,288 |
| Growth rate (compared to the same period in the prior year) | (6.2)% | 4.7% | (2.0)% |

Along with the mandatory tariff reduction for domestic long distance telephone services, the minutes of use increased in 2012. See Item 5. Operating and Financial Review and Prospects Overview Tariff adjustments. However, call minutes declined in 2013 compared to 2012. We expect the minutes of use for domestic long distance calls will continue to decline as a result of traffic migration to mobile services and increased use of VoIP applications.

The following table sets forth information with respect to the average domestic long distance telephone usage charge per minute for the periods indicated.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| Average domestic long distance telephone usage fee (per minute) | NT$0.90 | NT$0.84 |
| Growth rate (compared to the same period in the prior year) | (41.2)% | (6.6)% |

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According to the resolution released by the NCC on November 30, 2011, we reduced our peak hour domestic long distance rate from NT$0.032 per second to our current rate of NT$1.6 per three minutes, and off-peak hours rate from NT$0.023 per second to our current rate of NT$1.0 per three minutes, in January 2012. All domestic long distance calls, regardless of the distance between the calling parties, are subject to the same tariff. Our average domestic long distance usage charge per minute decreased 41.2% in 2012 due to the mandatory tariff reduction mentioned above. The slight difference in the average domestic long distance usage charge per minute in 2012 and 2013 was due to the higher tariff in early January 2012 before the tariff reduction mentioned above. For more details of the NCC s mandatory tariff reduction, please see Item 5. Operating and Financial Review and Prospects Overview Tariff adjustments .

We provide so-called intelligent network services over our domestic long distance network, including toll-free calling, personal number, televoting, premium rate service and virtual private network, or VPN, services. We also focus on offering our customers an increasing number of value-added services with flexible tariff packages.

***Broadband (ADSL+ and FTTx) Access***

We provide broadband internet access through connections based on ADSL and our FTTx technology. FTTx generally offers a faster access medium for our internet customers compared to ADSL by using fiber optic technology. We are continuing the build-out of our FTTx infrastructure. The majority of our FTTx deployments consist of fiber-to-the-node with some fiber-to-the-building deployments.

The following table sets forth our revenues from our broadband access services for the periods indicated.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (in billions) | |
| Broadband access revenues: | | |
| Broadband access (ADSL and FTTx) | 19.1 | 19.1 |

We provide broadband access services to other internet service providers that do not have their own network infrastructure, and as a result, our broadband customers also include some customers that use only our broadband data access lines and choose another provider for internet service provider, or ISP, services. We began to provide our ADSL service in August 1999 and had approximately 1.6 million customers as of December 31, 2013. As of December 31, 2013, approximately 68.8%, or 1.1 million, of our ADSL customers were also our HiNet subscribers. As a result of increased migration to our higher-bandwidth FTTx services, the number of our ADSL customers continued to decline in 2013.

The number of our FTTx customers increased significantly in 2011, 2012 and 2013 as prices became more affordable, coverage areas expanded and customer demand for higher bandwidth heightened. Many of new FTTx customers have migrated from using our ADSL internet services. We also provide FTTx access services to other internet service providers that do not have their own network infrastructure, and as a result, our FTTx customers also include some customers who only use us for the FTTx data access lines and choose another ISP to provide internet services. Of the approximately 3.0 million FTTx customers as of December 31, 2013, approximately 2.7 million were also our HiNet subscribers. We currently offer various promotional packages to encourage more migration of our ADSL subscribers to our FTTx service. As of December 31, 2013, 69% of HiNet subscribers accessed the internet through our FTTx service, and we expect this ratio to increase in the future as a result of these promotional measures.

Our market share of Taiwan s broadband market was approximately 79.2%, 79.2% and 77.7% in 2011, 2012 and 2013, respectively.

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The following table sets forth our broadband service customers as of each of the dates indicated.

| | As of December 31 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| ADSL service customers (in thousands) | 2,101 | 1,839 | 1,598 |
| FTTx service customers (in thousands) | 2,398 | 2,719 | 2,955 |
| Average downlink speed (Mbps) | 11.2 | 16.3 | 26.9 |

Our ADSL service offers downlink speeds that range from 1 Mbps to 8 Mbps and uplink speeds that range from 64 kilobits per second, or Kbps, to 640 Kbps. Our FTTx service offers downlink speeds of 12, 20, 50 and 100 Mbps matched with uplink speeds of 20, 40 and 100 Mbps, respectively. As of December 31, 2013, our average downlink speed was 26.9 Mbps.

We have experienced competition in the ADSL and FTTx service market from cable operators and other fixed-line operators. Our strategy is to continue the migration of ADSL subscribers to FTTx so as to increase the ARPU. In addition, in order to strengthen customer loyalty, we have provided free speed upgrades for broadband customers since August 2010. In April and October 2013, we further reduced our broadband tariff, especially for higher speed services, such as 60 Mbps and 100 Mbps, in order to speed up the migration to fiber solutions and facilitate the take-up of relevant applications. Although the lower broadband tariff had a temporary impact on our revenue, we believe the speed upgrade will have a positive effect on our promotion of broadband value-added services in the long run.

Charges for our HiNet dial-up service include a monthly fee entitling the customer to a fixed number of minutes of service, with an additional charge per minute when the fixed number of minutes is exceeded. Alternatively, we offer our customers an unlimited number of minutes for a fixed monthly fee. Charges for our ADSL and FTTx services include one-time installation charges and monthly subscription fees. These charges for our ADSL and FTTX services vary based on connection speed.

The following table sets forth our ARPU for each of the periods indicated.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| ARPU for HiNet dial-up services per month[1] | 15 | 11 |
| ARPU for ADSL services per month[2] | 437 | 424 |
| ARPU for FTTx services per month[3] | 895 | 859 |

(1) ARPU for HiNet dial-up services per month is calculated by dividing the sum of local telephone usage revenues generated by HiNet dial-up subscribers and internet access revenues by the average of the number of our HiNet dial-up subscribers on the first and last days of the period and dividing the result by the number of months in the relevant period.

(2) ARPU for ADSL services per month is calculated as the sum of (a) ADSL access revenues for the relevant period divided by the average of the number of our ADSL access customers on the first and last days of the period divided by the number of months in the relevant period and (b) HiNet ADSL ISP service revenues divided by the

average of the number of HiNet ADSL ISP service subscribers on the first and last days of the period divided by the number of months in the relevant period.

(3) ARPU for FTTx services per month is calculated as the sum of (a) FTTx access revenues for the relevant period divided by the average of the number of our FTTx access customers on the first and last days of the period divided by the number of months in the relevant period and (b) HiNet FTTx ISP service revenues divided by the average of the number of HiNet FTTx ISP service subscribers on the first and last days of the period divided by the number of months in the relevant period.

The decline of our ADSL ARPU was due to the NCC s mandatory tariff reduction. The decline of FTTx ARPU was due to (1) the NCC mandatory tariff reduction and (2) the promotional packages and discounts provided for existing customers. For more details of the NCC s mandatory tariff reduction, please see Item 5. Operating and Financial Review and Prospects Overview Tariff adjustments.

***Leased Line Services Local and Domestic Long Distance***

We are the leading provider of domestic leased line services in Taiwan. Leased line services involve offering exclusive lines that allow point-to-point connection for voice and data traffic. Leased lines are used by business customers to assemble their own private networks and by telecommunications service providers to establish networks to offer telecommunications services.

We provide data transmission services to major corporate customers in Taiwan. We also provide leased lines to other mobile and fixed-line service operators for interconnection with our fixed-line network and for connection within their networks.

The following table shows the bandwidth of local and domestic long distance lines leased to third parties as of each of the dates indicated.

| | As of December 31 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| | (in gigabits per second, or Gbps) | | |
| Total bandwidth | 1,705.7 | 1,294.6 | 1,054.7 |

The total bandwidth of local and domestic long distance lines leased to third parties decreased from 2011 to 2013 primarily due to the general trend of migrating to broadband services and the increased competition from other service providers constructing their own lines.

Rental fees for local leased lines are generally based on transmission speed while domestic long distance leased line rental fees are generally based on transmission speed and distance. We continue to experience a decline in rental fees for all of our leased line products. We attribute the general decline in rental fees since 2000 to a general migration toward broadband services and increased competition from other service providers constructing their own lines mentioned above. In response, we continue to implement marketing and service campaigns to retain our high-value corporate customers for our leased line products. Our local and domestic long distance leased line services revenues were NT$5.5 billion and NT$5.1 billion (US$0.2 billion) in 2012 and 2013, respectively.

***Wi-Fi Services***

We launched our wireless local area network service in May 2002. As of December 31, 2012 and 2013, we had a total of approximately 1,280,315 and 1,816,090 residential and business customers that leased our access points, respectively. In addition, we had established 42,000 hot spots and 150 hot zones in public areas by the end of 2013, such as convenience stores, airports and international convention centers, where our smartphone subscribers can access our Wi-Fi network and help to offload 3G data network traffic.

***Multimedia on Demand Services***

Using video streaming technology through a set top box that connects to our FTTx and ADSL data connections, our customers can access TV programs, video-on-demand and other services. We had over 160 broadcasting channels and over 12,000 hours of on-demand programs and served approximately 1.24 million customers as of December 31, 2013. In addition, our video-on-demand service provides movies, dramas, animations, documentaries, e-learning and music programs for home entertainment. Also, as of December 31, 2013, we offered 88 high definition, or HD, channels and other HD video-on-demand programming, such as

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sports, movies and knowledge materials. In 2013, we offered TV Everywhere service for our MOD subscribers to enjoy seamless program viewing experience on multi-screens including smartphones, tablets and PCs. Additionally, we offered movie SVoD, or Subscription Video on Demand, targeting customers who are film fans. In addition, we also offered new family packages to attract more subscription and broadcasted free movies every week to increase the household TV usage rate and enhance user experience. MOD revenues accounted for NT$1.9 billion and NT$2.2 billion (US$74.4 million) in 2012 and 2013, respectively.

***Other Domestic Services***

Our other domestic services include information and communication technology services, corporate solution and bill handling services.

**Mobile Communications Business**

Mobile communications services are one of our principal business activities. Our mobile communications services include mobile services, sales of mobile handsets and data cards and other mobile services.

***Mobile Services***

We are Taiwan s largest provider of mobile services in terms of both revenues and customers. In 2012, we generated revenues of NT$72.5 billion, or 32.8% of our total revenues, from mobile services. In 2013, we generated revenues of NT$76.7 billion, or 33.6% of our total revenues, from mobile services. In 2012, we managed to increase our mobile revenue by promoting mobile internet services, which fully offset the decline of mobile voice revenue due to the NCC s mandatory tariff reduction and market competition. In 2013, we continued to migrate customers (1) from 2G to 3G with additional data plans and (2) from 3G voice only to data plan adoption. As a result, our mobile VAS revenue grew 38.4% year over year in 2013.

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2012 | 2013 | |
| | NT$ | NT$ | US$ |
| | (in billions) | | (in millions) |
| Mobile services revenues: | | | |
| Usage[(1)] | 42.1 | 40.1 | 1,345.6 |
| Interconnection | 7.3 | 6.0 | 200.7 |
| Mobile data | 20.4 | 28.3 | 948.4 |
| Other | 2.7 | 2.3 | 76.6 |
| Total mobile services | 72.5 | 76.7 | 2,571.3 |

(1) Includes monthly fees.

As the market for mobile services has continued to expand, we have experienced growth in our mobile customer base. We are the largest mobile operator in Taiwan in terms of revenues and number of customers. We had 10.7 million mobile customers, for a market share of approximately 35.9% of total mobile customers and approximately 35.3% of total mobile services revenues in Taiwan, as of December 31, 2013.

In October 2013, we obtained a 4G mobile services spectrum of 10 MHz paired spectrum in the 900 MHz frequency band and 25 MHz paired spectrum in the 1800 MHz frequency band. In November 2013, we paid NT$39.1 billion to the government for our 4G mobile services spectrum. Our 4G mobile services license is valid until December 31, 2030. We are currently deploying our 4G network, and we plan to launch 4G services using LTE technology in July 2014.

In February 2002, the Ministry of Transportation and Communications granted 3G mobile services concessions to five companies, including us. In March 2002, we paid NT$10.2 billion to the government for our

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concession. Our 3G mobile services license is valid until December 31, 2018. In July 2005, we launched our 3G mobile services, using WCDMA technology. We have been allocated 15 MHz paired spectrum plus 5 MHz unpaired spectrum in the 2 GHz frequency band for 3G mobile services, and 15 MHz in the 900 MHz frequency band and 11.25 MHz in the 1800 MHz frequency band for GSM services and general packet-switched radio services, or GPRS. We offer the largest international roaming network among Taiwan mobile service providers. By the end of 2013, our 3G roaming contracts includes 213 networks in 89 countries, our 2G GSM roaming contracts include 425 networks in 198 countries, and our 2.5G GPRS roaming contracts include 350 networks in 144 countries.

As of December 31, 2013, we had upgraded all of our 3G cellular base stations with HSDPA capacity, and 2,400 GSM base stations with EDGE capacity in the larger metropolises of Taiwan. We will continue this process of implementing HSDPA and EDGE upgrades in the major areas of Taiwan.

The following table sets forth information regarding our mobile service operations and our mobile customer base for the periods indicated.

| | As of or for the Year Ended December 31 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| Taiwan population (in thousands)(1) | 23,225 | 23,316 | 23,374 |
| Total mobile customers in Taiwan (in thousands)(2) | 28,862 | 29,449 | 29,701 |
| Penetration (as a percentage of the population)(2) | 124.3% | 126.2% | 127.1% |
| Total mobile revenues in Taiwan (in billions)(3) | NT$217.0 | NT$219.2 | NT$216.8 |
| Number of our mobile customers (in thousands)(2)(4) | 10,072 | 10,269 | 10,656 |
| Our market share by customers | 34.9% | 34.9% | 35.9% |
| Our market share by revenues(5) | 32.6% | 33.0% | 35.3% |
| Number of our prepaid customers (in thousands)(4) | 1,052 | 1,124 | 1,325 |
| Our prepaid customers as a percentage of our total customers | 10.4% | 10.9% | 12.4% |
| Annualized churn rate(6) | 11.52% | 13.26% | 13.87% |
| Minutes of usage (in millions of minutes) | | | |
| Incoming | 11,368 | 12,536 | 12,372 |
| Outgoing | 10,897 | 12,258 | 12,316 |
| Average minutes of usage per user per month(2)(7) | 188 | 203 | 197 |
| ARPU per month(2)(8) | NT$598 | NT$594 | NT$611 |

(1) Data from the Department of Population, Ministry of the Interior, Republic of China.
(2) The number of mobile customers is based on the number of subscriber identification module, or SIM, cards. Since 2006, the total number of mobile customers in Taiwan included 2G, 3G and personal handy-phone system, or PHS, customers. The number of our mobile customers also includes our prepaid and VPN customers.
(3) Data from the statistical monthly release by the NCC, in the Republic of China, which include mobile revenues 2G, 3G and PHS. The figures of 2011 and 2012 have not been adjusted by the NCC after the adoption of IFRSs.
(4) Includes GSM, GPRS and 3G services.
(5) Market share by revenues is calculated by dividing mobile service revenues by the total mobile revenues in Taiwan.
(6) Measures the rate of customer disconnections from mobile service, determined by dividing (a) our aggregate voluntary and involuntary deactivations (excluding deactivations due to customers switching from one of our

mobile services to another) during the relevant period by (b) the average number of customers during the period (calculated by averaging the number of customers at the beginning of the period and the end of the period), and multiplying the result by the fraction where (c) the numerator is 12 and (d) the denominator is the number of months in that period.

(7) Average minutes of use per user per month is calculated by dividing the total minutes of use during the period by the average of the number of our mobile customers on the first and last days of the period and dividing the result by the number of months in the relevant period.
(8) ARPU per month is calculated by dividing our aggregate mobile services revenues during the relevant period by the average of the number of our mobile customers on the first and last days of the period and dividing the result by the number of months in the relevant period.

The total mobile customers in Taiwan had reached approximately 29.7 million as of December 31, 2013. Mobile penetration was approximately 127.1% on the same date. The overall mobile services market experienced a slight decrease of 1.1% in revenues in 2013 mainly due to the downturn in overall 2G mobile market and the tariff cut for 3G services owing to the promotion of our 3G data services. As of December 31, 2013, we had 8.04 million and 2.62 million subscribers for 3G and 2G services, respectively.

We began offering prepaid card services in October 2000 and prepaid 3G card services in February 2008. As of December 31, 2013, we had approximately 1.33 million prepaid customers, representing approximately 12.4% of our total mobile customers. Prepaid customers do not pay monthly fees but pay a higher usage charge on a per second basis. Once the prepayment has been fully utilized, a prepaid customer can make additional prepayments to continue the service. Alternatively, the customer may convert to become a post-paid customer while retaining the same telephone number.

We offer incentives, such as mobile handset subsidies, when new customers agree to sign a service contract with us or when existing customers renew their contracts with us ranging from 12 months to 30 months. We generally offer subsidies on mobile handsets equipped with more advanced data functions to promote the expansion of our 3G mobile services. Smart phones accounted for 87% of the total handsets we offered in 2013, and we expect the percentage to reach more than 90% in 2014. We expect our average subsidy per handset in 2014 to decrease as we focus more on promoting mid-tier and low-tier smart phones. At the same time, we expect to maintain our mobile internet market leadership.

Our tariffs for post-paid mobile customers primarily consist of usage fees and monthly fees. When our customers are outside Taiwan, they pay roaming charges plus international long distance charges and, where applicable, local charges in roaming destinations. Our strategic alliance with Vodafone has been terminated by the end of April 2013 after our agreement expired, as Vodafone has already entered into another strategic alliance with one of our competitors. We have already signed agreements with other European providers, such as T-Mobile, Telefonica, Orange, TeliaSonera, for strategic cooperation for our roaming business, and we also continue cooperating with local operators in different countries. We also offer discounts on usage fees for calls made between our mobile customers to encourage subscription to our mobile service. Our 3G service provides a monthly flat rate service to our customers using our 3G service for internet purposes.

Our ARPU per month increased from NT$594 in 2012 to NT$611 in 2013, mainly due to our strong promotion on mobile internet services. We intend to continue migrating mobile voice only customers to adopt additional data plan.

In addition to our basic mobile services, we also offer a broad range of value-added telecommunications and information services. In August 2001, we introduced a platform of integrated mobile value-added services under the brand name emome . Our emome services offer a broad range of value-added services, including financial information, transaction services, emergency services access numbers, directory information, time, weather and traffic reports. After the launch of our 3G mobile services, we began providing video phone, video-on-demand and other related 3G mobile value-added services as well. In 2009, we offered the Hami value-added service platform and provided e-book and Hami Apps services. Revenues from mobile data services represented 28.3% and 37.0% of our total mobile services revenues in 2012 and 2013, respectively. The increase of mobile data service revenue percentage was mainly

attributed to the increase in mobile data plan subscriber number.

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*Paging Services*

Due to substitution by mobile services and a decline in demand for our paging services in recent years, beginning in February 2007, we started downsizing our paging services by limiting access to certain telephone prefixes. We ceased providing paging services since September 2011 as approved by the NCC.

*Sales of Mobile Handsets*

We engage in the distribution and sales of mobile handsets for use on our mobile network to customers through our directly-owned stores, our subsidiary Senao, and also through third-party retailers. See Marketing Strategy Distribution Channels and Sales and Distribution in Marketing, Sales and Distribution .

In January 2007, we acquired 31.33% equity ownership of Senao, a major distributor of mobile handsets in Taiwan. Senao has been listed on the TWSE under the number 2450 since May 2001. Our equity ownership in Senao decreased from 31.33% as of January 15, 2007 to 28.18% as of March 31, 2014 due to the exercise of options by employees that were previously granted before 2007. We consolidated the results of operations of Senao because we control four out of seven seats on the board of directors through the support of large beneficial shareholders of Senao. Please refer to note 3 and note 15 of our consolidated financial statements included elsewhere in this annual report for description about the control relationship between the parent company and Senao. Our investment in Senao enhanced our mobile handset distribution and sales capabilities. Starting from January 2014, customers can subscribe for our broadband service, MOD service and other services at Senao retail stores. See Item 7. Major Stockholders and Related Party Transactions B. Related Party Transactions for a discussion of the agreement between the parent company and Senao about our business cooperation.

*Other Mobile Services*

Our mobile other services include information and communication technology services, corporate solution and bill handling services.

**Internet Business**

Our internet business includes HiNet, our internet service provider, internet value-added services, or VAS, data communication services, internet data center services, and other internet services. Our internet revenues represented 11.2% and 11.1% of our revenues in 2012 and 2013, respectively.

*HiNet Internet Service*

We are the largest ISP in Taiwan, with a market share of 68.8% as of December 31, 2013. As of December 31, 2013, HiNet had approximately 4.2 million subscribers. Our HiNet internet service generated revenues of NT$16.9 billion and NT$17.2 billion (US$0.6 billion) in 2012 and 2013, respectively. Although our ISP service subscribers increased from 2011 to 2013, the revenues decreased mainly due to the tariff reductions for the HiNet ISP service.

The following table sets forth HiNet s subscribers as of each of the dates indicated.

| | As of December 31 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| | (in thousands, except percentages) | | |
| Total internet subscribers in Taiwan | 6,092 | 6,101 | 6,158 |
| HiNet subscribers: | | | |
| HiNet dial-up subscribers | 487 | 469 | 454 |
| HiNet ADSL subscribers | 1,559 | 1,321 | 1,099 |
| HiNet FTTx subscribers | 2,132 | 2,451 | 2,683 |
| Other access technology subscribers | 4 | 3 | 3 |
| Total HiNet subscribers | 4,182 | 4,244 | 4,239 |
| Market share(1) | 68.6% | 69.6% | 68.8% |

(1) Based on data provided by the NCC.

We have maintained our leading market position despite a highly competitive market with approximately 218 ISPs in Taiwan. We expect the competitive conditions currently prevailing in the internet service provider market to continue to intensify.

***Internet Value-added Services***

Our HiNet portal at www.hinet.net provides value-added services to our customers, such as network security, Blog, travel, games, e-learning, financial information, music, video, anti-virus and links to other portals. We charge fees for some of these services. We also receive commissions for transactions completed on some of these other portals. Our internet video portal at www.hichannel.hinet.net offers online entertainment services through the internet. In particular, our HiNet broadband (ADSL and FTTx) subscribers can access music, television programs, movies and other multimedia content on demand. We charge access fees for some of this content. We expect the revenues generated from these value-added services to grow as a percentage of our total internet services revenues.

***Data Communication Services and Internet Data Center Services***

We provide a wide range of managed data services, including frame relay services, asynchronous transfer mode services, and VPN services. Frame relay services provide high-speed data communications linking remote sites. Asynchronous transfer mode services are used to handle high-bandwidth, integrated voice, video, data and internet traffic between sites.

Internet data centers are facilities providing the physical environment necessary to keep computer network servers running at all times. These facilities are custom-designed with high-volume air conditioning temperature control systems, secure access, reliable electricity supply and connections to high-bandwidth internet networks. Data centers house, protect and maintain network server computers that store and deliver internet and other network content, such as web pages, applications and data. We currently have the largest floor area of internet data centers in Taiwan compared to our competitors in Taiwan. We offer co-location, web hosting and application service provider services.

***Other Internet Services***

Our other internet services include government services, corporate solution and ICT services.

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### International Fixed Communications Business

Our international fixed communications business includes international long distance telephone services, international leased line services, international data services, satellite services and other international services.

#### *International Long Distance Telephone*

We provide international long distance telephone services in Taiwan. Total revenues from international long distance telephone services comprised 5.2% and 4.9% of our revenues in 2012 and 2013, respectively. In addition, we provide wholesale international long distance services to international simple resale operators that do not possess their own telephone network or infrastructure. Our international long distance telephone revenues decreased by 2.6% from NT$11.5 billion in 2012 to NT$11.2 billion (US$0.4 billion) in 2013 primarily due to the increased competition from VoIP-based international long distance service providers and free VoIP applications.

Since international fixed communication services have been open for competition since 2001, we expect competition in this line of business will continue to intensify. Our average market share of the international long distance market by minutes was approximately 54.9%, 51.0% and 55.1% in 2011, 2012 and 2013, respectively. Despite the decrease in our international long distance traffic volume, our market share increased from 2012 to 2013 because our international long distance traffic volume decreased less than our competitors. However, the overall market for international long distance services declined due to the intense competition from VoIP-based international long distance service providers and free VoIP applications. Our international long distance services consist primarily of international direct dial services and the wholesale of international long distance traffic.

We commenced the wholesale of international long distance minutes to licensed domestic international simple resale, or ISR operators, and other international carriers in 2001. The domestic ISR operators require fixed-line operators in Taiwan, such as us, to provide international long distance telephone services to their end-users. We provide time-division multiplexing, or TDM and VoIP connections with committed standard and premium route quality to connect to over 230 worldwide destinations for ISR operators and international carriers. We offer customized solutions with competitive prices and 24 hours a day, 7 days a week service to satisfy their needs. In 2012 and 2013, we sold 1,064 million and 743 million minutes of wholesale international long distance traffic, which represented approximately 42.2% and 35.5% of our total outgoing international long distance traffic, respectively. Despite the decrease in international long distance traffic volume, revenues from the wholesale of international long distance minutes increased by 5.4% from NT$2.9 billion in 2012 to NT$3.1 billion (US$0.1 billion) in 2013 primarily due to our focus on expanding such services in higher-unit-price areas, such as Europe.

International calls to our top five destinations represented 62.4% of our outgoing international long distance call traffic in 2013. International calls from our top five destinations represented 47.7% of our incoming international long distance call traffic in 2013.

The following table shows the percentage of total outgoing international long distance minutes for our top five outgoing destinations in 2013.

| Destination | Percentage of Total Outgoing Minutes (%) |
| --- | --- |
| Mainland China | 27.2 |
| Indonesia | 16.1 |

| | |
|---|---|
| Philippines | 8.2 |
| Vietnam | 6.5 |
| United States | 4.4 |
| | |
| Total of top five destinations | 62.4 |

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The following table shows the percentage of total incoming international long distance minutes for our top five incoming destinations in 2013.

| **Destination** | **Percentage of Total Incoming Minutes (%)** |
|---|---|
| Mainland China | 19.0 |
| United States | 8.1 |
| Indonesia | 7.3 |
| Canada | 6.7 |
| Malaysia | 6.6 |
| | |
| Total of top five destinations | 47.7 |

The following table sets forth information with respect to usage of our international long distance services for the periods indicated.

| | **As of December 31** | | |
|---|---|---|---|
| | **2011** | **2012** | **2013** |
| | **(in thousands, except percentages and incoming/ outgoing ratio)** | | |
| Incoming minutes | 1,737 | 1,529 | 1,198 |
| Growth rate (compared to the same period in the prior year) | (9.3)% | (11.9)% | (21.6)% |
| Outgoing minutes | 2,560 | 2,523 | 2,095 |
| Growth rate (compared to the same period in the prior year) | (5.7)% | (1.4)% | (17.0)% |
| Total minutes | 4,297 | 4,052 | 3,293 |
| Incoming/outgoing ratio | 0.68 | 0.61 | 0.57 |

Total outgoing call volume decreased by 21.6% from 2012 to 2013 primarily due to intensified market competition from VoIP-based international long distance service providers and other international long distance service providers.

Outgoing calls made by customers in Taiwan and by customers from foreign destinations using Taiwan direct service are billed in accordance with our international long distance rate schedule for the destination called.

Rates vary depending on the time of day at which a call is placed. Customers are billed on a six-second unit basis for international direct dial services.

The following table sets forth information with respect to the average international long distance usage charge per minute that we received for outgoing international calls during the periods indicated:

**Year Ended December 31**

| | **2012** | **2013** |
|---|---|---|
| Average international long distance usage charge (per minute) | NT$3.4 | NT$3.8 |
| Growth rate (compared to the same period in the prior year) | (5.6)% | 11.8% |

In 2012, since other operators offered competitive tariff to grab market share, we reduced our retail price to maintain competitiveness which resulted in the lower average charge per minute. Despite the decrease in average charge per minute, our growth rate increased from negative 5.6% in 2012 to 11.8% in 2013 due to our focus on expanding the wholesale of international long distance minutes in higher-unit-price areas, such as Europe.

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We pay for the use of networks of carriers in foreign destinations for outgoing international calls and receive payments from foreign carriers for the use of our network for incoming international calls. Traditionally, these payments have been made pursuant to settlement arrangements under the general auspices of the International Telecommunications Union. Settlement payments are generally denominated in U.S. dollars and are made on a net basis.

The following table sets forth information with respect to our gross international settlement receipts and payments during the periods indicated.

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2012 | 2013 | |
| | NT$ (in billions) | NT$ (in billions) | US$ (in millions) |
| Gross international settlement receipts | 3.0 | 3.3 | 0.1 |
| Gross international settlement payments | 5.6 | 6.0 | 201.1 |

Our payments to international carriers on an aggregate basis have been greater than our receipts from these carriers primarily because our customers outgoing minutes exceeded incoming minutes. Both international settlement receipts and payments increased in 2013 because we promoted our international wholesale business.

In order to compete more effectively in the international long distance market, we have implemented innovative and customized discount calling plans and marketing campaigns directed at high-usage business customers. We also continue to promote our intelligent network services, including international VPNs, international toll free calling and calling card services, and our international long distance minutes wholesale business. Our subsidiary, Chief Telecom, launched its 070 phone-to-phone VoIP service in April 2009. In addition to the change in policy for collecting the tariffs for fixed-line-to-mobile calls starting from 2011, we are also required to pay transition fees to the mobile operators, which as a whole caused a negative impact on our revenues. As we did not have the right to set and collect the tariffs for our 070 service at that time, we filed with NCC to return 30 thousand 070 numbers assigned by the NCC to Chunghwa Telecom, until the NCC gives us the right to set and collect the tariffs for outbound calls from 070 numbers. The application was approved by the NCC on July 1, 2011.

***Leased Line Services International***

We are a leading provider of international leased line services in Taiwan. Leased line services involve offering exclusive lines that allow point-to-point connection for voice and data traffic. Leased lines are used by business customers to assemble their own private networks and by telecommunications service providers to establish networks to offer telecommunications services.

We provide data transmission services to major corporate customers in Taiwan. Since August 2001, licenses have been awarded to four undersea cable operators to engage in leased line services. Demand for high-speed data transmission services has been growing rapidly, as a result of growing consumer demand and lower tariffs due to increased competition. In particular, the total bandwidth of our lines leased increased by 6.2% in 2013.

The following table shows the bandwidth of international lines leased to third parties as of each of the dates indicated.

| | As of December 31 | | |
|---|---|---|---|
| | **2011** | **2012** | **2013** |
| | **(in gigabits per second, or Gbps)** | | |
| Total bandwidth | 243.9 | 531.7 | 564.8 |

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Rental fees for international long distance leased line are generally based on transmission speed and distance.

We continue to experience a decline in rental fees for all of our leased line products. The decline in rental fees since 2000 has been substantial, particularly for international leased lines, partly as a result of competition from new international leased line service providers. In response, we continue to implement marketing and service campaigns to retain our high-value corporate customers. Our international leased line services revenues were NT$1.2 billion and NT$1.4 billion (US$47.9 million) in 2012 and 2013, respectively.

***International Data Services***

Our international data services include international IP VPN services and Taiwan internet gateway services. Total revenues for international data services were NT$1.3 billion and NT$1.5 billion (US$48.0 million) for 2012 and 2013, respectively. Due to growth of the number of Taiwanese corporations with operations outside of Taiwan, we expect demand for IP VPN and Taiwan internet gateway services to continue to increase and our revenues from our international data services to continue to grow.

***Satellite Services***

We entered into a contract with ST-2 Satellite Ventures Pte., Ltd. on March 12, 2010 to lease capacity on the ST-2 satellite. The lease term is 15 years starting from the official start of operations of the ST-2 satellite, and the total contract value is approximately NT$6.0 billion. This contract requires a prepayment of NT$3.1 billion, and the remaining amount will be paid annually when ST-2 satellite starts its official operation. The ST-2 telecommunications satellite launched on May 21, 2011 and began commercial operation in August 2011. Please refer to note 39 of our consolidated financial statements included elsewhere in this annual report for further details.

In addition, we have two satellite communication centers that enable us to provide TV broadcast, satellite value-added services and backup systems for use in major emergencies. We also provide satellite services to Southeast Asia.

***Other International Services***

Our other international services include corporate solution services.

### Others

Our other business segment includes our non-telecom services, including property sales made by our subsidiary, Light Era Development Co., Ltd.

### Interconnection

We provide interconnection of our fixed line network and mobile network with other operators.

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The following table sets forth our interconnection fee revenues and costs for the periods indicated. These revenues and costs are included, depending on the nature of the call made, in domestic fixed communications or mobile communications revenues and expenses, respectively.

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2012 | 2013 | |
| | NT$ | NT$ | US$ |
| | (in billions) | | (in millions) |
| Interconnection fee revenues: | | | |
| Fixed line | 1.3 | 1.2 | 40.2 |
| Mobile(1) | 8.0 | 6.6 | 219.8 |
| Interconnection costs: | | | |
| Fixed line | 5.7 | 4.6 | 155.3 |
| Mobile | 7.7 | 6.2 | 207.7 |

(1) Includes SMS air time charges.

The interconnection rate between fixed-line customers and other fixed-line customers is NT$0.32 per minute during peak times and NT$0.09 per minute during off-peak times. The interconnection rate for calls initiated by mobile customers to fixed-line customers is NT$0.5219 per minute during peak times and NT$0.2718 per minute during off-peak times.

The NCC has mandated mobile interconnection rate reduction over a period of four years starting on January 5, 2013. The rate should be reduced from NT$2.15 per minute to NT$1.15 per minute in four years with a CAGR of -14.5%. Therefore, our mobile interconnection revenues and costs both decreased in 2013.

Before January 1, 2011, the rates of telecommunication fees for telephone calls between fixed-line customers and mobile customers were set by the mobile network operators. Mobile network operators collected such telecommunication fees from customers and paid the fixed-line network operators interconnection fees based on minutes of use, regardless of which party of the interconnection initiated the call. The above mechanism was changed by the NCC on August 4, 2010, and starting from January 1, 2011, the fixed-line network operators that initiate the call have the right to set the rates of telecommunication fees and to collect such fees from customers for fixed-line-to-mobile calls. Meanwhile, fixed-line network operators have to pay interconnection fees to mobile network operators in accordance with the interconnection rate set forth by the NCC mentioned in the preceding paragraph. To balance the competition between the market leader of fixed-line network operators, namely us, and other mobile network operators, in addition to the interconnection fees, we are also required by the NCC to pay transition fees to the mobile network operators for a period of six years starting from January 1, 2011. The transition fees will decrease gradually over the six-year period and we will not be required to pay such transition fees from January 1, 2017.

Fixed interconnection costs decreased in 2013 mainly due to (1) decreasing transition fees year over year, (2) reduction of mobile interconnection rate for fixed-line-to-mobile calls, and (3) decreasing traffic volume.

In accordance with governmental regulations, the contracts governing our interconnection arrangements must specifically address a number of prescribed issues. For example, our interconnection charge should reflect our costs

with respect to the network elements used. In addition, cost increases are subject to approval by the regulatory authorities. We expect that our interconnection contracts will generally be reviewed annually, although we may also enter into long-term contracts.

**Emerging Services**

Our ICT services includes integrated services such as our Intelligent Energy Network, or iEN, and our Intelligent Transportation System, or ITS, services. Our iEN service helps companies and corporations

implement energy saving measures through computer analysis of data. Our ITS service provides navigation, real-time traffic information and infotainment through mobile devices for cars and drivers. In addition to developing ICT businesses, such as iEN, ITS, IS, Call Center, IDC, we also pursue and bid for government projects aiming to boost our revenues. We won several significant ICT projects in 2013, including but not limited to a monitoring and recording system project for the Taipei City Police Department, a network construction project for Taiwan Lottery Co., Ltd., a core system project for MingTai Insurance Co., Ltd. and a thin client (meaning a remote computer or computer program that heavily relies on its server for data access, computing and storage) and storage service project for Farglory Land Development co., Ltd.

Cloud Computing is also one of our key new business initiatives, as it is expected to be one of the main long-term growth platforms for telecom operators in the coming years. We have made advances in this segment throughout past two years which we believe will position us as an industry leader over the long run. We continue to cooperate with the government network communication entities and independent software vendors to promote innovative cloud services and applications. We have already begun to offer software as a service customer relationship management, or SaaS CRM, hicloud CaaS, and hicloud Apps mall to small and medium sized enterprises and public users. We have also made over 1,000 SaaS applications in hicloud Apps mall available for our cloud services customers, which exceeded 4,000 small and medium sized enterprises as of the December 31, 2013. Underpinning the rollout of our cloud computing services is our capability and experience in offering data center services to enterprise customers, including our ongoing initiative to build the largest cloud computing data center in Taiwan in anticipation of growing demand for this service. In 2013, we began the construction of our cloud data center in Panchiao, New Taipei City. The Panchiao cloud data center is expected to commence operations in 2015 and will offer high quality and high security cloud services to international and domestic enterprise customers. We believe the strength and reliability of our technology and services provide us with competitive advantages to continue expanding our cloud computing services in the future.

As an integrated telecom service provider, we are providing and continuing to develop integrated services. For example, we have integrated our internal resources to offer cross-platform services over our broadband, mobile and internet platforms. These integrated services allow our customers to access our services, such as our multimedia programs, through a variety of terminals and devices.

**Marketing, Sales and Distribution**

***Marketing Strategy***

In order to retain and expand our large customer base and to encourage our customers to increase their use of our services and products, we continue to focus our marketing strategy on the following areas.

Services, Products and Bundled Offerings. We continually develop new value-added services and products, and bundle our services and products based on different market segments, with the aim of increasing our high-usage customers and enhancing customer loyalty. For example, we entered into an agreement with Apple Inc. and are currently a reseller of the iPhone in Taiwan. The iPhone combined with our mPro service helps retain existing customers and generate revenues through the increased use of our value-added services. In addition, we exempt deposits that we collect from specific mobile subscribers in advance for bundling subsidized mobile handsets with service plans.

Pricing and Promotions. We design flexible pricing packages that allow customers to select structures best tailored to their usage patterns, and design special promotional packages to encourage usage. For example, we have provided Let s Talk , My Hotline , Triple Save and Big Save promotion packages to attract mobil customers.

Distribution Channels. We seek to facilitate customer subscription by adding more service points. In addition, we seek to broaden our distribution reach by strengthening our cross-industry alliances and marketing relationships. Furthermore, we seek to expand our sales channels by implementation of a

sales agent system. In 2009, we began a collaboration with Tsann Kuen Trans-Nation Group, allowing the registration of mobile numbers at electronics stores for the first time, effectively increasing our points of sale. We also developed staff incentive programs to better motivate our sales staff.

Business Customers. We expanded our customer focus to include small and medium-sized enterprises in addition to large corporations. We seek to serve the needs of large corporate customers by devoting a project manager or project engineer to service these customers. These account managers are responsible for developing customized solutions and tariff packages to meet the specific needs of our customers. We continually update and expand our service offerings so that we can remain a one-stop telecommunications services provider to our corporate customers and provide for all of their telecommunications needs. Our dedicated local teams serve the needs of small and medium-sized enterprises. These teams also use our data bank to identify and target potential clients for promoting our e-commerce and mobile services. In addition, we help our corporate customers improve their efficiency and competitiveness by creating information systems for them.

Advertising. We are committed to further strengthening the Chunghwa Telecom brand and image as well as strengthening and expanding market recognition of our specialized product brands, such as HiNet and emome. We plan to leverage our leading market position and status to strengthen the overall advantage of our product brands.

***Sales and Distribution***

Our marketing department at our corporate headquarters in Taipei is responsible for central business planning and formulating our marketing strategies and objectives. We have multiple marketing departments for our various businesses which are responsible for business and marketing planning.

As of December 31, 2013, we also had 17 operations offices, 431 service centers, 271 exclusive service stores and 6 customer service call centers located throughout Taiwan that are responsible for operations, sales and customer service in their respective local areas.

**Customer Service and Billing**

We believe our reputation for quality customer service has helped us attract new customers and maintain customer loyalty. We regularly survey our customers to improve our service and better understand market demand and customer preferences, and seek to develop products and services accordingly.

We provide the following services to our customers:

- 24-hour customer service and technical support through our service centers, call centers and website;
- English billing documents available upon request;
- free of charge itemized billing for international and domestic long distance calls;

bill payment services at 24-hour convenience stores, bank service counters, automatic teller machines, and service centers throughout Taiwan, via direct debit, over the phone, online at our website (www.cht.com.tw), on MOD, and on mobile handset emome or Hami;

online information and bill payment services at our website (www.cht.com.tw) and customer service hotline for telephone payment; and

consolidated and automated billing for all services.

**Network Infrastructure**

Our network infrastructure consists of transmission networks that convey voice and data traffic, switching networks that route traffic between networks, and mobile, internet, leased line and data switching networks.

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We purchase most of our network equipment from well-known international suppliers. As part of the purchase contract, these suppliers deliver and install the equipment for us. We also purchase from local suppliers a variety of components such as transmission lines, switches, telephone sets, MOD set-top boxes, and radio transmitters.

Approximately 13,951 of our employees were engaged in network infrastructure development, maintenance, operation and planning as of December 31, 2013.

*Transmission Networks*

As of December 31, 2013, our transmission networks consisted of approximately 1.47 million fiber kilometers of fiber optic cable for trunking and approximately 7.11 million fiber kilometers of fiber optic cable for local loop.

Synchronous digital hierarchy, or SDH, architecture is an advanced technology that allows for instantaneous rerouting and eliminates downtime in the event of a fiber cut. In addition, SDH offers better reliability and performance for optical fiber transmissions at a lower operating cost. In December 2002, we installed synchronous transport module 64 or STM 64, multiplexer and 32-wavelength dense wavelength division multiplexing, or DWDM, equipment on our long-haul backbone network. Our STM 64 multiplexer can multiplex several low speed signals into a 10 gigabits per second, or Gbps, high-speed signal. DWDM equipment uses a technology that puts data from different sources together on an optical fiber with each signal carried on its own separate wavelength. Both STM 64 multiplexer and DWDM equipment can increase our network capacity. Between 2007 and 2013, we deployed 40/80-wavelength Re-configurable Optical Add-Drop Multiplexer, or ROADM, for backbone transmission network in order to provide new data services such as gigabit Ethernet, fiber channel, 2.5 gigabit and 10 gigabit packet over SDH and 10 gigabit Ethernet. We have already completed the deployment of 1,135 wavelength ROADM by the end of 2013. To meet the demand for broadband services, we have installed an optical cross-connect, or OXC, network and a next generation synchronous digital hierarchy, or NG SDH, network, which provides gigabit Ethernet over SDH service, between 2009 and 2013. We have already completed the deployment of 5,519 GbE OXC/NG SDH by the end of 2013.

Based on the transmission network described above, we have been providing connection circuit service of 10 gigabit packet over SDH and 10 gigabit Ethernet to the government s Taiwan Advanced Research and Education Network since November 2006 and will continue the service until November 2014.

As part of our strategic focus on the internet and data markets, our local loop connections use ADSL technology. This enables us to deliver high-speed internet, multimedia and other data services to our customers. Substantially all of our installed telephone lines are capable of delivering ADSL services. As of December 31, 2013, we had approximately 2.97 million lines of ADSL. In addition, the Ethernet-based FTTx system is also introduced into our access network to provide broadband services, such as MOD, high speed internet access and VPN. As of December 31, 2013, we have constructed approximately 6.07 million FTTx ports. Our FTTx service can offer high-speed broadband internet access rates up to 1Gbps.

*Switching Networks*

**Domestic telecommunications network.** Our domestic public switched telephone network currently consists of 19 message areas connected by a long distance network. As of December 31, 2013, we had 38 long distance exchanges, which are interconnection points between our telecommunications network and approximately 17.8 million telephone lines, which reached virtually all homes and businesses in Taiwan.

We currently have intelligent networks installed over our public switched telephone networks for our domestic long distance and international networks, as well as a local intelligent network in the Taipei, Taichung

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and Kaohsiung metropolitan areas. Our intelligent network is designed to facilitate the use of value-added services by providing more information about calls and allowing greater management of those calls.

As of December 31, 2013, our next generation network, or NGN core network consisted of 985,500 local telephone subscribers, comprising 448,000 Session Initiation Protocol-based, or SIP-based, and 537,500 Access Gateway-based, or AG-based, subscribers.

Our NGN Managed IP backbone network consists of an inner core network and an outer core network. We completed the construction of our high-speed NGN Managed IP backbone network at the end of 2013 with 12 sets of 1.6 Tbps switch routers for the inner core network and more than 34 sets of 1.6 Tbps switch routers for the outer core network. The bandwidth of the network is approximately 915 Gbps as of the end of 2013. We believe this network will enable us to meet the increasing demand for NGN services, such as VoIP, and all managed services, including MOD and VPN.

**International network.** Our international transmission infrastructure consists of both submarine cable and satellite transmission systems, which link our national network directly to 102 telecommunications service providers in 44 international destinations.

International calls are routed between Taiwan and international destinations through one of our two international switching centers, one located in Taipei and the other in Kaohsiung. Each center had time-division multiplexing, or TDM, international gateway switches and NGN international gateway switch. We had a trunk capacity of 150,040 channels in total as of December 31, 2013.

As of December 31, 2013, we had invested in 19 submarine cables, nine of which land in Taiwan. We had increased the capacity of each of our current submarine cables, increasing our aggregate total capacity from 1,208 Gbps in 2012 to 1,655 Gbps in 2013.

***Mobile Services Network***

Our mobile services network consists of:

cell sites, which are physical locations equipped with a base station consisting of transmitters, receivers and other equipment used to communicate through radio channels with customers   mobile handsets within the range of a cell;

BSC (base station controllers) for GSM or RNC (radio network controller) for 3G, which connect to, and control, the base station within each cell site;

cellular switching service centers, which control the base station controllers and the processing and routing of telephone calls;

GGSN (gateway GPRS support nodes), which connect our GPRS network to the internet;

SGSN (serving GPRS support nodes), which connect the GPRS network to the base station controllers; and

transmission lines, which link (i) with respect to the GSM or 3G network, the mobile switching service centers, base station controllers, base stations and the public switched telephone network, and (ii) with respect to the GPRS network, the base station controllers, the support nodes and the internet.

We provide mobile services based on the GSM network standards. We have the 900 MHz and 1800 MHz frequency bands paired with spectrums of 15 MHz and 11.25 MHz, respectively, for our GSM services. As of December 31, 2013, we had provided up to 99.9% population coverage. Since the launch of our 3G mobile services, we have gradually transitioned GSM subscribers to 3G and have started to consolidate our GSM network.

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We have installed an intelligent network on our mobile services network infrastructure to enable us to provide prepaid services as well as a wide range of advanced call features and value-added services, such as VPN service.

We have 15 MHz paired spectrum plus 5 MHz unpaired spectrum in the 2 GHz frequency band for our 3G mobile services, which was launched in July 2005. We contracted with Nokia Siemens Networks to provide the core network, radio access network, service network, transmission network and maintenance network for our 3G network. To promote mobile internet use, we upgraded our network to 3.5G in September 2006, with downlink and uplink speeds of 7.2 Mbps and 2.0 Mbps, respectively. To meet the high growth in mobile data traffic, we have upgraded our existing High-Speed Packet Access (HSPA with capability of 14.4 Mbps and 5.76 Mbps each for Down-link and Up-link) Network to DC HSPA+ (with capability of 42 Mbps and 11.5 Mbps each for Down-link and Up-link).

In order to operate our packet-switched network more efficiently, we have consolidated GSM and 3G serving GPRS support nodes (SGSN) into a single core network. We have also introduced the Direct Tunnel technology to flatten the packet-switched network to enhance the user s experience.

*Internet Network*

HiNet, our internet service provider, has the largest internet access network in Taiwan, with 33 points of presence approximately 5,626,000 broadband remote access server ports and a backbone bandwidth of approximately 3,109 Gbps as of December 31, 2013. We plan to increase HiNet s points of presence and backbone bandwidth to approximately 3,917 Gbps by the end of 2014.

HiNet s broadband backbone network consists of an inner core network and an outer core network. We completed the construction of our high-speed internet protocol backbone network at the end of 2013 with 16 sets of 7.04Tbps/4.48Tbps/1.6Tbps/1.28Tbps switch routers for the inner core network and more than 50 sets of 2.64Tbps/1.6Tbps/880Gbps/640Gbps switch routers for the outer core network. We believe this network will enable us to meet the increasing demand for our internet services.

HiNet s total international connection bandwidth is 612.599 Gbps as of December 31, 2013. As we expect that internet traffic flows to and from the United States will continue to increase, we plan to expand our bandwidth to the United States. We also plan to increase our links to other countries, including Japan, Korea, Hong Kong, Singapore, Mainland China, Malaysia and Thailand.

*Leased Line and Data Switching Networks*

We operate leased line networks on both a managed and unmanaged basis. In addition, we operate a number of switched digital networks used principally for the provision of packet-switched, frame relay, asynchronous transfer mode technology and a multi-protocol label switching internet protocol VPN. We have completed the construction of a digital cross connect system for provisioning and managing voice-grade data services throughout Taiwan with a total of 50 nodes. As of December 31, 2013, we had 462 frame relay ports, 999 asynchronous transfer mode ports and approximately 83,107 multi-protocol label switching internet protocol VPN virtual ports.

Our data networks support a variety of transmission technologies, including frame relay, asynchronous transfer mode and ethernet technology. We have also built up our HiLink VPN that combines internet protocol and asynchronous transfer mode technologies. The advantage of HiLink VPN based on multi-protocol label switching technology is that it can carry different classes of services, such as video, voice and data together to provide services with various qualities of service, high performance transmission and fast forward solution in an enhanced security network. HiLink VPN can be accessed by xDSL/FTTx/NG-SDH and can include built-in

mechanisms that can deal with overlapping internet protocol addresses. Therefore, the network potentially is less costly and requires less management for business applications.

### Competition

We face competition in virtually all aspects of our business.

#### *Domestic Fixed Communications*

Local and domestic long distance telephone services: Revenue from local and domestic long distance telephone service of telecommunication services providers has continuously decreased in the past few years primarily due to mobile and VoIP substitution. Competition from mobile data service providers increased significantly due to the popularity of smart mobile devices and mobile applications such as LINE and WeChat. In addition, we are required by the ROC regulations to provide number portability and unbundled local loop access, which has increased the level of competition. Although there are other providers of fixed communications, including Taiwan Fixed Network, New Century Infocomm Tech. Co., Ltd. and Asia Pacific Telecom Co. Ltd., competition from these providers was not significant in the past few years.

Leased line services: Major competitors in this field are three fixed line operators including Taiwan Fixed Network, New Century Infocomm Tech. Co., Ltd. and Asia Pacific Co. Ltd. We believe that the leased line services providers primarily compete on the basis of price and the bandwidth speed of services.

Broadband internet access services: Major competitors in this field are five multiple-system operators, or MSOs, including Kbro Co., Ltd., China Network Systems Co., Ltd., Taiwan Fixed Network, Taiwan Broadband Communication Co., Ltd. and Taiwan Optical Platform Co., Ltd. With the increasing speed of mobile data service, we also face fierce competition from mobile data providers. We believe that the broadband internet access service providers primarily compete on the basis of price and the bandwidth speed of services.

MOD services: Major competitors in this field include five cable TV MSOs and 26 independent MSOs. We believe that the different service providers compete on the basis of the multimedia content offered along with the ability to offer converged services by offering comprehensive solutions including data communications, voice communications and multimedia content.

#### *Mobile Communications*

There are currently three major mobile operators in Taiwan, namely, Taiwan Mobile Co., Ltd., FarEasTone Telecommunications Co., Ltd. and us. Smart phones with 3G mobile data packages are becoming popular in recent years. To attract more data users, all three major operators offer free intra-network calling packages bundled with mobile data service. Also, there are two 3G mobile operators in Taiwan in addition to us, namely Asia Pacific Telecom Co., Ltd. and Vibo Telecom Inc., as well as one personal handyphone system operator, First International Telecom. Furthermore, the government issued a total of 16 mobile virtual network operator, or MVNO, licenses, which allow operators without a spectrum allocation to provide mobile services by leasing the capacity and facilities of a mobile service network from a licensed mobile service provider. We are currently cooperating with Carrefour

Telecom Co., Ltd. We may cooperate with other mobile virtual network operators in the future. As of the end of 2013, there were also six WiMAX service providers in Taiwan. We compete in the wireless services market primarily on the basis of price, quality of service, network reliability and attractiveness of service packages.

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*Internet*

Our primary competitors in internet services are other internet services providers, including SeedNet, TWM Broadband. We compete in the internet services market primarily on the basis of price, technology, speed of transmission, amount of bandwidth available for use, network coverage and value-added services.

*International Fixed Communications*

Our major competitors are Taiwan Fixed Network, New Century Infocomm Tech. Co., Ltd. and Asia Pacific Telecom Co. Ltd., which have provided fixed-line services since June 2001. These operators are primarily focused on international long distance services and corporate customer services, which typically generate higher revenue than residential customers. There have been four submarine cable services licenses granted since August 2001. These submarine cable operators have begun offering international leased line services to other fixed-line operators, internet service providers and international simple resale operators.

Our international long distance services compete with international long distance resale services and VoIP services such as those provided by Line and Skype.

**Cybersecurity and Personal Information Protection**

To prevent increasing cyber risks and threats, we have implemented the measures described below.

We have built an online service system that enables Certificate Authority s Secure Socket Layer functions that performs as a secure tunnel to transmit encrypted customer s information. In addition, we offered the Global Trust Secure Site Seal to protect from phishing attacks on payment web sites.

The high-availability systems in our data centers deploy firewall and Intrusion Prevention System, or IPS, to defend against hackers attacks, and the web application programs enforce vulnerability assessment and penetration test to ensure the security of our customers information.

We have enhanced the firewall policy and adopted minimum principle to limit the IPs and ports access control, in order to reduce intrusion risk from hackers.

We have used two-factor authentication mechanism and isolated endpoint device for operating critical information system.

The network equipment in our data centers could distinguish DDoS threats and reject or block the attacks. In the future, we could even block the DDoS traffic over the backbone network.

On May 26, 2010, the President of the Republic of China announced the amendment of the Personal Information Protection Act, or PIPA, which became fully effective on October 1, 2012, except for its Articles 6 and 54 that await further determination by the Executive Yuan. PIPA applies to all individuals, legal entities and enterprises that collect, process and use personal information, and has a significant impact on the banking and service industries in Taiwan.

Due to the adoption of PIPA, the level of responsibility and liability on personal information protection of a company was raised. We have conducted inventory checks of personal information that we currently hold, established standard operating procedures, or SOP, to comply with the requirements under PIPA, and have taken information security measures to protect the data.

To comply with the PIPA, we implemented a series of measures to avoid the customer s information leakage:

Our auditing department completes an annual audit plan and regularly audits information circulation in each department on customer information management and protection.

Enforce customer service center and call center to comply with BS10012 and pass the BS10012 certification.

Documents containing customer s personal information are labeled highly confidential. All levels of managers shall monitor the usage of customers personal information by employees.

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### Properties, plants and equipment

Our properties, plants and equipment consist mainly of telecommunications equipment, land and buildings located throughout Taiwan. Although we have a significant amount of land and buildings throughout Taiwan, most of our properties are for operational use and only a small part of them are for investment purposes, which were classified as investment properties in our consolidated financial statements included in this annual report. Our property development subsidiary, Light Era Development Co., Ltd., acquired land located near the high speed rail station in Taoyuan in October 2012. This property, which was classified as inventories in our consolidated financial statements included in this annual report, will be used to develop intelligent homes, in which our fiber broadband and ICT services, such as energy saving technologies, will be deployed. We are now focusing more on rental income and will continue seeking development opportunities from the ROC central and local governments urban planning programs to increase the value of our land, buildings and equipment. We have received approximately NT$573 million (US$19.2 million) in rental income from properties in 2013.

### Insurance

We do not carry comprehensive insurance for our properties or any insurance for business disruptions. We do, however, maintain in-transit insurance for key materials, such as cables, equipment and equipment components. We do not carry insurance for the ST-2 satellite since we only lease capacity for our operations instead of owning the satellite.

### Employees

Please refer to Item 6. Directors, Senior Management and Employees D. Employees for a discussion of our employees.

### Our Pension Plans

Currently, we offer two types of employee retirement plans our defined contributions plan and defined benefits plan which are administered in accordance with the Republic of China Labor Standards Act and the Republic of China Labor Pension Act.

### Legal Proceedings

We are involved in various legal proceedings of a nature considered in the ordinary course of our business. It is our policy to provide for reserves related to these legal matters when it is probable that a liability has been incurred and the amount is reasonably estimable.

We believe that the various asserted claims and litigation in which we are involved will not materially affect our financial condition or results of operations although no assurance can be given with respect to the ultimate outcome of any such claim or litigation.

We had not been involved in any legal proceedings that would materially affect our financial condition or results of operations in 2013.

### Capital Expenditures

See Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources Capital Expenditures for a discussion of our capital expenditures.

**Enforceability of Judgments in Taiwan**

We are a company limited by shares and incorporated under the Republic of China Company Act and the Statute of Chunghwa Telecom Co., Ltd. All of our directors, executive officers and some of the experts named in

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this annual report are residents of Taiwan and a substantial portion of our assets and the assets of those persons are located in Taiwan. As a result, it may not be possible for investors to effect service of process upon us or those persons outside of Taiwan, or to enforce against them judgments obtained in courts outside of Taiwan. We have been advised by our Republic of China counsel that in their opinion any final judgment obtained against us in any court other than the courts of the Republic of China in connection with any legal suit or proceeding arising out of or relating to the ADSs will be enforced by the courts of the Republic of China without further review of the merits only if the court of the Republic of China in which enforcement is sought is satisfied that:

- the court rendering the judgment has jurisdiction over the subject matter according to the laws of the Republic of China;
- the judgment and the court procedure resulting in the judgment are not contrary to the public order or good morals of the Republic of China;
- if the judgment was rendered by default by the court rendering the judgment, we, or the above mentioned persons, were duly served within a reasonable period of time in accordance with the laws and regulations of the jurisdiction of the court or process was served on us with judicial assistance of the Republic of China; and
- judgments at the courts of the Republic of China are recognized and enforceable in the court rendering the judgment on a reciprocal basis.

A party seeking to enforce a foreign judgment in the Republic of China would be required to obtain foreign exchange approval from the Central Bank of the Republic of China (Taiwan) for the payment out of Taiwan of any amounts recovered in connection with the judgment denominated in a currency other than NT dollars if a conversion from NT dollars to a foreign currency is involved.

**Regulation**

***Overview***

We were subject to the Statute of Chunghwa Telecom Co., Ltd. prior to our privatization. Although we have been privatized, the Legislative Yuan has not yet abolished the Statute of Chunghwa Telecom Co., Ltd.

***Regulatory Authorities***

Prior to March 1, 2006, we were under the supervision of the Ministry of Transportation and Communications and the Directorate General of Telecommunications. On March 1, 2006, the NCC was formed in accordance with the Organization Law, which was intended to transfer regulatory authority over the Taiwan telecommunications industry from the Ministry of Transportation and Communications and the Directorate General of Telecommunications to the NCC. The NCC was comprised of nine commissioners who were recommended by the government and opposition political parties in the Legislative Yuan, as well as recommended by the Executive Yuan and approved by the Legislative Yuan. However, the Executive Yuan considered the composition of the NCC unconstitutional and petitioned the Grand Justices of the Republic of China, or the Grand Justices, to interpret the constitutionality of the

formation of the NCC and the procedure for nominating commissioners to serve on the NCC. On July 21, 2006, the Grand Justices rendered an interpretation and held that the relevant provisions under the Organization Law as to the nomination procedures for the commissioners of the NCC were unconstitutional. However, the Grand Justices granted a grace period allowing such provisions of the Organization Law to remain in effect until December 31, 2008.

On January 9, 2008, an announcement issued by the President amended the Organization Law, or New Amendment, amending the unconstitutional formation articles and reducing the total number of commissioners to seven with a term of four years, but three of the commissioners appointed after the New Amendment served a term of two years. The commissioners will be nominated by the premier of the Executive Yuan and approved and appointed by the Legislative Yuan.

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The new nomination method under the New Amendment became effective on February 1, 2008 when the Legislative Yuan started its new term. The nine incumbent commissioners continued to serve until July 31, 2008, when their terms ended. The premier of the Executive Yuan nominated seven commissioners on July 1, 2008, and they were approved and appointed by the Legislative Yuan on July 18, 2008. The new commissioners took office on August 1, 2008. Thereafter, upon the resignation of one commissioner and the expiry of the term for the three commissioners, four new commissioners were nominated by the premier of the Executive Yuan, approved and appointed by the Legislative Yuan and began serving as commissioners on August 1, 2010. The Organization Law was further amended on December 28, 2011. The amendment stipulates that the premier of the Executive Yuan shall appoint one Commissioner to serve as Chairperson, and one as Vice Chairperson upon nomination of the commissioners. Accordingly, the Chairperson, the Vice Chairperson and two new Commissioners were nominated by the premier on April 30, 2012, approved and appointed by the Legislative Yuan and began tenure as commissioners on August 1, 2012.

In accordance with the Organization Law, the NCC is responsible for:

- formulating, implementing and interpreting telecommunications laws and regulations;
- issuing telecommunications licenses and regulating the operation of telecommunications industry participants;
- assessing and testing telecommunication systems and equipment;
- drafting and promulgating technical standards for telecommunications and broadcasting;
- classifying and censoring the contents of telecommunications and broadcasting;
- managing telecommunications and media resources in Taiwan;
- maintaining competition order in the telecommunication and broadcasting industries;
- governing technical standards in connection with the safety of information communications;
- managing and facilitating the resolution of disputes pertaining to the Taiwan telecommunications and broadcasting industries;
- managing offshore matters relating to Taiwan s telecommunications and broadcasting industries including matters of international cooperation;

managing funds allocated for the development of Taiwan s telecommunications and broadcasting industries;

monitoring, investigating and determining matters in relating to Taiwan s telecommunications and broadcasting industries;

enforcing restrictions under telecommunications and broadcasting laws and punishing violators; and

supervising other matters in relation to communications and media.

***Telecommunications Act***

The Telecommunications Act and the regulations under the Telecommunications Act establish the framework and govern the various aspects of the Taiwan telecommunications industry, including:

licensing of telecommunications services;

telecommunication numbers;

restrictions on dominant telecommunications service providers;

tariff control and price cap regulation;

- accounting separation system;
- interconnection arrangements;
- bottleneck facilities;
- spectrum allocation;
- provision of universal services;
- equal access;
- number portability;
- local loop unbundling;
- co-location; and
- ownership limitations.

Each of these aspects is described below. The Telecommunications Act also establishes a non-auction pricing system for assignment of radio frequencies.

***Licensing of Telecommunications Services***

*Type I and Type II Service Providers*

Under the Telecommunications Act, telecommunications service providers are classified into two categories:

*Type I.* Type I service providers are providers that install network infrastructure, such as network transmission, switching and auxiliary equipment for the provision of telecommunications services. Type I services include fixed-line services such as local, domestic long distance and international long distance services, as well as interconnection, leased line, ADSL and satellite services and wireless services such as mobile, including 3G mobile, paging, mobile data and trunked radio services.

*Type II.* Type II service providers are defined as all telecommunications service providers other than Type I service providers. Type II services are divided into special services and general services. Special services include simple resale, VoIP international leased circuit and other services specified by the Ministry of Transportation and Communications before March 1, 2006 or by the NCC from March 1, 2006. General services include any Type II service other than special services.

Until 1996, we were the sole provider of Type I services in Taiwan. In 1996, the government opened the market for mobile, paging and trunked radio, mobile data and digital low power cordless telephone services. In 1998, the government opened the market for fixed-line and mobile satellite services. In June 2001, the government granted licenses to three operators for establishing fixed-line services, thereby opening the market for fixed-line services. Since August 2000, the government has permitted four undersea cable operators to engage in the undersea cable leased-circuit business.

Commencing in 2007, the NCC began accepting applications for licenses to provide fixed-line services in March, June, September and December of each year. The NCC started to accept applications for fixed-line services on a daily basis beginning in 2008. There is no limit on the number of fixed-line licenses that they may decide to issue.

*Granting of Licenses*

*Type I*

Type I service providers are more closely regulated than Type II service providers. The government has broad powers to limit the number of providers and their business scope and to ensure that they meet their

facilities roll-out obligations. Under the Telecommunications Act, Type I service providers are subject to pre-licensing merit review of their business plans and tariff rates.

Before March 1, 2006, licenses for Type I services were granted by the Ministry of Transportation and Communications through a three-step procedure. Applicants obtained a concession from the Ministry of Transportation and Communications. After obtaining a concession, the applicant obtained a network construction permit and an assignment of spectrum, in the case of mobile telephone services and satellite services, from the Directorate General of Telecommunications or the Ministry of Transportation and Communications prior to applying for a license. Upon completion of construction of its network and review by the Directorate General of Telecommunications, the applicant was granted a Type I license. The Ministry of Transportation and Communications had the authority to grant Type I licenses for each of fixed-line services, wireless services and satellite services. Type I licenses have different minimum paid-in capital requirements for applicants and varying durations depending on the particular type of service.

Since March 1, 2006, the same procedure applies except that the licenses are granted by the NCC.

The Telecommunications Act further authorizes the competent authority, now the NCC, to promulgate separate regulations governing each Type I service, including the business scope of the Type I service provider, as well as the procedures and conditions for granting special permits and the length of the period of the special permits of each Type I service. Each holder of a Type I license will pay a fee ranging from 0.5% to 2% of or their bid price ratio (Article 2 of the Type I Service Provider Special Tariff Standards) multiplied by their annual revenues generated from the particular Type I service for which a license has been granted.

*Fixed Line Services*. Under the Telecommunications Act, the Fixed Network Regulations govern the issuance of fixed-line service licenses and the business scope of fixed-line providers. Fixed-line service licenses are subdivided into the following categories:

- integrated services, including local, domestic long distance and international long distance telephone services;
- local telephone services;
- domestic long distance telephone services;
- international long distance telephone services; and
- local, domestic long distance and international long distance leased line services. We conduct our fixed line services through a license for integrated services.

Licenses for local telephone and integrated services are valid for 25 years. Licenses for domestic long distance and international long distance telephone services are valid for 20 years. Licenses for leased line services are valid for 15 years. If the service provider wishes to continue operating, the service provider needs to apply for a license renewal to the NCC between nine months and six months before the expiration of their license. The minimum paid-in capital requirements for integrated services providers that applied for a license before June 30, 2004, between July 1, 2004

and January 31, 2008 and on or after February 1, 2008 are NT$21 billion, NT$8.4 billion and NT$6.4 billion, respectively. The minimum paid-in capital requirements for both domestic and international long distance telephone service providers that applied for a license between July 1, 2004 and January 31, 2008 and on or after February 1, 2008 are NT$1.05 billion and NT$800 million, respectively. The minimum paid-in capital requirements for international undersea leased cable service providers that applied for a license before June 30, 2004, between July 1, 2004 and January 31, 2008, between February 1, 2008 and June 30, 2013 and on or after July 1, 2013 are NT$420 million, NT$420 million, NT$320 million, and NT$300 million, respectively. The minimum paid-in capital requirement for local telephone service providers that applied for a license between July 1, 2004 and January 31, 2008 and on or after February 1, 2008 are NT$6.3 billion and NT$4.8 billion, respectively, multiplied by the Local Network Operation Weights for the

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regions in which local network managerial rights have been granted to the service provider. The Local Network Operation Weights are calculated as the population of the region as a proportion of the entire population of Taiwan and are announced by the competent authority every three years. If an applicant for a license is also a Type I service provider, it will need to combine the minimum paid-in-capital requirements for all relevant services.

In March 2000, the government granted three new concessions to fixed-line services providers for integrated services. Recipients of these concessions are required to apply for a network construction permit to deploy broadband local access networks. Each recipient of these concessions is required to have capacity for 150,000 customers before it is able to apply for a fixed-line license to launch its proposed services. The three fixed-line service providers have since obtained fixed-line licenses and are required to achieve capacity for one million customers by the sixth year following the date of the grant of the network construction permit awarded. Operators that applied for integrated service provider licenses before June 30, 2004, between July 1, 2004 and January 31, 2008 and on or after February 1, 2008 must achieve a capacity for 1.0 million, 0.4 million and 0.3 million customers, ports or a combination of both, respectively, by the fourth year following the date of the grant of the network construction permit.

*Wireless Services.* Under the Telecommunications Act, the Wireless Regulations promulgated by the Ministry of Transportation and Communications before March 1, 2006 or by the NCC from March 1, 2006 continue to govern the issuance of wireless services licenses and the business scope of wireless service providers. Wireless service licenses are subdivided into the following categories:

- mobile services;
- paging services;
- mobile data services;
- digital low-power cordless telephone services; and
- trunked radio services.

Wireless service licenses are granted to both regional and national service providers through review and bidding procedures.

The wireless service license for mobile or paging service, once granted, should be valid for a term of 15 years starting from the date when such license is granted, and licenses for mobile data, digital low-power cordless telephone and trunked radio are valid for 10 years starting from the date when such license is granted. According to the Regulations for Administration of Mobile Communications Businesses amended by the NCC on September 19, 2011, the wireless service provider may file an application with the NCC for extension of the valid term of its license for providing mobile or paging service one year prior to the expiry of the 15-year valid term. Once the NCC approves the application, the valid term of the wireless service license for mobile or paging service will be extended to June 30, 2017. The valid terms of our licenses granted by the ROC government authorities for providing 2G mobile services on the 900MHz and 1800MHz spectrum will expire in 2012 and 2013 respectively. We filed the application with the NCC for extending the valid terms of our 2G licenses on November 29, 2011. Our application was approved by the

NCC in November 2012 and the terms of our licenses for providing 2G mobile services on the 900MHz and 1800MHz spectrum should be valid until June 2017.

The minimum paid-in capital requirements for different mobile communication businesses are as follows: Digital Low-Power Wireless Telephone Business, NT$200 million; Trunking Wireless Telephone Business, NT$20 million for regional operation and NT$60 million for island-wide operation; Mobile Data Communication Business, NT$50 million for regional operation and NT$150 million for island-wide operation; Radio Paging Business, NT$200 million for regional operation and NT$400 million for island-wide operation; Mobile Telephone Business, NT$2 billion for regional operation and NT$6 billion for island-wide operation. If one

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single applicant acquires operational licenses of two or more businesses with minimum paid-in capital requirements, the paid-in capital for the businesses should be calculated and collected by the applicant separately.

For an operator who obtains the permission of operation over two businesses through the legal procedure, its minimum paid-in capital shall be separately calculated upon approval for establishment, if such other businesses are subject to the minimum paid-in capital restriction.

*Third Generation Mobile Services.* The Ministry of Transportation and Communications promulgated the Third Generation Mobile Telecommunications Services Regulations on October 15, 2001. The NCC amended the above regulations on July 5, 2007, designating itself as the authority in charge of the third generation, or 3G, mobile services regulations and further amended such regulations on December 30, 2008 for the establishment of base stations. The regulations govern voice and non-voice telecommunications services provided using the spectrum assigned by the Ministry of Transportation and Communications, and now governed by the NCC, that utilizes the IMT-2000 technical standards as announced by the International Telecommunications Union. Licenses for 3G mobile services were granted by the Ministry of Transportation and Communications and are now granted by the NCC. We have received our 3G mobile services license, which is valid from May 26, 2005 to December 31, 2018.

Under the Third Generation Mobile Telecommunications Services Regulations, the operation area of this business is the whole nation; the minimal paid-in capital for operating this business shall be NT$6 billion. If the applicant operates another business of a Type I telecommunications enterprise at the same time and there is a restriction on the paid-in capital to the other business, after acquiring the establishment approval, the required minimal paid-in capital shall be calculated by aggregating the minimal requirement of each service.

*Mobile Broadband Services.* The NCC promulgated the Regulations for Administration of Mobile Broadband Businesses on May 8, 2013. Under such regulation, the 4G service providers must obtain the concession license issued by the NCC before providing 4G services. The license is valid from the date of issuance until December 31, 2030. The operation area of 4G services covers throughout the ROC.

The minimum paid-in capital for operating the mobile broadband services is NT$6 billion. If an applicant also operates another business of Type I telecommunications enterprise, the minimal paid-in capital required for operating the mobile broadband services and the other Type I telecommunications services shall be determined by aggregating the paid-in capital of the entity required for operating the mobile broadband services and that of the entity required for operating the other Type I telecommunications services.

We have received the system installation permit on March 12, 2014 and are currently constructing our network system. The NCC will grant the concession license to us once it confirms that our network system and business operation satisfy the requirements under the Regulations for Administration of Mobile Broadband Businesses.

*Satellite Services.* Under the Telecommunications Act, the Satellite Regulations promulgated by the Ministry of Transportation and Communications govern the issuance of satellite services licenses and the business scope of satellite service providers. The NCC amended the above regulations on July 20, 2007, designating itself as the authority in charge of the Satellite Regulations. Satellite services licenses are subdivided into fixed satellite services licenses and mobile satellite services licenses.

The satellite services license should be valid for a term of 10 years starting from the date when such license is granted. If the service provider wants to re-new its satellite services license before the expiry of the 10-year term, such service provider needs to file a renew application with the NCC within the period from 9 months to 6 months before the expiry date of the original satellite license. The valid term of the renewed satellite license will be 10 years. Minimum

paid-in capital requirements for fixed satellite service providers and mobile satellite service providers are NT$100 million and NT$500 million, respectively.

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We currently hold a fixed satellite services license, valid from December 10, 2008 to December 9, 2018.

*Type II*

The Telecommunications Act was amended in 1996 to open the market for all Type II services. Under the Type II Services Regulations, Type II services are divided into special services and general services. Special services include simple resale, VoIP, network telephone service of E.164 and non-E.164 user numbers (IP Phone Numbers), international leased circuit and other services specified by governing authority. General services include any Type II service other than special services. The policy for granting a Type II service license is as follows:

- there is no limit on the number of licenses to be issued;
- licenses were granted by the Directorate General of Telecommunications before March 1, 2006 and are now granted by the NCC; and
- no bidding procedure is required.

We hold a license to operate all Type II services. Type II service licenses issued before November 15, 2005 are valid for ten years and may be renewed by application made two months prior to the expiration date. Type II service licenses issued or renewed on or after November 15, 2005 are valid for three years and may be renewed during the period commencing two months prior to the expiration date. There is no minimum paid-in capital requirement for Type II service providers. Our license to operate Type II services is included in our license to operate integrated services, and is valid from July 29, 2000 to July 28, 2025.

Under regulations governing the fees payable for Type II licenses, operators of simple resale or network telephone services of E.164 or non-E.164 user numbers must pay an annual license fee equal to 1% of annual revenues generated from these services during the previous year. Type II service operators providing services other than simple resale or network telephone services of E.164 or non-E.164 user numbers must pay license fees ranging from NT$6,000 to NT$150,000 depending on their respective paid-in capital. For operators who operate over two or more businesses, their license fee shall be separately calculated but jointly collected. The regulations do not apply to integrated services providers who are permitted to provide Type II services without additional Type II Licenses.

The Directorate General of Telecommunications started to process the applications for allocating E.164 and non-E.164 user numbers (IP phone numbers) on November 15, 2005. A few operators, including our company, have applied for IP phone numbers. We applied to the NCC for E.164 user numbers and as of January 30, 2008, we have received approval to build a network with a capacity of 30,000 numbers. As we are governed by fixed-line regulations, we need to receive approval from the NCC for our operation rules, tariff and service agreement for IP phone numbers before we can commence E.164 service. We filed with NCC to return 30,000 E.164 numbers, and the application was approved by the NCC on July 1, 2011. Please refer to B. Business Overview for further discussion.

***Telecommunications Numbers***

According to the Telecommunications Act, numbering codes, subscriber numbers, identification numbers and other telecommunication numbers will be distributed and managed by the NCC. These telecommunication numbers may not be used or changed without approval by the NCC. In order to maintain effective use of available telecommunication

numbers, the Telecommunications Act empowers the NCC to reallocate and retrieve and to collect a usage fee for distributed telecommunication numbers. The NCC promulgated the Fee Standards for Special Telecommunication Numbers on March 18, 2010, effective immediately, requiring telecommunications service providers to pay 70% of revenues collected from the auctioning off and selection of golden numbers and the standard usage rates for special identification numbers in use.

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***Restrictions on Dominant Telecommunications Services Providers***

Under the Telecommunications Act, the regulations governing dominant telecommunications services providers apply only to Type I service providers. A Type I service provider is deemed to be dominant if it meets any of the following criteria and was declared by the Ministry of Transportation and Communications or now the NCC as dominant:

- controls key basic telecommunications infrastructure;
- has dominant power over market price; or
- has more than a 25% market share in terms of customers or revenues.

We have been declared by the former competent authority Ministry of Transportation and Communications as a dominant Type I service provider for fixed-line and GSM mobile services. On July 7, 2012, we have been classified as a dominant Type I service provider for 3G mobile services by the NCC. Under the Telecommunications Act, a dominant Type I service provider must not engage in the following activities:

- directly or indirectly hinder a request for interconnection with its proprietary technology by other Type I service providers;
- refuse to release to other Type I service providers the calculation methods of its interconnection fees and other relevant materials;
- improperly determine, maintain or change its tariffs or means of services;
- reject, without due cause, a request for leasing network components by other Type I service providers;
- reject, without due cause, a request for leasing lines by other service providers or customers;
- reject, without due cause, a request for negotiation or testing by other service providers or customers;
- reject, without due cause, a request for negotiation for co-location by other service providers;
- discriminate, without due cause, against other service providers or customers; or

abuse its position as a dominant provider, or engage in other unfair competition activities as determined by the regulatory authorities.

In addition, a dominant Type I service provider is subject to special regulations limiting its tariff changes.

***Tariff Control and Price Cap Regulation***

In order to promote competition in the telecommunications market, and as part of the government s overall policy toward deregulation, the Telecommunications Act was amended in 1999 to abolish the former rate of return system on tariff setting in favor of price cap regulation of Type I services.

Under the Administrative Regulation Governing Tariffs of Type I Telecommunications Enterprises, a dominant Type I service provider must submit its proposed adjustment in primary tariffs and promotional packages including primary tariffs to the NCC for approval at least 14 days prior to the date of the proposed tariff changes and announce such change on media, website and business locations on the day after the NCC grants the approval. The tariff change will come into effect seven days after the announcement.

Primary tariffs include:

for fixed line local telephone services: monthly fees, usage fees, monthly rental fees of leased lines, pay telephone usage fees and internet connection service;

for fixed line domestic long distance telephone services: monthly rental fees of leased lines;

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- for fixed line international long distance telephone services: leased line monthly rental fees;
- for wireless services, including 3G mobile services: monthly rental fees and the prepaid communication charges;
- the wholesale price enacted in accordance with this regulation; and
- other fees or tariffs announced by the NCC.

In addition, a dominant Type I service provider is required to set wholesale prices for the provision of its telecommunication services to other telecommunication enterprises. Factors affecting the determination and adjustments of the wholesale price include the establishment, change, cancellation and connection fees. These telecommunication services and their suitable targets, all of which are subject to annual reviews by the NCC, include:

- interface circuits (local and long distance) between internet access service providers and customers for Type I and Type II service providers;
- interface circuits (local and long distance) between internet access service providers for Type I and Type II service providers that are internet access service providers;
- interconnection circuits between Type I service providers and between Type I and Type II service providers of international simple resale, or ISR, and E.164 VoIP services;
- DSL-family (xDSL) circuits for fixed line service providers and internet service providers;
- other local and long distance data circuits for Type I and Type II service providers; and
- broadband internet interconnection for Type I and Type II service providers that are internet access service providers.

The initial wholesale prices set by a dominant Type I service provider may be the retail price less fees and expenses which need not be incurred, but shall not be higher than its promotional pricing. Changes in the wholesale price charged by a dominant Type I service provider may not be greater than (i) the retail price less fees and expenses which need not to be incurred but not greater than the promotional pricing; or (ii) the annual growth rate of the consumer price index in Taiwan minus the constant set by the NCC, whichever is the lower. The Regulations Governing Tariffs of Type I Service Providers further prohibits a dominant Type I service provider from practicing unfair competition against other telecommunication enterprises.

In addition, changes in tariffs charged by dominant Type I service providers (notwithstanding the type of their respective services) may not, in any event, be greater than the annual growth rate of the consumer price index in Taiwan adjusted by a set constant, which will be periodically determined and announced by the NCC. For example, if:

the annual growth rate of the consumer price index in Taiwan minus the set constant is positive, the increased percentage of tariffs must not exceed such positive figure;

the annual growth rate of the consumer price index in Taiwan minus the set constant is negative, the decreased percentage of tariffs must be at least the absolute value of such negative figure, and the tariffs used in the given year must not be higher than the decreased tariff; and

the annual growth rate of the consumer price index in Taiwan minus the set constant equals to zero, no increase in tariffs is allowed to be made by any Type I service providers.

On January 29, 2010, the NCC announced that effective from April 1, 2010 to March 31, 2013:

the set constant to be applied to the tariff adjustment for the fixed line integrated services is 4.816% and covers the following:

dominant providers of fixed line services

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tariffs of the following:

the monthly fee for ADSL leased line and the usage fee for domestic long distance telephone services (excluding public pay phones)

wholesale prices of the following:

the monthly fee for leased lines services (including local and domestic long distance leased lines) between internet service providers and their customers

the monthly fee for leased lines services (including local and domestic long distance leased lines) between an internet service provider and another internet service provider

the monthly fee for the interconnection (including local and domestic long distance lines) between a Type 1 telecommunication service provider and another Type 1 telecommunication service provider; the monthly fee for the interconnection (including local and domestic long distance lines) between a Type 1 telecommunication service provider and a Type 2 telecommunication service provider who provides simple resale and network telephone service of E.164 user numbers

the monthly fee for other local and domestic long distance leased lines

the interconnection fee for internet bandwidth interconnection

no set constant to be applied to the call charges for the domestic fixed communication services during the following periods:

the integrated services operators and the domestic telephone services operators can determine the tariff adjustment for the domestic telephone services during the specific period and seek NCC s approval or recognition

the specific periods include 11:00 p.m. to 8:00 a.m. from Monday to Friday, 12:00 a.m. Saturday to 8.00 a.m. Monday, and the whole day of a national holidays

the set constant to be applied to the tariff adjustment for the mobile services and the 3G mobile services is 5% and covers the following:

2G mobile service and 3G mobile service operators

tariffs of the following:

domestic short messaging services

calls made from a 2G mobile services customer or from a 3G service network to a domestic fixed communication network

calls made from a 2G mobile services customer or from a 3G service network to a 2G mobile service network, a 3G mobile service network, a 1900MHz Digital Low-Tier Cordless Telephone Services, or PHS, or WiMAX services

the set constant to be applied to the cellular voice access charge will be announced separately after the amendment to the relevant regulations.

the set constant to be applied to the tariff adjustment for other Type 1 telecommunication services is the annual growth rate of the consumer price index in Taiwan.

On February 7, 2013, the NCC announced that effective from April 1, 2013 to March 31, 2017:

the set constant to be applied to the tariff adjustment for the fixed line integrated services is 5.1749% and covers the following:

dominant providers of local network services and long-distance network services in Type I service

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tariffs of the following:

- the monthly fee for fixed-line broadband access services (excluding fiber-to-the-home, or FTTH, and fiber-to-the-building, or FTTB)
- wholesale prices of the following:
  - the monthly fee for leased lines services (including local and domestic long distance leased lines) between internet service providers and their customers
  - the monthly fee for leased lines services (including local and domestic long distance leased lines) between an internet service provider and another internet service provider
  - the monthly fee for the interconnection (including local and domestic long distance lines) between a Type 1 telecommunication service provider and another Type 1 telecommunication service provider; the monthly fee for the interconnection (including local and domestic long distance lines) between a Type 1 telecommunication service provider and a Type 2 telecommunication service provider who provides simple resale and network telephone service of E.164 user numbers
  - the monthly fee for other local and domestic long distance leased lines
  - the interconnection fee for internet bandwidth interconnection
- the set constant to be applied to the tariff adjustment for other Type 1 telecommunication services is the annual growth rate of the consumer price index in Taiwan, no increase in tariffs is allowed.

In comparison, all non-dominant Type I service providers are only required to fully disclose and notify the public of their proposed tariff adjustments and promotional packages, through the media, websites, and at all business premises, in an appropriate manner, and to report to the NCC prior to the date of the proposed tariff change, with respect to all tariffs.

Type II service providers are free to establish their own tariff schemes, but are required to notify the NCC and the public upon adoption and upon any subsequent adjustments.

***Accounting Separation System***

The Telecommunications Act requires that a Type I service provider, including one who concurrently offers Type II services, separately calculate the profits and losses for its different services and prohibits any cross-subsidization among services that will impede fair competition.

***Interconnection Arrangements***

The Telecommunications Act requires all Type I service providers to allow other Type I service providers access to their networks. It further requires Type I service providers, within three months upon request by the other Type I service provider, to reach an agreement on the relevant terms for the interconnection. Prices charged for interconnection must be based on cost. If the parties fail to reach an agreement within three months, the NCC may, either at the request of the parties or on its own accord, arbitrates and determines the interconnection terms for the parties. The Telecommunications Act authorizes the Directorate General of Telecommunications or, from March 1, 2006, the NCC to issue rules and regulations pertaining to interconnection.

The Administrative Rules for Network Interconnection establishes the basis for determining the interconnection charge of a dominant Type I service provider, which shall be reviewed every four years. The interconnection charge of a dominant Type I service provider shall be reviewed by the NCC in advance, and the NCC has the right to modify the rate.

A dominant Type I service provider shall unbundle its network elements. The unbundled network elements shall contain the following:

- local loops;
- local switch transmission equipment;

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- local trunks;
- toll switch transmission equipment;
- long distance trunks;
- international switch transmission equipment;
- network interfaces;
- directory equipment and services; and
- signaling network equipment.

Unless otherwise provided by the laws, interconnection charge of the providers for mobile communications businesses and the 3G mobile communications business should be calculated based on the decrees issued by NCC. The foregoing shall apply, mutatis mutandis, to the calculation and reviewing method of the interconnection charge of the dominant providers for fixed communication services.

Unbundled network components of the providers for mobile communications businesses and the 3G mobile communications business include:

- mobile telecommunications trunks;
- mobile telecommunications base stations;
- controlling equipment of mobile telecommunications base stations;
- mobile telecommunications switch transmission equipment; and
- other items recognized by the NCC.

The Administrative Rules for Network Interconnection Between Telecommunication Service Providers specifies the charges for network interconnection among Type I service providers as follow:

Before January 1, 2011, except for international communications, tariffs for communications between a mobile telecommunications network and a fixed-line network were collected from the call-originating subscribers by the call-originating service provider pursuant to the tariff schedules set by the mobile communication service provider, and revenues or any uncollectible accounts from such tariffs went to the mobile service provider. However, from January 1, 2011, although the tariffs shall still be paid by the call-originating subscribers, the tariff schedules are set by the call-originating network service provider, and revenues or any uncollectible accounts from such tariff shall go to the call-originating service provider. During the transition period from January 1, 2011 to December 31, 2016, we, as a dominant Type I fixed-line service provider, shall pay extra transition fee in addition to access charges to the mobile communications service providers.

Tariffs for communications between mobile telecommunications networks shall be paid by the call-originating subscribers pursuant to the tariff schedules set by the call-originating service providers, and the revenues or any uncollectible accounts from such tariffs shall go to the call-originating service providers.

Tariffs for communications between fixed-line network will be determined by the following principles:

tariffs for communications between the local telephone networks shall be paid by the call- originating subscribers pursuant to the tariff schedules set forth by the call-originating service providers, and revenues or any uncollectible accounts from such tariffs shall go to the call-originating service providers;

tariffs schedules for the local telephone network subscribers using domestic long-distance telephone services shall be set by the domestic long-distance telephone services provider and tariffs shall be

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collected from the local telephone network subscribers using domestic long-distance telephone services. Revenues or any uncollectible accounts from such tariffs shall go to the domestic long-distance telephone services providers; and

tariffs schedules for the local telephone network subscribers using international long-distance telephone services shall be set by the international long-distance telephone services provider and collected from the local telephone network subscribers using international long-distance telephone services. Revenues or any uncollectible accounts from such tariffs shall go to the international long-distance telephone service providers.

Tariffs schedules for communications between satellite mobile networks and between satellite mobile networks and fixed-line communications networks or mobile communications networks shall both be set by the call-originating service providers. Revenues or any uncollectible accounts from such the tariffs shall go to the call-originating service providers.

Tariffs schedules for communications between the E. 164 VoIP networks provided by the Type I service providers and mobile telecommunications networks, or local telephone networks, or satellite mobile networks shall be set by the call-originating service providers. Revenues or any uncollectible accounts from such tariffs shall go to the call-originating service providers.

***Bottleneck Facilities***

Under the Telecommunications Act, when a Type I service provider cannot construct bottleneck facilities within a reasonable period of time or substitute those facilities with other available technologies, it may request for co-location on a fee basis from the owner of the facilities located at the bottleneck of the relevant telecommunications network. The owner of the facilities so requested may not reject these requests without due cause. The NCC has the authority to prescribe facilities as bottleneck facilities, and has prescribed bridges, tunnels, lead-in tubes and telecommunications chambers located within buildings and horizontal and vertical telecommunications cables and lines as bottleneck facilities in relation to fixed-line telecommunications networks. The NCC, in an announcement on December 21, 2006, has defined local loop facilities as the bottleneck of the telecommunications network and amended the Administrative Rules for Network Interconnection Between Telecommunication Service Providers in April 2007, providing that we, as a Type I service provider, can only charge other local telephone service providers at cost for local loop services. The rental tariff is derived from a cost basis and must be approved by the NCC each year.

***Spectrum Allocation***

The Ministry of Transportation and Communications is responsible for allocating all telecommunications related frequencies primarily according to the standards set by the International Telecommunications Union. The NCC is responsible for the licensing of operators to use these frequencies. The 900 MHz and 1,800 MHz frequency bands have been allocated for 2G mobile services and the licenses will be expired in June 2017. A total of 40 MHz of FDD spectrum around the 850 MHz frequency band and a total of 110 MHz of FDD spectrum and 20 MHz of TDD spectrum around the 2 GHz band have been allocated for 3G mobile services.

On October 30, 2013, NCC completed the bidding process for the spectrum to provide 4G mobile services and a total of 270MHz of FDD spectrum over 700MHz, 900MHz, and 1800MHz frequency bands have been assigned to six nominated bidders, including us.

***Provision of Universal Services***

Under the Telecommunications Act, a Type I service provider may be required by the NCC, previously the Ministry of Transportation and Communications, to provide universal telecommunications services in remote or unprofitable areas. These services include voice communication services, such as public phones, and data communication services, such as internet provision for libraries and public primary and secondary schools. All

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Type I service providers and certain Type II service providers designated by the NCC, previously the Ministry of Transportation and Communications, will be required to contribute a fixed portion of their annual revenues to a universal services fund. Such a fund will be used to compensate for any losses, bad debts and management fees incurred by the relevant Type I service provider in providing the universal services. All providers of universal services cannot refuse any request for service, unless for legitimate reasons, and cannot charge more than the predetermined tariffs.

***Equal Access***

As a result of the liberalization of Taiwan s telecommunications industry, a Type I service provider, including a 3G mobile services provider and a WiMax service operator, is required to provide its customers with equal access to the domestic and international long distance telephone services provided by other service providers. A Type I service provider may provide equal access through pre-selection or call-by-call selection. Before July 1, 2005, all Type I service providers, including us, provide equal access only through call-by-call selection. When a customer makes a call using call-by-call selection, such customer has the option to select a service provider by dialing the network identification prefix assigned to the service provider of his choice. This will result in the automatic selection of the preferred service provider for the provision of relevant telecommunication services. Starting from July 1, 2005, all Type I service providers also provide equal access through pre-selection in Keelung City, Taipei City/County, Taichung City/County and Kaohsiung City/County. Equal access through pre-selection is available throughout Taiwan since January 1, 2006. The pre-selection function allows any customer to select in advance a long distance or international service provider of his or her choice. When such customer makes a call using this function, the communications network will automatically interconnect to the long distance or international network previously selected by such customer.

***Number Portability***

According to the Telecommunications Act and the Administration Rules Governing Number Portability, Type I service providers shall provide number portability service which enables customers to retain their existing local and toll free fixed-line telephone numbers or mobile phone numbers when they switch from the original Type I service provider to other Type I service providers. Meanwhile, Type I service providers shall mutually grant each other number portability services on a reciprocal basis, and shall conform in accordance with the principle of impartiality and reasonableness, and shall not be discriminatory.

Under the regulation, we are required to provide number portability service for fixed-line customers in Taipei City, New Taipei City, Keelung City, Taichung City, Kaohsiung City and other areas where there are two or above fixed-line service providers. We have also provided number portability service for mobile communication customers since October 15, 2005. Pursuant to the regulation, we shall compile and submit related information of number portability for the previous six months to NCC by January 10 and July 10 of each year.

***Local Loop Unbundling***

In December 2006, the NCC defined the local loop as facilities at the bottleneck of telecommunications networks in accordance with the Regulations Governing Fixed Network Telecommunications Businesses. The NCC requires us to unbundle the local loops and allow other telecommunications operators to use these connections. The local loop or last mile connections are the physical wire connections between the telephone exchange s central office to the customer s premises usually owned by the incumbent telephone company. The NCC further amended the Administrative Rules for Network Interconnection between Telecommunication Service Providers in April 2007 which provides that we can only charge other local telephone service providers at cost for local loop services instead of on the basis of

commercial negotiations.

*Co-location*

We have been declared by the Ministry of Transportation and Communications as a dominant Type I service provider for fixed-line and mobile services. According to the Telecommunication Act, the Regulations Governing Fixed Network Telecommunications Businesses and the Administrative Rules for Network Interconnection between Telecommunication Service Providers, if any other service provider requests for co-location, we must negotiate with them, unless otherwise provided by laws or regulations. As of the end of 2013, we are currently co-locating 27 POI sites and 2 cable stations with other Type I fixed-line service providers and 11 POI sites with other Type I mobile service providers.

*Ownership Limitations*

The laws of the Republic of China limit foreign ownership of our common shares. Prior to March 1, 2006, the Ministry of Transportation and Communications, as the competent authority under the Telecommunications Act, had the power to prescribe the limits on foreign ownership of our common shares. After the formation of the NCC on March 1, 2006, the NCC replaced the Ministry of Transportation and Communications as the competent authority under the Telecommunications Act pursuant to the Organization Law. On July 18, 2006, the Ministry of Transportation and Communications and the NCC reached an agreement where the Ministry of Transportation and Communications will have the authority to adjust foreign ownership limits only after negotiations with the NCC. On June 14, 2007, we applied to both the NCC and the Ministry of Transportation and Communications, asking for an increase in direct and indirect foreign ownership cap of our common shares. After consultation with the NCC, the Ministry of Transportation and Communications raised our foreign ownership cap of direct and indirect shareholdings from 49% to 55%. Our foreign ownership limitation of total direct shareholdings remained at 49%.

Under the current Telecommunications Act, the Chairman of a Type I service provider is required to be a citizen of the Republic of China.

*Fair Trade Act*

The requirements and restrictions under the Telecommunication Act regarding price control, IP peering, equal access and accounting separation regulates certain competitive activities among telecommunication industries and aims to reduce the occurrence of anti-competition activities.

By comparison to the Telecommunications Act, the Fair Trade Act, or the FTA, plays a more comprehensive role in regulating all matters relating to competition between enterprises. The Fair Trade Act seeks to deter and prevent anti-competitive conduct by granting the Fair Trade Commission s powers to investigate and to impose penalties.

The Fair Trade Act is administered and enforced by the Fair Trade Commission, or the FTC, which has independent administration rights granted to it under the Fair Trade Act and is empowered to impose disciplinary actions for fair trade matters. The Fair Trade Commission may initiate an investigation either on its own account in accordance with its discretion granted by the Fair Trade Act or upon receipt of a complaint.

*Regulation on Telecommunication Enterprise with Monopoly Status*

The term monopoly used in the FTA refers to the circumstance where an enterprise conducts its business operation in a relevant market without facing any competition or where an enterprise is able to dominate the relevant market and block competition in the market. If there are two or more enterprises within the same market that do not engage in any price competition with each other, the whole group of non-competing enterprises should be deemed as a single

monopoly enterprise in the market.

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According to the FTA, an enterprise or a group of enterprises will not be considered as monopolistic enterprise(s) if none of the following circumstances exists:

- the market share of the enterprise in a relevant market reaches one-half of the market;
- the combined market share of two enterprises in a relevant market reaches two-thirds of the market; and
- the combined market share of three enterprises in a relevant market reaches three-fourths of the market.

If the market share of any respective enterprise does not reach one-tenth of the relevant market or if the amount of the enterprise s total sales in the preceding fiscal year is less than one billion NT dollars, such enterprise shall not be considered as a monopolistic enterprise in the relevant market. Notwithstanding the above, the FTC has the ultimate discretion to consider an enterprise as a monopolistic enterprise upon any other events evidencing such enterprise s capability to affect the supply and demand in relevant market or eliminate competition.

Under the FTA, any enterprise with monopoly status is prohibited from engaging in any of the following activities:

- directly or indirectly, by using any unfair method to prevent any other enterprises from competing;
- improperly set, maintain or change the price for goods or the remuneration for services;
- forcing the enterprise s trading counterpart to give preferential treatment without justification; or
- abusing its market power.

According to the FTC s Explanation on Regulations Governing Telecommunication Industry, a telecommunication enterprise with monopoly status is likely to be involved with the following activities regulated by the FTA: conducting predatory pricing, price squeezing, cross-subsidies, price discrimination, blocking access to essential facilities, entering into long-term agreements to restrict the ability to change counterparties.

***Regulations on Combination Between Telecommunication Enterprises***

The term merger used in the FTA refers to any of the following circumstances:

- where an enterprise and another enterprise are merged into one;
- where any enterprise holds or acquires more than one-thirds of total voting shares or capital of another enterprise;

- where any enterprise is assigned by or leases from another enterprise the whole or the major part of the business or properties of such other enterprise;
- where any enterprise operates jointly with another enterprise on a regular basis or is entrusted by another enterprise to operate the latter s business; or
- where any enterprise directly or indirectly controls the business operation or the appointment or discharge of personnel of another enterprise.

If any merger between or among multiple enterprises falls within any of the following circumstances, a prior approval granted by the FTC shall be required:

- as a result of the merger, the enterprise will own at least one-third of the total market share;
- there is any enterprise involved with the merger has one-fourth of the market share; or
- the sales amount for the preceding fiscal year of one of the enterprises involved with the merger exceeds the threshold amount publicly announced by the FTC from time to time.

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Once the telecommunication enterprise files the merger application with the FTC, the FTC will evaluate the pros and cons of the merger by weighing the potential economic efficiency against the disadvantage of reduced competition. If the FTC finds the potential economic efficiency generated from the merger should be able to offset the disadvantage of reduced competition caused, the FTC will grant the approval for the merger.

***Regulations on Concerted Action (Cartel) in Telecommunication Industry***

The term concerted action (cartel) as used in the FTA means the conduct of any enterprise, by means of contract, agreement or any other form of mutual understanding, with any other competing enterprise, to jointly determine the price of goods or services, or to limit the terms of quantity, technology, products, facilities, trading counterparts, or trading territory with respect to such goods and services, and thereby to restrict each other s business activities. Notwithstanding the above, the term concerted action as used in the FTA is limited to any horizontal concerted action at the same production and/or marketing stage that would affect the market function of production, trade in goods, or supply and demand of services. Under the FTA, the enterprises are prohibited from engaging in any concerted actions unless the FTC holds the concerted action may be beneficial to overall economy and public interest.

According to the FTC s Explanation on Regulations Governing Telecommunication Industry, a telecommunication enterprise may be able to involve with the following concerted actions: entering into common pricing agreement, restriction of output and market segregation, concerted refusal to deal, or entering into agreement for exchange of information.

***Regulations on Unfair Competition in Telecommunication Industry***

The FTA prohibits any enterprise from conducting any of the following activities that may restrict competition or impede fair competition:

forcing another enterprise to discontinue supply, purchase or other business transactions with a particular enterprise for the purpose of injuring such particular enterprise;

treating another enterprise discriminatively without justification;

forcing the trading counterpart(s) of its competitor(s) to do business with itself by way of coercion, inducement with interest, or other improper means;

forcing another enterprise to refrain from competing in price, or to take part in a merger or a concerted action by coercion, inducement with interest, or other improper methods;

acquiring undisclosed information of another enterprise regarding the production and sales, information concerning trading counterparts or other technology related secret by way of coercion, inducement with interest, or other improper means; or

setting improper restrictions on its trading counterparts business activity as the condition to reach business engagement.

According to the FTC s Explanation on Regulations Governing Telecommunication Industry, the telecommunication enterprise may be involved with the following activities that may restrict competition or impede fair competition: conducting vertical trading restraint, boycott, discrimination, improper sales discount, sales with gift or lottery or tie-in sales.

***Regulations on the Representations or Symbol Used by Telecommunication Enterprise on Goods or in Advertisement***

The FTA prohibits any enterprise from making or using false or misleading representations or symbol as to price, quantity, quality, content, production process, production date, valid period, method of use, purpose of use, place of origin, manufacturer, place of manufacturing, processor, or place of processing on goods or in advertisements, or in any other way making known to the public.

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*Other Regulations*

In addition to the competitive activities expressly regulated by the FTA, the enterprise shall further be prohibited from conducting any fraudulent activity or significantly unfair activity that may impact the trade order.

The FTC may order any enterprise that violates any of the provisions of the FTA to cease therefrom, rectify its conduct or take necessary corrective action within the time prescribed in the order; in addition, the FTC may assess upon such enterprise an administrative fine of not less than NT$50,000 nor more than NT$25,000,000. Should such enterprise fail to cease therefrom, rectify the conduct or take any necessary corrective action after the lapse of the prescribed period, the FTC may continue to order such enterprise to cease therefrom, rectify the conduct or take any necessary corrective action within the time prescribed in the order, and each time may successively assess thereupon an administrative fine of not less than NT$100,000 nor more than NT$50,000,000 until its ceasing therefrom, rectifying its conduct or taking the necessary corrective action.

If the FTC finds an enterprise liable for violation of regulations governing monopoly or concerted action (cartel), the FTC could impose a monetary fine of up to 10% of the total sales of the enterprise in the preceding fiscal year.

*Administrative Fee Law*

According to the Administrative Fee Law, central and local governments, government agencies and schools are empowered to collect administrative fees from us and other telecommunications services providers for the telecommunications facilities built on public roads and properties. Under the Administrative Fee Law, Urban Road Act and Local Road Act, road authorities of municipal governments may collect usage fees from users of local roads, including us, for establishing lines along with the local roads. The fee schedule is set up in the Standard for Usage Fees of Local Roads.

Under the Public Road Law, administrative authorities of public roads may collect usage fees from the users of public roads. According to the Rules Governing Collection of Usage Fees on Public Roads, the relevant collection agencies, including agencies designated by the Ministry of Transportation and Communications and municipal governments, depending on the types of public roads, may collect usage fees from users, including us, for establishing lines along with the public roads.

*Personal Data Protection*

On May 26, 2010, the President of the Republic of China announced the amendment of the Personal Information Protection Act, or PIPA, which replaced the former Computer-Processed Personal Data Protection Act, or CPPDPA, and became fully effective on October 1, 2012, except for its Articles 6 and 54 that await further determination by the Executive Yuan. Under the PIPA, every individuals or governmental or non-governmental agencies, including us, should be subject to certain requirements and restrictions for collecting, processing or using personal data. The definition of personal data is extended to cover a broad scope, including name, birthday, ID, special features, fingerprints, marriage status, family, education, occupation, medical records, medical history, generic information, sex life, health examination report, criminal records, contact information, financial status, social activities, and any other data which is sufficient to directly or indirectly identify a specific person. If we fail to comply with the PIPA, we may be subject to serious punishment for civil claims, criminal offenses and administrative liabilities: the ceiling of the aggregate compensation amount for damages payable in a single case will be up to NT$200 million or the actual value of loss arising from our violation provided the amount of actual value of such loss is higher than NT$200 million; the defendant may be subject to an imprisonment of up to five years; and the penalty for administrative liabilities will be up to NT$500,000 for each violation, and may be imposed consecutively if such violation continues.

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*Statute of Chunghwa Telecom Co., Ltd.*

The Executive Yuan, on April 27, 2012, proposed a motion for the abolishment of the Statute of Chunghwa Telecom Co., Ltd. for legislative approval. We cannot determine when this motion will be approved by the Legislative Yuan. Under Republic of China law, the Statute of Chunghwa Telecom Co., Ltd will continue in effect until the Legislative Yuan formally approves the motion and the President of the Republic of China pronounces the abolishment of the law.

*Approval of Ministry of Transportation and Communications*

While the continued application of the Statute of Chunghwa Telecom Co., Ltd. remains unclear and it may be abolished in the near future, under that statute we are required to obtain approval of the Ministry of Transportation and Communications for:

- the adoption of and any changes to our articles of incorporation and board of directors organization rules;
- any changes to our authorized capital and any issuance of our common shares;
- any changes to primary tariffs for Type I services; and
- any changes to operational procedures of Type I services.

*Employee Subscription Rights for New Issues of Our Common Shares*

In accordance with the Statute of Chunghwa Telecom Co., Ltd., our employees have rights to subscribe for not more than 10% of a new issuance of our common shares in accordance with subscription rules which were to be announced by the Ministry of Transportation and Communications. However, no such rules were ever announced. In addition, under the Republic of China Company Act, unless exempted by the relevant government authorities, a Republic of China company must give its employees pre-emptive rights to subscribe between 10-15% of any new issue of shares by us. The pre-emptive subscription rights do not apply to issuance of restricted shares by a public company to its employees.

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**C. Organizational Structure**

Set forth below is a diagram indicating our organization structure as of March 31, 2014.

**D. Property, Plant and Equipment**

Please refer to B. Business Overview for a discussion of our property, plant and equipment.

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

*You should read the following discussion of our financial condition and results of operations together with the consolidated financial statements and the notes to such statements included in this annual report.*

*For the convenience of readers, NT dollar amounts used in this section for, and as of, the year ended December 31, 2013 have been translated into U.S. dollar amounts using US$1.00=NT$29.83, set forth in the statistical release of the Federal Reserve Board on December 31, 2013. The U.S. dollar translation appears in parentheses next to the relevant NT dollar amount.*

**Overview**

A number of recent and expected future developments have had, and in the future may have, a material impact on our financial condition and results of operations. These developments include:

- changes in our revenue composition and sources of revenue growth;

- tariff adjustments;

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capital expenditures as a result of technological improvements and changes in our business;

personnel expenses;

taxation; and

effect of adopting Taiwan-IFRSs on our dividends and employee bonuses.

Each of these developments is discussed below.

***Changes in our revenue composition and sources of revenue growth***

Our domestic fixed communications business revenues are derived primarily from the provision of local, domestic long distance, broadband access, leased line service, MOD, and other domestic services including information and communication technologies, cloud services, corporate solution services, billing handling services and the leasing of real estate properties. In addition, we also derive fixed-line revenues from providing interconnection services to other carriers. Our revenues from mobile communications business are principally derived from the provision of mobile services, sales of mobile handsets and data cards and mobile other services. Our revenues from internet business are generated principally from HiNet internet service, internet VAS, data communication services, internet data center, and other internet services including information and communication technologies and cloud services. Our revenues from international fixed communications business are derived primarily from international long distance, international leased line, international data services, satellite services, and other international services. Our other revenues are principally derived from non-telecom services.

The table below sets forth the revenues from our principal lines of business as a percentage of total revenues for the periods indicated.

| | Year Ended December 31 | |
|---|---|---|
| | **2012** | **2013** |
| Revenues: | | |
| Domestic fixed communications business | 34.4% | 32.2% |
| Mobile communications business | 45.5 | 48.5 |
| Internet business | 11.2 | 11.2 |
| International fixed communications business | 6.9 | 6.9 |
| Others | 2.0 | 1.2 |
| Total | 100.0% | 100.0% |

Our domestic fixed communications business has been an important source of revenue over the last two years. We derive domestic fixed communications from the provision of ADSL and FTTx access services that provides customers with data access lines. The percentage of total revenues derived from domestic fixed communication decreased in 2013 mainly due to tariff reductions for ADSL and FTTx services and the decline of domestic long distance and local call service revenue because of mobile and VoIP substitution. We believe that domestic fixed communications business will continue to generate a significant portion of our revenues.

Revenues from our mobile communications business made a major contribution to our revenues over the last two years. We have experienced a significant increase in revenues generated by our mobile value-added services due to the popularity of smart phone and increase in mobile internet subscribers. In addition, the increased popularity of smart phones also boosted our handset sales. As a result, we believe that our mobile communications business will continue to generate a significant portion of our revenues.

Our internet business was another important source of revenues over the last two years. We derived internet business revenues from the provision of HiNet internet service and internet value-added services. The percentage

of revenues from internet services within total revenues remained flat in 2013, while internet services revenue declined due to the tariff reduction in internet services along with the ADSL and FTTx tariff reduction.

We derived our international fixed communications revenues mainly from international long distance telephone services, international leased line services and international data services. The revenues from our international fixed communications business as a percentage of our total revenues remained flat from 2012 to 2013, while international long distance telephone services revenue continued to decline due to VoIP substitution.

Our other revenues decreased from 2012 to 2013 primarily due to lower property sales by our subsidiary, Light Era Development Co., Ltd.

***Tariff adjustments***

We adjust our tariffs and offer promotional packages from time to time primarily in response to market conditions. We also from time to time are required to adjust our pricing in line with domestic regulations.

The NCC passed a resolution on December 21, 2006 adopting a price reduction plan requiring the continuous reduction in telecommunication tariffs over three years. Minimum reductions of 4.88% for fixed-line to mobile call tariffs, 4.88% for the tariffs of our highest monthly rate plan, 4.88% for mobile prepaid calling card tariffs and 5.35% for ADSL tariffs must be made each year. On January 29, 2010, the NCC announced a new tariff reduction plan starting on April 1, 2010 to March 31, 2013. The percentage of decrease set by NCC was DCPI 4.816% for IP Peering fees, domestic leased-line fees, ADSL access fees and long distance tariffs, and DCPI 5.00% for fees for mobile calls to local fixed-lines and other networks and domestic mobile SMS, where DCPI is the year-over-year change of the consumer price index of previous year released by the Directorate-General of Budget, Accounting and Statistics of the Executive Yuan. On February 7, 2013, the NCC announced a new plan for tariff reductions in wholesale tariffs for IP peering and domestic leased line services, and in monthly fees for fixed-line broadband access services (excluding fiber-to-the-home, or FTTH, and fiber-to-the-building, or FTTB) over a period of four years starting on April 1, 2013, which are subject to a reduction by DCPI 5.1749%. The DCPI for 2012 that was used for the tariff reduction starting from April 1, 2013 was 1.93%; and the DCPI for 2013 that was used for the tariff reduction starting from April 1, 2014 was 0.79%. While mobile tariffs will not be regulated in this round, according to the revised Administrative Rules for Network Interconnection, the mobile interconnection fees should be reduced from the current NT$2.15 per minute to NT$1.15 per minute, over the period of four years starting from January 5, 2013.

On January 1, 2011, we implemented the NCC s change in policy for collecting the tariffs of fixed-line-to-mobile calls from mobile service providers to fixed communications service providers. As a result, our fixed communications business now has the right to set and collect the tariffs for fixed-line-to-mobile phone calls.

On June 22, 2011, we implemented a discounted tariff along with broadband speed upgrade for our broadband service, under which we provided a 30% or more discount to subscribers of 20 Mbps, 50 Mbps or 100 Mbps broadband access services. We further reduced our ADSL tariffs by approximately 20% starting from 2012 in order to attract more broadband customers. In April 2013, we implemented another discounted tariff for our ADSL and fiber broadband service. In October 2013, we implemented another discounted tariff along with broadband speed upgrade for our broadband service of 60 Mbps and 100 Mbps.

In addition, in 2011, there were complaints from the general public regarding our mobile data network congestion. To address the situation, we adopted measures such as offering a 20% discount of the mobile data monthly fees from August 2011 to the end of 2012 for customers whose monthly data usage volume was less than one gigabyte.

As requested by the Legislative Yuan and NCC, we implemented a discounted tariff for telecommunication services from Kinmen, Matsu and Penghu Islands to Taiwan in April 1, 2011. We further applied one single tariff to all the telecommunication services for the entire country since January 2012.

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We expect to continue to adjust tariffs and offer a variety of promotional packages from time to time in response to increasing competition and in order to take advantage of our pricing power from economies of scale. We may also be required to adjust our pricing due to changes in domestic regulations.

***Capital expenditures as a result of technological improvements and changes in our business***

In recent years, we have focused on modernizing and upgrading our mobile services network and on developing our FTTx network, which enables transmission of digital information at a high bandwidth over fiber loops. In particular, we have enhanced our telecommunications services through:

- the implementation of a network modernization program, including a gradual transfer from our public switched telephone network to a system based on internet protocol, to remain at the forefront of new technologies;
- the development and deployment of Green IDC for meeting the new demands of cloud computing services;
- the deployment of a high-capacity long-haul reconfigurable optical add drop multiplexing system and a nationwide internet protocol backbone network with hundreds of Gbps switching routers for internet and managed IP services;
- the expansion and upgrade of our mobile services network as well as WiFi/Femtocell to improve indoor mobile network coverage and transmission speed for mobile internet; and
- accelerating LTE network construction to launch 4G services in July 2014.

Our long-term goal is to optimize our capital expenditures by focusing on investing in innovative products and services with attractive return profiles. We evaluate our investment opportunities by benchmarking them against internal return requirements. We are upgrading our public switched telephone network to a next-generation network, which will have more capacity, greater upgrade flexibility, and increased operational efficiencies. We have also devoted resources toward the effective upgrade of our 3G mobile network to HSPA+/Dual carrier HSPA+, accelerating the construction of 4G network, and the continuing build-out of our FTTx infrastructure. In addition, we are planning to deploy green internet Data Centers and service delivery network for the innovative services, such as cloud computing, fixed mobile convergence services and multi-screen digital convergence services.

P***ersonnel expenses***

Personnel expenses constitute a significant portion of our operating costs and expenses. In 2012 and 2013, personnel expenses represented 25.9% and 25.0% of our total operating costs and expenses, respectively, and pension costs represented 1.8% of our total operating costs and expenses for each year. The table below sets forth information regarding our personnel expenses and as a percentage of our total operating costs and expenses for the periods indicated.

| | Year Ended December 31 | | | |
|---|---|---|---|---|
| | 2012 | | 2013 | |
| | (in billions of NT$, except percentages) | | | |
| Personnel expenses: | | | | |
| Salaries | 24.3 | 14.2% | 24.9 | 13.9% |
| Insurance | 2.3 | 1.3 | 2.4 | 1.3 |
| Pension | 3.1 | 1.8 | 3.3 | 1.8 |
| Other[1] | 14.7 | 8.6 | 14.5 | 8.0 |
| Total personnel expenses | 44.4 | 25.9% | 45.1 | 25.0% |
| Total operating costs and expenses | 171.4 | 100.0% | 180.4 | 100.0% |

(1) Includes employee bonuses.

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According to ROC laws and regulations, we offset the decrease of retained earnings arising from the impact of first adoption of Taiwan-IFRSs with earnings generated in 2013 before we made any appropriation of earning. As a result, retained earnings in 2013 for earnings appropriation purposes decreased, which affected dividends to our shareholders and bonuses to our employees. In order to compensate for the decreased employee bonuses, at our board of directors meeting held in March 2014, our directors approved to appropriate a one-time bonus to our employees. See Effect of adopting Taiwan-IFRSs on our dividends and employee bonuses below.

At the time of our privatization, we settled all of our then existing defined benefit pension obligations in full. After completing our privatization on August 12, 2005, all of our continuing employees were deemed to have commenced employment as of August 12, 2005 for seniority purposes under our pension plans in effect after privatization. Under applicable Republic of China regulations, upon our privatization, the Ministry of Transportation and Communications assumed the obligation to make annuity payments to all of our employees that retired before our privatization.

***Taxation***

The income tax rate for profit-seeking enterprises is 17% in the Republic of China. We benefit from tax incentives, including tax credits of up to 15% of some of our research and development expenses in accordance with the Statute for Innovating Industries. We also qualify for tax benefits at a rate of 5% to 15% of our investment amount for qualified equipment and technology under the Statute for Upgrading Industries. However, due to the expiration of the Statute for Upgrading Industries at the end of 2009, we will no longer receive tax credits for new investments in automation, employee training expenditures incurred, and equipment and technology purchased after January 2010.

In 1997, the Income Tax Law of the Republic of China was amended to integrate corporate income tax and stockholder dividend tax to eliminate the double taxation effect for resident stockholders of Taiwan companies. Under the amendment, all retained earnings generated from January 1, 1998 and not distributed to stockholders as dividends in the following year are assessed with a 10% retained earnings tax. See Item 10. Additional Information E. Taxation Republic of China Taxation Dividends . Under IFRSs, the 10% tax on unappropriated earnings is accrued during the year the earnings arise and adjusted to the extent that distributions are approved by the stockholders in the following year. According to ROC laws and regulations, we offset the decrease of retained earnings arising from the impact of first adoption of Taiwan-IFRSs with earnings generated in 2013 before we made any appropriation of earnings, therefore, the accrued 10% retained earnings tax was lower than that in 2012. As a result, our effective tax rate decreased from 14.7% in 2012 to 13.2% in 2013.

***Effect of adopting Taiwan-IFRSs on our dividends and employee bonuses***

Beginning on January 1, 2013, we have adopted Taiwan-IFRSs for reporting our annual and interim consolidated financial statements in the ROC in accordance with the requirements of the FSC. At the same time, we have adopted IFRSs, which has certain significant differences from Taiwan-IFRSs, for reporting our annual and interim consolidated financial statements with the SEC, including this annual report and future annual reports on Form 20-F. See Item 3. Key Information A. Selected Financial Data .

Our dividends for 2013 and thereafter will be calculated based on Taiwan-IFRSs. According to local regulations, our retained earnings before earnings distributions for the year ended December 31, 2013 needs to first offset the decrease of retained earnings on the date of transition to Taiwan-IFRSs (January 1, 2012), which led to a decrease in earnings available for our dividends and employee bonuses compared to prior years. As a result of these decreases in our dividends and employee bonuses, in March 2014, our board of directors approved an additional distribution to our shareholders from additional paid-in capital in the amount of NT$16.6 billion and a one-time additional bonus to our employees in the amount of NT$0.7 billion. We expect the NT$16.6 billion additional distributions to our

shareholders to be approved at our annual general stockholders meeting scheduled on June 24, 2014.

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Our financial statements prepared under Taiwan IFRSs have not been included in this annual report and do not form a part of this annual report.

**Critical Accounting Policies**

Summarized below are our accounting policies that we believe are both important to the portrayal of our financial results and involve the need for management to make estimates about the effect of matters that are uncertain in nature. Actual results may differ from these estimates, judgments and assumptions. Certain accounting policies are particularly critical because of their significance to our reported financial results and the possibility that future events may differ significantly from the conditions and assumptions underlying the estimates used and judgments made by our management in preparing our financial statements. The following discussion should be read in conjunction with the consolidated financial statements and related notes, which are included in this annual report.

***Revenue Recognition***

Revenues from the sale of goods are recognized when the goods are delivered and titles of the goods are transferred, and the following conditions are satisfied at the:

- The significant risks and rewards of ownership of the goods are transferred to the buyer;
- We no longer retain managerial involvement to the degree that usually associated with ownership or effective control over the goods sold;
- The amount of the revenues can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to us; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue is measured at the fair value of the consideration received or receivable and represents amounts for goods sold in the normal course of business, net of sales discounts and volume rebates. For trade receivables due within one year from the balance sheet date, as the nominal value of the consideration to be received approximates its fair value and transactions are frequent, fair value of the consideration is not determined by discounting all future receipts using an imputed rate of interest.

Usage revenues from fixed-line services (including domestic and international), cellular services, internet and data services, and interconnection and call transfer fees from other telecommunications companies and carriers are billed in arrears and are recognized based upon seconds or minutes of traffic processed when the services are provided in accordance with contract terms.

Other revenues are recognized as follows: (a) one-time subscriber connection fees (on fixed-line services) are deferred and recognized over the average expected customer service periods, (b) monthly fees (on fixed-line services, mobile, internet and data services) are accrued every month, and (c) prepaid services (fixed-line, mobile, internet and data

services) are recognized as income based upon actual usage by customers or when the right to use those services expires.

Where we enter into transactions which involve both the provision of air time bundled with products such as 3G data card and handset, total consideration received from products and air time in these arrangements are allocated and measured using units of accounting within the arrangement based on their relative fair values limited to the amount that is not contingent upon the delivery of products or services. Relative fair values are based on the selling prices of 3G data cards and handsets on a standalone basis and the monthly fees provided in the subscription contracts.

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Services revenue is recognized when service is provided.

Revenue from a contract to provide services is recognized by reference to the stage of completion of the contract.

Dividend income from investments is recognized when the shareholder s right to receive payment has been established.

Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to us and the amount of income can be measured reliably.

***Impairment of Accounts Receivable***

When there is objective evidence showing indications of impairment as a result of one or more events that occurred after the initial recognition of the accounts receivable, we will consider the estimation of future cash flows. The amount of impairment will be measured on the difference between the carrying amount and the present value of estimated future cash flows discounted by the original effective interest rates of the financial assets. However, the impact from the discount of short-term receivables is not material; therefore, the impairment of short-term receivables is based on the undiscounted estimated future cash flows. Where the actual future cash flows are less than expected, a material impairment loss may arise.

We implemented some measures which have improved the collectability of our accounts receivable. These procedures, which include enhanced credit assessments, strengthened overall risk management and improvements in bill collection practices, have reduced our exposure to uncollected receivables.

We maintain an allowance for doubtful accounts for estimated losses that result from the inability of our customers to make required payments. When determining the allowance, we consider the probability of recoverability based on past customer default experience and their credit status, and economic and industrial factors. Credit risks are assessed based on historical write-offs, net of recoveries, and an analysis of the aged accounts receivable balances with allowances generally increasing as the receivable ages. Accounts receivable may be fully reserved for when specific collection issues are known to exist, such as pending bankruptcy or catastrophes. The analysis of receivables is performed monthly, and the allowances for doubtful accounts are adjusted through expense accordingly.

***Provision for inventory valuation and obsolescence***

Inventories are stated at the lower of cost or net realizable value. Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made at the end of reporting period. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period. Inventory write-downs are determined on an item by item basis, except for those similar items which could be categorized into the same groups. We use the inventory holding period and turnover as the evaluation basis for inventory obsolescence losses.

***Estimated Useful Lives of Long-Lived Assets***

A significant portion of our total assets consists of long-lived assets, primarily property, plant and equipment and definite-lived intangibles. We estimate the useful lives of property, plant and equipment and other long-lived assets with finite lives in order to determine the period of time over which depreciation and amortization expense should be recorded. The useful lives are estimated at the time assets are acquired and are based on historical experience with

similar assets as well as the anticipated technological evolution or other environmental changes. Further, we review the estimated useful lives of long-lived assets at the balance sheet

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date. If technological changes were to occur more rapidly than anticipated or in a different form than anticipated, the useful lives assigned to these assets may need to be shortened, resulting in the recognition of increased depreciation and amortization in the relevant periods. Alternatively, technological obsolescence could result in a write-down in the value of the assets to reflect impairment. We review these types of assets for impairment quarterly, or when events or circumstances indicate that the carrying amount may not be recoverable over the remaining life of an asset. In assessing impairments, we use estimated cash flows that take into account management s estimates of future operations.

***Investments in Unconsolidated Companies***

An associate is an entity over which we have significant influence and that is neither a subsidiary nor an interest in a joint venture. Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as joint venture.

The operating results and identifiable net assets of associates and joint venture are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, an investment in an associate and joint venture is initially recognized in the consolidated balance sheet at cost and adjusted thereafter to recognize our share of the profit or loss, any impairment losses, and other comprehensive income of the associate and joint venture.

Any excess of the cost of acquisition over our share of the fair value of the identifiable net assets, liabilities and contingent liabilities of an associate and joint venture recognized at the date of acquisition is recognized as goodwill, which is included in the carrying amount of the investment and shall not be amortized.

We assess the impairment of investments accounted for using the equity method whenever triggering events or changes in circumstances indicate that an investment may be impaired and carrying value may not be recoverable. The entire carrying amount of the investment, including goodwill, is tested for impairment as a single asset by comparing its recoverable amount with its carrying amount. We measure the impairment based on the projected future cash flow of the investees, the underlying assumptions for which had been formulated by such investees internal management team, taking into account sales growth and capacity utilization. Any impairment loss recognized forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognized to the extent that the recoverable amount of the investment subsequently increases.

Our other equity investments are classified as available-for-sale financial assets, or AFS, including: a) listed stocks and emerging market stocks that are traded in an active market that are stated at fair value at the end of each reporting period; b) equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

Changes in the carrying amount of AFS monetary financial assets relating to changes in foreign currency rates, interest income calculated using the effective interest method and dividends on AFS equity investments are recognized in profit or loss. Other changes in the carrying amount of available-for-sale financial assets are recognized in other comprehensive income. When the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognized in other comprehensive income is reclassified to profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to profit or loss in the period.

The process of assessing whether a particular investment s net realizable value is less than its carrying cost requires a significant amount of judgment. We periodically evaluate these investments based on quoted market prices, if available, the financial condition of the investee company, economic conditions in the industry and our intent and ability to hold the investment for a long period of time. If quoted market prices are not available, we estimate the fair value using the recoverable amounts in consideration of the financial condition of the investee

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company. This information may be based on information that we request from the investee companies and may not be subject to the same disclosure and audit requirements as required of non-foreign private issuers, and as such, the reliability and accuracy of the information may vary. If we deem the fair value of an investment to be less than the carrying value based on the above factors, and the decline in value is deemed to be other than temporary, we record the difference as impairment in the period of occurrence. In 2012 and 2013, we recognized impairment losses of NT$203 million and NT$66 million (US$2.2 million) for the investments classified as AFS financial assets.

***Impairment of long-lived assets, intangible assets***

We assess the impairment of long-lived assets and intangible assets whenever triggering events or changes in circumstances indicate that the asset may be impaired and carrying value may not be recoverable. Indications we consider important which could trigger an impairment review include, but are not limited to, the following:

External sources of information:

- during the period, an asset s market value has declined significantly more than would be expected as a result of the passage of time or normal use.
- significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.
- market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset s value in use and decrease the asset s recoverable amount materially.
- the carrying amount of the net assets of the entity is more than its market capitalization.

Internal sources of information:

- evidence is available of obsolescence or physical damage of an asset.
- significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used.
- evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

When an indication of impairment is identified for long-lived assets and intangible assets other than goodwill, any excess of the carrying amount of an asset over its recoverable amount is recognized as a loss. If the recoverable amount increases in a subsequent period, the amount previously recognized as impairment would be reversed and recognized as a gain. However, the adjusted amount may not exceed the carrying amount that would have been determined, as if no impairment loss had been recognized.

Goodwill represents the excess of the consideration paid for business acquisition over the fair value of identifiable net assets acquired. Goodwill is tested for impairment at least annually, or if an event occurs or circumstances change which indicates that the fair value of goodwill is below its carrying amount, an impairment loss is recognized. A subsequent reversal of such impairment loss is not allowed.

In 2012 and 2013, we determined that partial telecommunication equipment and miscellaneous equipment were impaired and recognized an impairment loss of NT$301 million and NT$254 million, respectively. In 2012, we determined that parts of our investment properties were impaired and recognized an impairment loss of NT$1,261 million. In 2013, based on the evaluation of fair value, some impaired investment properties increased in value and therefore we reversed the impairment losses of NT$246 million. In 2012, we also recognized impairment losses of NT$5 million for definite-lived intangible assets.

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Goodwill amounting to NT$18 million arising from the business combination of a subsidiary, CHI, was fully impaired for the year ended December 31, 2013 because CHI underwent organizational and operational downsizing, and the goodwill was considered no longer exist.

***Pension Benefits***

Payments to defined contribution retirement benefit plans are recognized as expenses when employees rendered services entitling them to the contributions.

For defined benefit retirement benefit plans, the cost of providing benefits is determined using the Projected Unit Credit Method with actuarial calculations being carried out at the year end. Actuarial assumptions comprise the discount rate, rate of employee turnover, and long-term average future salary increase. Changes in economic circumstances and market conditions will affect these assumptions and may have a material impact on the amount of the expense and the liability.

Remeasurement, comprising actuarial gains and losses, the effect of the changes to the asset ceiling (if applicable) and the return on plan assets (excluding interest), is reflected immediately in the balance sheet with a charge or credit recognized in other comprehensive income in the period in which they occur. Remeasurement recognized in other comprehensive income is reflected immediately in retained earnings and will not be reclassified to profit or loss and past service cost is recognized in profit or loss in the period of a plan amendment. Net interest is calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or asset. Defined benefit costs are categorized as follows:

- service cost (including current service cost, past service cost, as well as gains and losses on curtailments and settlements);

- net interest expense or income; and

- remeasurement.

The retirement benefit obligation recognized in the consolidated balance sheet represents the actual deficit or surplus in our defined retirement benefit plans. Any surplus resulting from this calculation is limited to the present value of any economic benefits available in the form of refunds from the plans or reductions in future contributions to the plans.

***Accounting for Income Taxes***

Income tax expense represents the sum of the tax currently payable and deferred tax.

The current tax is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period. Income tax (10%) on undistributed earnings is accrued during the period the earnings arise and adjusted to the extent that distributions are approved by the stockholders in the following year.

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences, loss carryforwards, unused tax credits from purchases of machinery, equipment and technology, research and development expenditures, and personnel training expenditures can be utilized. Deferred tax liabilities are recognized for taxable temporary

differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where we are able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the balance sheet date, and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Current and deferred tax are recognized in profit or loss, except when they relate to items that are recognized in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognized in other comprehensive income or directly in equity respectively.

**Our Financial Reporting Obligations**

Our ongoing financial reporting in our Form 20-F annual reports and interim financial reporting furnished to the SEC on Form 6-K had been based on U.S. GAAP through fiscal year 2007. Beginning with our first quarter interim financial report furnished on Form 6-K and our Form 20-F annual report for fiscal year 2008, we prepared our financial statements under ROC GAAP, with reconciliations of net income and balance sheet differences of our consolidated financial statements to U.S. GAAP. Beginning in 2013, we adopted Taiwan IFRSs for our reporting obligations in the ROC, including our annual consolidated financial statements and our interim quarterly unaudited consolidated financial statements beginning in the first quarter of 2013. While we have adopted Taiwan IFRSs for ROC reporting obligations, we prepared financial statements under IFRSs for certain filings with the SEC, including our annual reports on Form 20-F for the year ended December 31, 2013 and thereafter. Following our adoption of IFRSs for the SEC filing purposes, we are no longer required to provide any reconciliation of our consolidated financial statements with U.S. GAAP.

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**A. Operating Results**

The following table sets forth our revenues, operating costs and expenses, income from operations and other financial data for the periods indicated.

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2012 | 2013 | |
| | NTS | NTS | US$ |
| | | (in billions) | |
| Revenues: | | | |
| Domestic Fixed Communications | 76.1 | 73.5 | 2.5 |
| Mobile communications | 100.8 | 110.6 | 3.7 |
| Internet | 24.8 | 25.4 | 0.9 |
| International fixed communications | 15.3 | 15.8 | 0.5 |
| Others | 4.4 | 2.7 | |
| Total revenues | 221.4 | 228.0 | 7.6 |
| Operating costs | 141.5 | 147.3 | 4.9 |
| Operating expenses: | | | |
| Marketing | 22.2 | 25.2 | 0.8 |
| General and administrative | 4.0 | 4.2 | 0.2 |
| Research and development | 3.7 | 3.7 | 0.1 |
| Total operating expenses | 29.9 | 33.1 | 1.1 |
| Other income and expenses | (1.6) | 0.1 | |
| Income from operations | 48.4 | 47.7 | 1.6 |
| Other income, net | 1.6 | 1.4 | |
| Income before income tax | 50.0 | 49.1 | 1.6 |
| Income tax expense | 7.4 | 6.5 | 0.2 |
| Consolidated net income | 42.6 | 42.6 | 1.4 |
| Attributable to: | | | |
| Stockholders of the parent | 41.5 | 41.5 | 1.4 |
| Non-controlling interests | 1.1 | 1.1 | |

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The following table sets forth our revenues, operating costs and expenses, income from operations and other financial data as a percentage of our total revenues for the periods indicated.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | (as percentages of total revenues) | |
| Revenues: | | |
| Domestic fixed communications | 34.4% | 32.2% |
| Mobile communications | 45.5 | 48.5 |
| Internet | 11.2 | 11.1 |
| International fixed communications | 6.9 | 7.0 |
| Others | 2.0 | 1.2 |
| Total revenues | 100.0% | 100.0% |
| Operating costs | 63.9% | 64.6% |
| Operating expenses: | | |
| Marketing | 10.0 | 11.1 |
| General and administrative | 1.8 | 1.8 |
| Research and development | 1.7 | 1.6 |
| Total operating expenses | 13.5 | 14.5 |
| Other income and expenses | (0.7) | |
| Income from operations | 21.9 | 20.9 |
| Other income, net | 0.7 | 0.6 |
| Income before income tax | 22.6 | 21.5 |
| Income tax expense | 3.4 | 2.8 |
| Consolidated net income | 19.2% | 18.7% |
| Attributable to: | | |
| Stockholders of the parent | 18.7 | 18.2 |
| Minority interests | 0.5 | 0.5 |

Each of our operating segments is managed separately because each represents a strategic business unit that serves a different market. We measure our segment performances mainly based on revenues and income before tax.

**The year ended December 31, 2013 compared with the year ended December 31, 2012**

***Revenues***

Our revenues increased by 3.0% from NT$221.4 billion in 2012 to NT$228.0 billion (US$7.6 billion) in 2013. This increase was primarily due to the increase in revenues generated from mobile communications.

*Domestic fixed communications*

Domestic fixed communications revenues accounted for 34.4% and 32.2% of our revenues in 2012 and 2013, respectively. Our domestic fixed-line revenues decreased by 3.5% from NT$76.1 billion in 2012 to NT$73.5 billion (US$2.5 billion) in 2013 primarily due to the general migration to the use of mobile and internet services.

*Local telephone services.* Our local telephone revenues decreased from NT$40.9 billion in 2012 to NT$37.8 billion (US$1.3 billion) in 2013 with a 7.5% decline in traffic volume from 14.4 billion minutes in 2012 to 12.9 billion minutes in 2013. The decline in traffic volume was primarily due to the traffic migration from

fixed-line services to mobile and internet telephone services. We expect this trend to continue as broadband and mobile services become more popular in Taiwan.

*Domestic long distance telephone services*. Our domestic long distance telephone revenues decreased by 8.0% from NT$3.8 billion in 2012 to NT$3.5 billion (US$0.1 billion) in 2013 with a 2.0% decline in traffic volume from 3.4 billion minutes in 2012 to 3.3 billion minutes in 2013, and the application of a higher tariff in January 2012 before the tariff reduction. See Item 4. Information on the Company B. Business Overview for the discussion of the change in the domestic long distance tariff. The decline in traffic volume was mainly due to the traffic migration to mobile services and the increased use of VoIP applications.

*Broadband access*. The number of our ADSL customers decreased from 1.8 million in 2012 to 1.6 million in 2013 due to the customers migration to our FTTx services. The number of our FTTx customers increased from approximately 2.7 million in 2012 to approximately 3.0 million in 2013. Despite our effort to migrate our customers to higher ARPU FTTx services, revenues generated from broadband access remained the same of approximately NT$19.1 billion (US$0.6 billion) in both 2012 and 2013 mainly due to the 4.4% mandatory tariff reduction starting from April 1, 2013 as required by the NCC.

*Domestic leased line*. Our tariffs for overall leased line services have continued to decreased due to the competition from other fixed-line operators, as well as the continued migration of domestic leased line customers to high speed broadband services. Revenues generated from domestic leased line decreased from NT$5.5 billion in 2012 to NT$5.1 billion (US$0.2 billion) in 2013.

*MOD*. Revenues generated from our MOD services increased by 15.0% from NT$1.9 billion in 2012 to NT$2.2 billion (US$0.1 billion) in 2013. This increase was due to the increase in the number of MOD subscribers and the increase in the ARPU.

*Others*. Other revenues increased by 17.1% from NT$4.9 billion in 2012 to NT$5.8 billion (US$0.2 billion) in 2013. This increase was mainly due to the increased corporate customers of our ICT solution services and the increased sales of high definition TV.

*Mobile communications*

Revenues from our mobile communications business segment accounted for 45.5% and 48.5% of our revenues in 2012 and 2013, respectively. Revenues from our mobile communications business segment increased by 9.7% from NT$100.8 billion in 2012 to NT$110.6 billion (US$3.7 billion) in 2013. This increase was principally due to the growth of mobile VAS revenues and mobile handsets sales revenues and was partially offset by the decline of mobile voice telecommunication revenues over years. The decrease of mobile voice telecommunication traffic was mainly due to the migration to free VoIP applications.

*Mobile services*. Revenues from our mobile services accounted for 32.8% and 33.6% of our revenues in 2012 and 2013, respectively. Revenues from our mobile services increased by 5.7% from NT$72.5 billion in 2012 to NT$76.7 billion (US$2.6 billion) in 2013 due to the increase in mobile VAS revenues from NT$20.5 billion in 2012 to NT$28.4 billion (US$1.0 billion) in 2013, which was partially offset by the decline of mobile voice telecommunication revenues.

*Sales of mobile handsets and data cards*. Revenues from our sales of mobile handsets and data cards accounted for 12.5% and 14.5% of our revenues in 2012 and 2013, respectively. Revenues from our sales of mobile handsets and data cards increased by 19.7% from NT$27.6 billion in 2012 to NT$33.1 billion (US$1.1 billion) in 2013. This

increase was principally due to the increased sales of smart phones.

*Internet*

Internet revenues accounted for 11.2% and 11.1% of our revenues in 2012 and 2013, respectively. Revenues from our internet services increased by 2.7% from NT$24.8 billion in 2012 to NT$25.4 billion (US$0.9 billion)

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in 2013 due to (1) a 9.5% increase in the number of subscribers to HiNet FTTx which has higher ARPU and (2) a 4.4% increase in internet VAS revenues. As of December 31, 2013, approximately 83.1% of our broadband customers were also HiNet subscribers, using HiNet as their ISP.

*International fixed communications*

International fixed communications revenues accounted for 6.9% and 7.0% of our revenues in 2012 and 2013, respectively. Our international fixed communications revenues increased by 2.8% from NT$15.3 billion in 2012 to NT$15.8 billion (US$0.5 billion) in 2013. This increase was mainly due to the increase in revenues from our international leased line services and international data services.

*International long distance telephone services.* Our international long distance telephone revenues decreased by 2.6% from NT$11.5 billion in 2012 to NT$11.2 billion (US$0.4 billion) in 2013 due to the migration to VoIP-based international long distance service providers and free VoIP applications.

*International leased line and international data services*. Our international leased line and international data revenues increased by 12.1% from NT$2.5 billion in 2012 to NT$2.9 billion (US$0.1 billion) in 2013. The increase was mainly due to our expansion to the overseas market, such as Japan, Hong Kong, Singapore, Thailand and Indonesia, and the increased demand for our international leased line, VPN and various managed ICT services from multinational corporations.

*Others*

Other revenues accounted for 2.0% and 1.2% of our revenues in 2012 and 2013, respectively. Our other revenues decreased by 38.9% from NT$4.4 billion in 2012 to NT$2.7 billion (US$0.1 billion) in 2013. The decrease was mainly due to lower total property sales value by our subsidiary, Light Era Development Co., Ltd., in 2013 compared with 2012.

***Operating Costs***

Operating costs include depreciation and amortization expenses, personnel expenses, cost of goods sold, interconnection and service expenses, costs of materials and maintenance and spectrum usage and license fees.

Our operating costs increased by 4.1% from NT$141.5 billion in 2012 to NT$147.3 billion (US$4.9 billion) in 2013. This increase was primarily due to an increase of NT$7.4 billion (US$0.2 billion) in cost of goods sold, which was due to the increased sales of smart phones. The increase in our operating costs was partially offset by a decrease of NT$2.0 billion (US$0.01 billion) in interconnection and service expenses.

***Operating Expenses***

Our operating expenses increased by 10.5% from NT$29.9 billion in 2012 to NT$33.1 billion (US$1.1 billion) in 2013. This increase was primarily due to an increase in marketing expenses.

*Marketing*

Our marketing expenses, which includes personnel expenses, expenses relating to advertising and marketing-related activities and provision for bad debt, increased by 13.3% from NT$22.2 billion in 2012 to NT$25.2 billion (US$0.8 billion) in 2013. This increase was primarily due to the NT$1.5 billion reversal of bad debts allowance in 2012, the

NT$0.3 billion (US$0.01 billion) provision of bad debts allowance in 2013 and an increase of NT$1.1 billion (US$0.04 billion) in expenses relating to personnel and marketing-related activities due to business expansion of our subsidiary, Senao. See Item 5. Operating and Financial Review and Prospects Critical Accounting Policies Impairment of Accounts Receivable for a discussion of our policy for bad debts allowance.

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*General and administrative*

Our general and administrative expenses increased by 4.2% from NT$4.0 billion in 2012 to NT$4.2 billion (US$0.2 billion) in 2013. This increase was primarily due to the increase in personnel expenses and other administrative activities for service centers and channel expansion.

*Research and development*

Our research and development expenses remained NT$3.7 billion (US$0.1 billion) in 2012 and 2013. In 2012 and 2013, we did not capitalize any research and development expenses as intangible assets arising from development or from the development phase of an internal project.

***Operating Costs and Expenses by Business Segment***

| | Domestic Fixed Communications | Mobile Communications | Internet | International Fixed Communications | Others | Adjustment | Total |
|---|---|---|---|---|---|---|---|
| **For the year ended December 31, 2013** | | | | | | | |
| Operating costs and expenses | 75.0 | 92.4 | 20.4 | 17.0 | 7.4 | (31.8) | 180.4 |
| Depreciation and amortization | 19.0 | 8.1 | 3.1 | 1.6 | 0.4 | | 32.2 |
| **For the year ended December 31, 2012** | | | | | | | |
| Operating costs and expenses | 76.3 | 81.4 | 19.1 | 16.2 | 8.1 | (29.7) | 171.4 |
| Depreciation and amortization | 19.2 | 8.5 | 2.7 | 1.5 | 0.3 | | 32.2 |

*Domestic fixed communications*

Our domestic fixed communications costs and expenses decreased by 1.7% from NT$76.3 billion in 2012 to NT$75.0 billion (US$2.5 billion) in 2013, primarily due to a decrease of NT$1.0 billion (US$ 0.03 billion) in interconnection and service expenses and a decrease of NT$0.9 billion (US$0.03 billion) in bonus, and was partially offset by an increase of NT$0.6 billion (US$0.02 billion) in costs of corporate solution services and ICT costs.

*Mobile communications*

Our mobile communications operating costs and expenses increased by 13.4% from NT$81.4 billion in 2012 to NT$92.4 billion (US$3.1 billion) in 2013. This increase was primarily due to an increase of NT$6.2 billion (US$0.2 billion) in costs of mobile handsets sold, an increase of NT$2.8 billion (US$0.1 billion) in leased lines and internet access expenses resulting from the increased leased lines and higher speed rate of our mobile internet services. In addition, the provision of bad debt increased by NT$1.3 billion as a result of the NT$1.2 billion reversal of bad debts allowance in 2012 whereas NT$0.1 billion bad debts allowance was provided in 2013.

*Internet*

Our internet operating costs and expenses increased by 6.9% from NT$19.1 billion in 2012 to NT$20.4 billion (US$0.7 billion) in 2013. This increase was primarily due to an increase of NT$0.4 billion (US$0.02 billion) in depreciation and amortization expenses resulting from the increased cloud computing related facilities, an increase of NT$0.4 billion (US$0.01 billion) in leased line expenses for the promotion of the broadband access speed, and an increase of NT$0.2 billion (US$0.01 billion) in employee benefit expenses.

*International fixed communications*

Our international fixed communications costs and expenses increased by 4.9% from NT$16.2 billion in 2012 to NT$17.0 billion (US$0.6 billion) in 2013. The increase was primarily due to an increase of NT$0.4 billion (US$0.01 billion) in settlement payments for international long distance calls, an increase of NT$0.1 billion (US$3 million) in rental expenses, and an increase of NT$0.1 billion (US$ 3 million) in ICT costs.

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*Others*

The costs and expenses from our other business decreased by 8.9% from NT$8.1 billion in 2012 to NT$7.4 billion (US$0.2 billion) in 2013. The decrease was primarily due to lower total property sales value by our subsidiary, Light Era Development Co., Ltd., in 2013 compared to 2012.

***Other Income and Expenses***

We recorded net other expenses of NT$1.6 billion in 2012 and net other income of NT$0.1 billion (US$2.0 million) in 2013. The difference between 2012 and 2013 was primarily due to the fact that we recognized an impairment loss of NT$1.3 billion for investment properties in 2012 and then reversed the impairment of NT$0.2 billion (US$8.2 million) in 2013. See Item 5. Operating and Financial Review and Prospects Critical Accounting Policies Impairment of long-lived assets, intangible assets for a discussion the impairment.

***Income from Operations and Operating Margin***

As a result of the foregoing, our income from operations decreased by 1.5% from NT$48.4 billion in 2012 to NT$47.7 billion (US$1.6 billion) in 2013. Our operating margin decreased from 21.9% in 2012 to 20.9% in 2013.

The following table sets forth certain information regarding our operating income by business segment for the periods indicated.

| | Domestic Fixed Communications | Mobile Communications | Internet | International Fixed Communications | Others | Adjustment | Total |
|---|---|---|---|---|---|---|---|
| | | | | (in billions of NT$) | | | |
| **For the year ended December 31, 2013** | | | | | | | |
| Revenues from external customers | 73.5 | 110.6 | 25.4 | 15.8 | 2.7 | | 228.0 |
| Intersegment service revenues | 18.4 | 5.7 | 4.4 | 2.1 | 1.2 | (31.8) | |
| | 91.9 | 116.3 | 29.8 | 17.9 | 3.9 | (31.8) | 228.0 |
| Interest income | | | | | 0.5 | | 0.5 |
| Segment income before income tax | 17.3 | 23.7 | 9.4 | 0.9 | (2.2) | | 49.1 |
| **For the year ended December 31, 2012** | | | | | | | |
| Revenues from external customers | 76.1 | 100.8 | 24.8 | 15.3 | 4.4 | | 221.4 |
| Intersegment service revenues | 17.0 | 6.6 | 2.9 | 2.2 | 1.0 | (29.7) | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 93.1 | 107.4 | 27.7 | 17.5 | 5.4 | (29.7) | 221.4 |
| Interest income | | | | | 0.7 | | 0.7 |
| Segment income before income tax | 15.7 | 25.8 | 8.6 | 1.3 | (1.4) | | 50.0 |

As a result of the foregoing, segment income before tax for our domestic fixed communications business increased by 10.6% from NT$15.7 billion in 2012 to NT$17.3 billion (US$0.6 billion) in 2013; segment income before tax for our mobile communications business decreased by 8.3% from NT$25.8 billion in 2012 to NT$23.7 billion (US$0.8 billion) in 2013; segment income before tax for our internet business increased by 9.9% from NT$8.6 billion in 2012 to NT$9.4 billion (US$0.3 billion) in 2013; segment income before tax for our international fixed communications business decreased by 32.2% from NT$1.3 billion in 2012 to NT$0.9 billion (US$0.03 billion) in 2013; and segment loss for our other business segments increased by 51.7% from NT$1.4 billion in 2012 to NT$2.2 billion (US$0.1 billion) in 2013.

***Non-operating Income and Expenses***

Our other income decreased from NT$1.6 billion in 2012 to NT$1.4 billion (US$0.05 billion) in 2013. This decrease was primarily due to a decrease in interest income and was partially offset by an increase in share of the profit of associates and joint venture accounted for using equity method.

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*Income Tax*

Our income tax was NT$7.4 billion and NT$6.5 billion (US$0.2 billion) in 2012 and 2013, respectively. Our effective tax rate was 14.7% in 2012 and 13.2% in 2013. The decrease of our effective tax rate from 2012 to 2013 was primarily due to a decrease in the accrued 10% tax on unappropriated earnings. See Item 5. Operating and Financial Review and Prospects Overview Taxation for a discussion of the change in tax rate.

*Net Income*

As a result of the foregoing, our net income attributable to stockholders of the parent remained NT$41.5 billion (US$1.4 billion) in 2012 and 2013. Our net margin decreased from 18.7% in 2012 to 18.2% in 2013.

**B. Liquidity and Capital Resources**

**Liquidity**

The following table sets forth the summary of our cash flows for the periods indicated:

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2012 | 2013 | |
| | NT$ | NT$ | US$ |
| | | (in billions) | |
| Net cash provided by operating activities | 65.6 | 75.3 | 2.5 |
| Net cash used in investing activities | (18.6) | (49.1) | (1.6) |
| Net cash used in financing activities | (42.5) | (42.5) | (1.4) |
| Effect of exchange on rate change | | | |
| Net increase (decrease) in cash and cash equivalents | 4.5 | (16.3) | (0.5) |
| Cash and cash equivalents at end of year | 30.9 | 14.6 | 0.5 |

Our primary source of liquidity is cash flow from operations, which represents operating profit adjusted for non-cash items, primarily depreciation and amortization and changes in current assets and liabilities. We believe that our working capital is sufficient to meet our present cash flow requirements.

In 2013, we generated NT$75.3 billion (US$2.5 billion) net cash from operating activities as compared to NT$65.6 billion in 2012. The increase was primarily due to the decrease in cash outflows relating to payment of employee bonuses and income tax, accounts receivable and payable from operating activities, and a NT$2.0 billion procurement of land by our property development subsidiary in 2012 for construction, which was further discussed in Item 4. Information on the Company B. Business Overview Property, plant and equipment .

Historically, net cash from operating activities has been sufficient to cover our capital expenditures, including ongoing expansion and modernization of our networks.

In 2013, net cash used in investing activities was NT$49.1 billion (US$1.6 billion), an increase from NT$18.6 billion in 2012. The change was primarily due to the one-time NT$39.1 billion (US$1.3 billion) cost of acquiring the 4G spectrum in 2013.

In 2013, our net cash used in financing activities totaled NT$42.5 billion (US$1.4 billion), which mainly reflected NT$35.9 billion (US$1.4 billion) of payment of dividends during that period and NT$5.6 billion (US$0.2 billion) of cash distribution from our capital surplus to our stockholders.

In 2012, our net cash used in financing activities totaled NT$42.5 billion, which mainly reflected NT$42.4 billion of payment of dividends during that period.

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**Capital Resources**

We have historically financed our capital expenditure requirements with our cash flows from operations and some bank loans. In future years, we expect to have capital expenditure requirements for the ongoing expansion and upgrade of our networks, including 3G/HSPA/HSPA+/Dual cell HSPA+, FTTx, Wi-Fi/femtocell and service platforms, and future construction of LTE to migrate mobile and data service customers to higher contribution platforms. We also expect to make dividend payments on an ongoing basis. See Item 8. Financial Information A. Consolidated Statements and Other Financial Information . Furthermore, we may require working capital from time to time to finance purchases of materials for our maintenance and other overhead expenses. We expect to primarily rely on cash generated from operations and, to a lesser extent, loans from commercial banks to meet our planned capital expenditures, make our planned dividend payments, repay debts and fulfill other commitments over the next twelve months.

As of December 31, 2013, our primary source of liquidity was NT$14.6 billion (US$0.5 billion) in cash and cash equivalents. In addition, the unused line of credit for unsecured and secured bank loans amounted to NT$8.5 billion (US$0.3 billion) and NT$0.6 billion (US$20.1 million), respectively, as of December 31, 2013.

As of December 31, 2013, our subsidiary, Chief Telecom, had short-term unsecured loans in the amount of NT$50.0 million (US$1.7 million) at an interest rate at 1.27%.

As of December 31, 2013, our subsidiary, Light Era Development Co., Ltd. had long-term secured loans in the amount of NT$1.7 billion (US$57.0 million) with interest rates ranging from 1.15% to 2.10%, with NT$0.3 billion due in 2014, NT$1.3 billion due in 2015, and NT$0.1 billion due in 2017. Light Era also had a short-term unsecured loan in the amount of NT$100.0 million (US$3.4 million) with interest rate at 1.18% as of December 31, 2013.

As of December 31, 2013, our subsidiary Chunghwa Precision Test Technology Co., Ltd. had a short-term unsecured loan of NT$45.0 million (US$1.5 million) with interest rates ranging from 1.50% to 1.52%.

As of December 31, 2013, our subsidiary Chunghwa Sochamp Technology Inc. had short-term unsecured loans of NT$59.4 million (US$2.0 million) at interest rates ranging from 2.00% to 2.395%.

As part of the government s effort to upgrade the existing telecommunication infrastructure, we and other public utility companies were required by the ROC government to contribute a total of NT$1.0 billion to a Piping Fund, administered by the Taipei City Government. This fund is used to finance various telecommunication infrastructure projects. We accounted for the contribution as other financial assets on our consolidated balance sheets.

Note 40 to our consolidated financial statements included elsewhere in this annual report provides a description of the assets that are pledged as collateral for long-term bank loans and contract deposits.

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**Capital Expenditures**

Substantially all of our capital expenditures in 2012 and 2013 were made for operations in the Republic of China. We have financed our capital expenditures using cash flow from operations and bank loans. The following table sets forth a summary of our capital expenditures for the periods indicated.

| | Year Ended December 31 | | | |
|---|---|---|---|---|
| | 2012 | | 2013 | |
| | (NT$ in billions, except percentages) | | | |
| **Capital Expenditures:** | | | | |
| Domestic fixed communications business | 19.6 | 59% | 20.4 | 56% |
| Mobile communications business | 7.2 | 22 | 9.2 | 25 |
| Internet business | 3.4 | 10 | 4.6 | 13 |
| International fixed communications business | 2.4 | 7 | 1.6 | 4 |
| Others | 0.7 | 2 | 0.6 | 2 |
| Total capital expenditures | 33.3 | 100% | 36.4 | 100% |

The following table sets forth a summary of our planned capital expenditures for the year ending December 31, 2014.

| | Year Ending December 31, 2014 (NT$ in billions, except percentages) | |
|---|---|---|
| **Capital Expenditures:** | | |
| Domestic fixed communications business | 21.5 | 53.6% |
| Mobile communications business | 9.3 | 23.2 |
| Internet business | 6.7 | 16.7 |
| International fixed communications business | 1.9 | 4.7 |
| Others | 0.7 | 1.8 |
| Total capital expenditures | 40.1 | 100% |

We expect our total capital expenditures to be approximately NT$40.1 billion in 2014. We expect our capital expenditures to slightly decrease in 2015 and 2016. Our capital expenditures for 2014 are planned to be allocated to the launch of new businesses, including our 4G LTE network deployment, FTTx network expansion, access bandwidth enhancement, service platforms, cloud computing, including cloud data center construction and submarine cables. We expect to finance these capital expenditures with our cash flows from operations and bank loans.

**Inflation**

We do not believe that inflation in Taiwan has had a material impact on our results of operations in 2012 and 2013.

**C. Recent Accounting Pronouncements**

***Transition to IFRSs in 2013***

See Item 3. Key Information A. Selected Financial Data for description about the adoption of new financial reporting standards. While we have adopted Taiwan IFRSs for ROC reporting purposes, we adopt

IFRSs for certain filings with the SEC, including our annual reports on Form 20-F for the year ended December 31, 2013 and thereafter. Following our adoption of IFRSs for SEC filing purposes, we are no longer required to prepare any reconciliation of our consolidated financial statements with U.S. GAAP.

Taiwan IFRSs differs from IFRSs in certain significant respects, including to the extent that any new or amended standards or interpretations applicable under IFRSs may not be timely endorsed by the FSC. For example, as of the date of this annual report, the FSC has not endorsed any accounting pronouncements issued by the International Accounting Standards Board after January 1, 2011. Therefore, these pronouncements will not be applicable to Taiwan IFRSs until endorsed by the FSC. Some of the major differences between IFRSs and Taiwan IFRSs that are relevant to us as of the date of this annual report are set forth below.

The income taxes on undistributed earnings should be recognized at the year of earnings under IFRSs, while it should be recognized at the year of distribution under Taiwan IFRSs.

Prior to incorporation, according to the laws and regulations applicable to state-owned enterprises in Taiwan, we recorded revenue from fixed-line service at the time the connection service was performed or the prepaid card was sold. Upon incorporation, net assets greater than capital stock was credited as additional paid-in capital. Part of our additional paid-in capital was from unearned revenues from fixed-line services as of that date. Under IFRSs, following the revenue recognition guidance, the above service revenue should be treated as deferred income and recognized over the time when the service is continuously provided or as consumed. Therefore, upon our first adoption of IFRSs, we should retrospectively decrease additional paid-in capital while increase retained earnings on the transition date of January 1, 2012. There is no difference in the recognition of unearned revenues or deferred income between IFRSs and Taiwan IFRSs. However, according to the guidance released by the Taiwan Stock Exchange Corporation, or TWSE, in March 2012, which is a part of Taiwan IFRSs, the additional paid-in capital under ROC GAAP that is not specifically promulgated under Taiwan IFRSs should not be adjusted on the transition date of January 1, 2012. Therefore, we retain such additional paid-in capital under Taiwan IFRSs.

It is difficult for us to evaluate the precise impact of the adoption of Taiwan IFRSs and IFRSs on our financial statements, because the FSC may issue new rules governing the adoption of Taiwan IFRSs and as other laws and regulations may be amended with the adoption of Taiwan IFRSs.

Upon our first adoption of IFRSs, we are required to apply IFRSs retrospectively unless otherwise exempted from certain applications and to present the opening balance sheet on the transition date of January 1, 2012 with adjusted opening balances prepared under IFRSs. Any transactions after the transition date are accounted for in accordance with IFRSs.

***Other recent accounting pronouncements under IFRSs***

For a summary of new standards, amendments and interpretations issued under IFRSs but not effective for 2013 and which have not been adopted early by us, see note 5 to our consolidated financial statements included elsewhere in this annual report.

For a summary of standards and exceptions applied by us in connection with the transition to IFRSs starting in 2013, see note 43 to our consolidated financial statements included elsewhere in this annual report.

**D. Research, Development, Patents and Licenses**

**Research and Development**

Our research and development efforts are focused on the development of advanced network services and operation technologies as well as the development of core technologies for the domestic telecommunications market. For 2012 and 2013, our research and development expenses were both NT$3.7 billion (US$0.1 billion), or approximately 1.7% and 1.6% of our revenues, respectively.

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As of March 31, 2014, we have more than 2,546 researchers focusing on the following areas:

- wireless communication;
- broadband networks;
- network management;
- business management information;
- billing information;
- information and communication security;
- business and marketing strategy;
- convergence services;
- business solution;
- intent of things; and
- cloud computing.

We have developed a number of advanced network services, operation technologies and applications and value-added services, including our xDSL/FTTx deployment, internet-based call center, e-commerce platform, mobile internet services, global standard for mobile communications billing system, a new telecommunications operation service system for all business units of our company, government public key infrastructure, a leased line testing and monitoring system and an intelligent transportation system. As of December 31, 2013, we have been granted 518 domestic patents and 110 foreign patents.

**E. Trend Information**

See Overview for a discussion of the most significant recent trends that have had, and in the future may have, a material impact on our results of operations, financial condition and capital expenditures. In addition, see discussions included in this Item for a discussion of known trends, uncertainties, demands, commitments or events that we believe are reasonably likely to have a material effect on our net operating revenues, income from continuing operations,

profitability, liquidity or capital resources, or that would cause reported financial information not necessarily to be indicative of future operating results or financial condition.

**F. Off-Balance Sheet Arrangements**

There are no off-balance sheet arrangements that are material to investors.

**G. Tabular Disclosure of Contractual Obligations**

Set forth below are our total contractual obligations as of December 31, 2013.

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 Year | 1-3 years | 3-5 years | More than 5 years |
| | (NT$ in billions) | | | | |
| Contractual Obligations[1] | | | | | |
| Short-term loans | 0.3 | 0.3 | | | |
| Long-term loans | 1.7 | 0.3 | 1.3 | 0.1 | |
| Obligations related to ST-2 satellite | 2.4 | 0.2 | 0.4 | 0.4 | 1.4 |
| Operating leases[2] | 11.2 | 3.1 | 3.6 | 2.8 | 1.7 |
| Total | 15.6 | 3.9 | 5.3 | 3.3 | 3.1 |

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(1) Unfunded defined benefit obligation is not included as the schedule of payments is difficult to determine. We made pension contributions of approximately NT$2.6 billion (US$0.1 billion) in 2013 and expected to made pension contributions of approximately NT$2.6 billion (US$0.1 billion) in 2014. See note 27 to our consolidated financial statements for additional details regarding our pension plan.

(2) Operating leases obligations are described in note 35 to our consolidated financial statements included elsewhere in the annual report.

As of December 31, 2013, we had remaining commitments under non-cancelable contracts with various parties, including acquisition of lands and buildings of NT$3.7 million (US$0.1 million), acquisition of telecommunications equipment of NT$31.3 billion (US$1.0 billion), unused letters of credit of NT$0.2 billion (US$6.8 million) and contracts for printing bills, envelopes and marketing gifts of NT$29 million (US$1.0 million).

**H. Foreign Exchange**

Our revenues and costs and expenses are largely denominated in NT dollars. Our principal expenses denominated in foreign currencies are capital expenditures on telecommunications equipment and settlement payments for the use of networks of carriers in foreign countries for outgoing international calls. Settlement receipts have been a principal source of foreign currency for us. While future fluctuations of the NT dollar against foreign currencies could impact our financial condition and results of operations, we have not yet been materially affected in the past.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. Directors and Senior Management

The following table sets forth the name, age, position and tenure of each of our directors and such person s position as of March 31, 2014. There is no family relationship among any of these persons. 11 of these directors were elected at our annual general stockholders meeting held on June 25, 2013 and have terms from June 25, 2013 to June 24, 2016, and the other two were reelected on August 23 and September 1, 2013, respectively.

| Name | Age | Position |
|---|---|---|
| Lih-Shyng Tsai | 63 | Chairman, chief executive officer and director |
| Mu-Piao Shih | 61 | President and director |
| Yu-Fen Hong | 57 | Director |
| Yi-Bing Lin | 53 | Director |
| Chung-Yu Wang[(1)] | 69 | Director |
| Zse-Hong Tsai[(1)] | 53 | Director |
| Chung-Fern Wu[(1)] | 57 | Director |
| Shih-Peng Tsai | 65 | Director |
| Su-Ghen Huang | 49 | Director |
| Tain-Jy Chen[(1)] | 61 | Director |
| Yun-Tsai Chou[(1)] | 46 | Director |

| | | |
|---|---|---|
| Hui-Ling Wu | 58 | Director |
| Chich-Chiang Fan | 63 | Director |

(1) Independent director.

**Lih-Shyng Tsai** is the chairman, chief executive officer and director of our company starting January 28, 2014. Dr. Tsai was the chairman and chief executive officer of TSMC Solar Ltd. and TSMC Solid State Lighting Ltd. from 2011 to 2013. From June 2009 to July 2011, Dr. Tsai served as the president of TSMC s new business department. Dr. Tsai holds a Ph.D. degree in Material Science and Engineering from Cornell University.

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**Mu-Piao Shih** is the president and acting chief financial officer of our company. Mr. Shih was a senior executive vice president of our company from August 2011 to April 1, 2013. Mr. Shih was an executive vice president of our company and the manager of our Mobile Business Group from September 2009 to August 2011. Mr. Shih served as an assistant vice president and a deputy manager of our Mobile Business Group from March 2005 to September 2009. He also served as the senior chief engineer of our Mobile Business Group from October 2001 to March 2005. Mr. Shih holds a master s degree in Electronic Engineering from the National Taiwan University.

**Yu-Fen Hong** is a director of our company. Ms. Hong is currently the director of the accounting department at the Ministry of Transportation and Communications. She holds an MBA degree from the National Chiao Tung University in Taiwan.

**Yi-Bing Lin** is a director of our company. Dr. Yi-Bing Lin received his bachelor s degree from the National Cheng Kung University in Tainan, Taiwan in 1983, and his Ph.D. from the University of Washington in Seattle in 1990. From 1990 to 1995, he was a research scientist with Bellcore (Telcordia). He then joined the National Chiao Tung University, or NCTU, in Taiwan where he remains. In 1996, he served as the deputy director of Microelectronics and Information Systems Research Center at the NCTU. Between 1997 and 1999, Dr. Lin was chairman of the Department of Computer Science & Information Engineering at the NCTU. Since 2000, he has also been appointed as an adjunct research fellow at the Academia Sinica. Between 2004 and 2006, Dr. Lin was appointed the vice president of the office of research and development at the NCTU. From 2007 to February 22, 2011, Dr. Lin has served as the dean of the College of Computer Science at the NCTU. From February 23, 2011 to December 31, 2013, he was the vice president of NCTU. Starting from 2014, he became the political deputy minister of Ministry of Science and Technology of the Executive Yuan.

**Chung-Yu Wang** is currently an independent director of our company and also the former chairman of China Steel Corporation. He graduated from Chung Yuan Christian University with a bachelor s degree in Chemical Engineering. Mr. Wang received a certificate of senior management course from Harvard Business School.

**Zse-Hong Tsai** is an independent director of our company. Dr. Tsai is also currently a professor of electrical engineering at the National Taiwan University. His research interest includes broadband networking, performance evaluation and telecommunication regulations. Dr. Tsai holds a Ph.D. degree and a master s of science degree in Electrical Engineering from the University of California, Los Angeles, and a bachelor s of science degree in Electrical Engineering from the National Taiwan University.

**Chung-Fern Wu** is an independent director of our company. Dr. Wu is also currently a professor of Accounting at the National Taiwan University. She holds an MBA degree in finance and a bachelor s degree in accounting from the National Taiwan University. She started her career as a practicing CPA in Taiwan and a Systems Analyst in U.S.A. She started her academic career as an assistant professor in the Fisher School of Accounting, University of Florida after receiving her Ph.D. degree in Accounting and Information Management from the Anderson Graduate School of Management, University of California, Los Angeles.

**Shih-Peng Tsai** is a director of our company. Mr. Tsai is currently a representative of the Member s Convention of the Chunghwa Telecom Workers Union. Mr. Tsai graduated from Ta Tung Junior Technological College of Commerce.

**Su-Ghen Huang** is a director of our company. Ms. Huang is also currently the director of the Department of Planning of the Directorate General of Budget, Accounting and Statistics at the Executive Yuan. Ms. Huang served as our supervisor before June 25, 2013. Ms. Huang holds a bachelor s degree in Accounting from the Furen University in Taiwan.

**Tain-Jy Chen** is an independent director of our company. Dr. Chen is currently a professor of Department of Economics at the National Taiwan University. He was the Minister of Council for Economic Planning and

Development from 2008 to 2009 and the President of Chung-Hua Institution for Economic Research from 2002 to 2005. Dr. Chen holds a Ph.D. degree in Economics from Pennsylvania State University, University Park, U.S.A.

**Yun-Tsai Chou** is an independent director of our company. Dr. Chou currently directs research and development for five research centers at the public policy think tank 21st Century Foundation: Digital Convergence, Bio-Agriculture, Global Health, Innovative Governance, and Knowledge Economy. She is currently an associate professor of Department of Graduate Program teaching Social Informatics at the Yuan Ze University in Taiwan. Dr. Chou holds a Ph.D. degree in Public Policy from George Washington University, U.S.A.

**Hui-Ling Wu** is a director of our company. Ms. Wu is also currently the director of the General Affairs Department at the Ministry of Transportation and Communications. Ms. Wu holds a bachelor s degree in political science from the National Taiwan University.

**Chich-Chiang Fan** is a director of our company. Dr. Fan assumed chairmanship of Taiwan High Speed Rail Corporation starting from March 2014. Dr. Fan is also the chairman of Taiwan Futures Exchange starting from July 2010, after his term as the chairman of the Taiwan Depository & Clearing Corporation from 2008 to 2010. From 2001 to 2008, he was the chairman of TransAsian Airways Corporation, and chaired the Association of Airfreight Forwarding& Logistics from 2005 to 2008. He was also the chairman of Askey Computer Corp. from 2001 to 2006. From 1997 to 2001, he served as the chairman of the Fuhwa Securities Corp. Dr. Fan received a Ph.D. degree from the University of Cambridge, UK, in 1993.

The following people served as directors and supervisors on our board during 2013 but are no longer serving with us due to resignations or replacements.

**Yen-Sung Lee** was the chairman, chief executive officer and director of our company from April 1, 2013 to January 28, 2014. Dr. Lee was the president of our company from August 29, 2012 to April 1, 2013, and served as a senior executive vice president supervising the marketing and IT department from September 2008 till August 29, 2012. Prior to that, Dr. Lee was the manager of our Enterprise Business Group from February 2007 to September 2008. Dr. Lee holds a Ph.D. degree in Information Engineering from National Chiao Tung University in Taiwan.

**Shyue-Ching Lu** was a director of our company. Dr. Lu was the chief executive officer, a director and chairman of our company from August 2008 to April 1, 2013. Dr. Lu served as our president from May 1996 until he was appointed our chairman in August 2008. Prior to that, Dr. Lu was the director general of the Department of Posts and Communications of the Ministry of Transportation and Communications from 1993 to 1994 and the deputy director general of the Directorate General of Telecommunications from 1994 to 1996. Dr. Lu holds a Ph.D. degree in electrical engineering from the University of Hawaii and a bachelor s degree in Engineering from the National Cheng Kung University in Taiwan.

**Jeng-Fang Jong** was a director of our company. Mr. Jong is also a director of Personnel Department at the Ministry of Transportation and Communications. Mr. Jong received his bachelor s degree from the National Taiwan College of Education.

**Gordon S. Chen** was a director of our company. Dr. Chen is an emeritus professor in Finance Department of Chung Yuan Christian University. Dr. Chen has more than 28 years of services in financial sector. He gained profound financial expertise and banking experience from several government positions, including chairman of TWSE Corporation and chairman of Taiwan Certificate Authority Corporation. Dr. Chen obtained a Ph.D. degree from the National Taiwan University, a master s degree in Public Finance from National Chengchi University and a bachelor s degree in Economics at the Chinese Culture University.

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**Shih-Wei Pan** was a director of our company. Dr. Pan is also currently the minister of the Ministry of Labor. Dr. Pan holds a Ph.D. degree in Industrial and Labor Relations from Cornell University.

**I-chuan Liou** was a supervisor of our company. Mr. Liou was the general director of Department of Education, Science and Culture of the Executive Yuan. He holds a master s degree in Education from National Taiwan Normal University.

**I-Hwa Wu** was a supervisor of our company. Ms. Wu is also the vice president of Chunghwa Post Co., Ltd. She holds a bachelor s degree in Commerce of the National Taiwan University.

**Jih-Chu Lee** was a director of our company from June 25, 2013 to August 15, 2013. Dr. Lee is currently the Chairman of Taiwan Financial Holdings Co., Ltd. and Bank of Taiwan. Before this position, Dr. Lee was the Chairman of Chunghwa Post Co., Ltd. Dr. Lee was a professor of Department of Economics of National Chengchi University in Taiwan. Furthermore, she once held important positions in many government departments, including vice chairman of Financial Supervisory Commission and a legislator of the Legislative Yuan. Dr. Lee holds a Ph.D. degree in Economics from the National Taiwan University.

The following table sets forth the name, age, position and tenure of each of our executive officers and such person s position as of March 31, 2014. There is no family relationship among any of these persons.

| Name | Age | Position |
|---|---|---|
| Mu-Piao Shih | 61 | Acting chief financial officer |
| Chi-Mau Sheih | 60 | Senior executive vice president |
| Cheng-Kann Wu | 65 | Senior executive vice president |
| Hsiu-Gu Huang | 61 | Senior executive vice president |
| Yuan-Kuang Tu | 58 | President of business group |
| Ming-Yuan Lee | 62 | President of business group |
| Kuo-Feng Lin | 58 | President of business group |
| Fu-Kuei Chung | 60 | President of business group |
| Kuang-Yao Chang | 57 | President of business group |
| Tai-Feng Leng | 65 | President of business group |
| Feng-Yue Hung | 64 | President of business group |
| Shyang-Yih Chen | 62 | President of business group |

**Chi-Mau Sheih** is a senior executive vice president of our company. Mr. Sheih is also a director of Senao International Co., Ltd. Mr. Sheih was an executive vice president and the manager of our Southern Taiwan Business Group from March 2007 to June 2010. Prior to that, he was an executive vice president of our company and the manager of our Central Taiwan Business Group from September 2006 to March 2007. He served as the senior managing director of our Network Department from September 2001 to January 2004. He also served as an assistant vice president of our company and a deputy manager of our Central Taiwan Business Group from January 2004 to September 2006. Mr. Sheih holds a master s degree in Business Administration from the National Taiwan University.

**Cheng-Kann Wu** is a senior executive vice president of our company. Mr. Wu was the chief audit executive of our company from July 2011 to August 2012. Prior to that, he served as the deputy manager of our Northern Taiwan Business Group from March 2008 to July 2011. He also served as the managing director of our Accounting Department from July 2004 to March 2008. Mr. Wu holds a master s degree in Management Science from the National

Chiao Tung University

**Hsiu-Gu Huang** is a senior executive vice president of our company. Mr. Huang is also a director of China Airlines Co., Ltd. He served as the president of our Enterprise Business Group from September 2008 to May 2013. Prior to that, he was an assistant vice president of our company and a deputy manager of our Enterprise

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Business Group from January 2007 to September 2008. Mr. Huang holds a master s degree in Management Science from the National Chiao Tung University in Taiwan.

**Yuan-Kuang Tu** is the president of our Northern Taiwan Business Group. Dr. Tu is also a director of Senao International Co., Ltd. He served as the president of Chunghwa Telecom Laboratories from May 2009 to March 2012, the senior managing director of our Corporate Planning Department from May 2007 to May 2009, and a vice president of Chunghwa Telecom Laboratories from March 2006 to April 2007. He holds a Ph.D. degree in Electrical Engineering from National Taiwan University.

**Ming-Yuan Lee** is the president of our Southern Taiwan Business Group since November 2013. Prior to that, he served as a vice president of our Southern Taiwan Business Group from July 2012 to November 2013 and as the deputy manager of our Southern Taiwan Business Group from May 2007 to July 2012. Mr. Lee holds a master s degree in Telecommunications from the National Chiao Tung University in Taiwan.

**Kuo-Feng Lin** is the president of our Mobile Business Group. Mr. Lin served as a deputy manager of our Mobil business group from October 2009 to May 2012. Prior to that, he served as the manager of Taipei Branch, Mobile Business Group from April 2006 to October 2009. Mr. Lin holds a bachelor s degree in Electronic Engineering from National Taipei Institute of Technology.

**Fu-Kuei Chung** is the president of our Data Communications Business Group. He is also a director of Chunghwa Telecom Vietnam Co., Ltd. Before promoting to this position, he previously served as a deputy manager of our Data Communications Business Group from September 2010 to 2012 March and the senior managing director of our Corporate Planning Departing from May 2009 to August 2010. Mr. Chung holds the master s degree in Information Management from National Taiwan University.

**Kuang-Yao Chang** is the president of our Enterprise Business Group. Mr. Chang served as a vice president of our Telecommunication Laboratories from July 2012 to May 2013. Dr. Chang holds a Ph.D. degree in information engineering from the National Taiwan University in Taiwan.

**Tai-Feng Leng** is the president of the International Business Group. Miss Leng is also a director of Chief Telecom Inc., Donghwa Telecom Co., Ltd. and Chunghwa Telecom Singapore Pte., Ltd. Miss Leng served as the deputy manager of our International Business Group from July 2004 to December 2007 and as the senior managing director of our Marketing Department from October 2001 to July 2004. Miss Leng holds a master s degree in Management Science from the National Chiao Tung University in Taiwan.

**Feng-Yue Hung** is the president of our Telecommunication Laboratories. Mr. Hung served as the president of our Telecommunication Training Institute from December 2010 to March 2012. Prior to that, he served as the deputy manager of our Enterprise Business Group from September 2008 to December 2010 and served as the Director of our Information Technology Department from January 2006 to September 2008. Mr. Hung holds a master s degree in Electronic from National Chiao Tung University.

**Shyang-Yih Chen** is the president of our Telecommunication Training Institute. Mr. Chen served as an executive vice president of our company and the manager of the Data Communication Business Group from September 2006 to March 2012. Prior to that, he served as the deputy manager of our Data Communication Business Group from January 2005 to September 2006. Mr. Chen holds a master s degree in Electrical Engineering from National Taiwan University.

The following people served as our executive officers during 2013 but are no longer serving with us due to resignations or replacements.

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**Shu Yeh** was our chief financial officer and senior executive vice president from February 2010 to February 2014. Dr. Yeh was also a director of Chunghwa Investment Co., Ltd. Dr. Yeh served as an independent director of our company from June 2007 to January 2010. Dr. Yeh also served as a professor of accounting at National Taiwan University. Dr. Yeh holds a Ph.D. degree in accounting from the University of California, Los Angeles, a master s degree in professional accounting from the University of Texas at Austin, and a bachelor s degree in Economics from the National Taiwan University.

**Min-Hsuan Lin** was the president of our Southern Taiwan Business Group since June 2010. Prior to that, he served as an assistant vice president of our company and a deputy manager of our Southern Taiwan Business Group from September 2009 to June 2010. He also served as the manager of the Tainan Branch Office from May 2007 to September 2009. He also served as the manager of the Fong-Shan Branch Office from February 2006 to May 2007, and he also served as the managing director of the Marketing Department of our Southern Taiwan Business Group from August 2004 to February 2006. Mr. Lin holds a bachelor s degree in Transportation and Communication Management Science from the National Cheng Kung University.

**B. Compensation**

The board of directors has set up a compensation committee to be responsible for drafting, approving and periodically reviewing the compensation proposals for the directors and managers. See C. Board Practices for a discussion of our compensation committee.

the chairman of our board of directors may receive a fixed monthly income of NT$330,000 and a non-fixed income, including but not limited to performance-related bonuses or other rewards, which may not exceed his fixed income. The chairman will not receive any additional compensation for his role as a director;

our president may receive a fixed monthly income of NT$305,000 and a non-fixed income, including but not limited to performance-related bonuses or other rewards, which may not exceed his fixed income. The president will not receive any additional compensation for his role as a director;

independent directors who concurrently serve in military, public office or hold teaching or administrative post may receive a fixed monthly compensation of NT$8,000, and those who do not concurrently serve in military or public office or hold teaching or administrative post may receive a monthly compensation of NT$50,000; and

directors and supervisors who serve in military, public office or hold teaching or administrative post may receive a monthly compensation of NT$8,000, and those directors and supervisors who do not serve in military and public office or hold teaching or administrative post may receive a monthly compensation of NT$30,000.

Any compensation above the stipulated amounts in the compensation plan for our directors and supervisors, including but not limited to profit-based bonuses, received by our directors and supervisors who are serving as representatives of the Ministry of Transportation and Communications or other legal persons will be collected by the Ministry of Transportation and Communications or the legal persons they represent, respectively. Our chairman and president to our board of directors, Lih-Shyng Tsai and Mu-Piao Shih, respectively, do not receive monthly compensation for

acting as our directors because they receive salaries as employees.

The compensation plan was put into practice on January 1, 2006. The aggregate amount of compensation to our directors, supervisors and executive officers in 2012 and 2013 was NT$140,141,488 and NT$108,996,925 (US$3,653,936.5), respectively. The aggregate amount of compensation in 2013 includes a NT$73,527,994 (US$2,464,766.8) salary payment for directors, supervisors and executive officers, a NT$10,215,442 (US$342,455.3) pension payment for executive officers, a NT$19,303,489 (US$647,116.6) bonus accrued for directors and supervisors and a NT$5,950,000 (US$199,463.6) bonus accrued for executive officers. The 2013 bonus for our directors and supervisors may not exceed 0.2% of our distributable earnings and must be approved at our 2014 annual general stockholders meeting.

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Our non-independent directors are legal representatives of the MOTC. The bonus in the amount of NT$ 16,432,081 (US$550,857.6) were paid directly to the MOTC in 2013 because such earnings distributions are not the individual income of these directors. Independent directors will not receive any earnings distributions. The bonus in the amount of NT$2,871,408 (US$96,259.1) were paid directly to our juridical supervisors, National Development Fund of the Executive Yuan and Chunghwa Post Co., Ltd., in 2013, because such earnings distributions are not the individual income of legal representatives.

Pursuant to ROC disclosure rules, we have disclosed the compensation range of our directors, supervisors and senior management for the fiscal year ended December 31, 2013 as follows, excluding bonus accrued for legal entities:

| Total Compensation | Directors |
|---|---|
| Below NT$2,000,000 | Gordon S. Chen, Wen-Tsan Lin, Jih-Chu Lee, Jennifer Yuh-Jen Wu, Hui-Ling Wu, Jeng-Fang Jong, Shih-Wei Pan, Su-Ghen Huang(1), Yu-Fen Hong, Yi-Bing Lin, Chich-Chiang Fan, Tain-Jy Chen, Yun-Tsai Chou, Shih-Peng Tsai, Chung-Yu Wang, Chung-Fern Wu, Zse-Hong Tsai |
| NT$2,000,000 to NT$4,999,999 | None |
| NT$5,000,000 to NT$9,999,999 | Yen-Sung Lee(2), Mu-Piao Shih(3), Shyue-Ching Lu(4) |
| Total | 20 people |

(1) As compensation for serving as our supervisor and director.
(2) As salary for serving as our president and chief executive officer.
(3) As salary for serving as our senior executive vice president and president and as bonuses for serving as our employee.
(4) As salary for serving as our chief executive officer, as compensation for serving as our director after retiring from position as our chief executive officer, and as retirement pension payment.

| Total Compensation | Supervisors |
|---|---|
| Below NT$2,000,000 | I-Chuan Liou, Su-Ghen Huang, I-Hwa Wu |
| NT$2,000,000 to NT$4,999,999 | None |
| NT$5,000,000 to NT$9,999,999 | None |
| Total | 3 people |

| Total Compensation | Senior Management |
|---|---|
| Below NT$2,000,000 | None |
| NT$2,000,000 to NT$4,999,999 | Chi-Mao Hsieh, Cheng-Kann Wu, Hsiu-Gu Huang, Yuan-Kuang Tu, Ming-Yuan Lee, Kuo-Feng Lin, Fu-Kuei Chung, Kuang-Yao Chang, Tai-Feng Leng, Feng-Yue Hung, Shyang-Yih Chen, Shu Yeh |
| NT$5,000,000 to NT$9,999,999 | None |
| Over NT$10,000,000 | Min-Hsuan Lin(1) |
| Total | 13 people |

(1) Including retirement pension payment.

We accrued NT$6,251,139 (US$209,558.8) pension expense for executive officers mentioned above in 2013. See Item 5. Operating and Financial Review and Prospects Overview Provisions for pension payments to our employees and note 27 to our consolidated financial statements included elsewhere in this annual report for descriptions about our pension plans. We do not have any service contracts with any directors providing for any benefits upon termination of employment.

### C. Board Practices

Thirteen directors were elected in 2013 for three-year terms. Pursuant to the ROC Company Act, the directors may be removed from office at any time by a resolution adopted at a stockholders meeting. The chairman of our board of directors is elected by our directors. Our chairman presides at all meetings of our board of directors and also has the authority to act as our representative. We have not entered into any contract with any of our directors by which our directors are expected to receive benefits upon termination of their employment. Under the Article 12 of our articles of incorporation, our supervisors has been replaced by an audit committee, which is composed entirely of independent directors, starting from our 7th term of board of directors to be elected at our 2013 annual general stockholders meeting, pursuant to Paragraph 1, Article 14-4 of the Securities and Exchange Act. We no longer have supervisors after the beginning of our 7th term of our board of directors.

Our articles of incorporation provides for a board of directors consisting of seven to fifteen directors, one-fifth of whom shall be expert representatives. Pursuant to the ROC Company Act, the ROC Securities and Exchange Act and Article 12-1 of our articles of incorporation provides for the election of, starting from the fifth stockholders meeting, at least three independent directors out of the 7-to-15-member board. The term independent director may have a different meaning when used in Taiwan than in other jurisdictions. We have used a nominating process, with the stockholders choosing the independent directors from the list of nominees. Accordingly, we have elected five independent directors in the annual general meeting on June 25, 2013. With respect to certain material decisions to be made by our company as specified in the ROC Securities and Exchange Act, including the adoption or amendment to our internal control system, material loans or guarantees, the issuance of equity-type securities, matters in which directors have personal interests, the appointment and discharge of auditors, approval of financial reports, the appointment and discharge of financial, accounting or internal auditing officers and other matters prescribed by the ROC Financial Supervisory Commission, the dissenting opinion or qualified opinion of an independent director is required to be noted in the minutes of the board of directors meeting.

Our audit committee was established in September 2004 in accordance with the rules set forth in the NYSE Listed Company Manual, and was comprised of three independent directors. See Item 16G. Corporate Governance Audit Committee . Starting from the date of the annual general meeting in June 2013, we have established a new audit committee that replaces our supervisors and our old audit committee in accordance with Paragraph 1, Article 14-4 of the ROC Securities and Exchange Act and our articles of incorporation, and as a result, we simultaneously comply with the relevant rules of the NYSE Listed Company Manual and the relevant rules and regulations in the ROC. Therefore, we no longer have supervisors after the beginning of our 7th term of our board of directors. In addition, the number of members, or independent directors, in the audit committee, increases from three to five according to the resolution of our board meeting.

Under the ROC Company Act, a person may serve as our director in his personal capacity or as the representative of another legal entity. A director who serves as the representative of a legal entity may be removed or replaced at any time at the discretion of that legal entity, and the replacement director may serve the remainder of the term of office of the replaced director. Except for our five independent directors, all of our directors are representatives of the Ministry of Transportation and Communications.

The business address of our directors and executive officers is the same as our registered address.

Our audit committee should approve and deal following matters: (i) the adoption or amendment of the internal control system pursuant to Article 14-1 of the Securities and Exchange Act; (ii) the assessment of the effectiveness of the internal control system; (iii) the adoption or amendment, pursuant to Article 36-1 of the Securities and Exchange Act, of procedures governing material financial or operational actions, such as acquisition or disposal of assets and

derivatives trading, loaning of funds to others, and endorsements or guarantees for others; (iv) a matter relating to the personal interest of a director; (v) a material asset or derivatives transaction; (vi) the offering, issuance, or private placement of any equity-related securities; (vii) a matter relating to significant loan, endorsement or guarantee arrangement; (viii) the designation or dismissal of an

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attesting CPA, or the compensation given thereto; (ix) the appointment or discharge of a financial, accounting, or internal auditing officer; (x) annual and semi-annual financial reports; (xi) the first and third quarter financial reports; (xii) communicating with our independent auditor; (xiii) negotiating the conflicts over our financial reports between our management and independent auditor; (xiv) discussing and reporting other financial information and required disclosure under the Securities Exchange Act of 1934 with our management and independent auditor; (xv) accounting firm s annual audit and non-audit service items; (xvi) performing one-self review each year; and (xvii) any other material matter so required by the Company or the competent authorities. Our board of directors has concluded that Chung-Fern Wu is our audit committee financial expert.

In addition to our audit committee, we also have a corporate strategy committee. Our corporate strategy committee may be composed of five to seven directors. Currently, there are five directors in the Committee. It is responsible for reviewing and advising on the budgets, capital requirements, financial forecasts, matters related to investments, business license matters, corporate reorganization, development plans and other major issues affecting our development. The conclusions of the corporate strategy committee are considered at a subsequent board of directors meeting.

The board of directors passed a resolution on November 8, 2005 to set up a compensation committee. The Article 14-6 of ROC Securities and Exchange Act requires all listed companies to establish a compensation committee for directors, supervisors and managers compensation, which includes salary, stock options and other rewards, as well as authorizes the Competent Authority (i.e., Financial Supervisory Commission) to enact a regulation on the authorities of the compensation committee and the qualifications of its members. Our board of directors passed a resolution to amend the organization of our compensation committee on August 13, 2013. The compensation committee is composed of three independent directors (Chung-Yu Wang, Chung-Fern Wu and Tain-Jy Chen) and is responsible for drafting, approving and periodically reviewing the compensation proposals for the directors and managers. See Item 10. Additional Information B. Memorandum and Articles of Incorporation Directors .

In November 2003, the SEC approved changes to the New York Stock Exchange s listing standards related to the corporate governance practices of listed companies. Under these rules, listed foreign private issuers, like us, must disclose any significant ways in which their corporate governance practices differ from those followed by New York Stock Exchange-listed non-foreign private issuers under the New York Stock Exchange s listing standards. See Item 16G. Corporate Governance . A copy of the significant differences between our corporate governance practices and New York Stock Exchange corporate governance rules applicable to non-foreign private issuers is also available on our website http://www.cht.com.tw. The information contained on our website is not a part of this annual report.

**D. Employees**

*The following section sets forth information regarding the employees.*

As of December 31, 2013, we had 32,187 employees on a consolidated basis. Approximately 99% of our employees were based in the Republic of China. The following table is a breakdown of our employees from 2011 to 2013 on a consolidated basis.

| | 2011 | 2012 | 2013 |
|---|---|---|---|
| **Employees** | | | |
| Technical | 14,768 | 14,494 | 15,177 |
| Operations | 12,283 | 14,214 | 15,267 |

| | | | |
|---|---|---|---|
| Administrative | 1,721 | 1,724 | 1,743 |
| Total | 28,772 | 30,432 | 32,187 |

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The following table is a breakdown of our employees from 2011 to 2013 on a non-consolidated basis.

| | 2011 | 2012 | 2013 |
|---|---|---|---|
| **Employees** | | | |
| Technical | 13,959 | 13,840 | 13,951 |
| Operations | 9,336 | 9,170 | 8,958 |
| Administrative | 1,369 | 1,341 | 1,313 |
| Total | 24,664 | 24,351 | 24,222 |

As of December 31, 2013, approximately 75% of our employees had university, graduate or post-graduate degrees. To improve our operational efficiency by reducing personnel costs, we offered a number of voluntary retirement programs between June 1, 2000 and December 31, 2013, which resulted in a reduction of approximately 13,752 employees.

As of December 31, 2013, approximately 99% of our employees on a non-consolidated basis were members of our principal labor union. Our collective agreement sets forth work rules, grievance procedures and provides for union participation in performance evaluations and promotion decisions. Our union members also occupy a majority of the seats on our employee welfare and pension fund committees. We will continue to maintain a good relationship with our labor union. We strive to have good communication with our employees and the labor union by inviting representatives of our labor union to attend various meetings related to the performance of our employees.

Pursuant to our articles of incorporation, our employees are entitled to 2% to 5% of the distributable earnings as employee bonuses. Our practice in the past to determine the amount of the bonus has been based on the operating results. In the third quarter of 2013, we distributed an aggregate bonus to our employees of NT$1.5 billion (US$0.1 billion).

**E. Share Ownership**

As of March 31, 2014, our directors and executive officers personally held an aggregate 640,359 shares of our common shares, representing around 0.01% of our outstanding common shares. The following table sets forth information with respect to the beneficial ownership of our common shares as of March 31, 2014 by each of our directors and executive officers.

| Name | Number | % |
|---|---|---|
| Shih-Peng Tsai | * | * |
| Mu-Piao Shih | * | * |
| Chi-Mau Sheih | * | * |
| Cheng-Kann Wu | * | * |
| Hsiu-Gu Huang | * | * |
| Yuan-Kuang Tu | * | * |
| Ming-Yuan Lee | * | * |
| Kuang-Yao Chang | * | * |
| Kuo-Feng Lin | * | * |

| | | |
|---|---|---|
| Tai-Feng Leng | * | * |
| Fu-Kuei Chung | * | * |
| Feng-Yue Hung | * | * |
| Shyang-Yih Chen | * | * |

* Stockholder beneficially owns less than 1.0% of our outstanding common shares.

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**Employee Stock Subscription Program**

Under the Statute of Chunghwa Telecom Co., Ltd. and our articles of incorporation, we must reserve up to 10% to 15% of any new shares for subscription by our employees whenever we issue new shares for cash, except for any issuances of restricted stock to employees.

Our consolidated subsidiary, Senao, is publicly traded on the TWSE and resolved to grant the stock options plan for its employees to purchase common stock of Senao. As of December 31, 2012 and 2013, participants in Senao s stock incentive plan had outstanding stock options to purchase 1.1 million and 9.9 million common shares of Senao, respectively.

Our another consolidated subsidiary, Chunghwa Precision Test Tech Co., Ltd., or CHPT, a non-listed company, granted the stock options to its employees to subscribe for common shares of CHPT. As of December 31, 2012 , participants in CHPT s stock incentive plan had outstanding stock options to purchase 0.9 million common shares of CHPT. The registration of 0.8 million of employee stock options exercised in 2013 has been completed, and others were expired. As of December 31, 2013, CHPT has no outstanding employee stock options.

**ITEM 7. MAJOR STOCKHOLDERS AND RELATED PARTY TRANSACTIONS**
**A. Major Stockholders**

The following table sets forth information known to us with respect to the beneficial ownership of our shares (i) as of March 31, 2014, the most recent practicable date and (ii) as of certain record dates in each of the preceding three years, for the stockholders known by us to own at least 5.0% of our outstanding common shares. Beneficial ownership is determined in accordance with the SEC s rules.

| | As of March 31, 2011 | | As of March 31, 2012 | | As of March 31, 2013 | | As of March 31, 2014 | |
|---|---|---|---|---|---|---|---|---|
| Name | number | % | number | % | number | % | number | % |
| The ROC government[1][2] | 2,957,318,085 | 38.12 | 2,885,164,257 | 37.19 | 3,000,346,630 | 38.68 | 3,099,602,788 | 39.96 |
| The Ministry of Transportation and Communications | 2,737,718,976 | 35.29 | 2,737,718,976 | 35.29 | 2,737,718,976 | 35.29 | 2,737,718,976 | 35.29 |
| Fubon Life Assurance Co., Ltd[2] | * | * | 428,621,087 | 5.53 | 467,321,087 | 6.02 | 450,471,087 | 5.81 |

* Less than 5%.

(1) Includes shares held through the Ministry of Transportation and Communications and other government-controlled entities

(2) The information as of January 15, 2011, July 27, 2011, July 19, 2012, and July 18, 2013, the latest book closure date, which were the most recent practicable dates for us to obtain complete ownership information.

As of March 31, 2014, 25 record holders held 25,336,522 ADSs (each representing ten common shares), which represents approximately 3.3% of our total outstanding common shares. Because many of these ADSs were held by brokers or other nominees, we cannot ascertain the exact number of beneficial shareholders with addresses in the United States.

None of our shareholders has different voting rights from other shareholders. We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

**B. Related Party Transactions**

We have not extended any loans or credit to any of our directors or executive officers, and we have not provided guarantees for borrowings by any of these persons. We have not entered into any fee-paying contract with any of these persons for them to provide services not within his or her capacity as a director or executive officer of our company, except that three of our directors who are also our employees receive salaries from our company in their capacity as our employees.

Please refer to Item 4. Information on the Company A. History and Development of the Company for a discussion of our alliances, acquisitions and investments. Please refer to notes 3, 15, 16 and 39 to our consolidated financial statements included elsewhere in this annual report for descriptions of Chunghwa s subsidiaries, investments accounted for using equity method, and related party transactions.

On April 1, 2007, Chunghwa entered into an agreement with Senao making Senao the exclusive distributor of mobile handsets to Chunghwa s retail outlets. Under the terms of the agreement, Senao also provides mobile handset sales services in Chunghwa s retail outlets, exclusively sells Chunghwa s SIM cards in Senao s own retail stores, and gets commission, subsidies of handset sold and warranties from Chunghwa. For the year ended December 31, 2013, Senao received NT$12.4 billion (US$415.5 million) from Chunghwa. Chunghwa also sells mobile handsets and data cards to Senao. For the year ended December 31, 2013, Chunghwa sold mobile handsets and data cards to Senao that amounted to NT$0.4 billion (US$12.1 million).

Chunghwa acquired network equipment and related supplies from Chunghwa System Integration for approximately NT$2.0 billion (US$67.1 million) in 2013.

Chunghwa paid Taiwan International Standard Electronics approximately NT$1.8 billion (US60.7 million) in 2013 for the purchase of telecommunications exchange facilities and related supplies, and the maintenance expenses.

Terms and conditions of the foregoing transactions with related parties were not significantly different from transactions with non-related parties. When no similar transactions with non-related parties can be referenced, terms and conditions were determined in accordance with mutual agreements.

### C. Interests of Experts and Counsel

Not applicable.

## ITEM 8. FINANCIAL INFORMATION

### A. Consolidated Statements and Other Financial Information

See Item 18 for a list of all consolidated financial statements filed as part of this annual report on Form 20-F.

Except as described in Item 4. Information on the Company B. Business Overview Legal Proceedings, we are not currently involved in material litigation or other proceedings that may have or have had in the recent past, significant effects on our financial position or profitability.

For our policy on dividend distributions, see Item 10. Additional Information B. Memorandum and Articles of Incorporation Dividends and Distributions . The following table sets forth the dividends declared on each of our common shares and in the aggregate for each of the years ended December 31, 2009, 2010, 2011, 2012 and 2013. All of these dividends were paid, in the fiscal year following the period with respect to which the dividends relate.

| | **Dividends Per Common Share[(1)] NT$** | **Total Dividends[(1)] NT$ in billions** |
|---|---|---|

| | | |
|---|---|---|
| Year ended December 31, 2009 | 4.06 | 39.4 |
| Year ended December 31, 2010 | 5.52 | 42.8 |
| Year ended December 31, 2011 | 5.46 | 42.4 |
| Year ended December 31, 2012(2) | 4.63 | 35.9 |
| Year ended December 31, 2013(3) | 2.39 | 18.5 |

(1) Cash dividend unless otherwise indicated.

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(2) In addition to the cash dividend from retained earnings disclosed in table above, we also made cash distributions from additional paid-in capital of NT$0.72 per share, which amounted to an aggregate of NT$5.6 billion.
(3) Dividends for 2013 were approved for distribution in the board meeting in March 2014 and are expected to be approved at our annual general stockholders meeting scheduled for June 24, 2014. In addition to the cash dividends from retained earnings disclosed in the table above, our board of directors also resolved to distribute from our additional paid-in capital NT$2.14 per share, which amounts to an aggregate of NT$16.6 billion. See Item 5. Operating and Financial Review and Prospects Overview Effect of adopting Taiwan-IFRSs on our dividends and employee bonuses.

We have historically distributed cash dividends to our stockholders equal to approximately 90% of our annual net income. We intend to maintain this dividend payout ratio in the future, subject to a number of commercial factors, including the interests of our stockholders, cash requirements for future capital expenditures and investments, as well as relevant industry and market practice. The amount of our net income determined for purposes of calculating our annual dividend payout will be calculated based on Taiwan IFRSs, which may differ from the amount of our net income determined in accordance with IFRSs.

**B. Significant Changes**

Other than as disclosed elsewhere in this annual report, we have not experienced any significant changes since the date of the annual consolidated financial statements included in this annual report.

**ITEM 9. THE OFFER AND LISTING**
**A. Offer and Listing Details**

**Market Price Information for Our Common Shares**

Our common shares have been listed on the TWSE since October 27, 2000. There is no public market outside Taiwan for our common shares. The table below shows, for the periods indicated, the high and low closing prices and the average daily volume of trading activity on the TWSE for our common shares. The closing price for our common shares on the TWSE on March 31, 2014 was NT$93.7 per share.

A capital reduction plan approved at the special stockholders meeting on August 14, 2008 was executed in 2009. The last trading date for our old shares was March 2, 2009. Trading of our shares was suspended in the TWSE from March 3 to March 19, 2009. Trading of our new shares commenced on March 20, 2009. The amount of the capital reduction was NT$19,115,553,820, corresponding to 1,911,555,382 common shares of total listed common shares a reduction ratio of 16.46705301419%. Every thousand shares were converted to 835.329469858 shares. For the fractional common shares resulting from the capital reduction, we paid the stockholder cash based on the closing price on March 2, 2009, which was NT$54.9, rounded off to the nearest whole NT dollar. After the capital reduction, the share price was restated in accordance with Article 67-1 of the Operating Rules of the TWSE Corporation.

Another capital reduction plan approved at the general shareholders meeting on June 19, 2009 was executed in 2009. The last trading date for our old shares was January 20, 2010. Trading of our shares was suspended in the TWSE from January 21 to February 7, 2010. Trading of our new shares commenced on February 8, 2010. The amount of the capital reduction was NT$9,696,808,180, corresponding to 969,680,818 common shares of total listed common shares a reduction ratio of 9.09090909006%. Every thousand shares were converted to 909.0909090994 shares. For the fractional common shares resulting from the capital reduction, we paid the stockholder cash based on the closing price on January 20, 2010, which was NT$58.1, rounded off to the nearest whole NT dollar. After the capital reduction, the

share price was restated in accordance with Article 67-1 of the Operating Rules of the TWSE Corporation.

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An additional capital reduction plan approved at the general shareholders meeting on June 18, 2010 was executed in 2011. The last trading date for our old shares was January 6, 2011. Trading of our shares was suspended in the TWSE from January 7 to January 24, 2011. Trading of our new shares commenced on January 25, 2011. The amount of the capital reduction was NT$19,393,616,360, corresponding to 1,939,361,636 common shares of total listed common shares a reduction ratio of 20%. Every thousand shares were converted to 800 shares. For the fractional common shares resulting from the capital reduction, we paid the stockholder cash based on the closing price on January 6, 2011, which was NT$73.1, rounded off to the nearest whole NT dollar. After the capital reduction, the share price was restated in accordance with Article 67-1 of the Operating Rules of the TWSE Corporation.

We did not execute any capital reduction plan during 2012 and 2013.

| | Closing Price Per Common Share(1) | | Average Daily Trading Volume |
|---|---|---|---|
| | High NT$ | Low NT$ | (in thousands) |
| 2009 | 62.54 | 52.08 | 20,048 |
| 2010 | 78.94 | 57.37 | 13,142 |
| 2011 | 93.12 | 73.39 | 14,355 |
| 2012 | 89.91 | 78.08 | 11,753 |
| First Quarter | 89.13 | 80.31 | 22,153 |
| Second Quarter | 83.78 | 78.08 | 10,347 |
| Third Quarter | 88.87 | 83.38 | 8,355 |
| Fourth Quarter | 89.91 | 86.12 | 7,180 |
| 2013 | 96.70 | 86.78 | 7,498 |
| First Quarter | 89.91 | 86.78 | 7,138 |
| Second Quarter | 96.53 | 87.35 | 7,717 |
| Third Quarter | 96.70 | 92.56 | 8,105 |
| Fourth Quarter | 94.60 | 90.60 | 7,005 |
| October | 94.60 | 90.60 | 10,653 |
| November | 93.30 | 91.40 | 5,658 |
| December | 93.40 | 91.80 | 4,642 |
| 2014 (through April 21) | 94.50 | 90.10 | 6,962 |
| First Quarter | 93.70 | 90.10 | 7,704 |
| January | 92.80 | 91.70 | 7,947 |
| February | 92.00 | 90.10 | 8,699 |
| March | 93.70 | 91.30 | 6,689 |
| Second Quarter (through April 21) | 94.50 | 93.20 | 3,996 |
| April (through April 21) | 94.50 | 93.20 | 3,996 |

(1) The historical prices and volumes of our common shares traded on the Taiwan Stock Exchange have been adjusted based on prior cash dividend payments, capital increases and capital reductions.

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**Market Price Information for Our American Depositary Shares**

Our ADSs have been listed on the New York Stock Exchange under the symbol CHT since July 17, 2003. The outstanding ADSs are identified by the CUSIP number 17133Q502. The table below shows, for the periods indicated, the high and low closing prices and the average daily volume of trading activity on the New York Stock Exchange for our ADSs. The closing price for our ADSs on the New York Stock Exchange on April 21, 2014 was US$31.22 per ADS. Each of our ADSs represents the right to receive ten shares.

| | Closing Price Per ADS[1] | | Average ADS Daily Trading Volume |
|---|---|---|---|
| | High US$ | Low US$ | (in thousands) |
| 2009 | 19.50 | 15.11 | 759 |
| 2010 | 26.05 | 17.40 | 590 |
| 2011 | 32.22 | 24.73 | 375 |
| 2012 | 30.85 | 26.30 | 355 |
| First Quarter | 29.43 | 26.56 | 716 |
| Second Quarter | 28.05 | 26.30 | 358 |
| Third Quarter | 30.09 | 27.84 | 188 |
| Fourth Quarter | 30.85 | 29.37 | 161 |
| 2013 | 32.58 | 29.06 | 206 |
| First Quarter | 31.14 | 29.06 | 260 |
| Second Quarter | 31.13 | 29.25 | 179 |
| Third Quarter | 32.58 | 30.53 | 164 |
| Fourth Quarter | 32.09 | 30.68 | 226 |
| October | 32.09 | 31.00 | 324 |
| November | 31.49 | 30.68 | 175 |
| December | 31.28 | 30.70 | 167 |
| 2014 (through April 21) | 31.28 | 29.13 | 155 |
| First Quarter | 30.84 | 29.13 | 170 |
| January | 30.84 | 29.27 | 202 |
| February | 30.28 | 29.13 | 178 |
| March | 30.72 | 30.02 | 131 |
| Second Quarter (through April 21) | 31.28 | 30.80 | 87 |
| April (through April 21) | 31.28 | 30.80 | 87 |

(1) The historical prices and volumes of our ADSs traded on the New York Stock Exchange have been adjusted based on prior cash dividend payments, capital increases and capital reductions.

As of April 21, 2014, a total of 24,903,289 ADSs and 7,757,446,545 common shares (including those represented by ADSs) were outstanding. With certain limited exceptions, holders of shares that are not Republic of China persons are required to hold these shares through a brokerage or custodial account in the Republic of China.

**B. Plan of Distribution**

Not applicable.

**C. Markets**

The principal trading market for our common shares is the TWSE and the principal trading market for our ADSs is the New York Stock Exchange.

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### D. Selling Stockholders

Not applicable.

### E. Dilution

Not applicable.

### F. Expenses of the Issue

Not applicable.

## ITEM 10. ADDITIONAL INFORMATION

### A. Share Capital

Not applicable.

### B. Memorandum and Articles of Incorporation

*Set forth below is information relating to our capital structure, including brief summaries of material provisions of our articles of incorporation, the Republic of China Securities and Exchange Law, the Republic of China Company Act, the Statute of Chunghwa Telecom Co., Ltd. and the Telecommunications Act, all as currently in effect. The following summaries are qualified in their entirety by reference to our articles of incorporation, the Republic of China Securities and Exchange Law, the Republic of China Company Act, the Statute of Chunghwa Telecom Co., Ltd. and the Telecommunications Act.*

### Objects and Purpose

The scope of business of Chunghwa Telecom Co., Ltd. as set forth in Article 2 of our articles of incorporation, includes (i) Telecommunications Enterprise Type 1 and Type 2 businesses pursuant to the Telecommunications Act of the Republic of China, (ii) installation of the computer equipment and radio-frequency equipment whose operation is controlled by the telecommunication business, (iii) telecommunications equipment wholesale, retail and engineering businesses, (iv) design, engineering and operation of information software and hardware service businesses, (v) apparatus and electric appliance installation and construction business, (vi) television program production, distribution and commercial business, (vii) broadcasting program distribution and commercial business, and (viii) other businesses, except any business requiring a special permit or otherwise restricted by law or regulation.

### General

Under our articles of incorporation, our authorized capital was NT$120,000,000,000, divided into 12,000,000,000 common shares, with par value of NT$10 per share. We have set aside 200,000,000 common shares for the conversion of any future issuances of preferred shares, warrants or convertible debt. Our paid-in capital is NT$77,574,465,450 divided into 7,757,446,545 common shares. We currently do not have any other equity in the form of preferred shares, convertible bonds or otherwise outstanding as of the date of this annual report.

The Ministry of Transportation and Communications, on behalf of the government of the Republic of China, owned approximately 35.29% of our outstanding common shares as of December 31, 2013. The remainder of our outstanding shares is held by public stockholders and other investors.

**Directors and Audit Committee**

Our articles of incorporation provide for a board of directors consisting of seven to fifteen directors, and one-fifth of these directors shall be professionals of domain knowledge**.** Under Article 12 of our articles of

incorporation, we shall establish an audit committee starting from our 7th term of our board of directors. As a result, our new audit committee started from the date of the annual general meeting on June 25, 2013. See Item 6. Directors, Senior Management and Employees C. Board Practices. Pursuant to Article 14-4 of the ROC Securities and Exchange Act, for a company that has established an audit committee, unless otherwise provided for by law, the provisions regarding supervisors in ROC Securities and Exchange Act, the ROC Company Act, and other laws and regulations shall apply mutatis mutandis to the audit committee.

Under the Republic of China Company Act, our board of directors, in conducting our business, shall act in accordance with laws and regulations, our articles of incorporation and the resolutions adopted at the meetings of stockholders. Where any resolution adopted by our board of directors contravenes laws, our articles of incorporation and the resolutions adopted at the meetings of stockholders, thereby causing loss or damage to us, all directors taking part in the adoption of such resolution shall be liable to compensate us for such loss or damage; however, those directors whose disagreement appears on record or is expressed in writing shall be exempted from liability.

If our board of directors decides, by resolution, to commit any act in violation of any law or our articles of incorporation, any of our independent directors or any stockholder who has continuously held our shares for a period of one year or longer may request our board of directors to discontinue such act. One or more stockholders who have held more than 3% of our issued and outstanding shares for over a year may require an independent director to bring an action on our behalf against a director for losses suffered by us as a result of the director s unlawful actions or failure to act by sending a written request to any of our independent directors. In addition, if our stockholders meeting resolves to institute an action against a director, we shall, within 30 days from the date of such resolution, institute such an action. In the case of a lawsuit between us and a director, an independent director shall act on our behalf, unless otherwise provided by law; and our stockholders meeting may also appoint some other person to act on our behalf in a lawsuit.

According to the Republic of China Company Act, our board of directors owes fiduciary duty to us. Our directors are liable to compensate us if they breach their fiduciary duty. In addition, a director who has a personal interest in a matter to be discussed at the meeting of the board of directors, shall specify such conflict; if the conflict may cause damages to the company, the director shall abstain from voting on the matter, and shall not serve as a proxy and vote on behalf of another director.

According to our articles of incorporation, the remuneration of the directors shall be determined by the board of directors based on the participation and the contribution of each director in the business operation of the Company and referencing the regular standards of other corporations in the similar industry. Our articles of incorporation also provide that we may make compensation to all directors and such compensation shall not exceed 0.2% of our distributable earnings and may be approved only by a validly convened stockholders meeting. Our articles of incorporation do not impose a mandatory retirement age for our directors. Furthermore, our articles of incorporation do not impose a shareholding qualification for each director. According to our current internal Loan Procedures, we may not extend any loan to our directors.

**Dividends and Distributions**

At each annual general stockholders meeting, our board of directors submits to the stockholders for their approval any proposal for the distribution of dividend or the making of any other distribution to stockholders from our net income for the preceding fiscal year. All common shares outstanding and fully paid as of the relevant record date are entitled to share equally in any dividend or other distribution so approved. Dividends may be distributed in cash, in the form of common shares or a combination of the two, as determined by the stockholders at the meeting.

We are not permitted to distribute dividends or make other distributions to stockholders in any year in which we do not have any net income or retained earnings (excluding reserves). The Republic of China Company Act

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also requires that 10% of our annual net income, less prior years losses and outstanding tax, if any, be set aside as a legal reserve until the accumulated legal reserve equals our paid-in capital. We may also set aside special reserve as determined by our stockholders at a stockholders meeting. In addition, our articles of incorporation provide that at least 50% of the remaining portion of the net income, less prior years losses, outstanding taxes, the legal reserve and any special reserve, plus undistributed retained earnings from prior years will be distributed as dividends to stockholders. Under our articles of incorporation, not less than 50% of the total amount of the distributed dividends must be in cash, but if the cash dividends to be distributed are less than NT$0.10 per share, the dividends may be distributed in the form of shares. Pursuant to our current articles of incorporation, prior to distributing any dividends to our stockholders, we were required to first distribute (i) between 2% and 5% of the distributable earnings to employees as bonuses and (ii) not more than 0.2% of the distributable earnings to directors as compensation. Also, in accordance to a clarification letter issued by the Ministry of Economic Affairs of Taiwan for the explanation of Article 64 of the Business Accounting Law on January 24, 2007, starting from January 1, 2008, employee bonuses are now categorized as an expense instead of as distributable earnings.

Under the Republic of China Company Act, if we do not incur a loss, we are permitted to make distributions on a pro rata basis to our stockholders of additional common shares or cash by the legal reserve, the premium derived from the issuance of new shares and the income from endowments received by us. We are allowed to make the above distributions to our stockholders by legal reserve only if the legal reserve exceeds 25% of our paid-in capital. Furthermore, subject to the provision under our articles of incorporation, such distribution should firstly be made by the premium derived from the issuance of new shares.

### Changes in Share Capital

Under the Republic of China Company Act, any change in our authorized share capital requires an amendment to our articles of incorporation, which in turn requires approval at our stockholders meeting. Authorized but unissued common shares may be issued, subject to applicable Republic of China law, upon terms as our board of directors may determine.

### Preemptive Rights

Under the Republic of China Company Act and our articles of incorporation, when we issue new shares for cash, existing stockholders who are listed on the stockholders register as of the record date have preemptive rights to subscribe for the new issue in proportion to their existing shareholdings, unless the law or competent authority provides otherwise. Under our articles of incorporation, our employees, except for the directors and executives involved with the approval and passage of the share issuance, have rights to subscribe for between 10% and 15% of any new issue.

In addition, in accordance with the Republic of China Securities and Exchange Law, a public company that intends to offer new shares for cash must offer to the public at least 10% of the shares to be sold except in certain limited circumstances. This percentage can be increased by a resolution passed at a stockholders meeting, held in accordance with the Company Act and our articles of incorporation which would diminish the number of new shares subject to the preemptive rights of existing stockholders.

### Meetings of Stockholders

We are required by the Republic of China Company Act and our articles of incorporation to hold a general meeting of our stockholders within six months following the end of each fiscal year, unless for specific legitimate reason or approved otherwise by the relevant authorities. Commencing from January 1, 2012, we must hold a general

shareholders meeting within six months after the end of fiscal year and may not seek any extension for such meeting accordingly to newly amended Article 36 of Securities and Exchange Act. These meetings are generally held in Taipei, Taiwan. Special stockholders meetings may be convened by resolution of the board of directors or by the board of directors upon the written request of any stockholder or stockholders who have held

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3% or more of the outstanding common shares for more than one year. Stockholders meetings may also be convened by an independent director. Notice in writing of general meetings of stockholders, stating the place, time and agenda must be dispatched to each stockholder at least 30 days, in the case of general meetings, and 15 days, in the case of special meetings, before the date set for each meeting. Except in certain circumstances described below, a majority of the holders of all issued and outstanding common shares present at a stockholders meeting constitutes a quorum for meetings of stockholders. Stockholders of 1% or more our issued and outstanding shares are entitled to submit one written proposal each year for consideration at our annual general stockholders meeting in accordance with the Republic of China Company Act.

**Voting Rights**

As previously required by the Republic of China Company Act, our articles of incorporation provide that a holder of common shares has one vote for each common share. Cumulative voting applies to the election of our directors. Separate ballots may be held for the election of independent directors.

In general, a resolution can be adopted by the holders of at least a majority of the common shares represented at a stockholders meeting at which the holders of a majority of all issued and outstanding common shares are present. Under the Republic of China Company Act, the approval by at least a majority of the common shares represented at a stockholders meeting in which a quorum of at least two-thirds of all issued and outstanding common shares are represented is required for major corporate actions, including:

- amendment to our articles of incorporation;
- entering into, modification or termination of any contracts regarding leasing of all business, outsourcing of operations or joint operations;
- transfer of the whole or substantial part of our business or assets;
- taking over of the whole of the business or assets of any other company which would have significant impact on our operations;
- distribution of any share dividend;
- dissolution;
- merger or spin-off; and
- removing of directors.

Alternatively, the Republic of China Company Act provides that in the case of a public company, such as us, a resolution may be adopted by the holders of at least two-thirds of the common shares represented at a meeting of stockholders at which holders of at least a majority of issued and outstanding common shares are present.

A stockholder may be represented at a general or special meeting by proxy if a valid proxy form is delivered to us five days before the commencement of the general or special stockholders meeting. Except for trust enterprises or share registrar approved by the Securities and Futures Bureau of the Financial Supervisory Commission, where one person is appointed as proxy by two or more stockholders who together hold more than 3% of the total issued common shares, the votes of those stockholders in excess of 3% of the outstanding common shares shall not be counted. Alternatively, if the stockholder would like to exercise its voting right at a general or special meeting but cannot be present at the meeting in person, according to the regulations promulgated by the Financial Supervisory Commission on February 20, 2012, starting from our 2012 general meeting, we are required to set up an electronic voting mechanism for such stockholder to exercise voting right. The stockholder is not allowed to exercise voting right through electronic voting mechanism if such stockholder fails to revoke the granted proxy (if any) at least two days prior to the general or special meeting.

At the time of any vote, if a director of a public company has pledged more than half of the holding at the time the director was elected, such director will not be allowed to exercise the voting rights with respect to the

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number of shares pledged, provided that the maximum number of shares ineligible for voting pursuant to the provision above cannot exceed half of the number of shares that such director held in such public company at the time the director was elected. In addition, any shares that were ineligible for voting pursuant to the above provision would not count as being present for such vote.

Any stockholder who has a personal interest in the matter under discussion at a stockholders meeting, the outcome of which may impair our interests, shall not vote or exercise voting rights on behalf of another stockholder; however, the shares held by such stockholder may be counted as present.

Holders of our ADSs generally will not be able to exercise voting rights on the common shares underlying ADSs on an individual basis.

**C. Other Rights of Stockholders**

Under the Republic of China Company Act, dissenting stockholders are entitled to appraisal rights in certain major corporate actions, such as a planned transfer of the whole or part of the business or a proposed merger by us. A dissenting stockholder may request us to purchase back all of the shares owned by the stockholder at a fair price determined by mutual agreement or determined by the court if a mutual agreement cannot be reached. Stockholders may exercise their appraisal rights by serving notice in writing to us prior to the related stockholders meeting and/or by raising his objection at the stockholders meeting. Moreover, a stockholder has the right to file a petition in the court for annulment of any resolution adopted at a stockholders meeting where the procedures for convening the stockholders meeting or the method of adopting the resolutions at the meeting is contrary to law or our articles of incorporation. One or more stockholders who have held more than 3% of the issued and outstanding shares of a company continuously for more than one year may require an independent director to institute, on behalf of us, an action against a director. In addition, one or more stockholders who has/have continuously held 3% or more of the total number of the outstanding shares of our company for more than one year may require the board of directors to convene a special stockholders meeting by sending a written request to the board of directors.

The Republic of China Company Act allows stockholders holding 1% or more of the total issued shares of a company to submit, during the period of time prescribed by us no less than 10 days, one proposal in writing for discussion at the general meeting of stockholders. It also provides that a company may adopt a nomination procedure for election of directors. We have adopted a nomination procedure for election of directors as stipulated in our articles of incorporation which provides that stockholders holding 1% or more of our total issued shares may submit to us a list of candidates for director, including independent director, along with relevant information and supporting documents.

**Register of Stockholders and Record Dates**

Our share registrar, Yuanta Securities Co., Ltd., maintains our register of stockholders at its offices in Taipei, Taiwan. Under the Republic of China Company Act and our articles of incorporation, we may, by giving advance public notice, set a record date and close the register of stockholders for a specified period in order for us to determine the stockholders or pledgees that are entitled to rights pertaining to the common shares. The specified period required is as follows:

general stockholders meeting 60 days;

special stockholders meeting 30 days; and

relevant record date 5 days.

**Annual Consolidated Financial Statements**

At least ten days before the annual general stockholders meeting, our annual consolidated financial statements prepared in accordance with Taiwan-IFRSs must be available at our principal office in Taipei, Taiwan for inspection by the stockholders.

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### Transfer of Common Shares

Under the current ROC Company Act, a public company, such as our company, may issue individual share certificates, one master certificate or no certificate at all, to evidence common shares. In accordance with our articles of incorporation, all of our shares are currently issued and transferred in book-entry form instead of issuing physical share certificates. On the book closure date, the Taiwan Depository & Clearing Corporation, or the TDCC, will deliver the names and addresses of the shareholders as of the book closure date to our registrar, Yuanta Securities Co., Ltd. Only shareholders as of the book closure date can assert shareholder rights against us.

### Acquisition of Our Own Common Shares

Under the Republic of China Company Act, with minor exceptions, we cannot acquire our own common shares. Any common shares acquired by us, under certain of such minor exceptions, must be sold at the market price within six months after their acquisition.

In addition, under the Republic of China Securities and Exchange Act, a company whose shares are listed on the TWSE or traded on the GreTai Securities Market may, pursuant to a board resolution adopted by a majority consent at a meeting attended by more than two-thirds of the directors and pursuant to the procedures prescribed by the Securities and Futures Bureau of the Financial Supervisory Commission, purchase its shares for the following purposes on the TWSE, the GreTai Securities Market or by a tender offer:

(1) for transfers of shares to its employees;

(2) for conversion into shares from bonds with warrants, preferred shares with warrants, convertible bonds, convertible preferred shares or certificates of warrants issued by us; and

(3) for maintaining its credit and its stockholders equity, provided that the shares so purchased shall be cancelled thereafter.

The total shares purchased by us shall not exceed 10% of its total issued and outstanding shares. In addition, the total amount for purchase of the shares shall not exceed the aggregate amount of the retained earnings, the premium from shares issues and the realized portion of the capital surplus.

The shares purchased by us pursuant to items (1) and (2) above shall be transferred to the intended transferees within three years after the purchase; otherwise the same shall be cancelled. For the shares to be cancelled pursuant to item (3) above, we shall complete amendment registration for such cancellation within six months after the purchase.

The shares purchased by us shall not be pledged or hypothecated. In addition, we may not exercise any stockholders rights attaching to these shares. Under ROC Company Act, we may transfer the treasury stock to our employees and impose transfer restrictions on the shares up to two years.

### Liquidation Rights

In the event of our liquidation, the assets remaining after payment of all debts, liquidation expenses and taxes will be distributed pro rata to the stockholders in accordance with the relevant provisions of the Republic of China Company Act and our articles of incorporation.

### Substantial Stockholders and Transfer Restrictions

The Republic of China Securities and Exchange Act currently requires for public companies that (i) each director, supervisor, manager, as well as their respective spouses, minor children and nominees, and substantial

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stockholder (i.e., a stockholder who together with his or her spouse, minor children or nominees, holds more than 10% of the shares of a public company) to report any change in that person s shareholding to the issuer of the shares on a monthly basis and (ii) each director, supervisor, manager or substantial stockholder holding such common shares for more than a six month period to report his or her intent to transfer any shares listed on the TWSE or traded on the GreTai Securities Market to the Securities and Futures Bureau of the Financial Supervisory Commission at least three days before the intended transfer, unless the number of shares to be transferred is less than 10,000 shares. ADS holders holding more than 10% of our common shares, including common shares represented by ADSs, may be subject to the reporting obligation in above item (i).

In addition, the number of shares that can be sold or transferred on the TWSE or GreTai Securities Market by any person subject to the restrictions described above on any given day may not exceed:

- 0.2% of the outstanding shares of the company in the case of a company with no more than 30 million outstanding shares;
- 0.2% of 30 million shares plus 0.1% of the outstanding shares exceeding 30 million shares in the case of a company with more than 30 million outstanding shares; or
- in any case, 5% of the average daily trading volume (number of shares) on the TWSE or the GreTai Securities Market for the ten consecutive trading days preceding the reporting day on which day the director, supervisor, manager or substantial stockholder or their respective spouse, minor child or nominee reports the intended share transfer to the Securities and Futures Bureau.

These restrictions do not apply to block trading, auction sale, purchase by auction, after-hour trading and sales or transfers of our ADSs. However, these restrictions will apply to sales of common shares upon withdrawal.

**D. Material Contracts**

We have not entered into any material contracts other than in the ordinary course of business and other than those described elsewhere in this annual report.

**E. Exchange Controls**

**Foreign Investment and Exchange Controls in Taiwan**

*We have extracted from publicly available documents the information presented in this section. Please note that citizens of the People s Republic of China and entities organized in the People s Republic of China are subject to special Republic of China laws, rules and regulations, which are not discussed in this section.*

**General**

Historically, foreign investments in the securities market of Taiwan were restricted. However, commencing in 1983, the Taiwan government has from time to time enacted legislation and adopted regulations to make foreign investment in the Taiwan securities market possible. Initially, only overseas investment trust funds of authorized securities investment trust enterprises established in Taiwan were permitted to invest in the Taiwan securities market. Since

January 1, 1991, qualified foreign institutional investors are allowed to make investments in the Taiwan listed securities market. Since March 1, 1996, overseas Chinese, non-resident foreign institutional and individual investors (other than qualified foreign institutional investors), called general foreign investors, are permitted to make direct investments in the Taiwan securities market.

**Foreign Investment in Taiwan Securities Market**

On December 28, 1990, the Executive Yuan, the cabinet of the Republic of China government, approved guidelines drafted by the Securities and Futures Commission (the predecessor of the Securities and Futures

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Bureau), which, since January 1, 1991, has allowed direct foreign investment in Taiwan s securities that are listed on the Taiwan Stock Exchange or other Taiwan securities approved by the Securities and Futures Bureau by certain eligible qualified foreign institutional investors.

In addition to qualified foreign institutional investors, certain individual and foreign institutional investors which meet certain qualifications set by the Securities and Futures Bureau may invest in the shares of Taiwan Stock Exchange-listed companies, GreTai Securities Market (formerly known as Over-The-Counter Securities Exchange) traded companies, emerging market companies or other Taiwan securities approved by the Securities and Futures Bureau up to a limit of US$50 million (in the case of institutional investors) and US$5 million (in the case of individual investors) after obtaining permission from the Taiwan Stock Exchange.

On September 30, 2003 and June 15, 2004, the Securities and Futures Bureau issued amendments to the Guideline Governing Investment in Securities by Overseas Chinese and Foreign Nationals and relevant regulations, in which the Securities and Futures Bureau lifted certain restrictions and simplified the procedures required for foreign investments in Taiwan s securities market. The amendment focuses mainly on the following aspects:

- The concept of qualified foreign institutional investors no longer exists. Foreign investors are reclassified as off-shore foreign institutional investors, on-shore foreign institutional investors, off-shore general foreign investors, and on-shore general foreign investors based on whether they are institutions or natural persons, and whether they have presence in Taiwan.

- For foreign investors to invest in Taiwan s securities market, registration with the Taiwan Stock Exchange, instead of the approval of the Securities and Futures Bureau, is required. The Taiwan Stock Exchange may withdraw or rescind the registration if the application documents submitted by foreign investors are untrue or incomplete, or if any material violation of the relevant regulations exists.

- Off-shore foreign investors may provide the securities they hold as the underlying shares of depositary receipts and act as selling stockholders in depositary receipts offerings.

- Off-shore foreign institutional investors are required to appoint their agent or nominee to attend the stockholders meeting of the invested company.

Currently, subject to the specific restriction imposed by relevant regulations, the off-shore foreign institutional investors may invest in the Taiwan securities market without any amount restriction. However, a ceiling will be separately determined by the Securities and Futures Bureau after consultation with the Central Bank of the Republic of China (Taiwan) for investment by offshore oversea Chinese and foreign individual investors.

**Foreign Investment Approval**

Other than:

- foreign institutional investors;

foreign individual investors; and

investors in overseas convertible bonds and depositary receipts,
foreign investors who wish to make direct investments in the shares of Taiwan companies may submit a foreign investment approval application to the Investment Commission of the Ministry of Economic Affairs of Taiwan or other government authority to qualify for benefits granted under the Statute for Investment by Foreign Nationals. The Investment Commission or other government authority reviews each foreign investment approval application and approves or disapproves the application after consultation with other governmental agencies. Any non-Taiwan person possessing a foreign investment approval may remit capital for the approved investment and repatriate annual net profits and interests and cash dividends attributable to an approved investment. Stock

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dividends, investment capital and capital gains attributable to the investment may be repatriated with approval of the Investment Commission or other government authority.

In addition to the general restrictions against direct investment by non-Taiwan persons in Taiwan companies, non-Taiwan persons are currently prohibited from investing in prohibited industries in Taiwan under the Negative List promulgated by the Executive Yuan from time to time. The prohibition on direct foreign investment in the prohibited industries in the Negative List is absolute with the consequence of certain specific exemption from the application of the Negative List. Under the Negative List, some other industries are restricted so that non-Taiwan persons may directly invest only up to a specified level and with the specific approval of the relevant authority which is responsible for enforcing the legislation which the negative list is intended to implement. The telecommunication industry is a restricted industry under the Negative List.

**Depositary Receipts**

In April 1992, the Securities and Futures Bureau began allowing Taiwan companies listed on the Taiwan Stock Exchange, with the prior approval of the Securities and Futures Bureau, to sponsor the issuance and sale of depositary receipts evidencing depositary shares. In December 1994, the Republic of China Ministry of Finance began allowing companies whose shares are traded on the GreTai Securities Market also to sponsor the issuance and sale of depositary receipts evidencing depositary shares representing shares of its capital stock. Approvals for these issuances are still required.

After the issuance of a depositary share, a holder of the depositary receipt evidencing the depositary shares may request the depositary issuing the depositary share to cause the underlying shares to be sold in Taiwan and to distribute the proceeds of the sale to or to withdraw the shares and deliver the shares to the depositary receipt holder. A citizen of the People s Republic of China is not permitted to withdraw and hold our shares.

If you are an offshore foreign institutional investor holding the depositary receipts, you must register with the Taiwan Stock Exchange as a foreign investor before you will be permitted to withdraw the shares represented by the depositary receipts. In addition to obtaining registration with the Taiwan Stock Exchange, you must also (i) appoint a qualified local agent to, among other things, open a securities trading account with a local securities brokerage firm and a bank account to remit funds, exercise stockholders rights and perform other functions as holders of ADSs may designate, (ii) appoint a custodian bank to hold the securities and cash proceeds, confirm transactions, settle trades and report and declare other relevant information and; (iii) appoint a tax guarantor as guarantor for the full compliance of the withdrawing depositary receipt holders tax filing and payment obligations in the Republic of China. A depositary receipt holder not registered as a foreign investor with the Taiwan Stock Exchange, or not has made the necessary appointments as outlined above, will be unable to hold or subsequently transfer the shares withdrawn from the depositary receipt facility.

No deposits of shares may be made in a depositary receipt facility and no depositary shares may be issued against deposits without specific Securities and Futures Bureau approval, unless they are:

(i) stock dividends;

(ii) free distributions of shares;

(iii) due to the exercise by the depositary receipt holder preemptive rights in the event of capital increases for cash; or

(iv) if permitted under the deposit agreement and custody agreement and within the amount of depositary receipts which have been withdrawn, due to the direct purchase by investors or purchase through the depositary on the Taiwan Stock Exchange or the GreTai Securities Market or delivery by investors of the shares for deposit in the depositary receipt facility. In this event, the total number of depositary receipts outstanding after an issuance cannot exceed the number of issued depositary receipts

previously approved by the Securities and Futures Bureau of the Financial Supervisory Commission in connection with the offering plus any ADSs issued pursuant to the events described in (i), (ii) and (iii) above.

An ADS holder or the depositary, without obtaining further approvals from the Central Bank of the Republic of China (Taiwan) or any other governmental authority or agency of the Republic of China, may convert NT dollars into other currencies, including U.S. dollars, in respect of:

- the proceeds of the sale of common shares represented by ADSs or received as share dividends with respect to the common shares and deposited into the depositary receipt facility; and

- any cash dividends or distributions received from the common shares.

In addition, the depositary may also convert into NT dollars incoming payments for purchases of common shares for deposit in the depositary receipt facility against the creation of additional ADSs. If you withdraw the common shares underlying your ADSs and become a holder of our common shares, you may convert into NT dollars subscription payment for rights offerings. The depositary may be required to obtain foreign exchange payment approval from the Central Bank of the Republic of China (Taiwan) on a payment-by-payment basis for conversion from NT dollars into foreign currencies of the proceeds from the sale of subscription rights of new common shares. Although it is expected that the Central Bank of the Republic of China (Taiwan) will grant approval as a routine matter, required approvals may not be obtained in a timely manner, or at all.

**Exchange Controls**

Taiwan s Foreign Exchange Control Statute and regulations provide that all foreign exchange transactions must be executed by banks designated to handle foreign exchange transactions by the Financial Supervisory Commission and by the Central Bank of the Republic of China (Taiwan). Current regulations favor trade-related foreign exchange transactions. Consequently, foreign currency earned from exports of merchandise and services may now be retained and used freely by exporters. All foreign currency needed for the importation of merchandise and services may be purchased freely from the designated foreign exchange banks.

Aside from trade-related foreign exchange transactions, Taiwan companies and residents may remit to and from Taiwan foreign currencies of up to US$50 million (or its equivalent) and US$5 million, (or its equivalent), respectively, in each calendar year. These limits apply to remittances involving a conversion between New Taiwan dollars and U.S. dollars or other foreign currencies. A requirement is also imposed on all private enterprises to register all medium and long-term foreign debt with the Central Bank of the Republic of China (Taiwan).

In addition, a foreign person without an alien resident card or an unrecognized foreign entity may remit to and from Taiwan foreign currencies of up to US$100,000 per remittance if required documentation is provided to Taiwan authorities. This limit applies only to remittances involving a conversion between New Taiwan dollars and U.S. dollars or other foreign currencies.

**F. Taxation**

**Republic of China Taxation**

The discussion below describes the principal Republic of China tax consequences of the ownership and disposition of ADSs representing common shares and of common shares. It applies to you only if you are:

an individual who is not a citizen of the Republic of China, who owns ADSs or common shares and who is not physically present in Taiwan for 183 days or more during any calendar year; or

a corporation or a non-corporate body that is organized under the laws of a jurisdiction other than the Republic of China for profit-making purposes and has no fixed place of business or other permanent establishment in Taiwan.

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You should also consult your tax advisors concerning the tax consequences of owning ADSs and common shares in the Republic of China and any other relevant taxing jurisdiction to which they are subject.

***Dividends***

Dividends declared by us out of our retained earnings and distributed to you are subject to Republic of China withholding tax, currently at the rate of 20%, on the amount of the distribution in the case of cash dividends or on the par value of the common shares in the case of stock dividends. However, a 10% Republic of China retained earnings tax paid by us on our undistributed after-tax earnings, if any, may provide a credit of up to 10% of the gross amount of any dividends declared out of such earnings that would reduce the 20% Republic of China withholding tax imposed on these distributions.

Share or cash dividends paid by us out of our capital surplus which are derived from the issuance of shares at a premium are not subject to Republic of China withholding tax. According to the rulings of Ref. Tai-Tsai-Hsuei-Tzi-09504509440 issued by the Ministry of Finance of the Republic of China, if a company reduces its share capital and redeems for cash its outstanding common shares issued to the company s stockholders by capitalization of capital surplus, those premiums under the capitalized capital surplus derived from re-evaluation of assets, sale of lands and/or merger with other enterprise shall be deemed as the gain in the stockholders capital investment, and shall be deemed as stockholders dividend income (or investment revenue) and be subject to ROC income tax.

As the legal reserve is set-aside from company s profit earnings (after tax) in accordance with Article 237 of ROC Company Act, receipt of distribution of legal reserve shall be deemed as stockholders dividend income (or investment revenue) and be subject to ROC income tax collected by way of withholding at the time of distribution, currently at the rate of 20%, unless a lower withholding rate is provided under a tax treaty between the ROC and the jurisdiction where the Non-ROC Stockholder is a resident.

***Capital Gains***

Gains from the sale of property in the Republic of China are generally subject to Republic of China income tax. Effective January 1, 2013, capital gains on the sale of common shares, including common shares withdrawn from the ADS facility, received by a Non-Resident Individual is subject to the capital gain tax at a flat rate of 15%. A Non-Resident Entity is exempted from income tax for its capital gains from sale of common shares, including common shares withdrawn from the ADS facility, and is further exempted from Alternative Minimum Tax, or the AMT.

Sales of ADSs by you are regarded as transactions relating to property located outside the Republic of China and thus any gains derived therefrom are currently not subject to Republic of China income tax.

***Preemptive Rights***

Distributions of statutory preemptive rights for common shares in compliance with Republic of China law are not subject to any Republic of China tax. Proceeds derived from sales of statutory preemptive rights evidenced by securities are subject to securities transaction tax at the rate of 0.3% of the gross amount received. A Non-Resident Individual is subject to income tax at a flat rate of 15% for such capital gains. A Non-Resident Entity is exempted from income tax for such capital gains and is further exempted from the AMT. Proceeds derived from sales of statutory preemptive rights which are not evidenced by securities are subject to capital gains tax at the rate of 20% of the gains realized.

Subject to compliance with Republic of China law, we, at our sole discretion, can determine whether statutory preemptive rights shall be evidenced by issuance of securities.

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*Securities Transaction Tax*

A securities transaction tax, at the rate of 0.3% of the gross amount received, payable by the seller will be withheld upon a sale of common shares in Taiwan. Transfers of ADSs are not subject to Republic of China securities transaction tax. According to a letter issued by the Ministry of Finance of the Republic of China in 1996, withdrawal of common shares from the deposit facility will not be subject to Republic of China securities transaction tax.

*Estate Taxation and Gift Tax*

Republic of China estate tax is payable on any property within Taiwan of a deceased person who is a non-resident individual, and Republic of China gift tax is payable on any property within Taiwan donated by any such person. Under Republic of China estate and gift tax laws, common shares issued by Taiwan companies are deemed located in Taiwan regardless of the location of the owner. It is not clear whether the ADSs will be regarded as property located in Taiwan under Republic of China estate and gift tax laws. Starting from January 21, 2009, the estate tax and gift tax rates were reduced to 10%.

*Tax Treaty*

The Republic of China does not have an income tax treaty with the United States. On the other hand, the Republic of China has income tax treaties with Indonesia, Israel, Singapore, South Africa, Australia, Vietnam, New Zealand, Malaysia, Macedonia, Swaziland, the Netherlands, United Kingdom, Gambia, Senegal, Sweden, Belgium, Denmark, Paraguay, Hungary, France, India, Slovakia, Germany, Thailand and Switzerland, which may limit the rate of Republic of China withholding tax on dividends paid with respect to common shares in Taiwan companies. It is unclear whether if you hold ADSs, you will be considered to hold common shares for the purposes of these treaties. Accordingly, if you may otherwise be entitled to the benefits of the relevant income tax treaty, you should consult your tax advisors concerning your eligibility for the benefits with respect to the ADSs.

*Retained Earnings Tax*

Under the Republic of China Income Tax Laws, a 10% retained earnings tax will be imposed on a company for its after-tax earnings generated after January 1, 1998 which are not distributed in the following year. The retained earnings tax so paid will further reduce the retained earnings available for future distribution. When the company declares dividends out of those retained earnings, up to a maximum amount of 10% of the declared dividends may be credited against the 20% withholding tax imposed on the non-resident holders of its shares.

**U.S. Federal Income Tax Considerations for U.S. Holders**

The following is a summary of certain U.S. federal income tax consequences of the ownership and disposition of our shares and ADSs as of the date hereof. The discussion set forth below is applicable to beneficial owners of our shares or ADSs that hold the shares or ADSs as capital assets and that are U.S. holders and non-residents of the Republic of China. You are a U.S. holder if you are:

- an individual who is a citizen or resident of the United States;

a corporation or other entity taxable as a corporation for U.S. federal income tax purposes created or organized in or under the laws of the United States, any state thereof or the District of Columbia;

an estate the income of which is subject to U.S. federal income taxation regardless of its source;

a trust that is subject to the primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust; or

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- a trust that has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

This summary is based on the provisions of the Internal Revenue Code of 1986, as amended (the Code ), and regulations, rulings and judicial decisions thereunder as of the date hereof, and such authorities may be replaced, revoked or modified so as to result in U.S. federal income tax consequences different from those discussed below. It is for general purposes only and you should not consider it to be tax advice. In addition, it is also based in part on representations made by the depositary and assumes that the deposit agreement and any related agreement will be performed in accordance with their terms. This summary does not represent a detailed description of all the U.S. federal income tax consequences to you in light of your particular circumstances and does not address the effects of any state, local or non-U.S. tax laws (or other U.S. federal tax consequences, such as U.S. federal estate or gift tax consequences). In addition, it does not represent a detailed description of the U.S. federal income tax consequences applicable to you if you are subject to special treatment under the U.S. federal income tax laws, including if you are:

- a dealer in securities or currencies;
- a trader in securities if you elect to use a mark-to-market method of accounting for your securities holdings;
- a financial institution or an insurance company;
- a regulated investment company;
- a real estate investment trust;
- a tax-exempt organization;
- a person liable for alternative minimum tax;
- a person holding shares or ADSs as part of a hedging, integrated or conversion transaction, constructive sale or straddle;
- a person owning, actually or constructively, 10% or more of our voting stock;
- a partnership or other pass-through entity for U.S. federal income tax purposes; or
- a person whose functional currency is not the U.S. dollar.

We cannot assure you that a later change in law will not alter significantly the tax considerations that we describe in this summary.

If a partnership holds our shares or ADSs, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. If you are a partner of a partnership holding our shares or ADSs, you should consult your tax advisor.

**You should consult your own tax advisor concerning the particular U.S. federal income tax consequences to you of the ownership and disposition of the shares or ADSs, as well as the consequences to you arising under the laws of any other taxing jurisdiction.**

In general, for U.S. federal income tax purposes, a U.S. holder who is the beneficial owner of an ADS will be treated as the owner of the shares underlying such ADS. Deposits or withdrawals of shares, actually or constructively, by U.S. holders for ADSs will not be subject to U.S. federal income tax.

***Taxation of Dividends***

The gross amount of distributions (other than certain pro rata distributions of shares to all stockholders) you receive on your shares or ADSs, including net amounts withheld in respect of Republic of China withholding taxes, will generally be treated as dividend income to you to the extent the distributions are made from our

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current and accumulated earnings and profits as calculated according to U.S. federal income tax principles. These amounts (including withheld taxes) will be includible in your gross income as ordinary income on the day you actually or constructively receive the distributions, which in the case of an ADS will be the date actually or constructively received by the depositary. You will not be entitled to claim a dividends-received deduction allowed to corporations under the Code with respect to distributions you receive from us.

With respect to U.S. holders who are individuals, certain dividends received from a foreign corporation, on shares, or ADSs backed by such shares, that are readily tradable on an established securities market in the United States may be subject to reduced rates of taxation, provided further that the foreign corporation was not, in the year prior to the year in which the dividends are paid, and is not, in the year in which the dividends are paid, a passive foreign investment company (see Passive Foreign Investment Company below). Under current U.S. Treasury Department guidance, our ADSs, which are listed on the New York Stock Exchange, but not our shares, are treated as readily tradable on an established securities market in the United States. Thus, we do not believe that dividends that we pay on our shares that are not backed by ADSs currently meet the conditions required for these reduced tax rates. There can be no assurance that our ADSs will continue to be readily tradable on an established securities market in later years, or that our shares will be readily tradable on an established securities market in any given year. Individuals that do not meet a minimum holding period requirement during which they are not protected from the risk of loss, or that elect to treat the dividend income as investment income pursuant to Section 163(d)(4) of the Code, will not be eligible for the reduced rates of taxation regardless of the trading status of our shares or ADSs. In addition, the rate reduction will not apply to dividends if the recipient of a dividend is obligated to make related payments with respect to positions in substantially similar or related property. This disallowance applies even if the minimum holding period has been met. You should consult your own tax advisor regarding the application of these rules given your particular circumstances.

The amount of any dividend paid in NT dollars will equal the U.S. dollar value of the NT dollars you receive, calculated by reference to the exchange rate in effect on the date you actually or constructively receive the dividend, which in the case of an ADS will be the date actually or constructively received by the depositary, regardless of whether the NT dollars are actually converted into U.S. dollars. If the NT dollars received as a dividend are converted into U.S. dollars on the date they are actually or constructively received, you generally will not be required to recognize foreign currency gain or loss in respect of the dividend income. If the NT dollars received as a dividend are not converted into U.S. dollars on the date of receipt, you will have a basis in the NT dollars equal to their U.S. dollar value on the date of receipt. Any gain or loss you realize if you subsequently sell or otherwise dispose of the NT dollars will be ordinary income or loss from sources within the United States for foreign tax credit limitation purposes.

Subject to certain conditions and limitations under the Code, you may be entitled to a credit or deduction against your U.S. federal income taxes for the net amount of any Republic of China taxes that are withheld from dividend distributions made to you. In determining the amounts withheld in respect of Republic of China taxes, any reduction of the amount withheld on account of a Republic of China credit in respect of the 10% retained earnings tax imposed on us is not considered a withholding tax and will not be treated as distributed to you or creditable by you against your U.S. federal income tax. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For purposes of calculating the foreign tax credit, dividends we pay with respect to shares or ADSs will generally be considered passive category income from sources outside the United States. Further, a U.S. holder that:

- has held shares or ADSs for less than a specified minimum period during which it is not protected from risk of loss, or

is obligated to make payments related to the dividends,

may not be allowed a foreign tax credit for foreign taxes imposed on dividends paid on shares or ADSs. The rules governing the foreign tax credit are complex. We therefore urge you to consult your tax advisor regarding the availability of the foreign tax credit under your particular circumstances.

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To the extent that the amount of any distribution you receive exceeds our current and accumulated earnings and profits for a taxable year, as determined under U.S. federal income tax principles, the distribution will first be treated as a tax-free return of capital, causing a reduction in your adjusted basis in the shares or ADSs and thereby increasing the amount of gain, or decreasing the amount of loss, you will recognize on a subsequent disposition of the shares or ADSs. The balance in excess of adjusted basis, if any, will be taxable to you as capital gain recognized on a sale or exchange. However, we do not expect to keep earnings and profits in accordance with U.S. federal income tax principles. Therefore, you should expect that a distribution will generally be treated as a dividend.

It is possible that pro rata distributions of shares or ADSs to all stockholders may be made in a manner that is not subject to U.S. federal income tax. The basis of any new shares or ADSs so received will generally be determined by allocating your basis in the old shares or ADSs between the old shares or ADSs and the new shares or ADSs, based on their relative fair market values on the date of distribution.

For U.S. tax purposes, any such tax-free share distribution would not result in foreign source income to you. Consequently, you may not be able to use the foreign tax credit associated with any Republic of China withholding tax imposed on such distributions unless you can use the credit (subject to applicable limitations) against U.S. federal income tax due on other foreign source income in the appropriate category for foreign tax credit purposes.

***Taxation of Capital Gains***

When you sell or otherwise dispose of your shares or ADSs, you will generally recognize capital gain or loss in an amount equal to the difference between the U.S. dollar value of the amount realized for the shares or ADSs and your basis in the shares or ADSs, determined in U.S. dollars. For foreign tax credit limitation purposes, such gain or loss will generally be treated as U.S. source gain or loss. Consequently, you may not be able to use the foreign tax credit arising from any Republic of China tax imposed on the disposition of shares or ADSs unless such credit can be applied (subject to applicable limitations) against tax due on other income treated as derived from foreign sources. If you are an individual or other non-corporate holder and have held the shares or ADSs being sold or otherwise disposed for more than one year, your gain recognized will be eligible for reduced rates of taxation. Your ability to deduct capital losses is subject to limitations.

Any Republic of China securities transaction taxes that you pay generally will not be creditable foreign taxes for U.S. federal income tax purposes, but you may be able to deduct such taxes, subject to certain limitations under the Code. You are urged to consult your tax advisors regarding the U.S. federal income tax consequences of these taxes.

***Passive Foreign Investment Company***

We believe that we were not a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for our taxable year ending on December 31, 2013, and we do not expect to become one for our current taxable year or in the future, although there can be no assurance in this regard. If we were treated as a PFIC for any taxable year during which you held our shares or ADSs, you could be subject to additional U.S. federal income taxes on gain recognized with respect to the shares or ADSs and on certain distributions, plus an interest charge on certain taxes treated as having been deferred under the PFIC rules.

Non-corporate U.S. holders will not be eligible for reduced rates of taxation on any dividends received from us, if we are a PFIC in the taxable year in which such dividends are paid or in the preceding taxable year.

***Information Reporting and Backup Withholding***

In general, information reporting will apply to dividends in respect of our shares or ADSs and the proceeds from the sale, exchange or redemption of our shares or ADSs that are paid to you within the United States (and in

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certain cases, outside the United States), unless you are an exempt recipient such as a corporation. A backup withholding tax may apply to such payments if you fail to provide a taxpayer identification number or certification of other exempt status or fail to report in full dividend and interest income.

Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against your U.S. federal income tax liability provided the required information is furnished to the Internal Revenue Service.

***Information Return under Section 6045B of the Internal Revenue Code***

Section 6045B of the Code imposes certain reporting requirements on us with respect to any organizational action that affects the basis of our shares or ADSs, such as the capital reduction plan described in Item 9 under A. Offer and Listing Details . We intend to comply with the requirements by making available on our website IRS Form 8937, Report of Organizational Actions Affecting Basis of Securities , with respect to such capital reduction plan and any other such organizational action.

**G. Dividends and Paying Agents**

Not applicable.

**H. Statement by Experts**

Not applicable.

**I. Documents on Display**

We have filed this annual report on Form 20-F, including exhibits, with the SEC. As allowed by the SEC, in Item 19 of this annual report, we incorporate by reference certain information we have already filed with the SEC. This means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is considered to be part of this annual report.

You may read and copy this annual report, including the exhibits incorporated by reference in this annual report, at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 and at the SEC s regional offices in New York, New York and Chicago, Illinois. You can also request copies of this annual report, including the exhibits incorporated by reference in this annual report, upon payment of a duplicating fee, by writing information on the operation of the SEC s Public Reference Room.

The SEC also maintains a website at www.sec.gov that contains reports, proxy statements and other information regarding registrants that file electronically with the SEC. Our annual report and some of the other information submitted by us to the SEC may be accessed through this web site.

**J. Subsidiary Information**

Not applicable.

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the risk of loss related to adverse changes in market prices, including interest rates and foreign exchange rates, of financial instruments. In the normal course of business, we are routinely subject to a variety of risks, including market risk associated with interest rate movements, currency rate movements on non-NT dollar denominated assets and liabilities and equity price movements on our portfolio of equity securities.

We regularly assess these financial instruments and their ability to address market risk and have established policies and business practices to protect against the adverse effects of these and other potential exposures.

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**Interest Rate Risk**

We do not expect interest rate risk to have a material impact on our financial condition and results of operations. Please refer to Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources for a discussion of our loans.

For our non-fixed interest rate loans, the interest rates will change in accordance with the fixed rates of the banks we borrowed from. For the financial assets, the risk associated with fluctuating interest rates is principally confined to our cash deposits in banks, which is one of the many ways we manage our capital. Assuming an increase or decrease of 0.25% in the interest rates of our non-fixed interest rate financial assets and loans, our profit before tax for the year ended December 31, 2013 would have increased or decreased by NT$22.2 million (US$0.7 million). We have not used any derivative financial instruments to hedge interest rate risk. We have not been exposed nor do we anticipate being exposed to material risks due to changes in interest rates. As of December 31, 2013, our cash and cash equivalents amounted to NT$14.6 billion (US$0.5 billion). Interest income from our cash deposits in banks accounts for only a very small percentage of our total revenue. Therefore, we believe our exposure to interest rate risk is immaterial.

**Foreign Currency Risk**

We are exposed to foreign currency risk as a result of (i) our foreign currency and derivative trading activities; (ii) our telecommunications equipment being sourced from overseas suppliers; (iii) our international settlement payments associated with our services for international calls and roaming traffic; and (iv) securities denominated in foreign currencies.

We entered into currency swap and forward exchange contracts to reduce our exposure to foreign currency risk due to fluctuations in exchange rates. We had no outstanding currency swap contracts as of December 31, 2013. Outstanding forward exchange contracts on December 31, 2013 were as follows:

| FX Instrument | Currencies Involved | Maturity Period | Contract Amount |
|---|---|---|---|
| Forward exchange contracts-Buy | NT$ /US$ | 2014.01 | NT$ 90 million/US$3 million |

Note 37 to our consolidated financial statements included elsewhere in this annual report provides a sensitivity analysis for foreign currency risk.

**Equity Price Risk**

We are exposed to equity price risk as a result of our available-for-sale equity securities, including publicly-traded equities, and we manage our equity investment portfolio in accordance with our internal regulations.

The table below presents the carrying amount and unrealized gain or loss for our available-for-sale equity securities traded in an active market and with quoted market price as of December 31, 2013.

| | Carrying Amount | Unrealized Gain | Unrealized Loss |
|---|---|---|---|

| | NT$ | NT$ (in millions) | NT$ |
|---|---|---|---|
| Available-for-sale equity securities | | | |
| Domestic listed stocks | $ 3,046 | $ 84 | $ 227 |
| Foreign listed stocks | 24 | 12 | |
| | 3,070 | 96 | 227 |

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The total value of our available-for-sale equity portfolio amounted to NT$3.1 billion (US$102.4 million) as of December 31, 2013, which decreased approximately 43% compared with the total value of our equity portfolio as of December 31, 2012. This decrease was mainly due to the fact that we redeemed all our interests in several open-ended mutual funds. Compared to a net unrealized gain of NT$262 million on our equity portfolio at the end of 2012, we recognized a net unrealized loss of NT$131 million (US$4.4 million) on our equity portfolio as of December 31, 2013. The net unrealized loss was mainly due to the decreasing price of the equity securities we held.

For the year ended December 31, 2013, we did not recognize any other-than-temporary impairment losses for listed stocks and we recognized an impairment loss of NT$66 million (US$2.2 million) for non-listed stock. The value of our equity holdings fluctuates depending on the market conditions. Assuming an increase or decrease of 5% in the equity prices, our comprehensive income before income tax for the year ended December 31, 2013 would have increased or decreased by NT$153 million (US$5.1 million). However, we do not expect the gains and losses in the values of the equities that we hold to have a material impact on our financial condition and results of operations.

### Other Market Risk

We have made investments in corporate bonds and bank debentures issued by domestic public companies with strong industry leadership and solid profits. Industries in which we have invested include materials, financials, utilities, technology, and so on. As of December 31, 2013, total value of our investments in corporate bonds and bank debentures amounted to NT$11.8 billion (US$394.4 million), all of which were classified as held-to-maturity financial assets. The fair value of these corporate bonds and bank debentures is valued using market-based observable inputs including duration, yield rate and credit rating, which are subject to fluctuation based on many factors such as prevailing market conditions. However, we do not expect the gains and losses in the values of these investments to have a material impact on our financial condition and results of operations.

## ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

### A. Debt Securities

Not applicable

### B. Warrants and Rights

Not applicable

### C. Other Securities

Not applicable

### D. American Depositary Shares

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**Depositary Fees**

Under the terms of the deposit agreement for our ADSs, an ADS holder may have to pay the following service fees to the depositary:

| Service | Fees |
| --- | --- |
| Issuance of ADSs | Up to US$5.00 per 100 ADS issued |
| Cancellation of ADSs | Up to US$5.00 per 100 ADS cancelled |
| Distribution of cash dividends or other cash distributions | Up to US$2.00 per 100 ADS held |
| Distribution of ADSs pursuant to stock dividends, free stock distributions or exercises of rights | Up to US$5.00 per 100 ADS held |
| Distribution of securities other than ADSs or rights to purchase additional ADSs | Up to US$5.00 per 100 ADS held |

**Depositary Charges**

In addition, an ADS holder shall be responsible for the following charges:

- taxes (including applicable interest and penalties) and other governmental charges;
- such registration fees as may from time to time be in effect for the registration of common shares or other deposited securities on the share register and applicable to transfers of common shares or other deposited securities to or from the name of the custodian, the depositary or any nominees upon the making of deposits and withdrawals, respectively;
- such cable, telex and facsimile transmission and delivery expenses as are expressly provided in the deposit agreement to be at the expense of ADS holders and beneficial owners of ADSs;
- the expenses and charges incurred by the depositary in the conversion of foreign currency; and
- the fees and expenses incurred by the depositary, the custodian or any nominee in connection with the servicing or delivery of deposited securities.

Depositary fees payable upon the issuance and cancellation of ADSs are typically paid to the depositary by the brokers (on behalf of their clients) receiving the newly-issued ADSs from the depositary and by the brokers (on behalf of their clients) delivering the ADSs to the depositary for cancellation. The brokers in turn charge these transaction fees to their clients.

Depositary fees payable in connection with distributions of cash or securities to ADS holders and the depositary services fee are charged by the depositary to the holders of record of ADSs as of the applicable ADS record date. The depositary fees payable for cash distributions are generally deducted from the cash being distributed. In the case of distributions other than cash (i.e., stock dividends, rights offerings), the depositary charges the applicable fee to the

ADS record date holders concurrent with the distribution. In the case of ADSs registered in the name of the investor (whether certificated or un-certificated in direct registration), the depositary sends invoices to the applicable record date ADS holders. In the case of ADSs held in brokerage and custodian accounts via the central clearing and settlement system, The Depository Trust Company, or DTC, the depositary generally collects its fees through the systems provided by DTC (whose nominee is the registered holder of the ADSs held in DTC) from the brokers and custodians holding ADSs in their DTC accounts. The brokers and custodians who hold their clients ADSs in DTC accounts in turn charge their clients accounts the amount of the fees paid to the depositary.

In the event of refusal to pay the depositary fees and charges, the depositary may, under the terms of the deposit agreement, refuse the requested service until payment is received or may set off the amount of the depositary fees from any distribution to be made to the ADS holder.

The fees and charges ADS holders may be required to pay may vary over time and may be changed by us and by the depositary. ADS holders will receive prior notice of such changes.

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**Payments by Depositary**

In 2013, we received the following net payments (after deducting the 30% U.S. withholding tax) from JPMorgan Chase Bank, N.A., the Depositary Bank for our ADR program:

| Item | US$ (in thousands) |
|---|---|
| Reimbursement of investor relations efforts | 360 |
| Reimbursement of legal fees | 125 |
| Reimbursement of NYSE listing fees | 29 |
| Reimbursement of proxy process expenses | 13 |
| Reimbursement of SEC filing fees | 3 |
| Reimbursement of Sarbanes-Oxley and accounting related expenses in connection with ongoing SEC compliance and listing requirements | 845 |
| Reimbursement of other ADR program-related expenses | 110 |
| Total | 1,485 |

* Total may not equal to sum of all items due to rounding. The amounts in the table are disclosed on a net basis after deducting US$636,366 that has been withheld for U.S. taxes. On December 17, 2010, the IRS published General Legal Advice Memorandum 2010-006 (the GLAM), which concludes that payments made by a U.S. depository institution to a non-U.S. corporation for expenses the ADR issuer incurs to institute a sponsored ADR program are treated as U.S.-source royalty income. Such income is therefore subject to a U.S. withholding tax of 30% or a lower applicable income tax treaty rate.

## PART II

### ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

### ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

None.

### ITEM 15. CONTROLS AND PROCEDURES

**Disclosure Controls and Procedures**

As of the end of the period covered by this annual report, an evaluation has been carried out under the supervision and with the participation of our management, including our chief executive officer and our acting chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined under Rules 13a-14(c) and 15d-14(c) promulgated under the Securities Exchange Act of 1934, as amended. Based on that evaluation, our chief executive officer and acting chief financial officer have concluded that our disclosure controls and procedures are effective in ensuring that material information required to be disclosed in this annual report is recorded, processed, summarized and reported to them for assessment, and required disclosure is made within the time period specified in the rules and forms of the SEC.

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**Management s Annual Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended, for our company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB), or IFRSs, and includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of a company s assets, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with IFRSs, and that a company s receipts and expenditures are being made only in accordance with authorizations of a company s management and directors, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of a company s assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance with respect to consolidated financial statement preparation and presentation and may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As required by Section 404 of the Sarbanes-Oxley Act of 2002 and related rules as promulgated by the SEC, management assessed the effectiveness of our internal control over financial reporting as of December 31, 2013 using criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2013 based on the criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The effectiveness of our internal control over financial reporting has been audited by Deloitte & Touche, an independent registered public accounting firm, who has also audited our consolidated financial statements as of and for the year ended December 31, 2013. Deloitte & Touche has issued an attestation report on the effectiveness of our internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States).

**Attestation Report of the Registered Public Accounting Firm**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of

Chunghwa Telecom Co., Ltd.

We have audited the internal control over financial reporting of Chunghwa Telecom Co., Ltd. and subsidiaries (the Company ) as of December 31, 2013, based on criteria established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of

the effectiveness of internal control over financial reporting, included in the accompanying Management s Annual Report on Internal Control over Financial Reporting . Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

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We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) ( IFRSs ). A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRSs, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2013 of the Company and our report dated April 28, 2014 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding the convenience translation of New Taiwan dollar amounts into U.S. dollar amounts.

/s/ DELOITTE & TOUCHE
Deloitte & Touche
Taipei, Taiwan

The Republic of China
April 28, 2014

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

Chung-Fern Wu is our audit committee financial expert and independent director. See Item 6. Directors, Senior Management and Employees C. Board Practices.

The SEC has indicated that the designation of Dr. Wu as the audit committee financial expert does not: (i) make Dr. Wu an expert for any purpose, including without limitation for purposes of Section 11 of the Securities Act of 1933, as amended, as a result of this designation; (ii) impose any duties, obligations or liability on Dr. Wu that are greater than those imposed on her as a member of the audit committee and the board of directors in the absence of such designation; or (iii) affect the duties, obligations or liability of any other member of the audit committee or the board of directors.

**ITEM 16B. CODE OF ETHICS**

We have adopted a Code of Ethics and Ethical Corporate Management Best Practice Principles that applies to our directors, employees and officers, including our chief executive officer and acting chief financial officer. We have posted a copy of our Code of Ethics and Ethical Corporate Management Best Practice Principles on our website at http://www.cht.com.tw/en/aboutus/companyrules.html

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by Deloitte & Touche, our principal accountant for the years indicated. We did not pay any other fees to Deloitte & Touche during the periods indicated below.

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2012 | 2013 | |
| | (in millions) | | |
| Audit fees[1] | NT$ 56.9 | NT$ 57.9 | US$ 1.9 |
| Audit-related fees[2] | | | |
| Tax fees[3] | | | |
| All other fees[4] | 4.5 | 5.5 | 0.2 |

(1) Audit fees means the aggregate fees billed in each of the fiscal years listed for professional services rendered by our principal accountant for the audit of our annual consolidated financial statements or services that are normally provided by the auditors in connection with statutory and regulatory filings or engagements.

(2) Audit-related fees means the aggregate fees billed in each of the fiscal years listed for assurance and related services by our principal accountant that are reasonably related to the performance of the audit or review of our consolidated financial statements and are not reported under Audit fees . Services comprising the fees disclosed under the category of Audit related fees involve principally the issuance of agreed upon procedures letters.

(3) Tax fees means the aggregate fees billed in each of the fiscal years listed for professional services rendered by our principal accountant for tax compliance, tax advice and tax planning. Services comprising the fees disclosed under the category of Tax Fees involve tax advice.

(4)

All other fees means the aggregate fees billed in each of the last two fiscal years for products and services provided by our principal accountant other than the services reported in items (1) to (3) above. The amount for the years ended December 31, 2012 and 2013 mainly consisted of professional services rendered by the Deloitte & Touche for consultation of the Personal Information Protection Act.

All audit and non-audit services provided by Deloitte & Touche were pre-approved by our audit committee according to the revised Rule 2-01(c) (7) of Regulation S-X, entitled Audit Committee Administration of the Engagement , that served to strengthen requirements regarding auditor independence.

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## ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

None.

## ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Not applicable.

## ITEM 16F. CHANGE IN REGISTRANT S CERTIFYING ACCOUNTANT

Not applicable.

## ITEM 16G. CORPORATE GOVERNANCE

As a ROC company listed on the New York Stock Exchange, or NYSE, we are subject to the U.S. corporate governance rules to the extent that these rules are applicable to foreign private issuers. The following summary details the significant differences between our corporate governance practices and corporate governance standards for non-foreign private issuers (e.g., U.S. companies) under the NYSE Listed Company Manual.

Under Section 303A of the NYSE Listed Company Manual, NYSE-listed foreign private issuers may, in general, follow their home country corporate governance practices in lieu of most of the new NYSE corporate governance requirements. However, all NYSE-listed foreign private issuers must comply with Sections 303A.06, 303A.11, 303A.12(b) and 303A.12(c) of the NYSE Listed Company Manual.

**The Legal Framework**. In general, corporate governance principles for Taiwanese companies are set forth in the Company Act of the Republic of China, or ROC Company Act, the ROC Securities Exchange Act, regulations promulgated by the Securities and Futures Bureau of the Financial Supervisory Commission and, to the extent they are listed on the TWSE, listing rules of the TWSE. Corporate governance principles under provisions of ROC law may differ in significant ways to corporate governance standards for non-foreign private issuers listed on the NYSE. Committed to high standards of corporate governance, we have generally brought our corporate governance in line with U.S. regulations. However, we have not adopted certain recommended NYSE corporate governance standards where such standards are not in conformity with ROC laws or regulations or generally prevailing business practices in Taiwan. We believe the following to be the significant differences between our corporate governance practices and NYSE corporate governance rules applicable to non-foreign private issuers listed on the NYSE.

**Director Independence**. The NYSE corporate governance rules applicable to non-foreign private issuers listed on the NYSE require companies to have a majority of independent directors on the board of directors. The ROC Securities Exchange Act requires the independent directors of a public company to comprise of no less than one-fifth of the board of directors. We currently have five independent directors on our thirteen-member board of directors. We follow the standards regulated under ROC Securities Exchange Act and by the FSC for determining director independence, which are comparable to the standards imposed by the NYSE.

In addition, under the ROC requirements, our board of directors is not required to make a formal determination of a director s independence. Nevertheless, we believe that our independent directors are free from any business or other relationships that would impair the exercise of their independent judgment. Furthermore, pursuant to the NYSE Listed

Company Manual, non-executive directors must meet on a regular basis without the management directors present. All of our directors attend our board of directors meetings; however, no separate meeting is held among non-executive directors.

**Audit Committee**. On April 1, 2003, the SEC adopted final rules relating to the audit committee requirements. Foreign private issuers listed on the NYSE were required to comply with the related NYSE corporate governance rules by July 31, 2005. Our audit committee was established in September 2004 in

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accordance with the rules set forth in the NYSE Listed Company Manual. According to the NYSE corporate governance rules applicable to non-foreign private issuers listed on the NYSE, the board must review status of any audit member that serves on more than three audit committees. There is no such requirement under the ROC law, which allows a person to serve as an independent director on up to four public companies in the ROC.

Section 303A.07 of the NYSE Listed Company Manual requires issuers to have at least three directors on the audit committee that meets the definition of independence set forth under Rule 10A-3 of the Exchange Act and Section 303A of the NYSE Listed Company Manual. There is no such requirement under the ROC law, which requires all independent directors of a public company to be members of the audit committee if the company has established such a committee.

On February 20, 2013, the FSC of the ROC announced that any (i) financial holding company, bank, bill finance company or insurance company, (ii) listed company whose paid-in capital reaches NT$50 billion or (iii) integrated securities firm controlled by a financial holding company, should establish an audit committee to replace supervisors. As a result, our new audit committee started from the date of the annual general meeting on June 25, 2013. See Item 6. Directors, Senior Management and Employees C. Board Practices. As a result, we now simultaneously comply with the relevant rules of the NYSE Listed Company Manual and the relevant rules and regulations in the ROC.

**Nominating/Corporate Governance Committee and Corporate Governance Principles**. The NYSE corporate governance rules applicable to non-foreign private issuers listed on the NYSE require companies to have a nominating/corporate governance committee, composed entirely of independent directors. In addition to identifying individuals qualified to become board members, the nominating/corporate governance committee must develop and recommend to the board a set of corporate governance principles. The ROC Company Act does not require companies incorporated in the ROC to have a nominating/corporate governance committee. We do not currently have a nominating committee or a corporate governance committee.

Currently, our board of directors performs the duties of a corporate governance committee and regularly reviews our corporate governance principles and practices. The ROC Company Act requires that directors shall be elected by stockholders. Our articles of incorporation requires us, beginning in the fifth commencement, to establish at least three independent directors in the number of directors. The elections for directors shall proceed with the candidate nomination system; the stockholders shall elect the directors from among the nominees listed in the roster of director candidates. Stockholders holding stock over 1% are entitled to nominate candidates of directors in written to us. The numbers of candidates nominated by stockholders shall not exceed the numbers of directors to be elected; neither the numbers of candidates nominated by the Board. Elections for independent and non-independent directors shall proceed concurrently, and the number of elected independent and non-independent directors shall be calculated separately.

Non-foreign private issuers listed on the NYSE are also required to adopt and disclose corporate governance guidelines. We currently comply with the ROC Non-Binding Corporate Governance Best-Practice Principles for TSEC/GTSM Listed Companies promulgated by the TWSE, or Best-Practice Principles, and we provide an explanation of differences between our practice and the principles, if any, in our ROC annual report.

**Compensation Committee**. The NYSE corporate governance rules applicable to non-foreign private issuers listed on the NYSE require companies to have a compensation committee, composed entirely of independent directors. The Article 14-6 of ROC Securities and Exchange Act requires all listed companies to establish a compensation committee for directors, supervisors and managers compensation, which includes salary, stock options and other rewards, as well as authorizes the Competent Authority (i.e., Financial Supervisory Commission) to enact a regulation on the authorities of the compensation committee and the qualifications of its members. See Item 6. Directors, Senior

Management and Employees C. Board Practices for description of our compliance.

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**Code of Business Conduct and Ethics**. The NYSE corporate governance rules applicable to non-foreign private issuers listed on the NYSE require companies must adopt a code of business conduct and ethics for directors, officers and employees and promptly disclose any waivers of the code for directors or executive officers. We have adopted Code of Ethics and Ethical Corporate Management Best Practice Principles that applies to our directors, supervisors, managers, employees and persons having substantial control over us. We have filed Code of Ethics and Ethical Corporate Management Best Practice Principles as an exhibit to our annual report filed with the U.S. SEC and a copy is available to any stockholder upon request.

**Equity Compensation Plans**. The NYSE corporate governance rules applicable to non-foreign private issuers listed on the NYSE require that equity compensation plans be approved by a company s stockholders. Under the ROC Company Act and the ROC Securities and Exchange Act, stockholders approval is required for the distribution of employee bonuses and any issuances of restricted stock to employees, while the board of director has authority to approve employee stock option plans and to grant options to employees pursuant to such plans, subject to the approval of the FSC and to approve share buy-back programs and transfer of shares to employees under such programs. We intend to follow only the ROC requirements.

**Means to Communicate with Non-Management Directors**. The NYSE corporate governance rules applicable to non-foreign private issuers listed on the NYSE require companies to establish a means for stockholders, employees and other interested parties to communicate with non-management directors. The ROC law does not have comparable requirements. However, according to the Best Practice Principles, companies are required to establish channels of communication with employees and encourage employees to communicate directly with the management or directors so as to reflect employees opinions about the management, financial conditions and material decisions of the company concerning employee welfare. We have complied with these provisions.

**Internal Audit Function**. The NYSE corporate governance rules applicable to non-foreign private issuers listed on the NYSE require companies to establish an internal audit function to provide management and the audit committee with assessments of the company s risk management processes and system of internal control. We have complied with the Best-Practice Principles by setting up an internal control/audit system in accordance with the ROC Regulations Governing Establishment of Internal Control Systems by Public Companies.

**CEO Certification to the NYSE.** The NYSE listing standards require the CEO of companies to certify compliance with NYSE corporate governance standards annually. ROC law does not contain such requirement. In this regard, we only follow ROC corporate governance requirement which does not require CEO annual certification. However, our CEO and CFO are required to certify in the 20-F annual report that, to his or her knowledge the information contained therein fairly represents in all material respects the financial condition and results of operation of our company.

## ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

# PART III

## ITEM 17. FINANCIAL STATEMENTS

The Registrant has elected to provide the consolidated financial statements and related information specified in Item 18 in lieu of Item 17.

**ITEM 18. FINANCIAL STATEMENTS**

The following is a list of the consolidated financial statements and report of independent registered public accounting firm included in this annual report beginning on page F-1.

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## INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS


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| Report of Independent Registered Public Accounting Firm | F-1 |
| Consolidated Balance Sheets as of December 31, 2012 and 2013 | F-2 |
| Consolidated Statements of Comprehensive Income for the years ended December 31, 2012 and 2013 | F-4 |
| Consolidated Statements of Changes in Equity for the years ended December 31, 2012 and 2013 | F-6 |
| Consolidated Statements of Cash Flows for the years ended December 31, 2012 and 2013 | F-7 |
| Notes to Consolidated Financial Statements | F-9 |


## ITEM 19. EXHIBITS

| Exhibit Number | Description of Exhibits |
|---|---|
| 1.1 | Statute of Chunghwa Telecom Co., Ltd. as last amended on November 29, 2000 (English translation) (incorporated by reference to Exhibit 1.1 to the Registrant s Annual Report on Form 20-F for the fiscal year ended December 31, 2003 (File No. 001-31731) filed with the Commission on May 17, 2004). |
| 1.2* | Articles of incorporation of Chunghwa Telecom Co., Ltd. (English translation), as last amended by Annual General Meeting on June 25, 2013. |
| 2.1 | Form of Amended and Restated Deposit Agreement dated as of November 2007 among Chunghwa Telecom Co. Ltd., JPMorgan Chase Bank, N.A., as depositary, and all holders from time to time of ADRs issued thereunder, including the Form of American Depositary Receipt (incorporated by reference to Exhibit (a) to the Registrant s Registration Statement on Form F-6 (File No. 333-147321) filed with the Commission on November 13, 2007). |
| 8.1* | List of Subsidiaries. |
| 11.1* | Code of Ethics (English translation), as last amended by the board of directors on August 13, 2013. |
| 11.2* | Ethical Corporate Management Best Practice Principles (English translation), as last amended by the board of directors on August 13, 2013. |
| 12.1* | Certification of our Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 12.2* | Certification of our Acting Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 13.1* | Certification of our Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 13.2* | Certification of our Acting Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

*  Filed herewith.

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## SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

CHUNGHWA TELECOM CO., LTD.

By: /S/ LIH-SHYNG TSAI
Name: Lih-Shyng Tsai
Title: Chairman and Chief Executive Officer

Date: April 28, 2014

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Chunghwa Telecom Co., Ltd.

We have audited the accompanying consolidated balance sheets of Chunghwa Telecom Co., Ltd. and subsidiaries (the Company ) as of January 1, 2012, December 31, 2012 and December 31, 2013, and the related consolidated statements of comprehensive income, changes in equity, and cash flows for the years ended December 31, 2012 and 2013, all expressed in New Taiwan dollars. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Chunghwa Telecom Co., Ltd. and subsidiaries as of January 1, 2012, December 31, 2012 and December 31, 2013, and the results of their operations and their cash flows for the years ended December 31, 2012 and 2013, in conformity with International Financial Reporting Standards as issued by the International Accounting Standard Board ( IASB ).

Our audits also comprehended the translation of New Taiwan dollar amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 6 to the consolidated financial statements. Such U.S. dollar amounts are presented solely for the convenience of the readers.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2013, based on the criteria established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 28, 2014 expressed an unqualified opinion on the Company s internal control over financial reporting.

/s/ DELOITTE & TOUCHE
Deloitte & Touche

Taipei, Taiwan

The Republic of China
April 28, 2014

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**CHUNGHWA TELECOM CO., LTD. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**(In Millions of New Taiwan or U.S. Dollars)**

| | Notes | January 1, 2012 NT$ | December 31, 2012 NT$ | December 31, 2013 NT$ | December 31, 2013 US$ (Note 6) |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| CURRENT ASSETS | | | | | |
| Cash and cash equivalents | 3, 7 | $ 26,407 | $ 30,938 | $ 14,585 | $ 489 |
| Financial assets at fair value through profit or loss | 3, 8 | 46 | 3 | | |
| Available-for-sale financial assets | 3, 9 | 2,499 | 2,250 | 24 | 1 |
| Held-to-maturity financial assets | 3, 10 | 1,201 | 4,250 | 4,264 | 143 |
| Trade notes and accounts receivable, net | 3, 4, 11 | 22,396 | 24,355 | 22,901 | 768 |
| Accounts receivable from related parties | 39 | 34 | 44 | 69 | 2 |
| Inventories | 3, 4, 12, 40 | 4,822 | 7,196 | 7,848 | 263 |
| Prepayments | 13, 38 | 1,889 | 1,986 | 2,224 | 75 |
| Other current monetary assets | 8, 14, 27 | 43,051 | 24,449 | 4,636 | 155 |
| Other current assets | 8, 20 | 3,039 | 4,476 | 3,962 | 133 |
| Total current assets | | 105,384 | 99,947 | 60,513 | 2,029 |
| NONCURRENT ASSETS | | | | | |
| Available-for-sale financial assets | 3, 9 | 2,818 | 5,746 | 5,470 | 183 |
| Held-to-maturity financial assets | 3, 10 | 13,495 | 11,796 | 7,502 | 251 |
| Investments accounted for using equity method | 3, 16 | 2,520 | 2,191 | 2,359 | 80 |
| Property, plant and equipment | 3, 4, 17, 38, 40 | 295,032 | 297,342 | 302,714 | 10,148 |
| Investment properties | 3, 4, 18 | 9,060 | 7,789 | 8,018 | 269 |
| Intangible assets | 3, 4, 19 | 6,278 | 5,782 | 44,399 | 1,488 |
| Deferred income tax assets | 3, 31 | 1,056 | 1,306 | 1,506 | 50 |
| Prepayments | 13, 39 | 3,547 | 3,554 | 3,608 | 121 |
| Other noncurrent assets | 20, 27, 40 | 3,858 | 4,596 | 4,883 | 164 |
| Total noncurrent assets | | 337,664 | 340,102 | 380,459 | 12,754 |
| TOTAL | | $ 443,048 | $ 440,049 | $ 440,972 | $ 14,783 |

(Continued)

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| | Notes | January 1, 2012 NT$ | December 31, 2012 NT$ | December 31, 2013 NT$ | December 31, 2013 US$ (Note 6) |
|---|---|---|---|---|---|
| **LIABILITIES AND EQUITY** | | | | | |
| CURRENT LIABILITIES | | | | | |
| Short-term loans | 21 | $ 75 | $ 111 | $ 254 | $ 9 |
| Financial liabilities at fair value through profit or loss | 3, 8 | 4 | 2 | | |
| Trade notes and accounts payable | 23 | 14,265 | 13,513 | 15,589 | 523 |
| Payables to related parties | 39 | 788 | 837 | 557 | 19 |
| Current tax liabilities | 3, 31 | 8,044 | 7,139 | 6,171 | 207 |
| Other payables | 24 | 26,302 | 26,102 | 26,792 | 898 |
| Provisions | 3, 25 | 148 | 221 | 129 | 4 |
| Advance receipts | 26 | 11,502 | 10,194 | 9,464 | 317 |
| Current portion of long-term loans | 22 | 702 | 8 | 300 | 10 |
| Other current liabilities | | 1,955 | 1,598 | 1,599 | 53 |
| Total current liabilities | | 63,785 | 59,725 | 60,855 | 2,040 |
| NONCURRENT LIABILITIES | | | | | |
| Long-term loans | 22 | 1,058 | 2,050 | 1,400 | 47 |
| Deferred income tax liabilities | 3, 31 | 111 | 98 | 101 | 3 |
| Provisions | 3, 25 | 34 | 45 | 123 | 4 |
| Customers deposits | 39 | 5,014 | 4,911 | 4,835 | 162 |
| Accrued pension liabilities | 3, 27 | 2,950 | 4,577 | 5,482 | 184 |
| Deferred revenue | | 3,888 | 3,839 | 3,701 | 124 |
| Other noncurrent liabilities | | 866 | 1,314 | 1,335 | 45 |
| Total noncurrent liabilities | | 13,921 | 16,834 | 16,977 | 569 |
| Total liabilities | | 77,706 | 76,559 | 77,832 | 2,609 |
| EQUITY ATTRIBUTABLE TO STOCKHOLDERS OF THE PARENT | | | | | |
| Common stock | | 77,574 | 77,574 | 77,574 | 2,601 |
| Additional paid-in capital | | 168,872 | 168,877 | 163,294 | 5,474 |
| Retained earnings | | | | | |
| Legal reserve | | 66,122 | 70,829 | 74,819 | 2,508 |
| Special reserve | | 2,676 | 2,676 | 2,676 | 90 |
| Unappropriated earnings | | 45,888 | 39,037 | 40,075 | 1,344 |
| Total retained earnings | | 114,686 | 112,542 | 117,570 | 3,942 |
| Other adjustments | | 29 | 161 | (144) | (5) |
| | 15, 28 | 361,161 | 359,154 | 358,294 | 12,012 |

| | | | | | |
|---|---|---|---|---|---|
| Total equity attributable to stockholders of the parent | | | | | |
| NONCONTROLLING INTERESTS | 15 | 4,181 | 4,336 | 4,846 | 162 |
| Total equity | | 365,342 | 363,490 | 363,140 | 12,174 |
| TOTAL | | $ 443,048 | $ 440,049 | $ 440,972 | $ 14,783 |

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

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**CHUNGHWA TELECOM CO., LTD. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In Millions of New Taiwan or U.S. Dollars, Except Earnings Per Share That Are in New Taiwan or U.S. Dollars)**

| | | Year Ended December 31 | | |
|---|---|---|---|---|
| | | 2012 | 2013 | |
| | Notes | NT$ | NT$ | US$ (Note 6) |
| REVENUES | 29, 39 | $ 221,420 | $ 227,981 | $ 7,643 |
| OPERATING COSTS | 12, 39 | 141,513 | 147,289 | 4,938 |
| GROSS PROFIT | | 79,907 | 80,692 | 2,705 |
| OPERATING EXPENSES | | | | |
| Marketing | | 22,208 | 25,164 | 844 |
| General and administrative | | 4,021 | 4,190 | 140 |
| Research and development | | 3,698 | 3,726 | 126 |
| Total operating expenses | 39 | 29,927 | 33,080 | 1,110 |
| OTHER INCOME AND EXPENSES | 30 | (1,569) | 59 | 2 |
| INCOME FROM OPERATIONS | | 48,411 | 47,671 | 1,597 |
| NON-OPERATING INCOME AND EXPENSES | | | | |
| Interest income | | 742 | 563 | 19 |
| Other income | 30, 39 | 441 | 356 | 12 |
| Other gains and losses | 30, 39 | (139) | (124) | (4) |
| Financial costs | 30 | (22) | (36) | (1) |
| Share of the profit of associates and joint venture accounted for using equity method | 16 | 520 | 666 | 23 |
| Total non-operating income and expenses | | 1,542 | 1,425 | 49 |
| INCOME BEFORE INCOME TAX | | 49,953 | 49,096 | 1,646 |
| INCOME TAX EXPENSE | 3, 31 | 7,336 | 6,478 | 217 |
| NET INCOME | | 42,617 | 42,618 | 1,429 |

| | | | | |
|---|---|---|---|---|
| OTHER COMPREHENSIVE INCOME (LOSS) | | | | |
| Items that will not be reclassified to profit or loss: | | | | |
| Remeasurements of defined benefit pension plans | | (1,539) | (617) | (21) |
| Share of remeasurements of defined benefit pension plans of associates | | (18) | (39) | (1) |
| Income tax relating to items that will not be reclassified | 31 | 265 | 105 | 4 |
| | | (1,292) | (551) | (18) |

(Continued)

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**CHUNGHWA TELECOM CO., LTD. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In Millions of New Taiwan or U.S. Dollars, Except Earnings Per Share That Are in New Taiwan or U.S. Dollars)**

| | | Year Ended December 31 | | |
|---|---|---|---|---|
| | | 2012 | 2013 | |
| | Notes | NT$ | NT$ | US$ (Note 6) |
| Items that may be reclassified subsequently to profit or loss: | | | | |
| Exchange differences arising from the translation of the foreign operations | | $ (58) | $ 129 | $ 4 |
| Share of exchange differences arising from the translation of the foreign operations of associates | | (8) | 4 | |
| Unrealized gain (loss) on available-for-sale financial assets | | 192 | (392) | (14) |
| Income tax relating to items that may be reclassified subsequently | | | (6) | |
| | | 126 | (265) | (10) |
| Total other comprehensive income (loss), net of income tax | | (1,166) | (816) | (28) |
| TOTAL COMPREHENSIVE INCOME | | $ 41,451 | $ 41,802 | $ 1,401 |
| NET INCOME ATTRIBUTABLE TO | | | | |
| Stockholders of the parent | | $ 41,492 | $ 41,494 | $ 1,391 |
| Noncontrolling interests | | 1,125 | 1,124 | 38 |
| | | $ 42,617 | $ 42,618 | $ 1,429 |
| COMPREHENSIVE INCOME ATTRIBUTABLE TO | | | | |
| Stockholders of the parent | | $ 40,350 | $ 40,636 | $ 1,362 |
| Noncontrolling interests | | 1,101 | 1,166 | 39 |
| | | $ 41,451 | $ 41,802 | $ 1,401 |
| EARNINGS PER SHARE | 32 | | | |
| Basic | | $ 5.35 | $ 5.35 | $ 0.18 |
| Diluted | | $ 5.33 | $ 5.34 | $ 0.18 |

| EARNINGS PER EQUIVALENT | 32 | | | | | | |
|---|---|---|---|---|---|---|---|
| ADS | | | | | | | |
| Basic | | $ | 53.49 | $ | 53.49 | $ | 1.79 |
| Diluted | | $ | 53.34 | $ | 53.40 | $ | 1.79 |

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

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**CHUNGHWA TELECOM CO., LTD. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

**(In Millions of New Taiwan or U.S. Dollars)**

| | Equity Attributable to Stockholders of the Parent | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Retained Earnings | | | | Other Adjustments | | | | | |
| | Common Stock NT$ | Additional Paid-in Capital NT$ | Legal Reserve NT$ | Special Reserve NT$ | Unappropriated Earnings NT$ | Total Retained Earnings NT$ | Exchange Differences Arising from the Translation of the Foreign Operations NT$ | Unrealized Gain (Loss) on Available-for-sale Financial Assets NT$ | Total Other Adjustments NT$ | Total Equity Attributable to Stockholders of the Parent NT$ | Noncontrolling Interests NT$ | Total Equit NT$ |
| LANCE, UARY 1, 2 | $ 77,574 | $ 168,872 | $ 66,122 | $ 2,676 | $ 45,888 | $ 114,686 | $ (39) | $ 68 | $ 29 | $ 361,161 | $ 4,181 | $ 365,3 |
| ropriation 011 ings | | | | | | | | | | | | |
| l reserve | | | 4,707 | | (4,707) | | | | | | | |
| n dividends by nghwa | | | | | (42,362) | (42,362) | | | | (42,362) | | (42,3 |
| n dividends by idiaries to controlling ests | | | | | | | | | | | (893) | (8 |
| income for year ended ember 31, 2 | | | | | 41,492 | 41,492 | | | | 41,492 | 1,125 | 42,6 |
| er prehensive me for the ended ember 31, 2 | | | | | (1,274) | (1,274) | (58) | 190 | 132 | (1,142) | (24) | (1,1 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| l prehensive me for the ended ember 31, 2 | | | | | 40,218 | 40,218 | (58) | 190 | 132 | 40,350 | 1,101 | 41,4 |
| rcise of loyee stock on of a idiary | | 5 | | | | | | | | 5 | 38 | |
| rease in controlling ests | | | | | | | | | | | (91) | ( |
| LANCE, CEMBER 2012 | 77,574 | 168,877 | 70,829 | 2,676 | 39,037 | 112,542 | (97) | 258 | 161 | 359,154 | 4,336 | 363,4 |
| ropriation 012 ings | | | | | | | | | | | | |
| al reserve | | | 3,990 | | (3,990) | | | | | | | |
| n dividends by nghwa | | | | | (35,913) | (35,913) | | | | (35,913) | | (35,9 |
| n dividends by idiaries to controlling ests | | | | | | | | | | | (811) | (8 |
| n ributed n capital lus | | (5,589) | | | | | | | | (5,589) | | (5,5 |
| income for year ended ember 31, 3 | | | | | 41,494 | 41,494 | | | | 41,494 | 1,124 | 42,6 |
| er prehensive me for the ended ember 31, 3 | | | | | (553) | (553) | 103 | (408) | (305) | (858) | 42 | (8 |
| l prehensive me for the ended ember 31, | | | | | 40,941 | 40,941 | 103 | (408) | (305) | 40,636 | 1,166 | 41,8 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 3 | | | | | | | | | | | | |
| rcise of loyee stock on of idiaries | | 6 | | | | | | | | 6 | 44 | |
| pensation of loyee stock ons of a idiary | | | | | | | | | | | 70 | |
| loyee k bonus ed by a idiary | | | | | | | | | | | 2 | |
| ease in controlling ests | | | | | | | | | | | 39 | |
| LANCE, CEMBER 2013 | $ 77,574 | $ 163,294 | $ 74,819 | $ 2,676 | $ 40,075 | $ 117,570 | $ 6 | $ (150) | $ (144) | $ 358,294 | $ 4,846 | $ 363,1 |
| LANCE, CEMBER 2013 (IN LIONS OF Note 6) | $ 2,601 | $ 5,474 | $ 2,508 | $ 90 | $ 1,344 | $ 3,942 | $ | $ (5) | $ (5) | $ 12,012 | $ 162 | $ 12,1 |

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

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**CHUNGHWA TELECOM CO., LTD. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In Millions of New Taiwan or U.S. Dollars)**

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2012 | 2013 | |
| | NT$ | NT$ | US$ (Note 6) |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Income before income tax | $ 49,953 | $ 49,096 | $ 1,646 |
| Adjustments to reconcile income before income tax to net cash provided by operating activities: | | | |
| Depreciation | 31,037 | 30,954 | 1,038 |
| Amortization | 1,123 | 1,238 | 42 |
| Provision for (reversal of) doubtful accounts | (1,451) | 253 | 8 |
| Interest expenses | 22 | 36 | 1 |
| Interest income | (742) | (563) | (19) |
| Dividend income | (21) | (79) | (3) |
| Compensation cost of employee share options | | 70 | 2 |
| Share of the profit of associates and joint venture accounted for using equity method | (520) | (666) | (23) |
| Impairment loss on available-for-sale financial assets | 203 | 66 | 2 |
| Provision for inventory and obsolescence | 113 | 203 | 7 |
| Impairment loss on property, plant and equipment | 301 | 254 | 9 |
| Impairment loss (reversal of) on investment properties | 1,261 | (246) | (8) |
| Impairment loss on intangible assets | 5 | 18 | 1 |
| Gain on disposal of financial instruments | (113) | (76) | (3) |
| Loss (gain) on disposal of property, plant and equipment | 2 | (85) | (3) |
| Gain on disposal of investments accounted for using equity method | | (13) | (1) |
| Valuation loss on financial instruments at fair value through profit or loss, net | 1 | 1 | |
| Loss (gain) on foreign exchange | (18) | 19 | 1 |
| Changes in operating assets and liabilities: | | | |
| Decrease (increase) in: | | | |
| Financial assets held for trading | 74 | 9 | |
| Trade notes and accounts receivable | (509) | 1,219 | 41 |
| Receivables from related parties | (10) | (25) | (1) |
| Inventories | (2,487) | (855) | (29) |
| Other current monetary assets | (118) | (1) | |
| Prepayment | (104) | (287) | (10) |
| Other current assets | (1,518) | 590 | 10 |
| Increase (decrease) in: | | | |

| | | | |
|---|---|---|---|
| Trade notes and accounts payable | (804) | 2,076 | 70 |
| Payables to related parties | 49 | (280) | (9) |
| Other payables | (263) | 447 | 8 |
| Provisions | 84 | (14) | |
| Advance receipts | (1,308) | (730) | (24) |
| Other current liabilities | (383) | 88 | 20 |
| Deferred revenue | (49) | (138) | (5) |
| Accrued pension liabilities | 88 | 289 | 10 |
| Cash generated from operations | 73,898 | 82,868 | 2,778 |
| Interest paid | (29) | (36) | (1) |
| Income tax paid | (8,213) | (7,544) | (253) |
| Net cash provided by operating activities | 65,656 | 75,288 | 2,524 |

(Continued)

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**CHUNGHWA TELECOM CO., LTD. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In Millions of New Taiwan or U.S. Dollars)**

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2012 | 2013 | |
| | NT$ | NT$ | US$ (Note 6) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Acquisition of designated financial assets at fair value through profit or loss | $ (30) | $ | $ |
| Proceeds from disposal of designated financial assets at fair value through profit or loss | 57 | | |
| Acquisition of available-for-sale financial assets | (4,502) | (1,822) | (61) |
| Proceeds from disposal of available-for-sale financial assets | 1,824 | 3,989 | 134 |
| Acquisition of time deposits and negotiable certificate of deposit with maturities of more than three months | (32,934) | (18,199) | (610) |
| Proceeds from disposal of time deposits and negotiable certificate of deposit with maturities of more than three months | 51,653 | 37,928 | 1,271 |
| Acquisition of held-to-maturity financial assets | (3,865) | | |
| Proceeds from disposal of held-to-maturity financial assets | 2,451 | 4,236 | 142 |
| Capital reduction of available-for-sale financial assets | 35 | 36 | 1 |
| Proceeds from disposal of hedging derivative assets | | 15 | 1 |
| Derecognition of hedging derivative liabilities | | (108) | (4) |
| Acquisition of investments accounted for using equity method | (26) | (90) | (3) |
| Proceeds from disposal of investments accounted for using equity method | | 24 | 1 |
| Capital reduction of investments accounted for using equity method | 65 | 16 | 1 |
| Acquisition of property, plant and equipment | (33,280) | (36,382) | (1,220) |
| Proceeds from disposal of property, plant and equipment | 33 | 205 | 7 |
| Acquisition of intangible assets | (632) | (39,872) | (1,337) |
| Increase in noncurrent assets | (624) | (291) | (10) |
| Interest received | 853 | 672 | 23 |
| Cash dividends received | 315 | 475 | 16 |
| Net cash used in investing activities | (18,607) | (49,168) | (1,648) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Proceeds from short-term loans | 857 | 1,399 | 47 |

| | | | |
|---|---|---|---|
| Repayment of short-term loans | (821) | (1,256) | (42) |
| Proceeds from long-term loans | 400 | | |
| Repayment of long-term loans | (102) | (358) | (12) |
| Increase (decrease) customers deposits | 63 | (50) | (2) |
| Increase in other liabilities | 447 | 22 | 1 |
| Cash dividends and cash distributed from additional paid-in capital | (42,362) | (41,502) | (1,391) |
| Proceeds from exercise of employee stock option granted by subsidiaries | 43 | 50 | 2 |
| Dividends paid to noncontrolling interests | (893) | (811) | (27) |
| Other change in noncontrolling interests | (102) | 42 | 1 |
| Net cash used in financing activities | (42,470) | (42,464) | (1,423) |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS | (48) | (9) | |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 4,531 | (16,353) | (547) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR | 26,407 | 30,938 | 1,036 |
| CASH AND CASH EQUIVALENTS, END OF THE YEAR | $ 30,938 | $ 14,585 | $ 489 |

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

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**CHUNGHWA TELECOM CO., LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**YEARS ENDED DECEMBER 31, 2012 AND 2013**

**(In Millions of New Taiwan, Unless Stated Otherwise)**

## 1. GENERAL

Chunghwa Telecom Co., Ltd. ( Chunghwa ) was incorporated on July 1, 1996 in the Republic of China ( ROC ) pursuant to the Article 30 of the Telecommunications Act. Chunghwa is a company limited by shares and, prior to August 2000, was wholly owned by the Ministry of Transportation and Communications ( MOTC ). Prior to July 1, 1996, the current operations of Chunghwa were carried out under the Directorate General of Telecommunications ( DGT ). The DGT was established by the MOTC in June 1943 to take primary responsibility in the development of telecommunications infrastructure and to formulate policies related to telecommunications. On July 1, 1996, the telecom operations of the DGT were spun-off to Chunghwa which continues to carry out the business and the DGT continues to be the industry regulator.

As the dominant telecommunications service provider of domestic and international fixed-line, Global System for Mobile Communications ( GSM ), and Third Generation ( 3G ) in the ROC, Chunghwa is subject to industry-specific regulations imposed by the ROC.

Effective August 12, 2005, the MOTC completed the process of privatizing Chunghwa by reducing the government ownership to below 50% in various stages. In July 2000, Chunghwa received approval from the Securities and Futures Commission (the SFC ) for a domestic initial public offering and its common stocks were listed and traded on the Taiwan Stock Exchange (the TWSE ) on October 27, 2000. Certain of Chunghwa s common stocks were sold, in connection with the foregoing privatization plan, in domestic public offerings at various dates from August 2000 to July 2003. Certain of Chunghwa s common stocks were also sold in an international offering of securities in the form of American Depository Shares ( ADS ) on July 17, 2003 and were listed and traded on the New York Stock Exchange (the NYSE ). The MOTC sold common stocks of Chunghwa by auction in the ROC on August 9, 2005 and completed the second international offering on August 10, 2005. Upon completion of the share transfers associated with these offerings on August 12, 2005, the MOTC owned less than 50% of the outstanding shares of Chunghwa and completed the privatization plan.

Chunghwa together with its subsidiaries are hereinafter referred to collectively as the Company .

## 2. APPROVAL OF FINANCIAL STATEMENTS

The consolidated financial statements were approved and authorized for issue by the management on April 28, 2014.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Starting from January 1, 2012, the Company has prepared its financial statements in accordance with the International Financial Reporting Standards as issued by the International Accounting Standard Board ( IASB ) (collectively, IFRSs ).

The consolidated financial statements for the year ended December 31, 2013 is its first IFRS consolidated financial statements. Prior to 2013, the Company prepared and reported its consolidated financial statements in accordance with accounting principles generally accepted in the Republic of China with reconciliation of net income and balance sheet differences of its consolidated financial statements to accounting principles generally accepted in the United States. The date of transition to IFRSs was January 1, 2012. Refer to Note 43 for the impact of IFRS conversion on the Company s consolidated financial statements.

**Statement of Compliance**

The consolidated financial statements have been prepared in conformity with IFRSs.

**Basis of Preparation**

The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments that are measured at revalued amounts or fair values, as explained in the accounting policies below.

The opening balance sheet at the date of transition is prepared in accordance with the recognition and measurement required by IFRS 1. According to IFRS 1, the Company is required to apply each effective IFRS retrospectively in its opening balance sheet at the date of transition to IFRSs; except for optional exemptions and mandatory exceptions to such retrospective application provided under IFRS 1. The main optional exemptions the Company adopted are described in Note 43.

Historical cost is generally based on the fair value of the consideration given in exchange for assets.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of IFRS 2, leasing transactions that are within the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as net realizable value in IAS 2 or value in use in IAS 36.

In addition, for financial reporting purposes, fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;

- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and

- Level 3 inputs are unobservable inputs for the asset or liability.

**Current and Noncurrent Assets and Liabilities**

Current assets include:

a. assets held primarily for the purpose of trading;

b. assets expected to be realized within twelve months after the reporting period; and

c. cash and cash equivalents unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

Current liabilities include:

a. liabilities held primarily for the purpose of trading;

b. liabilities due to be settled within twelve months after the reporting period; and

c. liabilities for which the Company does not have an unconditional right to defer settlement for at least twelve months after the reporting period.

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Assets and liabilities that are not classified as current are classified as non-current.

Light Era Development Co., Ltd. (LED) engages mainly in development of property for rent and sale. The assets and liabilities of LED related to property development within its operating cycle, which is over one year, are classified as current items.

**Basis of Consolidation**

a. The basis for the consolidated financial statements

The consolidated financial statements incorporate the financial statements of Chunghwa and entities controlled by Chunghwa (its subsidiaries). Control is achieved when the Company (a) has power over the investee; (b) is exposed, or has rights, to variable returns from its involvement with the investee; and (c) has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

The Company considers all relevant facts and circumstances in assessing whether or not the Company s voting rights in an investee are sufficient to give it power, including:

- The size of the Company s holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- Potential voting rights held by the Company, other vote holders or other parties;
- Rights arising from other contractual arrangements; and
- Any additional facts and circumstances that indicate that the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders meetings.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with those used by the Company.

All intra-company transactions, balances, income and expenses are eliminated in full upon consolidation.

The noncontrolling interests in the subsidiaries and the equity attributable to stockholders are presented separately.

Allocation of comprehensive income to the noncontrolling interests

Profit or loss and each component of other comprehensive income are attributed to the owners of the Company and to the noncontrolling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Company

and to the noncontrolling interests even if it results in the noncontrolling interests having a deficit balance.

Changes in the Company s ownership interests in subsidiaries

Changes in the Company s ownership interests in subsidiaries that do not result in the Company losing control over the subsidiaries are accounted for as equity transactions. The carrying amounts of the Company s interests and the noncontrolling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the noncontrolling interests

are adjusted and the fair value of the consideration paid or received is recognized directly in equity and attributed to owners of the Company.

b. The subsidiaries in the consolidated financial statements

The detail information of the subsidiaries at the end of reporting period was as follows:

| Name of Investor | Name of Investee | Main Businesses and Products | Percentage of Ownership January 1, 2012 | December 31, 2012 | December 31, 2013 | Note |
|---|---|---|---|---|---|---|
| Chunghwa Telecom Co., Ltd. | Senao International Co., Ltd. ( SENAO ) | Selling and maintaining mobile phones and its peripheral products | 28 | 28 | 28 | 1) |
| | Light Era Development Co., Ltd. ( LED ) | Housing, office building development, rent and sale services | 100 | 100 | 100 | |
| | Donghwa Telecom Co., Ltd. ( DHT ) | International telecommunications IP fictitious internet and internet transfer services | 100 | 100 | 100 | |
| | Chunghwa Telecom Singapore Pte., Ltd. ( CHTS ) | Telecommunication wholesale, internet transfer services international data and long distance call wholesales to carriers | 100 | 100 | 100 | |
| | Chunghwa System Integration Co., Ltd. ( CHSI ) | Providing communication and information aggregative services | 100 | 100 | 100 | |
| | Chunghwa Investment Co., Ltd. ( CHI ) | Investment | 89 | 89 | 89 | |
| | CHIEF Telecom Inc. ( CHIEF ) | Internet communication and internet data center ( IDC ) service | 69 | 69 | 69 | |
| | Chunghwa International Yellow Pages Co., Ltd. ( CHYP ) | Yellow pages sales and advertisement services | 100 | 100 | 100 | |
| | | Investment | 100 | 100 | 100 | |

| | | | | | |
|---|---|---|---|---|---|
| | Prime Asia Investments Group Ltd. (B.V.I.) ( Prime Asia ) | | | | |
| | Spring House Entertainment Tech. Inc. ( SHE ) | Network services, producing digital entertainment contents and broadband visual sound terrace development | 56 | 56 | 56 |
| | Chunghwa Telecom Global, Inc. ( CHTG ) | International data and internet services and long distance call wholesales to carriers | 100 | 100 | 100 |

(Continued)

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| Name of Investor | Name of Investee | Main Businesses and Products | Percentage of Ownership January 1, 2012 | December 31, 2012 | December 31, 2013 | Note |
|---|---|---|---|---|---|---|
| | Chunghwa Telecom Vietnam Co., Ltd. ( CHTV ) | Information and communications technology, international circuit, and intelligent energy network service | 100 | 100 | 100 | |
| | Smartfun Digital Co., Ltd. ( SFD ) | Software retail | 65 | 65 | 65 | |
| | Chunghwa Telecom Japan Co., Ltd. ( CHTJ ) | Telecom business, information process and information provide service, development and sale of software and consulting services in telecommunication | 100 | 100 | 100 | |
| | Chunghwa Sochamp Technology Inc. ( CHST ) | License plate recognition system | 51 | 51 | 51 | |
| | Honghwa Human Resources Co., Ltd. ( HHR ) | Human resources service | | | 100 | 2) |
| | New Prospect Investments Holdings Ltd. (B.V.I.) ( New Prospect ) | Investment | 100 | 100 | 100 | |
| Senao International Co., Ltd. | Senao International (Samoa) Holding Ltd. ( SIS ) | International investment | 100 | 100 | 100 | |
| CHIEF Telecom Inc. | Unigate Telecom Inc. ( Unigate ) | Telecommunication and internet service | 100 | 100 | 100 | |
| | Chief International Corp. ( CIC ) | Internet communication and internet data center ( IDC ) service | 100 | 100 | 100 | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Chunghwa System Integrated Co., Ltd. | Concord Technology Co., Ltd. ( Concord ) | Investment | 100 | 100 | 100 | |
| Spring House Entertainment Tech. Inc. | Ceylon Innovation Ltd. ( CEI ) | International trading, general advertisement and book publishing service | 100 | 100 | 100 | |
| Light Era Development Co., Ltd. | Yao Yong Real Property Co., Ltd. ( YYRP ) | Real estate management and leasing business | 100 | 100 | 100 | |
| Chunghwa Investment Co., Ltd. | Chunghwa Precision Test Tech Co., Ltd. ( CHPT ) | Semiconductor testing components and printed circuit board industry production and marketing of electronic products | 53 | 53 | 51 | 3) |
| | Chunghwa Investment Holding Co., Ltd. ( CIHC ) | Investment | 100 | 100 | 100 | |

(Continued)

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| Name of Investor | Name of Investee | Main Businesses and Products | Percentage of Ownership January 1, 2012 | December 31, 2012 | December 31, 2013 | Note |
|---|---|---|---|---|---|---|
| Concord Technology Co., Ltd. | Glory Network System Service (Shanghai) Co., Ltd. ( GNSS (Shanghai) ) | Planning and design of software and hardware system services and integration of information system | 100 | 100 | 100 | |
| Chunghwa Precision Test Tech. Co., Ltd. | Chunghwa Precision Test Tech. USA Corporation ( CHPT (US) ) | Semiconductor testing components and printed circuit board industry production and marketing of electronic products | 100 | 100 | 100 | |
| | CHPT Japan Co., Ltd. ( CHPT (JP) ) | Sale and maintenance of electronic parts and machinery processed products, and design of printed circuit board | | | 100 | 4) |
| | Chunghwa Precision Test Tech. International, Ltd. ( CHPT (International) ) | Wholesale electronic materials, electronic materials and general retail investment industry | | | 100 | 5) |
| Senao International (Samoa) Holding Ltd. | Senao International HK Limited ( SIHK ) | International investment | 100 | 100 | 100 | |
| Chunghwa Investment Holding Co., Ltd. | CHI One Investment Co., Limited ( COI ) | Investment | 100 | 100 | 100 | |
| Senao International HK | Senao Trading (Fujian) Co., Ltd. | Information technology | 100 | 100 | 100 | |

| | | | | | |
|---|---|---|---|---|---|
| Limited | ( STF ) | services and sale of communication products | | | |
| | Senao International Trading (Shanghai) Co., Ltd. ( SITS ) | Information technology services and sale of communication products | 100 | 100 | 100 |
| | Senao International Trading (Shanghai) Co., Ltd. ( SEITS ) | Information technology services and maintenance of communication products | 100 | 100 | 100 |
| | Senao International Trading (Jiangsu) Co., Ltd. ( SITJ ) | Information technology services and sale of communication products | 100 | 100 | 100 |
| Prime Asia Investments Group, Ltd. (B.V.I.) | Chunghwa Hsingta Co., Ltd. ( CHC ) | Investment | 100 | 100 | 100 |

(Continued)

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| Name of Investor | Name of Investee | Main Businesses and Products | Percentage of Ownership January 1, 2012 | December 31, 2012 | December 31, 2013 | Note |
|---|---|---|---|---|---|---|
| Chunghwa Hsingta Company Ltd. | Chunghwa Telecom (China) Co., Ltd. ( CTC ) | Planning and design of energy conservation and software and hardware system services, and integration of information system | 100 | 100 | 100 | |
| | Jiangsu Zhenhua Information Technology Company, LLC. ( JZIT ) | Intelligent energy conserving and intelligent building services | | 75 | 75 | 6) |
| | Hua-Xiong Information Technology Co., Ltd. ( HXIT ) | Intelligent system and energy saving system services in buildings | | 51 | 51 | 7) |

(Concluded)

1) The Company s equity ownership of SENAO decreased from 28.44% as of January 1, 2012 to 28.30% and 28.18% as of December 31, 2012 and 2013, respectively, due to the exercise of options by SENAO s employees. The Company owns 28% equity shares of SENAO. However, the Company has four out of seven seats of the board of directors of SENAO through the support of large beneficial shareholders. Therefore, the Company has control over SENAO and the accounts of SENAO are included in the consolidated financial statements.
2) Chunghwa established 100% owned subsidiary of HHR in January 2013.
3) The Company s equity ownership of CHPT decreased from 53.19% as of December 31, 2012 to 50.62% as of December 31, 2013 due to the exercise of options by CHPT s employees and CHPT issued employee stock bonus.
4) CHPT established 100% owned subsidiary of CHPT (JP) in January 2013.
5) CHPT established 100% owned subsidiary of CHPT (International) in July 2013.
6) JZIT was established in January 2012 and CHC owns 75% ownership of JZIT.
7) HXIT was established in November 2012 and CHC owns 51% ownership of HXIT.

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The following diagram presents information regarding the relationship and ownership percentages between Chunghwa and its subsidiaries as of December 31, 2013:

**Business Combination**

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Company, liabilities incurred by the Company to the former owners of the acquire and the equity interests issued by the Company in exchange for control of the acquiree. Acquisition-related costs are recognized in profit or loss as incurred.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any noncontrolling interests in the acquiree, and the fair value of the acquirer s previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any noncontrolling interests in the acquiree and the fair value of the acquirer s previously held interest in the acquiree (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain.

For each business combination, the Company shall measure at the acquisition date components of noncontrolling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity s net assets in the event of liquidation at either fair value or at the noncontrolling interest s proportionate share of the acquiree s identifiable net assets.

When the consideration transferred by the Company in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is

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measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the measurement period (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

**Foreign Currencies**

In preparing the financial statements of each individual entity, transactions in currencies other than the entity s functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences on monetary items denominated in foreign currencies are recognized in profit or loss when the transactions occur.

Foreign-currency nonmonetary assets or liabilities (such as equity instruments) that are carried at fair value are revalued using prevailing exchange rates at the balance sheet date and related exchange differences are recognized in profit or loss. Conversely, when the fair value changes were recognized in other comprehensive income, related exchange difference shall be recognized in other comprehensive income.

Chunghwa use New Taiwan dollars as the functional currency. For the purposes of presenting consolidated financial statements, the assets and liabilities of the Company s foreign operations are translated into New Taiwan dollars using exchange rates prevailing at the end of each balance date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are recognized in other comprehensive income and accumulated in equity attributed to noncontrolling interests as appropriate.

**Cash Equivalents**

Cash equivalent includes treasury bills, commercial paper, time deposits and negotiable certificate of deposit with original maturities within three months from the date of acquisition, are highly liquid, readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value. These cash equivalents are held for the purpose of meeting short-term cash commitments.

**Inventories**

Inventories are stated at the lower of cost (weighted-average cost) or net realizable value item by item, except for those that may be appropriate to group items of similar or related inventories. Net realizable value is the estimated selling price of inventories less all estimated costs of completion and costs necessary to make the sale. The calculation of the cost of inventory is derived using the weighted-average method.

**Buildings and Lands Consigned to Constructing Firm**

Inventories of LED are stated at the lower of cost or net realizable value item by item, except for those that may be appropriate to group as similar items or related inventories. Land acquired before construction is classified as land held for development, and then reclassified as land held under development after LED begins its construction project.

Prepayments for licensing and other

miscellaneous costs have been capitalized as part of inventory. For qualifying assets, cost includes capitalized borrowing costs.

When using the completed-contract method for its construction projects, LED recognizes the proceeds from customers as advances from customers for land and building before the construction project is completed. After completion of the construction project and ownership is transferred to the customers, LED recognizes the relevant revenues.

**Investments in Associates and Joint Venture**

An associate is an entity over which the Company has significant influence and that is neither a subsidiary nor an interest in a joint venture. Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as joint venture.

The operating results and identifiable net assets of associates and joint venture are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, an investment in an associate and joint venture is initially recognized in the consolidated balance sheet at cost and adjusted thereafter to recognize the Company s share of the profit or loss, any impairment losses, and other comprehensive income of the associate and joint venture. The Company also recognizes the changes in the Company s share of equity of associates and joint venture attributable to the Company.

When the Company reduces its ownership interest in an associate or a joint venture but the Company continues to use the equity method, the Company reclassifies to profit or loss the proportion of the gain or loss that had previously been recognized in other comprehensive income relating to that reduction in ownership interest if that gain or loss would be reclassified to profit or loss on the disposal of the related assets or liabilities.

Any excess of the cost of acquisition over the Company s share of the fair value of the identifiable net assets, liabilities and contingent liabilities of an associate and joint venture recognized at the date of acquisition is recognized as goodwill, which is included in the carrying amount of the investment and shall not be amortized.

The entire carrying amount of the investment (including goodwill) is tested for impairment as a single asset by comparing its recoverable amount with its carrying amount. Any impairment loss recognized forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognized to the extent that the recoverable amount of the investment subsequently increases.

When a Company entity transacts with its associate and joint venture, profits and losses resulting from the transactions with the associate are recognized in the Company consolidated financial statements only to the extent of interests in the associate and the joint venture that are not related to the Company.

**Property, Plant and Equipment**

When future economic benefits are expected to inflow to the Company and costs can be evaluated reliably, property, plant and equipment that are held for use in the production or supply of goods or services, or for administrative purposes for over one year are measured at costs. Subsequent to initial recognition, property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment.

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Depreciation is recognized so as to write off the cost of the assets less their residual values over their useful lives, and it is computed using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed periodically, however, at least annually, with the effect of any changes in estimates accounted for on a prospective basis.

Upon sale or disposal of property, plant and equipment, the related cost, accumulated depreciation and accumulated impairment losses are deducted from the corresponding accounts, and any gain or loss is recognized in profit or loss as incurred.

**Investment Properties**

Investment properties are properties held to earn rentals and/or for capital appreciation (including property under construction for such purposes). Investment properties also include land held for a currently undetermined future use as such land is regarded as held for capital appreciation.

Investment properties are measured initially at cost, including direct costs of bringing the assets to intended use. Subsequent to initial recognition, investment properties are measured at cost less accumulated depreciation and accumulated impairment.

The Company uses the straight line method to depreciate the assets, that is, to evenly allocate the cost less residual value over the expected useful lives of the investment properties.

Upon disposal of investment properties, the related cost, accumulated depreciation and accumulated impairment losses are deducted from the corresponding accounts, and any gain or loss is recognized in profit or loss as incurred.

**Goodwill**

Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business less accumulated impairment losses, if any.

For the purpose of impairment testing, goodwill is allocated to each of the Company s cash-generating units or groups of cash-generating units that are expected to benefit from the synergies of the business combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata based on the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognized directly in profit or loss. An impairment loss recognized for goodwill is not reversed in subsequent periods.

When the Company disposes of an operation within a cash-generating unit (group of units) to which goodwill has been allocated, the goodwill associated with that operation should be included in the carrying amount of the operation when determining the gain or loss on disposal; and measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit (group of units) retained.

**Intangible Assets Other Than Goodwill**

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives. The estimated useful life and amortization method are reviewed periodically,

however, at least annually, with the effect of any changes in estimate being accounted for on a prospective basis. Except for the intangible assets to be disposed by the Company before the end of the useful lives, the residual values of intangible assets with finite useful lives are expected to be zero.

Upon disposal of intangible assets, the related cost, accumulated amortization and accumulated impairment losses are deducted from the corresponding accounts, and any gain or loss is recognized in profit or loss as incurred.

**Impairment of Tangible and Intangible Assets Other Than Goodwill**

When an indication of impairment is identified for tangible and intangible assets other than goodwill, any excess of the carrying amount of an asset over its recoverable amount is recognized as a loss. If the recoverable amount increases in a subsequent period, the amount previously recognized as impairment would be reversed and recognized as a gain. However, the adjusted amount may not exceed the carrying amount that would have been determined, as if no impairment loss had been recognized.

**Financial Instruments**

Financial assets and financial liabilities are recognized when a consolidated entity becomes a party to the contractual provisions of the instruments.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

a. Financial assets

Regular way purchases or sales of financial assets are accounted for using trade date accounting. The regular way of transaction means the purchase or sale of financial assets delivered within the time frame established by regulation or convention in the marketplace.

1) Measurement category

a) Financial assets at fair value through profit and loss (FVTPL)

Financial assets are classified as at FVTPL when the financial asset is either held for trading or it is designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on measurement recognized in profit or loss. The net gain or loss recognized in profit or loss does not incorporate any dividend or interest earned on the financial asset.

b) Held-to-maturity financial assets

Held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturity date that the Company has positive intention and ability to hold to maturity other than those that are designated as at fair value

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through profit or loss or as available-for-sale and those that meet the definition of loans and receivables on initial recognition. When the counterparties of the Company s investments have good credit quality, and the Company has positive intention and ability to hold to maturity, the investments are classified as held-to-maturity financial assets.

Subsequent to initial recognition, held-to-maturity financial assets are measured at amortized cost using the effective interest method less any impairment.

The effective interest rate method is a method of calculating the amortized cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that discounts the estimated future cash receipts through the expected life of the debt instrument, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

c) Available-for-sale financial assets (AFS financial assets)

AFS financial assets are non-derivatives that are either designated as AFS or are not classified as loans and receivables, held-to-maturity financial assets or financial assets at fair value through profit or loss.

Listed stocks, emerging market stocks, open-end mutual funds, unlisted stocks and corporate bonds held by the Company in an active market and classified as AFS are measured at fair value at the end of each reporting period. AFS equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

Changes in the carrying amount of AFS monetary financial assets relating to changes in foreign currency rates, interest income calculated using the effective interest method and dividends on AFS equity investments are recognized in profit or loss. Other changes in the carrying amount of AFS financial assets are recognized in other comprehensive income. When the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognized in other comprehensive income is reclassified to profit or loss.

Dividends on AFS equity instruments are recognized in profit or loss when the Company s right to receive the dividends is established.

d) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the effect of discounting would be immaterial.

2) Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

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For financial assets carried at amortized cost, such as held-to-maturity investments and trade notes and accounts receivable, assets are assessed for impairment on a collective and individual basis.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset s carrying amount and the present value of estimated future cash flows, discounted at the financial asset s original effective interest rate. However, since the discounted effect of short-term receivables is immaterial, the impairment loss is recognized on the difference between carrying amount and estimated future cash flow.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to profit or loss in the period.

In respect of AFS equity securities, impairment losses previously recognized in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognized in other comprehensive income.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables and other receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable and other receivables is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

3) Derecognition of financial assets

The Company derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

On derecognition of a financial asset in its entirety, the difference between the asset s carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

c. Financial liabilities

1) Subsequent measurement

Except for financial liabilities at FVTPL, other financial liabilities are subsequently measured at amortized cost using the effective interest method.

2) Derecognition of financial liabilities

The Company derecognizes financial liabilities when, and only when, the Company s obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable (includes the transfer of non-cash assets or assumption of liabilities) is recognized in profit or loss.

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d. Derivative financial instruments

The Company enters into a variety of derivative financial instruments to manage its exposure to risk of foreign exchange rate and the fluctuation on stock price, including foreign exchange forward contracts, cross currency swap contracts and index future contracts.

Derivative financial instruments are initially recognized at fair value at the date the derivative contracts are entered into and are subsequently remeasured to their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. When the fair value of the derivative is positive, it is recognized as a financial asset; otherwise, it is recognized as a financial liability.

**Hedge Accounting**

The Company designates certain derivative instruments as fair value hedges.

At the inception of the hedge relationship, the Company documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Company documents whether the hedging instrument is highly effective in offsetting changes in fair values or cash flows of the hedged item attributable to the hedged risk.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognized in profit or loss immediately, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognized in the line of the consolidated statement of comprehensive income relating to the hedged item.

Hedge accounting is discontinued when the Company revokes the hedging relationship, when the hedging instrument expires or is sold, terminated, or exercised, or when it no longer qualifies for hedge accounting.

**Provisions**

Provisions for the expected cost of warranty obligations under sale of goods are recognized at the date of sale of the relevant products, at the management s best estimate of the expenditure required to settle the Company s obligation.

**Revenue Recognition**

Revenue from the sale of goods is recognized when the goods are delivered and titles have passed, at which time all the following conditions are satisfied:

a. The Company has transferred to the buyer the significant risks and rewards of ownership of the goods;

b. The Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

c. The amount of revenue can be measured reliably;

d. It is probable that the economic benefits associated with the transaction will flow to the Company; and

e. The costs incurred or to be incurred in respect of the transaction can be measured reliably.

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Services revenue is recognized when service is provided.

Revenue is measured at the fair value of the consideration received or receivable and represents amounts for goods sold in the normal course of business, net of sales discounts and volume rebates. For trade receivables due within one year from the balance sheet date, as the nominal value of the consideration to be received approximates its fair value and transactions are frequent, fair value of the consideration is not determined by discounting all future receipts using an imputed rate of interest.

Usage revenues from fixed-line services (including domestic and international), cellular services, internet and data services, and interconnection and call transfer fees from other telecommunications companies and carriers are billed in arrears and are recognized based upon seconds or minutes of traffic processed when the services are provided in accordance with contract terms.

Other revenues are recognized as follows: (a) one-time subscriber connection fees (on fixed-line services) are deferred and recognized over the average expected customer service periods, (b) monthly fees (on fixed-line services, mobile, internet and data services) are accrued every month, and (c) prepaid services (fixed-line, mobile, internet and data services) are recognized as income based upon actual usage by customers or when the right to use those services expires.

Where the Company enters into transactions which involve both the provision of air time bundled with products such as 3G data card and handset, total consideration received from products and air time in these arrangements are allocated and measured using units of accounting within the arrangement based on their relative fair values limited to the amount that is not contingent upon the delivery of products.

Services revenue from a contract to provide services is recognized by reference to the stage of completion of the contract.

Dividend income from investments is recognized when the shareholder s right to receive payment has been established.

Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably.

**Leasing**

a. The Company as lessor

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease.

b. The Company as lessee

Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

**Borrowing Costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

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**Retirement Benefit Costs**

Payments to defined contribution retirement benefit plans are recognized as an expense when employees have rendered entitling them to the contributions.

For defined benefit retirement benefit plans, the cost of providing benefits is determined using the Projected Unit Credit Method with actuarial calculations being carried out at the year end. Remeasurement, comprising actuarial gains and losses, the effect of the changes to the asset ceiling (if applicable) and the return on plan assets (excluding interest), is reflected immediately in the balance sheet with a charge or credit recognized in other comprehensive income in the period in which they occur. Remeasurement recognized in other comprehensive income is reflected immediately in retained earnings and will not be reclassified to profit or loss and past service cost is recognized in profit or loss in the period of a plan amendment. Net interest is calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or asset. Defined benefit costs are categorized as follows:

Service cost (including current service cost, past service cost, as well as gains and losses on curtailments and settlements);

Net interest expense or income; and

Remeasurement.

The retirement benefit obligation recognized in the consolidated balance sheet represents the actual deficit or surplus in the Company s defined retirement benefit plans. Any surplus resulting from this calculation is limited to the present value of any economic benefits available in the form of refunds from the plans or reductions in future contributions to the plans.

**Share-based Payments**

Equity-settled share-based payments to employees and others providing similar services are measured at the fair value of the equity instruments at the grant date.

The value of the stock options granted, which is equal to the best available estimate of the number of stock options expected to vest multiplied by the grant-date fair value, is expensed over the vesting period, with a corresponding adjustment to additional paid-in capital employee stock options. For those options with graded vesting schedules, each installment is treated as a separate share option grant for purposes of determining the grant date fair value. Expenses are recognized at the grant date in profit or loss if vested immediately.

At the balance sheet date, the Company reviews its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognized in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to additional paid-in capital employee stock options.

**Income Tax**

Income tax expense represents the sum of the tax currently payable and deferred tax.

Current and deferred taxes are recognized in profit or loss, except for those relate to items recognized in other comprehensive income or directly in equity; in which cases, the relevant tax effects (current and deferred taxes) are also recognized in other comprehensive income or directly in equity, respectively.

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a. Current tax

The current tax is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company s liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Income tax (10%) on undistributed earnings is accrued during the period the earnings arise and adjusted to the extent that distributions are approved by the stockholders in the following year.

Adjustments of prior years tax liabilities are added to or deducted from the current year s tax provision.

b. Deferred tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences, loss carryforwards, unused tax credits from purchases of machinery, equipment and technology, research and development expenditures, and personnel training expenditures can be utilized.

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the balance sheet date, and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. Current and deferred tax are recognized in profit or loss, except when they relate to items that are recognized in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognized in other comprehensive income or directly in equity respectively.

## 4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Company s accounting policies, which are described in Note 3, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

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The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period. Actual results may differ from these estimates.

a. Impairment of accounts receivable

When there is objective evidence showing indications of impairment, the Company will consider the estimation of future cash flows. The amount of impairment will be measured as the difference between the carrying amount and the present value of estimated future cash flows discounted by the original effective interest rates of the financial assets. However, the impact from discounting short-term receivables is not material; therefore, the impairment of short-term receivables is based on the undiscounted estimated future cash flows. Where the actual future cash flows are less than expected, a material impairment loss may arise.

b. Provision for inventory valuation and obsolescence

Inventories are stated at the lower of cost or net realizable value. Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made at the end of reporting period. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period. Estimates of net realizable value also take into consideration. Inventory write-downs are determined on an item by item basis, except for those similar items which could be categorized into the same groups. The Company uses the inventory holding period and turnover as the evaluation basis for inventory obsolescence losses.

c. Impairment of tangible and intangible assets

In the process of evaluating the potential impairment of tangible and intangible assets, the Company is required to consider internal and external indicators of impairment and make subjective judgments in determining the independent cash flows, useful lives, expected future revenue and expenses related to the specific asset groups within the context of the telecommunication industry. Any changes in these estimates based on changed economic conditions or business strategies could result in significant impairment charges in future periods.

d. Useful lives of property, plant and equipment

As discussed in Note 3, Summary of Significant Accounting Policies Property, Plant and Equipment , the Company reviews the estimated useful lives of property, plant and equipment at the balance sheet date.

e. Recognition and measurement of defined benefit plans

Accrued pension liabilities and the resulting pension expense under defined benefit pension plans are calculated using the Projected Unit Credit Method. Actuarial assumptions comprise the discount rate, rate of employee turnover, and

long-term average future salary increase. Changes in economic circumstances and market conditions will affect these assumptions and may have a material impact on the amount of the expense and the liability.

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**5. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS**

**New and Revised IFRSs in Issue But Not Yet Effective**

The Company has not applied the following new and revised IFRSs that have been issued but are not yet effective.

| New, Revised or Amended Standards and Interpretations | | Effective Date Issued by IASB (Note) |
|---|---|---|
| IFRS 9 | Financial Instruments | Tentatively determined as January 1, 2018 |
| Amendments to IFRS 9 and IFRS 7 | Mandatory Effective Date and Transition Disclosure | Tentatively determined as January 1, 2018 |
| Amendments to IFRS 10, IFRS 12 and IAS 27 | Investment Entities | January 1, 2014 |
| IFRS 14 | Regulatory Deferral Accounts | January 1, 2016 |
| Amendment to IAS 19 | Defined Benefit Plans: Employee Contributions | July 1, 2014 |
| Amendment to IAS 32 | Offsetting of Financial Assets and Financial Liabilities | January 1, 2014 |
| Amendments to IAS 36 | Recoverable Amount Disclosure for Non-financial Assets | January 1, 2014 |
| Amendment to IAS 39 | Novation of Derivatives and Continuation of Hedge Accounting | January 1, 2014 |
| IFRIC 21 | Levies | January 1, 2014 |
| IFRSs (Amendments) | Annual Improvements to IFRSs 2010-2012 Cycle | The amendments to IFRS 2 apply to share-based payment transactions for which the grant date is on or after July 1, 2014; the amendments to IFRS 3 apply to business combinations occurred on or after July 1, 2014; the amendments to IFRS 13 are effective immediately; the amendments to the remaining standards are effective for annual periods beginning on or after July 1, 2014. |
| IFRSs (Amendments) | Annual Improvements to IFRSs 2011-2013 Cycle | Effective for annual periods beginning on or after July 1, 2014 |

(Concluded)

Note: The aforementioned new, revised or amended standards or interpretations are effective after fiscal year beginning on or after the effective dates, unless specified otherwise.

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Except for the following items, the Company believes the adoption of the aforementioned new and revised IFRSs will not have material impact on the Company s financial statements.

a. IFRS 9 Financial Instruments

Recognition and measurement of financial assets

With regards to financial assets, all recognized financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement are to be subsequently measured at amortized cost or fair value. Specifically, financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other financial assets are measured at their fair values at the balance sheet date. However, the Company may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognized in profit or loss.

Hedge accounting

The main changes in hedge accounting amended the application requirements for hedge accounting to better reflect the entity s risk management activities. Compared with IAS 39, the main changes include: (1) enhancing types of transactions eligible for hedge accounting, specifically broadening the risk eligible for hedge accounting of non-financial items; (2) changing the way hedging derivative instruments are accounted for to reduce profit or loss volatility; and (3) replacing retrospective effectiveness assessment with the principle of economic relationship between the hedging instrument and the hedged item.

The mandatory effective date of IFRS 9, which was previously set on January 1, 2015, was removed and will be reconsidered once the standard is complete with a new impairment model and finalization of any limited amendments to classification and measurement.

The Company anticipates that the application of IFRS 9 in the future may have a significant impact on amounts reported in respect of the Company s financial assets. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed.

b. Amendments to IAS 36 Recoverable Amount Disclosure for Non-financial Assets

In issuing IFRS13 Fair Value Measurement , the IASB made some consequential amendments to the disclosure requirements in IAS 36 Impairment of Assets , introducing a requirement to disclose in every reporting period the recoverable amount of an asset or each cash-generating unit. The amendment clarifies that the disclosure of such recoverable amount is required during the period when an impairment loss has been recognized or reversed. Furthermore, the Company is required to disclose the discount rate used in current and previous measurements of the recoverable amount based on fair value less costs of disposal measured using a present value technique. The Company is currently evaluating the impact on the adoption of the amendments.

c. Amendments to IAS 39 Novation of Derivatives and Continuation of Hedge Accounting

The amendments to IAS 39 provide an exception to the requirement for the discontinuation of hedge accounting. The amendment states that the novation of a hedging instrument should not be considered

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an expiration or termination giving rise to the discontinuation of hedge accounting when a hedging derivative is novated:

As a consequence of laws and regulations, or the introduction of laws and regulations, one or more clearing counterparties replace the original counterparty; and

Any changes in terms of the novated derivative are limited to those necessary to effect the replacement of the counterparty.

Any changes to the derivative s fair value arising from the novation would be reflected in its measurement and therefore in the measurement and assessment of hedge effectiveness. The Company does not anticipate that the application of these amendments to IAS 39 will have a significant impact on the Company s consolidated financial statements as the Company does not have any novation of derivatives.

## 6. U.S. DOLLAR AMOUNTS

The Company maintains its accounts and expresses its consolidated financial statements in New Taiwan dollars. For readers convenience only, U.S. dollar amounts presented in the accompanying consolidated financial statements have been translated from New Taiwan dollars as set forth in the statistical release of the Federal Reserve Board of the United States as of December 31, 2013, which was NT$29.83 to US$1.00. The convenience translations should not be construed as representations that the New Taiwan dollar amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

## 7. CASH AND CASH EQUIVALENTS

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Cash | | | |
| Cash on hand | $ 239 | $ 447 | $ 236 |
| Bank deposits | 5,115 | 5,731 | 10,592 |
| | 5,354 | 6,178 | 10,828 |
| Cash equivalents | | | |
| Commercial paper | 18,966 | 18,957 | 2,375 |
| Time deposits with maturities of less than three months | 610 | 1,213 | 1,382 |
| Negotiable certificate of deposit | 1,177 | 4,590 | |
| Treasury bills | 300 | | |
| | 21,053 | 24,760 | 3,757 |

| | | | |
|---|---|---|---|
| | $ 26,407 | $ 30,938 | $ 14,585 |

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The annual yield rates of bank deposits, commercial paper, time deposits with maturities of less than three months from acquisition, negotiable certificate of deposit and treasury bills were as follows:

| | January 1, 2012 | December 31, 2012 | December 31, 2013 |
|---|---|---|---|
| Bank deposits | 0.00%-0.75% | 0.00%-0.75% | 0.00%-0.76% |
| Commercial paper | 0.45%-0.80% | 0.71%-0.74% | 0.60%-0.65% |
| Time deposits with maturities of less than three months | 0.40%-5.50% | 0.88%-4.70% | 0.05%-5.10% |
| Negotiable certificate of deposit | 0.63%-0.72% | 0.83%-0.96% | |
| Treasury bills | 0.70% | | |

## 8. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Financial assets held for trading | | | |
| Derivatives (not designated for hedge) | | | |
| Forward exchange contracts | $ | $ | $ |
| Currency swap contracts | 6 | 3 | |
| | 6 | 3 | |
| Financial assets designated as at fair value through profit or loss Convertible bonds | 40 | | |
| | $ 46 | $ 3 | $ |
| Financial liabilities held for trading | | | |
| Derivatives (not designated for hedge) | | | |
| Forward exchange contracts | $ | $ | $ |
| Currency swap contracts | 4 | 2 | |
| Index future contracts | | | |
| | $ 4 | $ 2 | $ |

(Concluded)

The Company did not apply hedge accounting on the aforementioned contracts at the balance sheet date.

Outstanding currency swap contracts and forward exchange contracts as of balance sheet dates were as follows:

| | Currency | Maturity Period | Contract Amount (In Millions) |
|---|---|---|---|
| January 1, 2012 | | | |
| Currency swap contracts | US$ /NT$ | 2012.01-2012.03 | US$ 43/NT$1,307 |
| | US$ /NT$ | 2012.01-2012.02 | US$ 19/NT$571 |
| Forward exchange contracts buy | NT$ /US$ | 2012.01 | NT$ 60/US$2 |
| December 31, 2012 | | | |
| Currency swap contracts | US$ /NT$ | 2013.01-2013.03 | US$ 34/NT$991 |
| | US$ /NT$ | 2013.01-2013.03 | US$ 32/NT$929 |
| Forward exchange contracts buy | NT$ /US$ | 2013.01 | NT$ 154/US$5 |
| December 31, 2013 | | | |
| Forward exchange contracts buy | NT$ /US$ | 2014.01 | NT$ 90/US$3 |

Outstanding index future contracts of subsidiaries on January 1, 2012 were as follows:

| | Maturity Period | Units | Contract Amount (In Millions) | |
|---|---|---|---|---|
| January 1, 2012 | | | | |
| TAIFEX futures | | | | |
| TX | 2012.01 | 2 | NT$ | 3 |
| TX | 2012.02 | 4 | NT$ | 6 |
| TX | 2012.03 | 37 | NT$ | 52 |
| TE | 2012.03 | 19 | NT$ | 11 |
| TF | 2012.01 | 8 | NT$ | 6 |
| TF | 2012.02 | 5 | NT$ | 4 |
| TF | 2012.03 | 15 | NT$ | 12 |

The deposits paid for outstanding index future contracts of subsidiaries (included in other current assets) were $5 million as of January 1, 2012.

The Company did not have any outstanding index future contracts as of December 31, 2012 and 2013.

The Company entered into the above currency swap contracts, forward exchange contracts and index future contracts to manage its exposure to foreign currency risk fluctuations in exchange rates and stock prices. However, the aforementioned derivatives did not meet the criteria for hedge accounting and were classified as financial assets or financial liabilities held for trading.

The convertible bonds owned by subsidiaries were hybrid financial instruments that were financial assets designated as at fair value through profit or loss.

**9. AVAILABLE-FOR-SALE FINANCIAL ASSETS**

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Equity securities | | | |
| Domestic listed stocks and emerging stocks | $ 528 | $ 3,278 | $ 3,046 |
| Domestic and foreign open-end mutual funds | 2,137 | 2,190 | |
| Domestic non-listed stocks | 2,470 | 2,328 | 2,224 |
| Foreign non-listed stocks | 105 | 140 | 200 |
| Foreign listed stocks | | 10 | 24 |
| | 5,240 | 7,946 | 5,494 |

| | | | |
|---|---|---|---|
| Debt securities | | | |
| Corporate bonds | 77 | 50 | |
| | $ 5,317 | $ 7,996 | $ 5,494 |
| Current | $ 2,499 | $ 2,250 | $ 24 |
| Non-current | 2,818 | 5,746 | 5,470 |
| | $ 5,317 | $ 7,996 | $ 5,494 |

Since the range of fair values measurement of the non-listed stocks is significant and the probabilities of the various estimates cannot be reasonably assessed, thus the above non-listed stocks investment owned by the Company were carried at costs less any impairment losses at the balance sheet date.

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CHI evaluated and concluded its available-for-sale financial assets were partially impaired, and recorded an impairment loss of $203 million and $66 million for the years ended December 31, 2012 and 2013, respectively.

## 10. HELD-TO-MATURITY FINANCIAL ASSETS

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Corporate bonds | $ 13,790 | $ 14,791 | $ 10,513 |
| Bank debentures | 906 | 1,255 | 1,253 |
| | $ 14,696 | $ 16,046 | $ 11,766 |
| Current | $ 1,201 | $ 4,250 | $ 4,264 |
| Non-current | 13,495 | 11,796 | 7,502 |
| | $ 14,696 | $ 16,046 | $ 11,766 |

The related information of corporate bonds and bank debentures as of balance sheet dates were as follows:

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Corporate bonds | | | |
| Par value | $ 13,865 | $ 15,955 | $ 10,473 |
| Nominal interest rate | 1.20%-2.98% | 1.15%-2.90% | 1.15%-2.49% |
| Effective interest rate | 0.83%-2.89% | 1.00%-2.89% | 1.00%-1.95% |
| Average expiry date | 4 years | 4 years | 4 years |
| Bank debentures | | | |
| Par value | $ 900 | $ 1,250 | $ 1,250 |
| Nominal interest rate | 1.37%-1.60% | 1.25%-1.60% | 1.25%-1.60% |
| Effective interest rate | 1.25%-1.40% | 1.15%-1.40% | 1.15%-1.40% |
| Average expiry date | 4 years | 4 years | 4 years |

## 11. TRADE NOTES AND ACCOUNTS RECEIVABLE

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Trade notes and accounts receivable | | | |
| Trade notes and accounts receivable | $ 24,819 | $ 25,166 | $ 23,823 |
| Less: Allowance doubtful accounts | (2,423) | (811) | (922) |
| | $ 22,396 | $ 24,355 | $ 22,901 |

The average credit terms range from 30 to 90 days. In determining the recoverability of a trade receivable, the Company considers significant change in the credit quality of the trade notes and accounts receivable from the date credit was initially granted up to the end of the reporting period. In general, with few exceptional cases, it is unlikely for the notes and accounts receivable due longer than 180 days to be collected, therefore the Company recognized 100% allowance of notes and accounts receivable overdue

longer than 180 days. For the notes and accounts receivable less than 180 days, the allowance for doubtful accounts was estimated based on the Company s historical recovery experience.

The Company serves a large consumer base; therefore, the concentration of credit risks is limited.

As of January 1, 2012, December 31, 2012 and December 31, 2013, the trade and accounts receivables that were neither past due nor impaired amounted to $21,108 million, $23,798 million and $22,399 million, respectively.

Aging of receivables that are past due but not impaired was as follows:

| | January 1, 2012 NT$ | December 31, 2012 NT$ | December 31, 2013 NT$ |
|---|---|---|---|
| | | (In Millions) | |
| Less than 30 days | $ 178 | $ 188 | $ 132 |
| 31-60 days | 84 | 49 | 41 |
| 61-90 days | 59 | 36 | 14 |
| 91-120 days | 9 | 8 | 85 |
| 121-180 days | | | 2 |
| More than 181 days | 11 | 9 | 12 |
| | $ 341 | $ 290 | $ 286 |

The above aging analysis was based on days overdue.

Movements of the allowance for doubtful accounts were as follows:

| | Year Ended December 31 | |
|---|---|---|
| | 2012 NT$ | 2013 NT$ |
| | (In Millions) | |
| Balance, beginning of year | $ 2,423 | $ 811 |
| Add: Provision for (reversal of) doubtful accounts | (1,473) | 239 |
| Deduct: Amounts written off | (139) | (128) |
| Balance, end of year | $ 811 | $ 922 |

The amount of allowance for doubtful accounts assessed individually included the impairment loss of accounts receivable from certain companies in liquidation process or in significant financial difficulties, which were $7 million, $164 million and $221 million as of January 1, 2012, December 31, 2012 and December 31, 2013, respectively.

Chunghwa evaluated the results of procedures implemented to enhance the collection of accounts receivable as well as the experience of decreases in uncollected receivables, and decided to refine the estimates used in the allowance

calculation which led to the reversal of allowance for doubtful accounts for the year ended December 31, 2012.

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## 12. INVENTORIES

| | January 1, 2012<br>NT$ | December 31, 2012<br>NT$<br>(In Millions) | December 31, 2013<br>NT$ |
|---|---|---|---|
| Merchandise | $ 2,999 | $ 4,243 | $ 5,221 |
| Project in process | 770 | 795 | 520 |
| Work in process | 12 | 18 | 26 |
| Raw materials | 25 | 36 | 26 |
| | 3,806 | 5,092 | 5,793 |
| Land held for sale | 579 | 15 | |
| Land and building held for sale | | 55 | 8 |
| Construction in progress | 290 | | 44 |
| Land held under development | 111 | | 1,999 |
| Land held for development | 36 | 2,034 | 4 |
| | $ 4,822 | $ 7,196 | $ 7,848 |

The operating costs related to inventories were $44,150 million and $50,860 million for the years ended December 31, 2012 and 2013, respectively.

For the years ended December 31, 2012 and 2013, the costs of valuation loss on inventories recognized as operating cost included the amount of $113 million and $203 million, respectively.

The capitalized borrowing costs of construction in progress were not significant for both 2012 and 2013.

As of January 1, 2012, December 31, 2012 and December 31, 2013, inventories of $1,023 million, $2,042 million and $2,057 million, respectively, were expected to be recovered for a time period longer than twelve months. The aforementioned amount of inventories is mainly related to property development owned by LED.

Land held for sale on January 1, 2012 was for Wan-Xi, Li-Shui (A) projects and Covent projects. Land held for sale on December 31, 2012 was for Wan-Xi and Li-Shui (A) projects.

Land and building held for sale on December 31, 2012 and 2013 was for the Guang-Diang project.

Land held under development and construction in progress on January 1, 2012 was for Guang-Diang and Li-Shui (A) projects. Land held under development and construction in progress on December 31, 2013 was for Qingshan Sec., Dayuan Township, Taoyuan County.

Land held for development on January 1, 2012 was for Subsection 2 Gongyuan Sec., Zhongzheng Dist., Taipei City and Yucheng Sec., Nangang Dist., Taipei City. Land held for development on December 31, 2012 was for Subsection 2 Gongyuan Sec., Zhongzheng Dist., Taipei City, Yucheng Sec., Nangang Dist., Taipei City and Qingshan Sec., Dayuan Township, Taoyuan County. Land held for development on December 31, 2013 was for Yucheng Sec., Nangang Dist., Taipei City.

Subsection 2 Gongyuan Sec., Zhongzheng Dist, Taipei City was sold in July 2013.

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## 13. PREPAYMENTS

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Prepaid rents | $ 3,852 | $ 3,566 | $ 3,389 |
| Others | 1,584 | 1,974 | 2,443 |
| | $ 5,436 | $ 5,540 | $ 5,832 |
| Current | | | |
| Prepaid rents | $ 994 | $ 919 | $ 953 |
| Others | 895 | 1,067 | 1,271 |
| | $ 1,889 | $ 1,986 | $ 2,224 |
| Non-current | | | |
| Prepaid rents | $ 2,858 | $ 2,647 | $ 2,436 |
| Others | 689 | 907 | 1,172 |
| | $ 3,547 | $ 3,554 | $ 3,608 |

## 14. OTHER CURRENT MONETARY ASSETS

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Time deposits and negotiable certificates of deposit with maturities of more than three months | $ 40,982 | $ 22,264 | $ 2,535 |
| Receivables from the Fund for Privatization of Government owned Enterprises under the Executive Yuan | 1,284 | 869 | 1,318 |
| Others | 785 | 1,316 | 783 |
| | $ 43,051 | $ 24,449 | $ 4,636 |

The annual yield rates of time deposits and negotiable certificates of deposit with maturities of more than three months at each period end were as follows:

| | January 1, 2012 | December 31, 2012 | December 31, 2013 |
|---|---|---|---|
| Time deposits and negotiable certificate of deposit with maturities of more than three months | 0.25%-3.30% | 0.25%-3.30% | 0.11%-3.30% |

**15. NON-WHOLLY OWNED SUBSIDIARIES THAT HAVE NONCONTROLLING MATERIAL INTERESTS**

The table below shows details of less than wholly owned subsidiaries of the Company that have material noncontrolling interests:

| | Place of Incorporation and Principal | Proportion of Ownership Interests and Voting Rights Held by Noncontrolling Interests | | |
|---|---|---|---|---|
| | Place of Business | January 1, 2012 | December 31, 2012 | December 31, 2013 |
| Senao International Co., Ltd. | Taiwan | 72% | 72% | 72% |

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| | Profit Allocated to Noncontrolling Interests | | Accumulated Noncontrolling Interests | | |
|---|---|---|---|---|---|
| | Year Ended December 31 | | January 1, | December 31, | December 31, |
| | 2012 | 2013 | 2012 | 2012 | 2013 |
| | NT$ | NT$ | NT$ | NT$ | NT$ |
| | | | (In Millions) | | |
| Senao International Co., Ltd. | $ 1,066 | $ 1,022 | $ 3,534 | $ 3,811 | $ 4,302 |
| Individually immaterial subsidiaries with noncontrolling interests | | | 647 | 525 | 544 |
| | | | $ 4,181 | $ 4,336 | $ 4,846 |

The Company owns 28% equity shares of Senao International Co., Ltd. (SENAO). However, the Company has four out of seven seats of the board of directors of SENAO through the support of large beneficial shareholders. Therefore, the Company has control over SENAO and the accounts of SENAO are included in the consolidated financial statements.

Summarised financial information in respect of SENAO that has material noncontrolling interests is set out below. The summarized financial information below represents amounts before intracompany eliminations.

| **Senao International Co., Ltd.** | **January 1, 2012** | **December 31, 2012** | **December 31, 2013** |
|---|---|---|---|
| | **NT$** | **NT$** | **NT$** |
| | | **(In Millions)** | |
| Current assets | $ 7,559 | $ 8,723 | $ 8,134 |
| Non-current assets | $ 1,704 | $ 1,926 | $ 2,386 |
| Current liabilities | $ 4,221 | $ 5,247 | $ 4,439 |
| Non-current liabilities | $ 79 | $ 100 | $ 91 |
| Equity attributable to the parent | $ 1,429 | $ 1,491 | $ 1,688 |
| Noncontrolling interests | $ 3,534 | $ 3,811 | $ 4,302 |

| | **Year Ended December 31** | |
|---|---|---|
| | **2012** | **2013** |
| | **NT$** | **NT$** |
| | **(In Millions)** | |
| Revenue | $ 35,241 | $ 43,033 |
| Expenses | 33,758 | 41,610 |

| | | | | |
|---|---|---|---|---|
| Profit for the year | $ | 1,483 | $ | 1,423 |
| Profit attributable to the parent | $ | 417 | $ | 401 |
| Profit attributable to the noncontrolling interests | | 1,066 | | 1,022 |
| Profit for the year | $ | 1,483 | $ | 1,423 |
| Other comprehensive income (loss) attributable to the parent | $ | (9) | $ | 12 |
| Other comprehensive income (loss) attributable to the noncontrolling interests | | (24) | | 30 |
| Other comprehensive income (loss) for the year | $ | (33) | $ | 42 |
| Total comprehensive income attributable to the parent | $ | 408 | $ | 413 |
| Total comprehensive income attributable to the noncontrolling interests | | 1,042 | | 1,052 |
| Total comprehensive income for the year | $ | 1,450 | $ | 1,465 |

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| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Dividends paid to noncontrolling interests | $ 827 | $ 739 |
| Net cash inflow (outflow) from operating activities | $ 1,554 | $ (240) |
| Net cash outflow from investing activities | $ (196) | $ (274) |
| Net cash outflow from financing activities | $ (1,111) | $ (993) |
| Net cash inflow (outflow) | $ 247 | $ (1,507) |

The Company s equity ownership of SENAO decreased from 28.44% as of January 1, 2012 to 28.30% and 28.18% as of December 31, 2012 and 2013, due to the exercise of options by SENAO s employees. The total proceeds from exercise of employee stock options were $43 million and $42 million for the years ended December 31, 2012 and 2013, respectively. The partial proceeds of $38 million and $36 million were attributed to noncontrolling interests for the years ended December 31, 2012 and 2013, respectively.

The Company s equity ownership of CHPT decreased from 53.19% as of December 31, 2012 to 50.62% as of December 31, 2013 due to the exercise of options by CHPT s employees and CHPT issued employee stock bonus. The total proceeds from exercise of employee stock options were $8 million, substantially all of which were attributed to noncontrolling interests for the year ended December 31, 2013.

## 16. INVESTMENTS ACCOUNTED FOR USING EQUITY METHOD

| | January 1, 2012 | December 31, 2012 | December 31, 2013 |
|---|---|---|---|
| | NT$ | NT$ | NT$ |
| | | (In Millions) | |
| Associates | $ 2,269 | $ 1,950 | $ 2,131 |
| Joint venture | 251 | 241 | 228 |
| | $ 2,520 | $ 2,191 | $ 2,359 |

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a. Investments in associates

Investments in associates were as follows:

| | Carrying Amount | | |
|---|---|---|---|
| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
| Listed | | | |
| Senao Networks, Inc. ( SNI ) | $ 332 | $ 393 | $ 484 |
| Non-listed | | | |
| ST-2 Satellite Ventures Pte., Ltd. ( STS ) | 462 | 542 | 520 |
| International Integrated System, Inc. ( IISI ) | 257 | 276 | 290 |
| Viettle-CHT Co., Ltd. | 255 | 265 | 278 |
| Taiwan International Standard Electronics Co., Ltd. ( TISE ) | 612 | 192 | 180 |
| Skysoft Co., Ltd. ( SKYSOFT ) | 111 | 124 | 152 |
| So-net Entertainment Taiwan Limited ( So-net ) | 34 | 31 | 92 |
| Kingwaytek Technology Co., Ltd. ( KWT ) | 74 | 76 | 74 |
| Alliance Digital Technology Co., Ltd. ( ADT ) | | | 29 |
| HopeTech Technologies Limited ( HopeTech ) | 21 | 22 | 25 |
| Xiamen Sertec Business Technology Co., Ltd. ( Sertec ) | 1 | 8 | 6 |
| Dian Zuan Integrating Marketing Co., Ltd. ( DZIM ) | 110 | 21 | 1 |
| Panda Monium Company Ltd. | | | |
| | $ 2,269 | $ 1,950 | $ 2,131 |

At the end of the reporting period, the percentage of ownership and voting rights in associates held by the Company were as follows:

| | % of Ownership and Voting Right | | |
|---|---|---|---|
| | January 1, 2012 | December 31, 2012 | December 31, 2013 |
| Senao Networks, Inc. ( SNI ) | 41 | 40 | 34 |
| ST-2 Satellite Ventures Pte., Ltd. ( STS ) | 38 | 38 | 38 |
| International Integrated System, Inc. ( IISI ) | 33 | 33 | 33 |

| | | | |
|---|---|---|---|
| Viettle-CHT Co., Ltd. | 30 | 30 | 30 |
| Taiwan International Standard Electronics Co., Ltd. ( TISE ) | 40 | 40 | 40 |
| Skysoft Co., Ltd. ( SKYSOFT ) | 30 | 30 | 30 |
| So-net Entertainment Taiwan Limited ( So-net ) | 30 | 30 | 30 |
| Kingwaytek Technology Co., Ltd. ( KWT ) | 33 | 33 | 33 |
| Alliance Digital Technology Co., Ltd. ( ADT ) | | | 19 |
| HopeTech Technologies Limited ( HopeTech ) | 45 | 45 | 45 |
| Xiamen Sertec Business Technology Co., Ltd. ( Sertec ) | 49 | 49 | 49 |
| Dian Zuan Integrating Marketing Co., Ltd. ( DZIM ) | 40 | 33 | 13 |
| Panda Monium Company Ltd. | 43 | 43 | 43 |

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None of the above associates is considered individually material to the Company. Aggregate information of associates that are not individually material was as follows:

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| The Company s share of the profit | $ 529 | $ 680 |
| The Company s share of other comprehensive income (loss) | (26) | (35) |
| The Company s share of total comprehensive income | $ 503 | $ 645 |

SNI was listed in December 2013. The fair value based on the closing market prices of SNI as of the balance sheet date is as follows:

| | December 31, 2013 NT$ (In Millions) |
|---|---|
| SNI | $ 2,545 |

SENAO s equity ownership of SNI decreased from 40% as of December 31, 2012 to 34% as of December 31, 2013 for the following reasons: (1) not participating in capital increase of SNI; (2) disposal some shares of SNI; and (3) the exercise of options by SNI s employees.

SENAO disposed of 245 thousand shares of SNI in December 2013 and the amount of profit and loss recognized was as follows:

| | Year Ended December 31, 2013 NT$ (In Millions) |
|---|---|
| Proceeds from disposal | $ 24 |
| Carrying amount of the disposed investment | (9) |
| Reclassification adjustment upon disposal exchange differences arising from the translation of the net investment in foreign operations | (2) |

| | | |
|---|---|---|
| Profit or loss, net | $ | 13 |

Chunghwa participated in the capital increase of So-net by investing $60 million in March 2013. The ownership interest remains 30% after the capital increase.

Chunghwa, Taiwan Mobile Corporation, Asia Pacific Telecom, Vibo Telecom, EasyCard Corporation and Far Eastone Telecommunications established an associate, ADT, in November 2013. Chunghwa invested $30 million cash and held 19% ownership of ADT. Based on the share of capital commitments, Chunghwa has one seat out of five seats in the board of directors; therefore it has significant influence over ADT. ADT engages mainly in the development of mobile payments and information processing service.

Chunghwa, President Chain Store Corporation and EasyCard Corporation established an associate, DZIM, in May 2011. Chunghwa invested $115 million cash and held 40% ownership of DZIM in May 2011. Chunghwa participated in the capital increase of DZIM by investing $14 million in May 2012 but did not subscribe to the shares at its corresponding proportion. Thus, the ownership interest

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decreased from 40% to 33% after the capital increase of DZIM. DZIM reduced its capital by $193 million in December 2012; Chunghwa received $65 million from the capital reduction and the ownership interest remains at 33%. DZIM reduced its capital to offset the deficits amounting to $131 million and made capital reduction of $49 million during its stockholders meeting held on March 31, 2013. Chunghwa received $16 million form the capital reduction. Chunghwa did not participate in the capital increase of DZIM in July 2013 and the ownership interest decreased from 33% to 13% after the capital increase of DZIM. The Company still has two seats out of five seats in the board of directors; therefore it remains an investor with significant influence over DZIM. DZIM engages mainly in information technology service and general advertisement service.

COI participated in the capital increase of Sertec by investing $12 million in February 2012. COI remained 49% ownership of Sertec after the capital increase.

The Company s share of profit (loss) and other comprehensive income (loss) of associates was recorded based on financial statements of the associates prepared in conformity with IFRSs for the years ended December 31, 2012 and 2013.

b. Investment in joint venture

Investment in joint venture was as follows:

| | Carrying Amount | | | % of Ownership and Voting Rights | | |
|---|---|---|---|---|---|---|
| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ | January 1, 2012 | December 31, 2012 | December 31, 2013 |
| Non-listed | | | | | | |
| Huada Digital Corporation ( HDD ) | $ 251 | $ 241 | $ 228 | 50 | 50 | 50 |

Chunghwa invested in HDD in September 2011 at $250 million cash to acquire 50% of its shares and the rest of 50% ownership interest was held by HTC Corporation ( HTC ). After the stockholders meeting of HDD held on March 2, 2012, Chunghwa and HTC each obtained half of director seats. Thus, neither entity obtained control over HDD. HDD engages mainly in providing software services.

Summarized financial information of joint venture that was not material to the Company was as follows:

| | Year Ended December 31 | |
|---|---|---|
| | 2012 NT$ | 2013 NT$ |
| | (In Millions) | |
| The Company s share of the loss | $ (9) | $ (14) |
| The Company s share of other comprehensive income | | |

| | | |
|---|---|---|
| The Company s share of total comprehensive loss | $ (9) | $ (14) |

The Company s share of loss of the joint venture was recorded based on audited financial statements for the years ended December 31, 2012 and 2013.

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## 17. PROPERTY, PLANT AND EQUIPMENT

| | December 31 | | |
|---|---|---|---|
| | 2011 NT$ | 2012 NT$ (In Millions) | 2013 NT$ |
| Carrying amount | | | |
| Land | $ 102,122 | $ 102,197 | $ 102,263 |
| Land improvements | 504 | 480 | 443 |
| Buildings | 47,619 | 46,604 | 45,586 |
| Computer equipment | 3,889 | 3,886 | 4,395 |
| Telecommunications equipment | 124,300 | 121,530 | 122,804 |
| Transportation equipment | 1,273 | 2,045 | 2,073 |
| Miscellaneous equipment | 1,636 | 1,917 | 2,297 |
| Construction in progress and advances related to acquisition of equipment | 13,689 | 18,683 | 22,853 |
| | $ 295,032 | $ 297,342 | $ 302,714 |

| | Land NT$ | Land Improvements NT$ | Buildings NT$ | Computer Equipment NT$ | Telecommuni-cations Equipment NT$ (In Millions) | Transportation Equipment NT$ | Miscellaneous Equipment NT$ | Construction in Progress and Advances Related to Acquisition of Equipment NT$ | Total NT$ |
|---|---|---|---|---|---|---|---|---|---|
| Cost | | | | | | | | | |
| Balance on January 1, 2012 | $ 102,122 | $ 1,521 | $ 67,289 | $ 14,808 | $ 655,543 | $ 2,527 | $ 7,220 | $ 13,689 | $ 864,719 |
| Additions | | | | 51 | 30 | 1 | 108 | 33,531 | 33,721 |
| Disposal | (17) | (5) | (47) | (921) | (11,204) | (399) | (417) | | (13,010) |
| Effect of foreign exchange differences | | | | (1) | (1) | | (1) | (21) | (24) |
| Other | 92 | 32 | 187 | 1,297 | 25,008 | 1,186 | 678 | (28,516) | (36) |
| Balance on December 31, | $ 102,197 | $ 1,548 | $ 67,429 | $ 15,234 | $ 669,376 | $ 3,315 | $ 7,588 | $ 18,683 | $ 885,370 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 2012 | | | | | | | | | |
| Balance on January 1, 2013 | $ 102,197 | $ 1,548 | $ 67,429 | $ 15,234 | $ 669,376 | $ 3,315 | $ 7,588 | $ 18,683 | $ 885,370 |
| Additions | | | 6 | 68 | 72 | 1 | 285 | 36,295 | 36,727 |
| Disposal | (56) | (9) | (18) | (1,132) | (14,778) | (158) | (439) | | (16,590) |
| Effect of foreign exchange differences | | | | 2 | 7 | | (9) | | |
| Other | 122 | 8 | 141 | 1,824 | 28,441 | 587 | 990 | (32,125) | (12) |
| Balance on December 31, 2013 | $ 102,263 | $ 1,547 | $ 67,558 | $ 15,996 | $ 683,118 | $ 3,745 | $ 8,415 | $ 22,853 | $ 905,495 |
| <u>Accumulated depreciation and impairment</u> | | | | | | | | | |
| Balance on January 1, 2012 | $ | $ (1,017) | $ (19,670) | $ (10,919) | $ (531,243) | $ (1,254) | $ (5,584) | $ | $ (569,687) |
| Depreciation Expenses | | (56) | (1,220) | (1,342) | (27,534) | (408) | (461) | | (31,021) |
| Disposal | | 5 | 47 | 918 | 11,191 | 398 | 416 | | 12,975 |
| Impairment losses | | | | | (281) | | (20) | | (301) |
| Effect of foreign exchange differences | | | | | 2 | | | | 2 |
| Other | | | 18 | (5) | 19 | (6) | (22) | | 4 |
| Balance on December 31, 2012 | $ | $ (1,068) | $ (20,825) | $ (11,348) | $ (547,846) | $ (1,270) | $ (5,671) | $ | $ (588,028) |
| Balance on January 1, 2013 | $ | $ (1,068) | $ (20,825) | $ (11,348) | $ (547,846) | $ (1,270) | $ (5,671) | $ | $ (588,028) |
| Depreciation Expenses | | (57) | (1,245) | (1,380) | (26,977) | (550) | (728) | | (30,937) |
| Disposal | | 9 | 18 | 1,129 | 14,735 | 158 | 421 | | 16,470 |
| Impairment losses | | | | | (254) | | | | (254) |
| Effect of foreign exchange | | | | (1) | 22 | | (27) | | (6) |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| differences | | | | | | | | | |
| Other | | 12 | 80 | (1) | 6 | (10) | (113) | | (26) |
| Balance on December 31, 2013 | $ | $ (1,104) | $ (21,972) | $ (11,601) | $ (560,314) | $ (1,672) | $ (6,118) | $ | $ (602,781) |

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The Company determined that some telecommunications equipment and miscellaneous equipment will not have future economic benefits, and wrote off their carrying amount to nil, which resulted in an impairment loss of $301 million and $254 million for the years ended December 31, 2012 and 2013, respectively.

Depreciation expense is computed using the straight-line method over the following estimated service lives:

| | |
|---|---|
| Land improvement | 8-30 years |
| Buildings | |
| Main building | 35-60 years |
| Other building facilities | 3-10 years |
| Computer equipment | 3-8 years |
| Telecommunications equipment | |
| Telecommunication circuits | 9-15 years |
| Telecommunication machinery and antennas equipment | 5-10 years |
| Transportation equipment | 3-10 years |
| Miscellaneous equipment | |
| Leasehold improvements | 2-6 years |
| Mechanical and air conditioner equipment | 8-16 years |
| Others | 3-10 years |

## 18. INVESTMENT PROPERTIES

| | | December 31 | |
|---|---|---|---|
| | **2011** | **2012** | **2013** |
| | **NT$** | **NT$** | **NT$** |
| | | **(In Millions)** | |
| Carrying amount | | | |
| Investment properties | $ 9,060 | $ 7,789 | $ 8,018 |
| Cost | $ 9,249 | $ 9,260 | $ 9,260 |

| | Investment Properties NT$ (In Millions) |
|---|---|
| Accumulated depreciation and impairment | |
| Balance on January 1, 2012 | $ (189) |
| Depreciation expense | (16) |
| Recognized impairment loss | (1,261) |
| Reclassification | (5) |

| | | |
|---|---|---|
| Balance on December 31, 2012 | $ | (1,471) |
| Balance on January 1, 2013 | $ | (1,471) |
| Depreciation expense | | (17) |
| Reversal of impairment loss | | 246 |
| Balance on December 31, 2013 | $ | (1,242) |

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The fair values of investment properties were based on appraisals conducted by independent appraisers. Those appraisals are based on the comparison approach, income approach or cost approach. Key assumptions and the fair values were as follows:

| | December 31 | | |
|---|---|---|---|
| | 2011 NT$ | 2012 NT$ | 2013 NT$ |
| | | (In Millions) | |
| Fair value | $ 15,058 | $ 15,511 | $ 17,501 |
| Overall capital interest rate | 1.46% | 1.46% | 1.46%-2.20% |
| Profit margin ratio | 12%-15% | 12%-15% | 12%-20% |
| Discount rate | 1.36% | 1.36% | 1.36% |
| Capitalization rate | 1.5%-2.05% | 1.5%-2.05% | 0.68%-2.02% |

After evaluating the investment properties, the Company determined that some land and buildings were impaired and recognized an impairment loss of $1,261 million for the year ended December 31, 2012.

The fair value associated with certain properties increased during 2013 and therefore the Company reversed a portion of previously recognized impairment losses amounting to $246 million for the year ended December 31, 2013.

The fair values of impaired investment properties were based on appraisals conducted by independent appraisers and are Level 3 in the hierarchy of valuations in IFRS 13. The appraisers used comparison approach or cost approach to estimate the fair values. For comparison approach, the valuation was based on observable inputs from comparable property transactions. For cost approach, the overall capital interest rate, profit margin ratio and discount rate were used in measuring fair value. The fair value less costs to sell is higher than the value in use and hence the recoverable amount of the relevant assets has been determined on the basis of their fair value less costs to sell. The fair values of these properties were $2,685 million and $2,858 million and the cost of disposal were $4 million and $5 million as of December 31, 2012 and 2013, respectively.

Depreciation expense is computed using the straight-line method over the following estimated service lives:

| | |
|---|---|
| Land improvements | 8-30 years |
| Buildings | |
| Main buildings | 35-60 years |
| Other building facilities | 3-10 years |

All of the Company s investment properties are held under freehold interest.

**19. INTANGIBLE ASSETS**

| | January 1, 2012 | December 31, 2012 | December 31, 2013 |
|---|---|---|---|

| | NT$ | NT$ (In Millions) | NT$ |
|---|---|---|---|
| Carrying amount | | | |
| 3G and 4G concession | $ 5,240 | $ 4,492 | $ 42,818 |
| Computer software | 751 | 1,015 | 1,331 |
| Goodwill | 181 | 181 | 163 |
| Others | 106 | 94 | 87 |
| | $ 6,278 | $ 5,782 | $ 44,399 |

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| | 3G and 4G Concession NT$ | Computer Software NT$ | Goodwill NT$ (In Millions) | Others NT$ | Total NT$ |
|---|---|---|---|---|---|
| Cost | | | | | |
| Balance on January 1, 2012 | $ 10,179 | $ 1,733 | $ 181 | $ 139 | $ 12,232 |
| Additions-acquired separately | | 630 | | 2 | 632 |
| Disposal | | (298) | | (24) | (322) |
| Balance on December 31, 2012 | $ 10,179 | $ 2,065 | $ 181 | $ 117 | $ 12,542 |
| Balance on January 1, 2013 | $ 10,179 | $ 2,065 | $ 181 | $ 117 | $ 12,542 |
| Additions-acquired separately | 39,075 | 796 | | 1 | 39,872 |
| Disposal | | (225) | | | (225) |
| Effect of foreign exchange difference | | 1 | | | 1 |
| Balance on December 31, 2013 | $ 49,254 | $ 2,637 | $ 181 | $ 118 | $ 52,190 |
| Accumulated amortization and impairment | | | | | |
| Balance on January 1, 2012 | $ (4,939) | $ (982) | $ | $ (33) | $ (5,954) |
| Amortization expenses | (748) | (366) | | (9) | (1,123) |
| Disposal | | 298 | | 24 | 322 |
| Impairment loss | | | | (5) | (5) |
| Effect of foreign exchange difference | | | | | |
| Balance on December 31, 2012 | $ (5,687) | $ (1,050) | $ | $ (23) | $ (6,760) |
| Balance on January 1, 2013 | $ (5,687) | $ (1,050) | $ | $ (23) | $ (6,760) |
| Amortization expenses | (749) | (481) | | (8) | (1,238) |
| Disposal | | 225 | | | 225 |
| Impairment loss | | | (18) | | (18) |
| Effect of foreign exchange difference | | | | | |
| Balance on December 31, 2013 | $ (6,436) | $ (1,306) | $ (18) | $ (31) | $ (7,791) |

(Concluded)

For long-term business development, Chunghwa participated in mobile broadband (4G) license bidding process announced by NCC and obtained certain spectrums. Chunghwa paid the 4G concession fee amounting to $39,075 million in November 2013. Amortization of the 4G concession fee would commence at the date the network is available for use. Chunghwa expects to amortize the 4G concession fee from the second half of 2014 to December 2030.

Except for goodwill, the amortization expense is computed using the straight-line method over the following estimated service lives:

The computer software is amortized using the straight-line method over the estimated useful lives of 2 to 10 years.

The 3G concession fee is amortized on a straight-line basis from the date operations commence through the date the license expires. The carrying amount of 3G concession fee will be fully amortized by December 2018. Goodwill is not amortized.

Other intangible assets are amortized using the straight-line method over the estimated useful lives of 3 to 20 years.

CHPT recognized an impairment loss of $5 million on the patent for the year ended December 31, 2012.

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The Company did not recognize any impairment loss on goodwill for the year ended December 31, 2012. Goodwill amounted to $18 million arising from the business combination of a subsidiary, CHI, was fully impaired for the year ended December 31, 2013 because CHI underwent organizational downsizing.

## 20. OTHER ASSETS

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Spare parts | $ 2,306 | $ 4,046 | $ 3,008 |
| Refundable deposits | 1,760 | 2,087 | 2,210 |
| Other financial assets | 1,000 | 1,000 | 1,000 |
| Others | 1,831 | 1,939 | 2,627 |
| | $ 6,897 | $ 9,072 | $ 8,845 |
| Current | $ 3,039 | $ 4,476 | $ 3,962 |
| Noncurrent | 3,858 | 4,596 | 4,883 |
| | $ 6,897 | $ 9,072 | $ 8,845 |
| Current | | | |
| Spare parts | $ 2,306 | $ 4,046 | $ 3,008 |
| Others | 733 | 430 | 954 |
| | $ 3,039 | $ 4,476 | $ 3,962 |
| Noncurrent | | | |
| Refundable deposits | $ 1,760 | $ 2,087 | $ 2,210 |
| Other financial assets | 1,000 | 1,000 | 1,000 |
| Others | 1,098 | 1,509 | 1,673 |
| | $ 3,858 | $ 4,596 | $ 4,883 |

Other financial assets noncurrent relates to the Piping Fund. As part of the government s effort to upgrade the existing telecommunications infrastructure, Chunghwa and other public utility companies were required by the ROC government to contribute to a Piping Fund administered by the Taipei City Government. This fund was used to finance various telecommunications infrastructure projects. Net assets of this fund would be returned proportionately after the project was completed.

## 21. SHORT-TERM LOANS

| | **January 1, 2012 NT$** | **December 31, 2012 NT$ (In Millions)** | **December 31, 2013 NT$** |
|---|---|---|---|
| Unsecured loans | $ 75 | $ 111 | $ 254 |
| Annual interest rate | 1.25%-1.53% | 1.25%-2.40% | 1.18%-2.40% |

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## 22. LONG-TERM LOANS (INCLUDING LONG-TERM LOANS CURRENT PORTION)

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Secured loans | $ 1,651 | $ 2,050 | $ 1,700 |
| Unsecured loans | 109 | 8 | |
| | 1,760 | 2,058 | 1,700 |
| Less: Current portion of long-term loans | 702 | 8 | 300 |
| | $ 1,058 | $ 2,050 | $ 1,400 |

The annual interest rates of loans were as follows:

| | January 1, 2012 | December 31, 2012 | December 31, 2013 |
|---|---|---|---|
| Secured loans | 1.10%-1.83% | 1.13%-2.10% | 1.15%-2.10% |
| Unsecured loans | 2.01%-2.04% | 2.01% | |

LED obtained a secured loan from Chang Hwa Bank in September 2010. Interest is paid monthly. $300 million and $1,350 million will become due in December 2014 and September 2015, respectively. LED obtained another secured loan from Chang Hwa Bank in December 2012 at $400 million which will be due in December 2017; LED repaid $350 million in February 2013.

CHIEF obtained an unsecured loan from Bank of Taiwan in January 2009. Interest and principal amount are paid monthly from January 2009 and all were repaid in January 2013.

CHPT obtained a secured loan from the E.SUN Commercial Bank in February 2009. Interest and the principal were paid monthly from March 2009 and all were repaid in February 2012.

## 23. TRADE NOTES AND ACCOUNTS PAYABLE

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Trade notes and accounts payable | $ 14,265 | $ 13,513 | $ 15,589 |

Trade notes and accounts payable were attributable to operating activities, and the trading term and conditions were agreed separately.

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## 24. OTHER PAYABLES

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Other payables | | | |
| Accrued salary and compensation | $ 10,506 | $ 9,838 | $ 10,336 |
| Payables to contractors | 1,834 | 2,380 | 2,733 |
| Accrued franchise fees | 2,246 | 2,164 | 2,009 |
| Payables to equipment suppliers | 1,870 | 1,884 | 1,820 |
| Amounts collected for others | 1,201 | 1,327 | 1,326 |
| Accrual amounts for bonuses to employees and remuneration to directors and supervisors | 2,344 | 1,785 | 980 |
| Accrued maintenance costs | 898 | 988 | 991 |
| Others | 5,403 | 5,736 | 6,597 |
| | $ 26,302 | $ 26,102 | $ 26,792 |

## 25. PROVISIONS

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Warranties | $ 148 | $ 221 | $ 201 |
| Employee benefits | 33 | 42 | 47 |
| Others | 1 | 3 | 4 |
| | $ 182 | $ 266 | $ 252 |
| Current | $ 148 | $ 221 | $ 129 |
| Noncurrent | 34 | 45 | 123 |
| | $ 182 | $ 266 | $ 252 |

| | Warranties | Employee Benefits | Others | Total |
|---|---|---|---|---|

| | NT$ | NT$ | NT$ | NT$ |
|---|---|---|---|---|
| | | (In Millions) | | |
| Balance on January 1, 2012 | $ 148 | $ 33 | $ 1 | $ 182 |
| Additional provisions recognized | 166 | 9 | 2 | 177 |
| Used during the period | (92) | | | (92) |
| Unused amounts reserved | (1) | | | (1) |
| Balance on December 31, 2012 | $ 221 | $ 42 | $ 3 | $ 266 |
| Balance on January 1, 2013 | $ 221 | $ 42 | $ 3 | $ 266 |
| Additional provisions recognized | 153 | 5 | 1 | 159 |
| Used during the period | (173) | | | (173) |
| Balance on December 31, 2013 | $ 201 | $ 47 | $ 4 | $ 252 |

(Concluded)

a. The provision for warranty claims represents the present values of the management s best estimate of the future outflow of economic benefits that will be required under the Company s obligation for warranties in sales agreements. The estimate has been made based on the historical warranty experience.

b. The provision for employee benefits represents vested long-term service leave entitlements accrued.

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**26. ADVANCE RECEIPTS**

Advance receipts are mainly from advance telecommunication charges. In accordance with NCC s regulation named Mandatory and Prohibitory Provisions To Be Included In Standard Contracts for Telecommunication Goods (Services) Coupons , the Company entered into a contract with Bank of Taiwan. Bank of Taiwan provided a performance guarantee from selling prepaid cards amounting to $1,058 million as of December 31, 2013.

**27. RETIREMENT BENEFIT PLANS**

a. Defined contribution plans

The pension plan under the Labor Pension Act of ROC (the LPA ) is considered as a defined contribution plan. Based on the LPA, Chunghwa and its domestic subsidiaries make monthly contributions to employees individual pension accounts at 6% of monthly salaries and wages. Its foreign subsidiaries would make monthly contributions based on the local pension requirements. The amount recognized as an expense for defined contribution plans were $311 million and $375 million for the years ended December 31, 2012 and 2013, respectively.

b. Defined benefit plans

Chunghwa completed its privatization plans on August 12, 2005. Chunghwa is required to pay all accrued pension obligations including service clearance payment, lump sum payment under civil service plan, additional separation payments, etc. upon the completion of the privatization in accordance with the Statute Governing Privatization of Stated-owned Enterprises. After paying all pension obligations for privatization, the plan assets of Chunghwa should be transferred to the Fund for Privatization of Government-owned Enterprises (the Privatization Fund ) under the Executive Yuan. On August 7, 2006, Chunghwa transferred the remaining balance of fund to the Privatization Fund. However, according to the instructions of MOTC, Chunghwa was requested to administer the distributions to employees on behalf of MOTC for pension obligations including service clearance payment, lump sum payment under civil service plan, additional separation payments, etc. upon the completion of the privatization and recognized such receivable from MOTC in other current monetary assets.

The Company s pension plan under the Labor Standards Law is considered as a defined benefit plan that provide benefits based on an employee s length of service and average last six-month salary prior to retirement. Chunghwa and its subsidiaries contribute an amount no more than 15% of salaries paid each month to their respective pension funds (the Funds), which are administered by the Labor Pension Fund Supervisory Committee (the Committee) and deposited in the names of the Committees in the Bank of Taiwan. To meet the minimum funding requirement, the Company is to make monthly contributions of at least 2% of eligible employees.

The most recent actuarial valuation of plan assets and the present value of the defined benefit obligation were carried out at December 31, 2013 by an independent actuary. The present value of the defined benefit obligation, and the related current service cost and past service cost, were measured using the Projected Unit Credit Method.

The principal assumptions used for the purpose of the actuarial valuations were as follows:

| | Measurement Date |
|---|---|

| | **January 1, 2012** | **December 31, 2012** | **December 31, 2013** |
|---|---|---|---|
| Discount rates | 1.75% | 1.60% | 2.00% |
| Expected rates of salary increase | 1.00%-3.00% | 1.00%-2.75% | 1.00%-2.75% |

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Amounts recognized in consolidated statement of comprehensive income in respect of these defined benefit plans are as follows.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Current service cost | $ 2,836 | $ 2,906 |
| Net interest expense | 26 | 53 |
| Components of defined benefit costs recognized in profit or loss | 2,862 | 2,959 |
| Remeasurement on the net defined benefit liability: | | |
| Return on plan assets | 132 | (226) |
| Actuarial gains and losses arising from changes in demographic assumptions | 534 | (3) |
| Actuarial gains and losses arising from changes in financial assumptions | 300 | (858) |
| Actuarial gains and losses arising from experience adjustments | 573 | 1,704 |
| Components of defined benefit costs recognized in other comprehensive income | 1,539 | 617 |
| | $ 4,401 | $ 3,576 |
| An analysis by function | | |
| Operating cost | $ 1,719 | $ 1,762 |
| Marketing expenses | 803 | 858 |
| General and administrative expenses | 158 | 162 |
| Research and development expenses | 105 | 100 |
| | $ 2,785 | $ 2,882 |

The cumulative amount of actuarial gains and losses recognized in other comprehensive income as of December 31, 2012 and 2013 was $1,539 million and $2,156 million, respectively.

The amount included in the consolidated balance sheets arising from the Company s obligation in respect of its defined benefit plans is as follows:

| | January 1, 2012 | December 31, 2012 | December 31, 2013 |
|---|---|---|---|
| | NT$ | NT$ | NT$ |

| | (In Millions) | | |
|---|---|---|---|
| Present value of funded defined benefit obligation | $ 18,697 | $ 22,100 | $ 25,457 |
| Fair value of plan assets | (15,750) | (17,528) | (19,982) |
| Net liability arising from defined benefit obligation | $ 2,947 | $ 4,572 | $ 5,475 |
| Accrued pension liabilities | $ 2,950 | $ 4,577 | $ 5,482 |
| Prepaid pension cost (included in other noncurrent assets others) | (3) | (5) | (7) |
| | $ 2,947 | $ 4,572 | $ 5,475 |

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Movements in the present value of the defined benefit obligation in the current year were as follows.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Balance, beginning of the year | $ 18,697 | $ 22,100 |
| Current service cost | 2,836 | 2,906 |
| Interest cost | 321 | 347 |
| Remeasurement on the net defined benefit liability: | | |
| Actuarial gains and losses arising from changes in demographic assumptions | 534 | (3) |
| Actuarial gains and losses arising from changes in financial assumptions | 300 | (858) |
| Actuarial gains and losses arising from experience adjustments | 573 | 1,704 |
| Benefits paid from plan assets | (1,026) | (632) |
| Benefits paid directly by the Company | (135) | (107) |
| Balance, end of the year | $ 22,100 | $ 25,457 |

Movements in the fair value of the plan assets were as follows.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Balance, beginning of the year | $ 15,750 | $ 17,528 |
| Interest income | 295 | 294 |
| Return on plan assets | (132) | 226 |
| Contributions from employer | 2,641 | 2,566 |
| Benefits paid from plan assets | (1,026) | (632) |
| Balance, end of the year | $ 17,528 | $ 19,982 |

The major categories of plan assets and the fair value of plan assets at the end of the reporting period for each category, were as follows:

| | Fair Value of Plan Assets | | |
|---|---|---|---|
| | January 1, 2012 | December 31, 2012 | December 31, 2013 |
| Stock and beneficiary certificates | $ 6,418 | $ 6,677 | $ 8,946 |

| | | | |
|---|---|---|---|
| Fixed income investments | 5,552 | 6,417 | 6,310 |
| Cash | 3,760 | 4,296 | 4,568 |
| Others | 20 | 138 | 158 |
| | $ 15,750 | $ 17,528 | $ 19,982 |

Under the Labor Standards Law, the rate of return on assets shall not be less than the average interest rate on a two-year time deposit published by the local banks and the government is responsible for any shortfall in the event that the rate of return is less than the required rate of return. The plan assets are held in a commingled fund which is operated and managed by the government s designated authorities; as such, the Company does not have any right to intervene in the investments of the funds.

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Significant actuarial assumptions for the determination of the defined obligation are discount rate and expected salary increase. The sensitivity analyses below have been determined based on reasonably possible changes of the respective assumptions occurring at the end of the reporting period, while holding all other assumptions constant.

If the discount rate is 0.5% higher, the defined benefit obligation would decrease by $1,027 million. If the discount rate is 0.5% lower, the defined benefit obligation would increase by $1,097 million.

If the expected salary growth increases by 0.5%, the defined benefit obligation would increase by $1,153 million. If the expected salary growth decreases by 0.5%, the defined benefit obligation would decrease by $1,131 million.

The sensitivity analysis presented above may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

Furthermore, in presenting the above sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the defined benefit obligation liability recognised in the consolidated balance sheets.

The average duration of the benefit obligation at 31 December, 2013 is from 8 to 18 years.

The Company s maturity analysis of the benefit payments was as follows.

| **Year** | **Amount NT$ (In Millions)** |
|---|---|
| 2014 | $ 1,184 |
| 2015 | 1,807 |
| 2016 | 2,892 |
| 2017 | 3,993 |
| 2018 and thereafter | 48,096 |

The Company expects to make a contribution of $2,590 million to the defined benefit plans in the next twelve months starting from December 31, 2013.

**28. EQUITY**

a. Share capital

1) Common stock

| | **January 1, 2012** | **December 31, 2012** | **December 31, 2013** |
|---|---|---|---|

| | NT$ | NT$ (In Millions) | NT$ |
|---|---|---|---|
| Number of authorized shares | 12,000 | 12,000 | 12,000 |
| Authorized shares | $ 120,000 | $ 120,000 | $ 120,000 |
| Number of shares issued and outstanding | 7,757 | 7,757 | 7,757 |
| Issued and outstanding shares | $ 77,574 | $ 77,574 | $ 77,574 |

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The issued common stock of a par value at $10 per share entitled the right to vote and receive dividends.

2) Global depositary receipts

For the purpose of privatizing Chunghwa, the MOTC sold 1,110 million shares of common stock of Chunghwa in an international offering of securities in the form of American Depositary Shares ( ADS ) amounting to 111 million units (one ADS represents ten shares of common stock) on the New York Stock Exchange on July 17, 2003. Afterwards, the MOTC sold 1,351 million common shares in the form of ADS amounting to 135 million units on August 10, 2005. Subsequently, the MOTC and Taiwan Mobile Co., Ltd. sold 505 million and 59 million common shares of Chunghwa, respectively, in the form of ADS totally amounting to 56 million units on September 29, 2006. The MOTC and Taiwan Mobile Co., Ltd. have sold 3,025 million common shares in the form of ADS amounting to 302 million units. As of December 31, 2013, there were 28 million ADSs outstanding, which represent 283 million common shares, representing 3.64% of Chunghwa s total outstanding common shares.

The ADS holders generally have the same rights and obligations as other common stockholders, subject to the provision of relevant laws. The exercise of such rights and obligations shall comply with the related regulations and deposit agreement, which stipulate, among other things, that ADS holders can, through deposit agents:

a) Exercise their voting rights,

b) Sell their ADSs, and

c) Receive dividends declared and subscribe to the issuance of new shares.

b. Addition paid-in capital

The adjustment of additional paid-in capital for the years ended December 31, 2012 and 2013 were as follows:

| | Share Premium NT$ | Donated Capital NT$ | Movements of Paid-in Capital for Associates Accounted for Using Equity Method NT$ | Share-based Payment Transactions NT$ | Stockholders Contribution Due to Privatization NT$ | Total NT$ |
|---|---|---|---|---|---|---|
| | | | (In Millions) | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Balance on January 1, 2012 | $ 148,211 | $ 13 | $ | $ | $ 20,648 | $ 168,872 |
| Exercise of employee stock option of a subsidiary | | | | 5 | | 5 |
| Balance on December 31, 2012 | $ 148,211 | $ 13 | $ | $ 5 | $ 20,648 | $ 168,877 |
| Balance on January 1, 2013 | $ 148,211 | $ 13 | $ | $ 5 | $ 20,648 | $ 168,877 |
| Cash distributed from capital surplus | (5,589) | | | | | (5,589) |
| Exercise of employee stock option of subsidiaries | | | 6 | | | 6 |
| Balance on December 31, 2013 | $ 142,622 | $ 13 | $ 6 | $ 5 | $ 20,648 | $ 163,294 |

Additional paid-in capital may only be utilized to offset deficits. However, the additional paid-in capital from shares issued in excess of par and donations may be distributed in cash or capitalized when a company has no deficit, which however is limited to a certain percentage of Chunghwa s paid-in capital.

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Additional paid-in capital from investments accounted for using equity method may not be used for any purpose.

The additional paid-in capital due to privatization relates to the retrospective adjustment at the date of transition to IFRSs. Please refer to Note 43 to the consolidated financial statement for further details.

c. Retained earnings and dividends policy

Before distributing a dividend or making any other distribution to stockholders, Chunghwa must pay all outstanding taxes, offset deficits in prior years and set aside a legal reserve equal to 10% of its net income, and depending on its business needs or requirements, may also set aside or reverse special reserves. In accordance with Chunghwa s Articles of Incorporation, no less than 50% of the remaining earnings comprising remaining balance of net income, if any, plus cumulative undistributed earnings shall be distributed in the following order: (a) from 2% to 5% of distributable earnings shall be distributed to employees as employee bonus; (b) no more than 0.2% of distributable earnings shall be distributed to board of directors and supervisors as remuneration; and (c) cash dividends to be distributed shall not be less than 50% of the total amount of dividends to be distributed. If cash dividend to be distributed is less than $0.10 per share, such cash dividend shall be distributed in the form of common stocks.

For the years ended December 31, 2012 and 2013, the accrual amounts for bonuses to employees and remuneration to directors and supervisors were accrued based on past experiences and the probable amount to be paid in accordance with Chunghwa s Articles of Incorporation and Implementation Guidance for the Employee s Bonus Distribution of Chunghwa Telecom Co., Ltd.

If the initial accrual amounts of the aforementioned bonus are significantly different from the amounts proposed by the board of directors, the difference is charged to the earnings of the year making the initial estimate. Otherwise, the difference between initial accrual amount and the amount resolved in the shareholders meeting is charged to the earnings of the following year as a result of change in accounting estimate. If the shareholders meeting approved to distribute the employee bonus as stocks, the share number of the stock bonus were determined by the amount of bonus divided by the fair value of the common stocks which was the closing market prices one day before shareholders meeting after taking into account the effects of ex-rights and ex-dividends.

Special reserve was appropriated in accordance with the relevant laws and regulations or as requested by local authority. Pursuant to existing regulations, the Company is required to set aside additional special reserve equivalent to debit balances under stockholder s equity. For subsequent decrease in the deduction amount to stockholder s equity, the decreased amount could be reversed from the special reserve to retained earnings.

The appropriation for legal reserve shall be made until the accumulated reserve equals the aggregate par value of the outstanding capital stock of Chunghwa. This reserve can only be used to offset a deficit, or, when the legal reserve has exceeded 25% of the Company s paid-in capital, the excess may be transferred to capital or distributed in cash.

Except for non-ROC resident shareholders, all shareholders receiving the dividends are entitled a tax credit equal to their proportionate share of the income tax paid by the Company.

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The appropriations and distributions of the 2011 and 2012 earnings of Chunghwa have been approved by the stockholders on June 22, 2012 and June 25, 2013 as follows:

| | Appropriation of Earnings | | Dividends Per Share | |
|---|---|---|---|---|
| | For Fiscal Year 2011 NT$ | For Fiscal Year 2012 NT$ | For Fiscal Year 2011 NT$ | For Fiscal Year 2012 NT$ |
| | (In Millions) | | | |
| Legal reserve | $ 4,707 | $ 3,990 | | |
| Cash dividends | 42,362 | 35,913 | $ 5.46 | $ 4.63 |

The stockholders of Chunghwa resolved to distribute cash $0.72 per share and the total amount of $5,589 million from additional paid-in capital on June 25, 2013. Such amount was subsequently paid in August 2013.

The bonuses to the employees and remuneration to the directors and supervisors of the 2011 and 2012 approved by the board of directors and the stockholders on June 22, 2012 and June 25, 2013 were as follows:

| | 2011 Cash Bonus NT$ | 2012 Cash Bonus NT$ |
|---|---|---|
| | (In Millions) | |
| Bonus distributed to the employees | $ 2,040 | $ 1,533 |
| Remuneration paid to the directors and supervisors | 44 | 37 |

There was no difference between the initial accrual amounts and the amounts resolved in shareholders meeting of the aforementioned bonuses to employees and the remuneration to directors and supervisors on June 22, 2012 and June 25, 2013.

Chunghwa s distributable earnings, bonus distributed to the employees and remuneration paid to the directors and supervisors as of the end of the period were based on the consolidated financial statements of 2012 prepared in conformity with the pre-revised Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the ROC ( ROC GAAP ).

The appropriations of earnings for 2013 had been approved by Chunghwa s board of directors on March 25, 2014. The appropriations and dividends per share were as follows:

| | Appropriation of Earnings | |
|---|---|---|
| | For Fiscal Year 2013 NT$ | For Fiscal Year 2013 NT$ |
| | (In Millions) | |
| Legal reserve | $ 2,074 | |
| Special reserve | 144 | |
| Cash dividends | 18,526 | $ 2.39 |

In addition, Chunghwa s board of directors resolved to distribute cash from additional paid-in-capital of $16,578 million, $2.14 per share, on March 25, 2014.

Information of the appropriation of Chunghwa s earnings, employees bonuses and remuneration to directors and supervisors resolved by the board of directors and approved by the stockholders is available on the Market Observation Post System website.

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d. Special reserves in accordance with local regulations

Under local regulation, on the first-time adoption of IFRSs, a company should appropriate a special reserve of an amount the same as that of unrealized revaluation increment and cumulative translation differences (gain) transferred to retained earnings as a result of the Company s use of exemptions under IFRS 1. However, at the date of transitions to IFRSs, if the increase in retained earnings that resulted from all IFRSs adjustments is not enough for this appropriation, only the increase in retained earnings that resulted from all IFRSs adjustments will be appropriated to special reserve. No appropriation of earnings shall be made until any shortage of the aforementioned special reserve is appropriated in subsequent years if the Company has earnings and the original need to appropriate a special reserve is not eliminated.

The adjustments of IFRSs adoption resulted in the decrease of retained earnings of the Company; therefore, the Company is not required to appropriate any amount to the special reserve.

e. Other equity items

1) Exchange differences arising from the translation of the foreign operations

The exchange differences arising from the translation of the foreign operations from their functional currency to New Taiwan dollars were recognized as exchange differences arising from the translation of the foreign operations in other comprehensive income.

2) Unrealized gain (loss) on available-for-sale financial assets

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Beginning balance | $ 68 | $ 258 |
| Unrealized gain (loss) on available-for-sale financial assets | 192 | (560) |
| Income tax relating to unrealized gain (loss) on available-for-sale financial assets | | (6) |
| Amount reclassified from equity to profit or loss on disposal | (26) | 158 |
| Amount reclassified from equity to impairment loss | 24 | |
| Ending balance | $ 258 | $ (150) |

Unrealized gain (loss) on available-for-sale financial assets were accumulated gains and losses on the available-for-sale financial assets measured at fair value, which were recognized in other comprehensive income and were included in the calculation of the related disposal gain and loss or impairment loss of such financial assets upon reclassified to profits or losses.

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f. Noncontrolling interests

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Beginning balance | $ 4,181 | $ 4,336 |
| Attributable to noncontrolling interests | | |
| Cash dividends paid by subsidiaries to noncontrolling interests | (893) | (811) |
| Net income of current period | 1,125 | 1,124 |
| Actuarial gains (loss) on the defined benefit plans | (20) | 3 |
| Income tax related to actuarial gains and losses | 2 | (1) |
| Exchange differences arising from the translation of the net investment in foreign operations | (7) | 27 |
| Share of exchange differences arising from the translation of the net investment in foreign operations of associates | (1) | 3 |
| Unrealized gain on available-for-sale financial assets | 2 | 11 |
| Income tax relating to unrealized loss on available-for-sale financial assets | | (1) |
| Exercise of employee stock option of subsidiaries | 38 | 44 |
| Compensation cost of employee stock options of a subsidiary | | 70 |
| Employee stock bonus issued by a subsidiary | | 2 |
| Increase (decrease) in noncontrolling interests | (91) | 39 |
| Ending balance | $ 4,336 | $ 4,846 |

**29. REVENUE**

The main source of revenue of the Company includes various telecommunications services in various different streams, and the related information were as discussed in Note 42.

**30. NET PROFIT (LOSS) AND OTHER COMPREHENSIVE INCOME (LOSS)**

a. Other income and expenses

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |

| | (In Millions) | |
|---|---|---|
| Gain (loss) on disposal of property, plant and equipment, net | $ (2) | $ 85 |
| Impairment loss on property, plant and equipment | (301) | (254) |
| Reversal gain (impairment loss) on investment properties | (1,261) | 246 |
| Impairment loss on intangible assets | (5) | (18) |
| | $ (1,569) | $ 59 |

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b. Other income

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Dividends income | $ 21 | $ 79 |
| Rental income | 43 | 43 |
| Others | 377 | 234 |
| | $ 441 | $ 356 |

c. Other gains and losses

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Net foreign currency exchange gains (losses) | $ 34 | $ (100) |
| Gain on disposal of financial instruments, net | 113 | 76 |
| Gain on disposal of investments accounted for using equity method | | 13 |
| Valuation loss on financial instruments at fair value through profit or loss, net | (1) | (1) |
| Loss arising on derivatives as designated hedging instruments in fair value hedges, net | | (93) |
| Gain arising on adjustments for hedged item attributable to the hedged risk in a designated fair value hedge accounting relationship, net | | 93 |
| Impairment losses on available-for-sale financial assets | (203) | (66) |
| Others | (82) | (46) |
| | $ (139) | $ (124) |

d. Finance costs

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |

| | | |
|---|---|---|
| Interest on bank borrowings | $ 20 | $ 33 |
| Other interest expenses | 2 | 3 |
| | $ 22 | $ 36 |

e. Impairment loss (reversal gain) on financial instruments

| | Year Ended December 31 | |
|---|---|---|
| | **2012** | **2013** |
| | **NT$** | **NT$** |
| | **(In Millions)** | |
| Notes and account receivables | $ (1,473) | $ 239 |
| Other receivables | $ 22 | $ 14 |
| Available-for-sale financial assets | $ 203 | $ 66 |

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f. Impairment loss (reversal gain) on non-fianacial assets

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Inventories | $ 113 | $ 203 |
| Property, plant and equipment | $ 301 | $ 254 |
| Investment properties | $ 1,261 | $ (246) |
| Intangible assets | $ 5 | $ 18 |

g. Depreciation and amortization expenses

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Property, plant and equipment | $ 31,021 | $ 30,937 |
| Investment properties | 16 | 17 |
| Intangible assets | 1,123 | 1,238 |
| Total depreciation and amortization expenses | $ 32,160 | $ 32,192 |
| Depreciation expenses summarized by functions | | |
| Operating costs | $ 29,089 | $ 28,813 |
| Operating expenses | 1,948 | 2,141 |
| | $ 31,037 | $ 30,954 |
| Amortization expenses summarized by functions | | |
| Operating costs | $ 865 | $ 987 |
| Operating expenses | 258 | 251 |
| | $ 1,123 | $ 1,238 |

(Concluded)

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h. Employee benefit expenses

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Post-employment benefit | | |
| Defined contribution plans | $ 311 | $ 375 |
| Defined benefit plans | 2,785 | 2,882 |
| | 3,096 | 3,257 |
| Share-based payment | | |
| Equity-settled share-based payment | | 70 |
| Other employee benefit | | |
| Salaries | 24,333 | 24,942 |
| Insurance | 2,288 | 2,450 |
| Other | 14,679 | 14,411 |
| | 41,300 | 41,803 |
| Total employee benefit expenses | $ 44,396 | $ 45,130 |
| Summary by functions | | |
| Operating costs | $ 24,928 | $ 25,038 |
| Operating expenses | 19,468 | 20,092 |
| | $ 44,396 | $ 45,130 |

i. Components of others comprehensive income unrealized gain (loss) on available-for-sale financial assets

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Gains (losses) arising during the year | $ 209 | $ (548) |
| Reclassification adjustments | | |
| Upon disposal | (44) | 156 |
| Upon impairment | 27 | |
| | $ 192 | $ (392) |

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## 31. INCOME TAX

a. Income tax recognized in profit or loss

The major components of income tax expense are as follows:

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Current tax | | |
| Current tax expenses recognized for the current period | $ 7,960 | $ 8,138 |
| Income tax benefit of unappropriated earnings | (676) | (1,704) |
| Income tax adjustments on prior years | 32 | 124 |
| Others | 24 | 21 |
| | 7,340 | 6,579 |
| Deferred tax | | |
| Deferred tax expense recognized for the current period | (4) | (101) |
| Income tax recognized in profit or loss | $ 7,336 | $ 6,478 |

A reconciliation of income tax expense calculated at the statutory rate and income tax expense was as follows:

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Income before income tax | $ 49,953 | $ 49,096 |
| Income tax expense calculated at the statutory rate (17%) | 8,492 | 8,346 |
| Nondeductible expenses in determining taxable income | 221 | (2) |
| Imputed income on tax | 2 | 2 |
| Temporary difference | (177) | 67 |
| Tax-exempt income | (321) | (265) |
| 10% tax on unappropriated earnings | (676) | (1,704) |
| Investment credits | (400) | (233) |
| Loss carryforwards | 107 | 129 |
| Effect of different tax rates of group entities operating in other jurisdictions | (1) | (10) |

| | | |
|---|---|---|
| Adjustments of tax expense on previous years | 32 | 124 |
| Others | 57 | 24 |
| Income tax expense recognized in profit or loss | $ 7,336 | $ 6,478 |

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b. Income tax recognized in other comprehensive income

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Deferred tax benefit | | |
| In respect of the current year: | | |
| Unrealised loss on available-for-sale financial assets | $ | $ 6 |
| Actuarial gains and losses on defined benefit plan | (265) | (105) |
| Income tax recognized in other comprehensive incomes | $ (265) | $ (99) |

c. Current tax assets and liabilities

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Current tax assets | | | |
| Tax refund receivable (included in other current asset-others) | $ 1 | $ 1 | $ 1 |
| Current tax liabilities | | | |
| Income tax payable | $ 8,044 | $ 7,139 | $ 6,171 |

d. Deferred income tax assets and liabilities

The movements of deferred income tax assets and deferred income tax liabilities were as follows:

For the year ended December 31, 2012

| Deferred Income Tax Assets | January 1, 2012 NT$ | Recognized in Profit or Loss NT$ | Recognized in Other Comprehensive Income NT$ | December 31, 2012 NT$ |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Temporary differences | | | | |
| Defined benefit obligation | $ 495 | $ 13 | $ 265 | $ 773 |
| Share of the profit of associates and joint venture accounted for using equity method | 41 | 48 | | 89 |
| Deferred revenue | 334 | (102) | | 232 |
| Impairment loss on property, plant and equipment | 12 | 47 | | 59 |
| Valuation loss on inventory | 62 | (18) | | 44 |
| Estimated warranty liabilities | 8 | 18 | | 26 |
| Accrued award credits liabilities | 14 | (2) | | 12 |
| Unrealized foreign exchange loss (gain), net | | 19 | | 19 |
| Others | 13 | 4 | | 17 |
| | 979 | 27 | 265 | 1,271 |
| Loss carryforwards | 74 | (42) | | 32 |
| Investment credits | 3 | | | 3 |
| | $ 1,056 | $ (15) | $ 265 | $ 1,306 |

(Concluded)

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| Deferred Income Tax Liabilities | January 1, 2012 NT$ | Recognized in Profit or Loss NT$ | Recognized in Other Comprehensive Income NT$ | December 31, 2012 NT$ |
|---|---|---|---|---|
| Temporary differences | | | | |
| Land value incremental tax | $ (95) | $ | $ | $ (95) |
| Unrealized foreign exchange loss (gain), net | (13) | 13 | | |
| Others | (3) | | | (3) |
| | $ (111) | $ 13 | $ | $ (98) |

For the year ended December 31, 2013

| Deferred Income Tax Assets | December 31, 2012 NT$ | Recognized in Profit or Loss NT$ | Recognized in Other Comprehensive Income NT$ | December 31, 2013 NT$ |
|---|---|---|---|---|
| Temporary differences | | | | |
| Defined benefit obligation | $ 773 | $ 50 | $ 105 | $ 928 |
| Share of the profit of associates and joint venture accounted for using equity method | 89 | 86 | | 175 |
| Deferred revenue | 232 | (45) | | 187 |
| Impairment loss on property, plant and equipment | 59 | | | 59 |
| Valuation loss on inventory | 44 | 12 | | 56 |
| Estimated warranty liabilities | 26 | (2) | | 24 |
| Accrued award credits liabilities | 12 | 9 | | 21 |
| Unrealized foreign exchange loss (gain), net | 19 | (8) | | 11 |
| Others | 17 | 1 | | 18 |
| | 1,271 | 103 | 105 | 1,479 |
| Loss carryforwards | 32 | (5) | | 27 |
| Investment credits | 3 | (3) | | |
| | $ 1,306 | $ 95 | $ 105 | $ 1,506 |

(Concluded)

**Deferred Income Tax Liabilities**

| | December 31, 2012 | Recognized in Profit or Loss | Recognized in Other Comprehensive Income | December 31, 2013 |
|---|---|---|---|---|
| | NT$ | NT$ | NT$ | NT$ |
| Temporary differences | | | | |
| Land value incremental tax | $ (95) | $ | $ | $ (95) |
| Valuation gain on financial instruments, net | | | (6) | (6) |
| Others | (3) | 3 | | |
| | $ (98) | $ 3 | $ (6) | $ (101) |

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e. Items for which no deferred income tax assets have not been recognized

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Loss carryforwards | | | |
| Expire in 2016 | $ | $ 38 | $ 38 |
| Expire in 2017 | | 65 | 65 |
| Expire in 2018 | | | 130 |
| Expire in 2019 | | | |
| Expire in 2020 | | | |
| Expire in 2021 | 1 | 1 | |
| Expire in 2022 | | 4 | 4 |
| Expire in 2023 | | | |
| | $ 1 | $ 108 | $ 237 |
| Investment credits | | | |
| Purchase of machinery and equipment | $ | $ | $ |
| Research and development | 3 | | |
| Personnel training expenditures | | | |
| | $ 3 | $ | $ |
| Deductible temporary differences | $ 177 | $ | $ 67 |

(Concluded)

f. Information about unused loss carryforwards

As of December 31, 2013, unused loss carryforwards was comprised of:

| Remaining Creditable Amount NT$ (In Millions) | Expiry Year |
|---|---|
| $ 38 | 2016 |
| 65 | 2017 |
| 130 | 2018 |

| | |
|---|---|
| 7 | 2019 |
| 8 | 2020 |
| 10 | 2021 |
| 4 | 2022 |
| 2 | 2023 |
| | |
| $264 | |

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g. The related information under the Integrated Income Tax System is as follows:
Imputation credit account

All Chunghwa s earnings generated prior to June 30, 1988 have been appropriated.

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Balance of Imputation Credit Account ( ICA ) | $ 4,899 | $ 4,553 | $ 4,038 |

The creditable ratio for distribution of earnings of 2012 and 2013 was 19.23% and 20.48% (expected ratio), respectively.

When Chunghwa appropriated the earnings generated in and after 1998, the imputation credit allocated to local shareholders was based on the creditable rate as of the date of the dividends distribution date. The actual imputation credits allocated to shareholders of the Chunghwa was based on the balance of the Imputation Credit Accounts (ICA) as of the date of dividend distribution. Therefore, the expected creditable ratio for the 2013 earnings may differ from the actual creditable ratio to be used in allocating imputation credits to the shareholders.

According to legal interpretation No. 10204562810 announced by the Taxation Administration of the Ministry of Finance, when calculating imputation credits in the year of first-time adoption of IFRSs, the cumulative retained earnings include the net increase or net decrease in retained earnings arising from first-time adoption of IFRSs.

h. Income tax examinations
Chunghwa s income tax returns have been examined by the tax authorities through 2011 except for 2008. The following subsidiaries income tax returns have been examined by the tax authorities through 2011: SENAO, CHPT, CHSI, CHIEF, CHI, SHE, LED, CHIYP, YYRP, CEI and CHST. Unigate and SFDs income tax returns have been assessed by the tax authorities through 2012.

Chunghwa s income tax returns for 2008 is still under discussion with the tax authorities; however, the disputed amount of $84 million was accrued in 2013.

**32. EARNINGS PER SHARE**

Net income and weighted average number of common stock used in the calculation of earnings per share were as follows:

**Net Income**

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Net income used to compute the basic earnings per share | | |
| Net income attributable to the parent | $ 41,492 | $ 41,494 |
| Assumed conversion of all dilutive potential common stock Employee stock options of subsidiaries | (4) | (3) |
| Net income used to compute the diluted earnings per share | $ 41,488 | $ 41,491 |

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**Weighted Average Number of Common Stock**

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | (Millions Shares) | |
| Weighted average number of common stock used to compute the basic earnings per share | 7,757 | 7,757 |
| Assumed conversion of all dilutive potential common stock Employee stock bonus | 12 | 20 |
| Weighted average number of common stock used to compute the diluted earnings per share | 7,769 | 7,777 |

If Chunghwa may settle the employee bonus in shares or cash, Chunghwa shall presume that it will be settled in shares and takes those shares into consideration when calculating the weighted average number of outstanding shares used in the calculation of diluted EPS if the shares have a dilutive effect. The dilutive effect of the shares needs to be considered until the stockholders approve the number of shares to be distributed to employees in their meeting in the following year.

**33. SHARE-BASED PAYMENT ARRANGEMENT**

a. SENAO share-based compensation plans

SENAO share-based compensation plans ( SENAO Plans ) described as follows:

| Effective Date | Grant Date | Stock Options (In Thousands) | Exercise Price NT$ |
|---|---|---|---|
| 2005.09.30 | 2006.05.05 | 10,000 | $12.1 (Original price $16.9) |
| 2007.10.16 | 2007.10.31 | 6,181 | $42.6 (Original price $44.2) |
| 2012.05.28 | 2013.04.29 | 10,000 | $89.4 (Original price $93.0) |
| | | 26,181 | |

Each option is eligible to subscribe for one common stock of SENAO when exercisable. Under the terms of SENAO Plans, the options are granted at an exercise price at the closing price of the SENAO s common stocks listed on the TSE on the grant dates except when the closing price is lower than par value, the option exercise price would become par value. The SENAO Plans have exercise price adjustment formula upon the issuance of new common stocks, capitalization of retained earnings and/or capital reserves, stock split as well as distribution of cash dividends (except for 2007 Plan), except (i) in the case of issuance of new shares in connection with mergers and in the case of

cancellation of outstanding shares in connection with capital reduction (2007 Plan is out of this exception), and (ii) except if the exercise price after adjustment exceeds the exercise price before adjustment. The options of all the Plans are valid for six years and the graded vesting schedule for which 50% of option granted will vest two years after the grant date and another two tranches of 25%, each will vest three and four years after the grant date respectively.

SENAO elected not to apply IFRS 2 retrospectively for the share-based payment transactions which were granted and vested before the transition date.

Stock options granted on May 7, 2013 applied IFRS 2. The recognized compensation cost was $70 million for the period from May 7 to December 31, 2013.

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SENAO used the fair value method to evaluate the options using the Black-Scholes model and the related assumptions were as follows:

| | Stock Options Granted on May 7, 2013 |
|---|---|
| Dividends yield | |
| Risk-free interest rate | 0.91% |
| Expected life | 4.375 years |
| Expected volatility | 36.22% |
| Weighted-average fair value of grants (NT$) | $ 28.72 |

Information about SENAO s outstanding stock options for the years ended December 31, 2012 and 2013 were as follows:

| | Year Ended December 31, 2012 | | | |
|---|---|---|---|---|
| | Granted on May 5, 2006 | | Granted on October 31, 2007 | |
| | Number of Options (In Thousands) | Weighted-average Exercise Price NT$ | Number of Options (In Thousands) | Weighted-average Exercise Price NT$ |
| Employee stock options | | | | |
| Options outstanding at beginning of the year | 280 | $ 12.10 | 1,998 | $ 42.60 |
| Options exercised | (275) | 12.10 | (947) | 42.60 |
| Options forfeited | (5) | | | |
| Options outstanding at end of the year | | | 1,051 | 42.60 |
| Options exercisable at end of the year | | | 1,051 | 42.60 |

| | Year Ended December 31, 2013 | | | |
|---|---|---|---|---|
| | Granted on October 31, 2007 | | Granted on May 7, 2013 | |
| | Number of Options (In Thousands) | Weighted-average Exercise Price NT$ | Number of Options (In Thousands) | Weighted-average Exercise Price NT$ |
| Employee stock options | | | | |
| Options outstanding at beginning of the year | 1,051 | $ 42.60 | | $ |

| | | | | |
|---|---|---|---|---|
| Options granted | | | 10,000 | 93.00 |
| Options exercised | (980) | 42.60 | | |
| Options forfeited | (71) | | (128) | |
| Options outstanding at end of the year | | | 9,872 | 89.40 |
| Options exercisable at end of the year | | | | |

As of December 31, 2012 information about employee stock options outstanding are as follows:

| | **Options Outstanding** | | | **Options Exercisable** | |
|---|---|---|---|---|---|
| **Range of Exercise Price NT$** | **Number of Options (In Thousands)** | **Weighted-average Remaining Contractual Life (Years)** | **Weighted-average Exercise Price NT$** | **Number of Options (In Thousands)** | **Weighted-average Exercise Price NT$** |
| $42.60 | 1,051 | 0.92 | $ 42.60 | 1,051 | $ 42.60 |

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As of December 31, 2013 information about employee stock options outstanding are as follows:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Price NT$ | Number of Options (In Thousands) | Weighted-average Remaining Contractual Life (Years) | Weighted-average Exercise Price NT$ | Number of Options (In Thousands) | Weighted-average Exercise Price NT$ |
| $89.40 | 9,872 | 5.35 | $ 89.40 | | $ |

Had SENAO used the fair value method to evaluate the options using the Black-Scholes model, the assumptions SENAO used and the fair value of the options would have been as follows:

| | Stock Options Granted on October 31, 2007 | Stock Options Granted on May 5, 2006 |
|---|---|---|
| Dividends yield | 1.49% | |
| Risk-free interest rate | 2.00% | 1.75% |
| Expected life | 4.375 years | 4.375 years |
| Expected volatility | 39.82% | 39.63% |
| Weighted-average fair value of grants (NT$) | $ 13.69 | $ 5.88 |

b. CHTP share-based compensation plan

CHTP granted one thousand options to some of its employees in December 2008. Under the terms of CHTP Plan, each option entitles the holder to subscribe for one thousand common shares at $12.6 per share when exercisable. The options are valid for 5 years and based on the graded vesting schedule, two tranches of 30% of the option will vest two and three years after the grant date, respectively, and the remaining 40% will vest four years after the grant date. There is an exercise price adjustment formula upon the issuance of new common shares, capitalization of retained earnings and/or capital reserves, stock split, issuance of new shares in connection with mergers, issuance of global depositary receipts as well as distribution of cash dividends, except if the exercise price after adjustment exceeds the exercise price before adjustment.

For the years ended December 31, 2012 and 2013 information about CHTP s outstanding stock options were as follows:

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |

| | Number of Options | Weighted-average Exercise Price NT$ | Number of Options | Weighted-average Exercise Price NT$ |
|---|---|---|---|---|
| Employee stock options | | | | |
| Options outstanding at beginning of the period | 920 | $ 10.10 | 920 | $ 10.10 |
| Options exercised | | | (810) | 10.10 |
| Options expired | | | (110) | 10.10 |
| Options outstanding at end of the period | 920 | 10.10 | | |
| Options exercisable at end of the period | 920 | 10.10 | | |

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As of December 31, 2012, information about employee stock options outstanding is as follows:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Price NT$ | Number of Options | Weighted-average Remaining Contractual Life (Years) | Weighted-average Exercise Price NT$ | Number of Options | Weighted-average Exercise Price NT$ |
| $10.10 | 920 | 1 | $ 10.10 | 920 | $ 10.10 |

CHPT used the fair value to evaluate the options using the Black-Scholes model, the assumptions of CHPT would have been as follows:

| | Stock Options Granted on December 31, 2008 |
|---|---|
| Dividends yield | |
| Risk free interest rate | 2.00% |
| Expected life | 3.1 years |
| Expected volatility | 20% |
| Weighted-average fair value of grants | $ 3.8 |

**34. NON-CASH TRANSACTIONS**

For the years ended December 31, 2012 and 2013, the Company entered into the following non-cash investing activities:

| | Year Ended December 31 | |
|---|---|---|
| | 2012 NT$ | 2013 NT$ |
| | (In Millions) | |
| Increase in property, plant and equipment | $ 33,721 | $ 36,727 |
| Other payables | (441) | (345) |
| | $ 33,280 | $ 36,382 |

**35. OPERATING LEASE ARRANGEMENTS**

a. The Company as lessee

Leasing arrangements

Except for the ST-2 satellite referred in Note 39 to the consolidated financial statement, the Company entered into several lease agreements with third parties for base stations located all over in Taiwan. The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Within one year | $ 2,401 | $ 2,837 | $ 3,061 |
| Longer than one year but within five years | 5,750 | 5,842 | 6,389 |
| Longer than five years | 2,037 | 2,047 | 1,720 |
| | $ 10,188 | $ 10,726 | $ 11,170 |

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b. The Company as lessor

The Company lease out some land and buildings to third parties. The future aggregate minimum lease collection under non-cancellable operating leases are as follows:

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Within one year | $ 454 | $ 430 | $ 445 |
| Longer than one year but within five years | 962 | 684 | 659 |
| Longer than five years | 117 | 100 | 165 |
| | $ 1,533 | $ 1,214 | $ 1,269 |

**36. CAPITAL MANAGEMENT**

The Company manages its capital to ensure that entities in the Company will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The capital structure of the Company consists of debt of the Company and the equity attributable to the parent.

The management reviews the capital structure of the Company as needed. As part of this review, the management considers the cost of capital and the risks associated with each class of capital.

At the management suggestion, the Company maintains a balanced capital structure through paying cash dividends, increasing its share capital, purchasing treasury stock, proceeds from new debt or repayment of debt.

**37. FINANCIAL INSTRUMENTS**

**Categories of Financial Instruments**

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Financial assets | | | |
| Measured at FVTPL | | | |

| | | | |
|---|---|---|---|
| Held for trading (Note d) | $ 6 | $ 3 | $ |
| Designated as at FVTPL (Note d) | 40 | | |
| Held-to-maturity financial assets (Note e) | 14,696 | 16,046 | 11,766 |
| Loans and receivables (Note a) | 92,888 | 80,786 | 43,192 |
| Available-for-sale financial assets (Note b) | 5,317 | 7,996 | 5,494 |

Financial Liabilities

| | | | |
|---|---|---|---|
| Measured at FVTPL | | | |
| Held for trading (Note d) | 4 | 2 | |
| Measured at amortized cost (Note c) | 30,340 | 30,998 | 33,576 |

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Note a: The balances included cash and cash equivalents, trade notes and accounts receivable, accounts receivable from related parties, other current monetary assets and other financial assets (included in other assets). Please refer to Note 7, 11, 14, 20 and 39.

Note b: Please refer to Note 9.

Note c: The balances included short-term loans, trade notes and accounts payable, other payables, payables to related parties and long-term loans which were financial liabilities carried at amortized cost. Please refer to Notes 21, 22, 23, 24 and 39.

Note d: Please refer to Note 8.

Note e: Please refer to Note 10.

**Financial Risk Management Objectives**

The main financial instruments of the Company include equity and debt investments, accounts receivable, accounts payables and loans. The Company s Finance Department provides services to its business units, co-ordinates access to domestic and international capital markets, monitors and manages the financial risks relating to the operations of the Company through internal risk reports which analyze exposures by degree and magnitude of risks. These risks include market risk (including foreign currency risk, interest rate risk and other price risk), credit risk, and liquidity risk.

The Company seeks to manage the effects of these risks by using derivative financial instruments to hedge risk exposures. The use of financial derivatives is governed by the Company s policies approved by the board of directors. Those derivatives are used to hedge the risks of exchange rate and interest rate fluctuation arising from operating or investment activities. Compliance with policies and risk exposure limits is reviewed by the Company s Finance Department on a continuous basis. The Company does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

The Company reports the significant risk exposures and related action plans timely and actively for the risks to the audit committee and if needed to the board of directors.

a. Market risk

The Company is exposed to market risks of changes in foreign currency exchange rates, interest rates and the prices in equity investments. The Company uses currency swap and forward exchange contracts to hedge the exchange rate risk arising from assets and liabilities denominated in foreign currencies.

There were no changes to the Company s exposure to market risks or the manner in which these risks are managed and measured.

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1) Foreign currency risk management

The carrying amounts of the Company s foreign currency denominated monetary assets and monetary liabilities at the end of the reporting period are as follows:

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Assets | | | |
| USD | $ 5,324 | $ 4,251 | $ 4,234 |
| EUR | 7 | 19 | 5 |
| JPY | 1 | 6 | 2 |
| SGD | 4 | 6 | 142 |
| Liabilities | | | |
| USD | 4,051 | 3,561 | 3,612 |
| EUR | 1,099 | 1,311 | 1,298 |
| JPY | 5 | 5 | 11 |
| SGD | 83 | 21 | 1 |

The carrying amount of the Company s derivatives with exchange rate risk exposures at the end of the reporting period are as follows:

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Assets | | | |
| USD | $ 6 | $ 3 | $ |
| Liabilities | | | |
| USD | 4 | 2 | |

Foreign currency sensitivity analysis

The Company is mainly exposed to the fluctuations of the currencies listed above.

The following table details the Company s sensitivity to a 5% increase and decrease in the functional currency against the relevant foreign currencies. 5% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management s assessment of the reasonably possible changes in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items, forward foreign exchange contracts and currency swap contracts. A positive number below indicates an increase in pre-tax profit where the functional currency weakens 5% against the relevant currency. For a 5% strengthening of the functional currency against the relevant currency, there would be a comparable impact on the profit, and the balances below would be negative.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 NT$ | 2013 NT$ |
| | (In Millions) | |
| Profit or loss | | |
| Monetary assets and liabilities (a) | | |
| USD | $ 35 | $ 31 |
| EUR | (65) | (65) |
| JPY | | |
| SGD | (1) | 7 |
| Derivatives(b) | | |
| USD | 104 | 5 |

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a) This is mainly attributable to the exposure on the outstanding foreign currency denominated receivables and payables in the Company at the end of the reporting period.
b) This is mainly attributable to the swaps and forward exchange contracts.

2) Interest rate risk

The carrying amount of the Company s exposures to interest rates on financial assets and financial liabilities at the end of the reporting period are as follows:

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Fair value interest rate risk | | | |
| Financial assets | $ 62,468 | $ 47,128 | $ 5,682 |
| Financial liabilities | 179 | 115 | 224 |
| Cash flow interest rate risk | | | |
| Financial assets | 4,403 | 5,445 | 10,609 |
| Financial liabilities | 1,656 | 2,054 | 1,730 |

Interest rate sensitivity analysis

The sensitivity analyses below have been determined based on the exposure to interest rates for non-derivative instruments at the end of the reporting period. A 25 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management s assessment of the reasonably possible change in interest rates.

If interest rates had been 25 basis points higher/lower and all other variables were held constant, the Company s pre-tax profit for the year ended December 31, 2012 would increase/decrease by $8 million. This is mainly attributable to the Company s exposure to floating interest rates on its financial assets and short-term and long-term loans; and other comprehensive income for the year ended December 31, 2012 would decrease/increase by $0.06 million, mainly as a result of the changes in the fair value of available-for-sale instruments with fixed rate.

If interest rates had been 25 basis points higher/lower and all other variables were held constant, the Company s pre-tax profit for the year ended December 31, 2013 would increase/decrease by $22 million. This is mainly attributable to the Company s exposure to floating interest rates on its financial assets and short-term and long-term loans.

3) Other price risks

The Company is exposed to equity price risks arising from listed equity investments. Equity investments are held for strategic rather than trading purposes. The management managed the risk through holding various risk portfolios. Further, the Company assigned finance and investment departments to monitor the price risk.

Equity price sensitivity analysis

The sensitivity analyses below have been determined based on the exposure to equity price risks at the end of the reporting period.

If equity prices had been 5% higher/lower:

Other comprehensive income before income tax would increase/decrease by $270 million and $153 million as a result of the changes in fair value of available-for-sale assets for the years ended December 31, 2012 and 2013, respectively.

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b. Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Company. The maximum credit exposure of the aforementioned financial instruments is equal to their carrying amounts recognized in consolidated balance sheet as of the balance sheet date.

The Company has large trade receivables outstanding with its customers. A substantial majority of the Company s outstanding trade receivables are not covered by collateral or credit insurance.

The Company implemented some measures which have improved the collectability of our accounts receivable. These procedures, which include enhanced credit assessments, strengthened overall risk management and improvements in bill collection practices, have reduced the exposure to uncollected receivables.

Accounts receivable are assessed for impairment at the end of each reporting period and considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the accounts receivable, the estimated future cash flows of the asset have been affected.

The Company maintains an allowance for doubtful accounts for estimated losses that result from the inability of our customers to make required payments. When determining the allowance, the Company considers the probability of recoverability based on past customer default experience and their credit status, and economic and industrial factors. Credit risks are assessed based on historical write-offs, net of recoveries, and an analysis of the aged accounts receivable balances with allowances generally increasing as the receivable ages. Accounts receivable may be fully reserved for when specific collection issues are known to exist, such as pending bankruptcy or catastrophes. The analysis of receivables is performed monthly, and the allowances for doubtful accounts are adjusted through expense accordingly.

As the Company serves a large consumer base, the concentration of credit risk was limited.

c. Liquidity risk management

The Company manages and contains sufficient cash and cash equivalent position to support the operations and reduce the impact on fluctuation of cash flow.

1) Liquidity and interest risk tables

The following table details the Company s remaining contractual maturity for its non-derivative financial liabilities with agreed repayment periods. The tables had been drawn up based on the undiscounted cash flows of financial liabilities from the earliest date on which the Company can be required to pay.

| | Weighted Average Effective Interest Rate (%) | Less Than 1 Month NT$ | 1-3 Months NT$ | 3 Months to 1 Year NT$ | 1-5 Years NT$ | Total NT$ |
|---|---|---|---|---|---|---|

| | | | | (In Millions) | | |
|---|---|---|---|---|---|---|
| January 1, 2012 | | | | | | |
| Non-derivative financial liabilities | | | | | | |
| Non-interest bearing | | $ 39,009 | $ | $ 2,346 | $ | $ 41,355 |
| Floating interest rate instruments | 1.10 | 5 | 1 | 600 | 1,050 | 1,656 |
| Fixed interest rate instruments | 1.72 | 91 | 80 | | 8 | 179 |
| | | $ 39,105 | $ 81 | $ 2,946 | $ 1,058 | $ 43,190 |

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| | Weighted Average Effective Interest Rate (%) | Less Than 1 Month NT$ | 1-3 Months NT$ | 3 Months to 1 Year NT$ (In Millions) | 1-5 Years NT$ | Total NT$ |
|---|---|---|---|---|---|---|
| December 31, 2012 | | | | | | |
| Non-derivative financial liabilities | | | | | | |
| Non-interest bearing | | $ 38,660 | $ | $ 1,793 | $ | $ 40,453 |
| Floating interest rate instruments | 1.32 | 4 | | | 2,050 | 2,054 |
| Fixed interest rate instruments | 1.75 | 48 | | 67 | | 115 |
| | | $ 38,712 | $ | $ 1,860 | $ 2,050 | $ 42,622 |
| December 31, 2013 | | | | | | |
| Non-derivative financial liabilities | | | | | | |
| Non-interest bearing | | $ 41,958 | $ | $ 980 | $ | $ 42,938 |
| Floating interest rate instruments | 1.18 | | 20 | 310 | 1,400 | 1,730 |
| Fixed interest rate instruments | 1.53 | 175 | 35 | 14 | | 224 |
| | | $ 42,133 | $ 55 | $ 1,304 | $ 1,400 | $ 44,892 |

The following table detailed the Company s liquidity analysis for its derivative financial instruments. The table summarized the undiscounted contractual net cash inflows and outflows on derivative instruments that settle on a net basis and the undiscounted gross inflows and outflows on those derivatives that require gross settlement.

| | Less Than 1 Month NT$ | 1-3 Months NT$ | 3 Months to 1 Year NT$ (In Millions) | 1-5 Years NT$ | Total NT$ |
|---|---|---|---|---|---|
| January 1, 2012 | | | | | |
| Net settled | | | | | |
| Index future contracts | $ | $ | $ | $ | $ |
| Gross settled | | | | | |
| Currency swap contracts | | | | | |
| Inflow | $ 940 | $ 937 | $ | $ | $ 1,877 |
| Outflow | 938 | 937 | | | 1,875 |
| | $ 2 | $ | $ | $ | $ 2 |
| Forward exchange contracts | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Inflow | $ 60 | $ | $ | $ | $ 60 |
| Outflow | 60 | | | | 60 |
| | $ | $ | $ | $ | $ |
| December 31, 2012 | | | | | |
| Gross settled | | | | | |
| Currency swap contracts | | | | | |
| Inflow | $ 726 | $ 1,194 | $ | $ | $ 1,920 |
| Outflow | 727 | 1,192 | | | 1,919 |
| | $ (1) | $ 2 | $ | $ | $ 1 |

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| | Less Than 1 Month NT$ | 1-3 Months NT$ | 3 Months to 1 Year NT$ (In Millions) | 1-5 Years NT$ | Total NT$ |
|---|---|---|---|---|---|
| Forward exchange contracts | | | | | |
| Inflow | $ 154 | $ | $ | $ | $ 154 |
| Outflow | 154 | | | | 154 |
| | $ | $ | $ | $ | $ |
| December 31, 2013 | | | | | |
| Gross settled | | | | | |
| Forward exchange contracts | | | | | |
| Inflow | $ 90 | $ | $ | $ | $ 90 |
| Outflow | 90 | | | | 90 |
| | $ | $ | $ | $ | $ |

2) Financing facilities

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Unsecured bank loan facility | | | |
| Amount used | $ 475 | $ 511 | $ 254 |
| Amount unused | 8,525 | 8,639 | 8,475 |
| | $ 9,000 | $ 9,150 | $ 8,729 |
| Secured bank loan facility | | | |
| Amount used | $ 1,651 | $ 2,050 | $ 1,700 |
| Amount unused | | 600 | 600 |
| | $ 1,651 | $ 2,650 | $ 2,300 |

**38. FAIR VALUE INFORMATION**

The fair value guidance requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements. The standard describes a fair value hierarchy based on three levels of inputs that may be used to measure fair value. The level in the fair value hierarchy within which the fair value measurement in its entirely falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date;

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability; or

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and are unobservable.

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Assets and liabilities measured at fair value on a recurring basis

The following table presents our assets and liabilities measured at fair value on a recurring basis:

January 1, 2012

| | Level 1 NT$ | Level 2 NT$ (In Millions) | Level 3 NT$ | Total NT$ |
|---|---|---|---|---|
| Financial assets at FVTPL | | | | |
| Derivative financial assets Currency swap contracts | $ | $ 6 | $ | $ 6 |
| Financial assets designated as at fair value through profit or loss | | | | |
| Convertible bonds | | 40 | | 40 |
| | $ | $ 46 | $ | $ 46 |
| Available-for-sale financial assets | | | | |
| Domestic securities | | | | |
| Equity investments | $ 528 | $ | $ | $ 528 |
| Corporate bonds | | 77 | | 77 |
| Foreign securities | | | | |
| Equity investments | | | | |
| Open-end mutual funds | 2,137 | | | 2,137 |
| | $ 2,665 | $ 77 | $ | $ 2,742 |
| Financial liabilities at FVTPL | | | | |
| Derivative financial assets | | | | |
| Forward exchange | $ | $ | $ | $ |
| Currency swap contracts | | 4 | | 4 |
| Index future contracts | | | | |
| | $ | $ 4 | $ | $ 4 |

(Concluded)

December 31, 2012

| | Level 1 NT$ | Level 2 NT$ (In Millions) | Level 3 NT$ | Total NT$ |
|---|---|---|---|---|
| Financial assets at FVTPL | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Derivative financial assets | | | | | | | | |
| Forward exchange | $ | | $ | | $ | | $ | |
| Currency swap contracts | | | | 3 | | | | 3 |
| | $ | | $ | 3 | $ | | $ | 3 |
| Available-for-sale financial assets | | | | | | | | |
| Domestic securities | | | | | | | | |
| Equity investments | $ | 3,278 | $ | | $ | | $ | 3,278 |
| Corporate bonds | | | | 50 | | | | 50 |
| Foreign securities | | | | | | | | |
| Equity investments | | 10 | | | | | | 10 |
| Open-end mutual funds | | 2,190 | | | | | | 2,190 |
| | $ | 5,478 | $ | 50 | $ | | $ | 5,528 |
| Financial liabilities at FVTPL | | | | | | | | |
| Derivative financial assets | | | | | | | | |
| Forward exchange | $ | | $ | | $ | | $ | |
| Currency swap contracts | | | | 2 | | | | 2 |
| | $ | | $ | 2 | $ | | $ | 2 |

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December 31, 2013

| | Level 1 NT$ | Level 2 NT$ | Level 3 NT$ | Total NT$ |
|---|---|---|---|---|
| | | (In Millions) | | |
| Financial assets at FVTPL | | | | |
| Derivative financial assets | | | | |
| Forward exchange | $ | $ | $ | $ |
| Available-for-sale financial assets | | | | |
| Domestic securities | | | | |
| Equity investments | $ 3,046 | $ | $ | $ 3,046 |
| Corporate bonds | | | | |
| Foreign securities | | | | |
| Equity investments | 24 | | | 24 |
| | $ 3,070 | $ | $ | $ 3,070 |
| Financial liabilities at FVTPL | | | | |
| Derivative financial assets | | | | |
| Forward exchange | $ | $ | $ | $ |

There were no transfers between Level 1 and 2 for the years ended December 31, 2012 and 2013.

There were no Level 3 investments measured at fair value on a recurring basis.

Index future contracts are actively traded or have quoted prices. For derivative financial assets forward exchange and currency swap contracts, fair values are estimated using discounted cash flow model. The model uses market-based observable inputs including interest rate curves, foreign exchange rates, and forward and spot prices for currencies to project fair value.

Available-for-sale financial assets include open-end mutual funds, domestic and foreign listed stocks that are actively traded or have quoted prices.

Convertible bonds and corporate bonds are valued using discounted cash flow model which incorporates the market-based observable inputs including duration, yield rate and credit rating.

Assets and liabilities measured at fair value on a nonrecurring basis

The Company measures certain assets at fair value on a nonrecurring basis when they are deemed to be impaired. Due to the significant unobservable inputs used, the Company classified these measurements as Level 3.

**For the Year Ended December 31, 2012**

| | Level 1 NT$ | Level 2 NT$ | Level 3 NT$ | Total Losses NT$ |
|---|---|---|---|---|
| | | (In Millions) | | |
| Available-for-sale financial assets | | | | |
| Domestic stocks | | | | |
| Equity investments | $ — | $ — | $ 103 | $ 176 |

| | For the Year Ended December 31, 2013 | | | |
|---|---|---|---|---|
| | Level 1 NT$ | Level 2 NT$ | Level 3 NT$ | Total Losses NT$ |
| | | (In Millions) | | |
| Available-for-sale financial assets | | | | |
| Domestic stocks | $ — | $ — | $ 20 | $ 66 |

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The AFS financial assets consisted of non-publicly stocks. The table below presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on nonrecurring basis during the years ended December 31, 2012 and 2013:

| | For the Year Ended December 31, 2012 | | | |
|---|---|---|---|---|
| | **Fair Value NT$ (In Millions)** | **Valuation Methodology** | **Unobservable Inputs** | **Range of Inputs** |
| Assets | | | | |
| AFS financial assets | $ 103 | Discounted cash flow | Return on investment | 7% |
| | | | Industrial risk | 1%-3% |
| | | | Enterprise risk | 1%-3% |
| | | | Sustainable growth rate | 2% |

| | For the Year Ended December 31, 2013 | | | |
|---|---|---|---|---|
| | **Fair Value NT$ (In Millions)** | **Valuation Methodology** | **Unobservable Inputs** | **Range of Inputs** |
| Assets | | | | |
| AFS financial assets | $ 20 | Discounted cash flow | Return on investment | 7% |
| | | | Industrial risk | 3% |
| | | | Enterprise risk | 2%-2.5% |
| | | | Sustainable growth rate | 2% |

The department of investment and the department of finance are responsible for the impairment tests of financial instruments. They have set forth the Company s valuation policies and procedures for the impairment test and are responsible for reporting to the general manager regarding the changes in fair value and reasonableness of the underlying assumptions utilized in the valuation whenever the impairment test is performed.

The Company evaluated its unlisted stocks for impairment by using valuation models based on discounted future cash flows because there were no quoted fair value for such investments. Pursuant to the established policies, the Company employed an internal valuation model in 2012 and 2013 to determine the fair value of unlisted AFS financial assets using the discounted cash flow approach based on management s projections. Variables utilized in discounted cash flow approach require the use of unobservable inputs (Level 3), including return on investment, industrial risk, enterprise risk and sustainable growth rate. Changes in management estimates to the unobservable inputs in the valuation models would significantly change the fair value of the above investee. The return on investment is the assumption that most significantly affects the fair value determination. AFS financial assets held with a carrying amount of NT$279 million were written down to their fair value of NT$103 million, resulting in an impairment charge of NT$176 million, which was included in earnings for the year ended December 31, 2012. AFS financial assets held with a carrying amount of NT$86 million were written down to their fair value of NT$20 million, resulting in an impairment charge of NT$66 million, which was included in earnings for the year ended December 31, 2013.

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Assets and liabilities not measured at fair value but for which fair value is disclosed

Except for the following table, the management considered that the carrying amounts of financial instruments approximate fair values or fair values of those instruments cannot be reliably measured.

| | January 1, 2012 | | | |
|---|---|---|---|---|
| | Carrying Amount NT$ | Estimated Fair Value | | |
| | | Level 1 NT$ | Level 2 NT$ | Level 3 NT$ |
| | (In Millions) | | | |
| Financial assets | | | | |
| Held-to-maturity investments | | | | |
| Corporate bonds | $ 13,790 | $ | $ 14,045 | $ |
| Bank debentures | 906 | | 904 | |
| | $ 14,696 | $ _ | $ 14,949 | $ |

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Carrying Amount NT$ | Estimated Fair Value | | |
| | | Level 1 NT$ | Level 2 NT$ | Level 3 NT$ |
| | (In Millions) | | | |
| Financial assets | | | | |
| Held-to-maturity investments | | | | |
| Corporate bonds | $ 14,791 | $ | $ 16,131 | $ |
| Bank debentures | 1,255 | | 1,257 | |
| | $ 16,046 | $ _ | $ 17,388 | $ |

| | December 31, 2013 | | | |
|---|---|---|---|---|
| | Carrying Amount NT$ | Estimated Fair Value | | |
| | | Level 1 NT$ | Level 2 NT$ | Level 3 NT$ |
| | (In Millions) | | | |
| Financial assets | | | | |
| Held-to-maturity investments | | | | |
| Corporate bonds | $ 10,513 | $ | $ 10,552 | $ |
| Bank debentures | 1,253 | | 1,256 | |
| | $ 11,766 | $ _ | $ 11,808 | $ |

Methods and assumptions used in the estimation of fair values of financial instruments:

a. The carrying amounts of cash and cash equivalents, other current monetary assets, short-term loans and current portion of long-term loans approximate fair value due to the short period of time to maturity.

b. Held-to-maturity investments were corporate bonds valued using discounted cash flow model with market-based observable inputs including duration, yield rate and credit rating.

**39. RELATED PARTIES TRANSACTIONS**

Balances and transactions between Chunghwa and its subsidiaries, which are related parties of Chunghwa, have been eliminated on consolidation and are not disclosed in this note.

The ROC Government, one of Chunghwa s customers held significant equity interest in Chunghwa. Chunghwa provides fixed-line services, wireless services, Internet and data and other services to the various departments and institutions of the ROC Government and other state-owned enterprises in the normal course

of business and at arm s-length prices. The information on service revenues from government bodies has not been provided because the ROC government has significant influence over Chunghwa.

a. The Company engages in business transactions with the following related parties:

| Company | Relationship |
|---|---|
| Taiwan International Standard Electronics Co., Ltd. ( TISE ) | Associate |
| So-net Entertainment Taiwan Co., Ltd. ( So-net ) | Associate |
| Skysoft Co., Ltd. ( SKYSOFT ) | Associate |
| KingWaytek Technology Co., Ltd. ( KWT ) | Associate |
| Dian Zuan Integrating Marketing Co., Ltd. ( DZIM ) | Associate |
| Viettel-CHT Co., Ltd. ( Viettel ) | Associate |
| International Integrated System, Inc. ( IISI ) | Associate |
| ST-2 Satellite Ventures Pte., Ltd. ( STS ) | Associate |
| Huada Digital Corporation ( HDD ) | Joint venture |
| Senao Networks, Inc. ( SNI ) | Associate of SENAO |
| HopeTech Technologies Limited ( HopeTech ) | Associate of SIS |
| Other related parties | |
| Chunghwa Telecom Foundation ( CTF ) | A nonprofit organization of which the funds donated by Chunghwa exceeds one third of its total funds |
| Senao Technical and Cultural Foundation ( STCF ) | A nonprofit organization of which the funds donated by SENAO exceeds one third of its total funds |
| Sochamp Technology Co., Ltd. ( Sochamp ) | Investor of significant influence over CHST |
| United Daily News Co., Ltd. ( UDN) | Investor of significant influence over SFD |
| E-Life Mall Co., Ltd | One of the directors of E-Life Mall and a director of SENAO are members of an immediate family |
| Cheng Fong Investment Co., Ltd. | The chairman of the board of directors of Cheng Fong is the general manager of SENAO |

b. Term of the foregoing transactions with related parties were not significantly different from transactions with non-related parties. When no similar transactions with non-related parties can be referenced, terms were determined in accordance with mutual agreements. Details of transactions between the Company and related parties are disclosed below:

1) Operating transactions

| | Revenues Year Ended December 31 | |
|---|---|---|
| | 2012 NT$ | 2013 NT$ |
| | (In Millions) | |
| Associates | $ 416 | $ 367 |

| | | | | |
|---|---|---|---|---|
| Joint ventures | $ | 4 | $ | 4 |
| Others | $ | 4 | $ | 69 |

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| | Operating Costs and Expenses Year Ended December 31 | |
|---|---|---|
| | 2012 NT$ | 2013 NT$ |
| | (In Millions) | |
| Associates | $ 1,471 | $ 1,486 |
| Joint ventures | $ | $ 1 |
| Others | $ 65 | $ 74 |

2) Non-operating transactions

| | Year Ended December 31 | |
|---|---|---|
| | 2012 NT$ | 2013 NT$ |
| | (In Millions) | |
| Associates | $ 32 | $ 33 |
| Others | $ | $ |

3) Receivables

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Associates | $ 34 | $ 44 | $ 60 |
| Joint ventures | | | |
| Others | | | 9 |
| | $ 34 | $ 44 | $ 69 |

4) Payables

| | January 1, 2012 | December 31, 2012 | December 31, 2013 |
|---|---|---|---|

| | NT$ | NT$ (In Millions) | NT$ |
|---|---|---|---|
| Associates | $ 784 | $ 833 | $ 549 |
| Others | 4 | 4 | 8 |
| | $ 788 | $ 837 | $ 557 |

5) Customers deposits

| | January 1, 2012 NT$ | December 31, 2012 NT$ (In Millions) | December 31, 2013 NT$ |
|---|---|---|---|
| Associates | $ 2 | $ 3 | $ 1 |

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6) Acquisition of property, plant and equipment

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Associates | $ 747 | $ 1,270 |

The above amount is mainly attributable to telecommunications equipment bought from TISE.

7) Prepayments

Chunghwa entered into a contract with STS on March 12, 2010 to lease capacity on the ST-2 satellite. This lease is for 15 years which should start from the official operation of ST-2 satellite and the total contract value is approximately $6,000 million (SG$261 million), including a prepayment of $3,068 million, and the rest of amount should be paid annually when ST-2 satellite starts its official operation. ST-2 satellite was launched in May 2011, and began its official operation in August 2011. The total rental expense for the year ended December 31, 2013 was $410 million, which consisted of an offsetting credit of the prepayment of $211 million and an additional accrual of $199 million. The prepayment was $2,567 million (classified as prepaid rents-current $204 million, and prepaid rents-noncurrent $2,363 million) as of December 31, 2013.

c. Compensation of key management personnel

The remuneration of directors and members of key management personnel for the years ended December 31, 2012 and 2013 was as follows:

| | Year Ended December 31 | |
|---|---|---|
| | 2012 | 2013 |
| | NT$ | NT$ |
| | (In Millions) | |
| Short-term benefits | $ 277 | $ 257 |
| Post-employment benefits | 9 | 10 |
| Share-based payment | | 6 |
| | $ 286 | $ 273 |

The remuneration of directors and key executives is determined by the compensation committee having regard to the performance of individual and market trends.

## 40. PLEDGED ASSETS

The following assets are pledged as collaterals for long-term bank loans and contract deposits.

| | January 1, 2012<br>NT$ | December 31, 2012<br>NT$ | December 31, 2013<br>NT$ |
|---|---|---|---|
| | | (In Millions) | |
| Property, plant and equipment, net | $ 2,736 | $ 2,694 | $ 2,668 |
| Land held under development and land held for development (included in inventories) | | 1,999 | 1,999 |
| Restricted assets (included in other noncurrent assets others) | 9 | 10 | 10 |
| | $ 2,745 | $ 4,703 | $ 4,677 |

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**41. SIGNIFICANT CONTINGENT LIABILITIES AND UNRECOGNIZED COMMITMENTS**

At the balance sheet date, the Company s remaining commitments under non-cancelable contracts with various parties, excluding those disclosed in other notes, were as follows:

a. Acquisitions of land and buildings of $3,650 million as of December 31, 2013.

b. Acquisitions of telecommunications equipment of $31,267 million as of December 31, 2013.

c. Unused letters of credit were of $202 million as of December 31, 2013.

d. Contract to print billing, envelopes and marketing gifts were of $29 million as of December 31, 2013.

e. A commitment to contribute $2,000 million to a Piping Fund administered by the Taipei City Government, of which $1,000 million was contributed by Chunghwa on August 15, 1996 (classified as other monetary assets noncurrent). If the fund is not sufficient, Chunghwa will contribute the remaining $1,000 million upon notification from the Taipei City Government.

**42. SEGMENT INFORMATION**

The Company has the following reportable segments that provide different products or services. Segment information is provided to CEO who allocate resources and assess segment performance. The Company s reportable segments are as follows:

a. Domestic fixed communications business the provision of local telephone services, domestic long distance telephone services, broadband access, and related services;

b. Mobile communications business the provision of mobile services, sales of mobile handsets and data cards, and related services;

c. Internet business the provision of HiNet services and related services;

d. International fixed communications business the provision of international long distance telephone services and related services;

e. Others the provision of non-Telecom services and the corporate related items not allocated to reportable segments.

The reportable segments are managed separately because each segment represents a strategic business unit that serves different markets. The Company s measure of segment performance is mainly based on revenues and income before tax.

a. Segment information

Analysis by reportable segment of revenue and operating results of continuing operations are as follows:

| | Domestic Fixed Communi- cations Business NT$ | Mobile Communi- cations Business NT$ | Internet Business NT$ | International Fixed Communi- cations Business NT$ | Others NT$ | Total NT$ |
|---|---|---|---|---|---|---|
| | | | (In Millions) | | | |
| Year ended December 31, 2012 | | | | | | |
| Revenue | | | | | | |
| From external customers | $ 76,133 | $ 100,794 | $ 24,766 | $ 15,319 | $ 4,408 | $ 221,420 |
| Intersegment revenues | 16,991 | 6,581 | 2,877 | 2,231 | 1,035 | 29,715 |
| Segment revenues | $ 93,124 | $ 107,375 | $ 27,643 | $ 17,550 | $ 5,443 | |
| Intersegment elimination | | | | | | (29,715) |
| Consolidated revenues | | | | | | $ 221,420 |
| Segment income before income tax | $ 15,675 | $ 25,827 | $ 8,579 | $ 1,316 | $ (1,444) | $ 49,953 |

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| | Domestic Fixed Communi-cations Business NT$ | Mobile Communi-cations Business NT$ | Internet Business NT$ | International Fixed Communi-cations Business NT$ | Others NT$ | Total NT$ |
|---|---|---|---|---|---|---|
| | | | (In Millions) | | | |
| Year ended December 31, 2013 | | | | | | |
| Revenue | | | | | | |
| From external customers | $ 73,502 | $ 110,590 | $ 25,447 | $ 15,750 | $ 2,692 | $ 227,981 |
| Intersegment revenues | 18,447 | 5,702 | 4,354 | 2,107 | 1,232 | 31,842 |
| Segment revenues | $ 91,949 | $ 116,292 | $ 29,801 | $ 17,857 | $ 3,924 | |
| Intersegment elimination | | | | | | (31,842) |
| Consolidated revenues | | | | | | $ 227,981 |
| Segment income before income tax | $ 17,339 | $ 23,676 | $ 9,432 | $ 892 | $ (2,243) | $ 49,096 |

b. Other segment information

Other information reviewed by the chief operating decision maker or regularly provided to the chief operating decision maker was as following:

For the year ended December 31, 2012

| | Domestic Fixed Communi-cations Business NT$ | Mobile Communi-cations Business NT$ | Internet Business NT$ | International Fixed Communi-cations Business NT$ | Others NT$ | Total NT$ |
|---|---|---|---|---|---|---|
| | | | (In Millions) | | | |
| Share of the profit of associates and joint venture accounted for using equity method | $ | $ | $ | $ | $ 520 | $ 520 |
| Interest revenue | $ 6 | $ 12 | $ 2 | $ 4 | $ 718 | $ 742 |
| Interest expense | $ | $ | $ 2 | $ | $ 20 | $ 22 |
| Operating costs and expenses | $ 69,327 | $ 71,092 | $ 10,280 | $ 13,352 | $ 7,389 | $ 171,440 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Depreciation and amortization | $ 19,230 | $ 8,478 | $ 2,685 | $ 1,434 | $ 333 | $ 32,160 |
| Capital expenditure | $ 19,551 | $ 7,232 | $ 3,441 | $ 2,379 | $ 677 | $ 33,280 |

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For the year ended December 31, 2013

| | Domestic Fixed Communi- cations Business NT$ | Mobile Communi- cations Business NT$ | Internet Business NT$ | International Fixed Communi- cations Business NT$ | Others NT$ | Total NT$ |
|---|---|---|---|---|---|---|
| | | | (In Millions) | | | |
| Share of the profit of associates and joint venture accounted for using equity method | $ | $ | $ | $ | $ 666 | $ 666 |
| Interest revenue | $ 12 | $ 9 | $ 6 | $ 2 | $ 534 | $ 563 |
| Interest expense | $ 1 | $ 9 | $ 1 | $ | $ 25 | $ 36 |
| Operating costs and expenses | $ 68,740 | $ 79,074 | $ 11,577 | $ 14,333 | $ 6,645 | $ 180,369 |
| Depreciation and amortization | $ 19,005 | $ 8,147 | $ 3,122 | $ 1,549 | $ 369 | $ 32,192 |
| Capital expenditure | $ 20,362 | $ 9,245 | $ 4,621 | $ 1,559 | $ 595 | $ 36,382 |

c. Main products and service revenues from external customer information

The following is an analysis of the Company s revenue from its major products and services.

| | Year Ended December 31 | |
|---|---|---|
| | 2012 NT$ | 2013 NT$ |
| | (In Millions) | |
| Mobile services revenue | $ 72,540 | $ 76,709 |
| Local telephone and domestic long distance telephone services revenue | 44,629 | 41,278 |
| Sales of product | 27,649 | 33,103 |
| Broadband access and domestic leased line services revenue | 24,606 | 24,183 |
| Internet services revenue | 16,938 | 17,191 |
| International network and leased telephone services revenue | 12,749 | 12,675 |
| Others | 22,309 | 22,842 |

| | | |
|---|---|---|
| | $ 221,420 | $ 227,981 |

d. Geographic information

The users of the Company s services are mainly from Taiwan, R.O.C. The revenues it derived outside Taiwan are mainly revenues from international long distance telephone and leased line services. The geographic information for revenues is as follows:

| | **Year Ended December 31** | |
|---|---|---|
| | **2012** | **2013** |
| | **NT$** | **NT$** |
| | **(In Millions)** | |
| Taiwan, R.O.C. | $ 213,837 | $ 217,986 |
| Overseas | 7,583 | 9,995 |
| | $ 221,420 | $ 227,981 |

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The Company has long-lived assets in U.S., Singapore, Hong Kong, China, Vietnam, and Japan and except for $1,415 million and $3,310 million as of December 31, 2012 and 2013, respectively, in the aforementioned areas, the other long-lived assets are located in Taiwan, R.O.C.

e. Major customers

For the years ended December 31, 2012 and 2013, the Company did not have any single customer whose net revenue exceeded 10% of the total net revenue.

## 43. DISCLOSURE FOR FIRST-TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

a. Basis of the preparation of financial information under International Financial Reporting Standards

The consolidated financial statements for the year ended December 31, 2013 are reported under IFRSs as issued by IASB. As the basis of the preparation, the Company not only follows the significant accounting policies stated in Note 3 but also applies IFRS 1 First-time adoption of International Financial Reporting Standards .

b. Based on IFRS 1 First-time adoption of International Financial Reporting Standards , when the Company first adopts IFRSs, the Company should apply the IFRSs to establish its accounting policies, to prepare its financial statements and make required adjustments retroactively to the transition date (January 1, 2012). IFRS 1 provides several optional exemptions. The main exemptions adopted by the Company were discussed as follows:

1) Business combination

The Company elected not to apply IFRS 3 retrospectively to business combinations which occurred before January 1, 2012.

2) Share-based payment transactions

The Company elected not to apply IFRS 2 retrospectively to the share-based payment transactions which were granted and vested before January 1, 2012.

3) Deemed costs

The Company elected to measure parcels of land it owned at the date of transition to IFRSs at its revalued amount determined under accounting principles generally accepted in the Republic of China ( ROC GAAP ) as its deemed cost. The other property, plant and equipment, investment properties and intangible assets were measured under a cost model under IFRSs.

4) Employee benefits

The Company elected to recognize all unrecognized cumulative actuarial gains and losses as retained earnings as of January 1, 2012.

The impacts of the aforementioned optional exemptions were included in the following part d. of explanation for the adjustments of IFRSs transition .

c. Impact after transition to IFRSs

The impact on the consolidated balance sheet and the consolidated statements of comprehensive income after transition to IFRSs are as follows:

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1) Reconciliation of consolidated balance sheet as of January 1, 2012

| ROC GAAP | | Adjustments | | IFRSs | | |
|---|---|---|---|---|---|---|
| | | Differences in Recognitions and Measurements | | | | |
| Items | Amount NT$ | Measurements NT$ | Differences in Presentations NT$ | Amount NT$ | Items | Notes |
| | | (In Millions) | | | | |
| Current assets | $ 106,539 | $ (350) | $ (805) | $ 105,384 | Current assets | 4), 9), 15) |
| Investments accounted for using equity method | 2,563 | (43) | | 2,520 | Investments accounted for using equity method | 10), 14) |
| Financial assets carried at cost | 2,760 | | (2,760) | | | 15) |
| Available-for-sale financial assets | 58 | | 2,760 | 2,818 | Available-for-sale financial assets | 15) |
| Held-to-maturity financial assets | 13,495 | | | 13,495 | Held-to-maturity financial assets | |
| Other monetary assets | 1,000 | | (1,000) | | | 15) |
| Property, plant and equipment | 302,612 | | (7,580) | 295,032 | Property, plant and equipment | 1), 2), 15) |
| | | | 9,060 | 9,060 | Investment properties | 1), 2) |
| Intangible assets | 6,330 | (65) | 13 | 6,278 | Intangible assets | 15) |
| Other assets | 7,563 | 569 | 329 | 8,461 | Other noncurrent assets | 1), 2), 4), 5), 6), 15) |
| Total | $ 442,920 | $ 111 | $ 17 | $ 443,048 | Total | |
| Current liabilities | $ 59,281 | $ 5,073 | $ (569) | $ 63,785 | Current liabilities | 7), 8), 9), 14) |
| Noncurrent liabilities | 10,502 | 2,738 | 681 | 13,921 | Noncurrent liabilities | 4), 6), 7), 8) |
| Reserve for land value incremental tax | 95 | | (95) | | | 4) |
| Total liabilities | 69,878 | 7,811 | 17 | 77,706 | Total liabilities | |
| Common stock | 77,574 | | | 77,574 | Common stock | |
| Additional paid-in capital | 169,536 | (664) | | 168,872 | Additional paid-in capital | 6),8), 12), 13) |
| Retained earnings | 115,866 | (1,180) | | 114,686 | Retained earnings | 3), 5), 6), 7), 8), 9), 10), 11), |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | | 12), 13), 14) |
| Other adjustments | 5,755 | (5,726) | | 29 | Other adjustments | 3), 6), 10) |
| Total equity attributable to stockholders of the parent | 368,731 | (7,570) | | 361,161 | Total equity attributable to shareholders of the parent | |
| Minority interests in subsidiaries | 4,311 | (130) | | 4,181 | Noncontrolling interests | 5), 6), 10), 11), 14) |
| Total stockholders equity | 373,042 | (7,700) | | 365,342 | Total equity | |
| Total | $ 442,920 | $ 111 | $ 17 | $ 443,048 | Total | |

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2) Reconciliation of consolidated balance sheet as of December 31, 2012

| ROC GAAP | | Adjustments | | | IFRSs | |
|---|---|---|---|---|---|---|
| Items | Amount NT$ | Differences in Recognitions and Measurements NT$ | Differences in Presentations NT$ | Amount NT$ | Items | Notes |
| | | (In Millions) | | | | |
| Current assets | $ 100,995 | $ | $ (1,048) | $ 99,947 | Current assets | 4), 9), 15) |
| Investments accounted for using equity method | 2,250 | (59) | | 2,191 | Investments accounted for using equity method | 10), 12), 14) |
| Financial assets carried at cost | 2,550 | | (2,550) | | | 15) |
| Available-for-sale financial assets | 3,196 | | 2,550 | 5,746 | Available-for-sale financial assets | 15) |
| Held-to-maturity financial assets | 11,796 | | | 11,796 | Held-to-maturity financial assets | |
| Other monetary assets | 1,000 | | (1,000) | | | 15) |
| Property, plant and equipment | 303,650 | | (6,308) | 297,342 | Property, plant and equipment | 1), 2), 15) |
| | | | 7,789 | 7,789 | Investment properties | 1), 2) |
| Intangible assets | 5,813 | (65) | 34 | 5,782 | Intangible assets | 15) |
| Other assets | 8,197 | 722 | 537 | 9,456 | Other noncurrent assets | 1), 2), 4), 5), 6), 15) |
| Total | $ 439,447 | $ 598 | $ 4 | $ 440,049 | Total | |
| Current liabilities | $ 56,784 | $ 3,883 | $ (942) | $ 59,725 | Current liabilities | 7), 8), 9), 14) |
| Noncurrent liabilities | 12,658 | 3,135 | 1,041 | 16,834 | Noncurrent liabilities | 4), 5), 6), 7), 8) |
| Reserve for land value incremental tax | 95 | | (95) | | | 4) |
| Total liabilities | 69,537 | 7,018 | 4 | 76,559 | Total liabilities | |
| Common stock | 77,574 | | | 77,574 | Common stock | |
| Additional paid-in capital | 169,544 | (667) | | 168,877 | Additional paid-in capital | 6), 8), 11), 12), 13) |
| Retained earnings | 113,408 | (866) | | 112,542 | Retained earnings | 3), 5), 6), 7), 8), 9), 10), 11), 12), 13), 14) |
| Other adjustments | 4,916 | (4,755) | | 161 | Other adjustments | 3), 5), 6), 10) |
| Total equity attributable to stockholders of the parent | 365,442 | (6,288) | | 359,154 | Total equity attributable to shareholders of the | |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | parent | |
| Minority interests in subsidiaries | 4,468 | (132) | | 4,336 | Noncontrolling interests | 5), 6), 10), 11), 14) |
| Total stockholders equity | 369,910 | (6,420) | | 363,490 | Total equity | |
| Total | $ 439,447 | $ 598 | $ 4 | $ 440,049 | Total | |

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3) Reconciliation of consolidated statement of comprehensive income for year ended December 31, 2012

| ROC GAAP | | Adjustments | | IFRSs | | |
|---|---|---|---|---|---|---|
| Items | Amount NT$ | Differences in Recognitions and Measurements NT$ | Differences in Presentations NT$ | Amount NT$ | Items | Notes |
| | | (In Millions) | | | | |
| Net revenues | $ 220,131 | $ 1,289 | $ | $ 221,420 | Revenues | 7), 8), 9) |
| Operating costs | (141,177) | (336) | | (141,513) | Operating costs | 6), 7), 9), 16) |
| Gross profits | 78,954 | 953 | | 79,907 | Gross profit | |
| Operating expenses | (30,041) | 78 | 36 | (29,927) | Operating expenses | 6), 7), 9), 11), 16) |
| Other income and expense | | | (1,569) | (1,569) | Other income and expense | 16) |
| Income from operations | 48,913 | 1,031 | (1,533) | 48,411 | Income from operations | |
| Non-operating income and losses | (17) | (10) | 1,569 | 1,542 | Non-operating income and expenses | 3), 10), 12), 14) |
| Income before income tax | 48,896 | 1,021 | 36 | 49,953 | Income before income tax | |
| Income tax expense | (7,858) | 558 | (36) | (7,336) | Income tax expenses | 5), 14), 16) |
| Consolidated net income | $ 41,038 | $ 1,579 | $ | 42,617 | Net income | |
| | | | | | Items that will not be reclassified to profit or loss: | |
| | | | | (1,539) | Remeasurements of defined benefit pension plans | 6) |
| | | | | (18) | Share of remeasurements of defined benefit pension plans of associates | 10) |
| | | | | 265 | Income tax relating to items that will not reclassified | 5) |
| | | | | (1,292) | | |

| | |
|---|---|
| | Items that may be reclassified subsequently to profit or loss: |
| (58) | Exchange differences arising from the translation of the foreign operations |
| (8) | Share of exchange differences arising from the translation of the foreign operations of associates |
| 192 | Unrealized gain on available-for-sale financial assets |
| 126 | |
| (1,166) | Total other comprehensive income |
| $ 41,451 | Total comprehensive income |

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d. Explanation for the adjustments of IFRSs transition:

1) Classification of investment properties

Under ROC GAAP, properties for lease were classified as property, plant and equipment and other assets; after transition to IFRSs, owned-property for either rental revenue or capital appreciation should be classified as investment properties.

On January 1, 2012, the assets that met the definition of investment properties under IAS 40 Investment Property were reclassified from property, plant and equipment of $8,597 million, and other assets idle assets of $463 million, to investment properties. The total amount of reclassification was $9,060 million. On December 31, 2012, the assets that met the definition of investment properties were reclassified from property, plant and equipment of $7,330 million, and other assets idle assets of $459 million to investment properties. The total amount of reclassification was $7,789 million.

2) Classification of leased assets and idle assets

Under ROC GAAP, leased and idle assets were classified as other assets; after the transition to IFRSs, leased and idle assets were reclassified to property, plant and equipment or investment properties based on the nature of these assets.

The Company reclassified leased assets to property, plant and equipment and the amounts were $400 million and $390 million as of January 1, 2012 and December 31, 2012, respectively. Except for the abovementioned Item 1) which discussed the reclassification from idle assets to investment properties, the Company reclassified the remaining idle assets to property, plant and equipment amounting to $437 million and $415 million, as of January 1, 2012 and December 31, 2012, respectively.

3) Deemed cost of property, plant and equipment

The Company elected to apply the optional exemption in IFRS 1. The management measured land (classified as property, plant and equipment and investment properties under IFRSs) at its revalued amount, which was determined under ROC GAAP as deemed cost. On January 1, 2012, the Company reclassified the unrealized revaluation increment (classified as stockholders equity) to retained earnings in the amount of $5,764 million. This reclassification did not affect total equity. Due to the disposal of some revalued assets and recognition of impairment loss of the revalued assets, the unrealized revaluation increment reclassified to retained earnings was decreased by $0.35 million and $2 million, respectively and revaluation increment as of December 31, 2012 was $5,760 million. As a result of the above adjustment, gain on disposal of property, plant and equipment decreased by $0.35 million, and impairment loss increased by $2 million for the year ended December 31, 2012.

4) Classification of deferred income tax asset and liability, and valuation allowance

Under ROC GAAP, a deferred income tax asset and liability should be classified as current and noncurrent in accordance with the classification of its related asset or liability. When a deferred income tax asset and liability does not relate to an asset or liability, then it is classified as either current or noncurrent based on the expected length of time before it is realized or settled. However, under IFRSs, a deferred income tax asset and liability should be classified as noncurrent, and could not be offset. Deferred income tax assets and liabilities are offset on the balance sheet when the entity has the legally enforceable right to offset current tax assets against current tax liabilities and they are levied by the same taxation authority on the same entity.

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Under ROC GAAP, if it is more likely than not that deferred income tax assets will not be realized, the valuation allowances are provided to the extent. However, under IFRSs, deferred income tax assets are only recognized when it is more likely than not to be realized, and the valuation allowance is not used under IFRSs.

Based on the Guidelines Governing the Preparation of Financial Reports by Securities Issuers in ROC, the reserve for land value incremental tax caused by revaluation of land is classified as long-term liabilities. Under IFRSs, if the Company elects to apply the IFRS 1 exemption and measure the revalued land using the carrying amount determined under ROC GAAP as its deemed cost, the related reserve for land value incremental tax should be classified as deferred income tax liabilities.

The Company reclassified its deferred income tax assets current to noncurrent assets and the amounts were $115 million and $143 million as of January 1, 2012 and December 31, 2012, respectively. Further, deferred income tax liabilities, which were netted with deferred income tax assets under ROC GAAP, were reversed. As a result of such reversal, deferred income tax liabilities noncurrent and deferred income tax assets noncurrent increased by $16 million and $4 million, respectively, and reserve for land value incremental tax of $95 million was also reclassified as deferred income tax liabilities noncurrent under IFRSs.

5) Income tax

Based on IAS 12 Income Taxes , the income tax adjustments as a result of the transition to IFRSs are as follows: deferred income tax assets increased by $584 million and $721 million (including the tax effects of actuarial gains and losses from defined benefit plans of $265 million) as of January 1, 2012 and December 31, 2012, respectively; retained earnings increased by $576 million and $710 million as of January 1, 2012 and December 31, 2012, respectively; noncontrolling interests increased by $8 million and $11 million as of January 1, 2012 and December 31, 2012, respectively. Deferred income tax liabilities decreased by $0.02 million as of December 31, 2012. For the year ended December 31, 2012, due to the adjustment of deferred income tax assets and deferred income tax liabilities (decreased by $128 million in deferred tax assets and decreased by $0.02 million in deferred income tax liabilities), income tax expense increased by $128 million and the income tax relating to other comprehensive income increased by $265 million.

6) Employee benefits

Under ROC GAAP, net transition obligation that resulted from the first time adoption of SFAS No. 18, Pension should be amortized on a straight-line basis over the average remaining service life of active plan participants and recognized as net periodic pension cost. After the transition to IFRSs, the transitional rules in IAS 19, Employee Benefits ( IAS 19 ) was not applicable, thus the related amounts of net transition obligation should be recognized at once and adjusted in retain earnings.

Under ROC GAAP, actuarial gains (losses) are recognized based on the corridor approach and the amounts are amortized over the average remaining service life of active plan participants. Under IFRSs, the Company recognized actuarial gains (losses) arising from defined benefit plans as other comprehensive income immediately and subsequent reclassification to earnings is not permitted.

Furthermore, under ROC GAAP, the prior service costs should be recognized as an expense on a straight-line basis over the average remaining service life of active plan participants until the benefits become vested. Under IFRSs, IAS 19 required entities to recognize past service costs in profit or loss immediately.

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As a result of the aforementioned adjustments, other liabilities increased by $1,504 million and $2,038 million as of January 1, 2012 and December 31, 2012, respectively; other noncurrent assets decreased by $15 million and increased by $1 million as of January 1, 2012 and December 31, 2012, respectively; retained earnings decreased by $1,472 million and $2,954 million as of January 1, 2012 and December 31, 2012, respectively; unrecognized net losses of pension decreased by $0.22 million, and $956 million as of January 1, 2012 and December 31, 2012, respectively; noncontrolling interests decreased by 47 million and $39 million as of January 1, 2012 and December 31, 2012, respectively. For the year ended December 31, 2012, pension cost decreased by $39 million which increased $0.17 million in operating costs and decreased $39 million in operating expenses and actuarial losses arising from defined benefit plans (classified as other comprehensive income) decreased by $1,539 million.

In addition, prior to Chunghwa s privatization in 2005, the pension contributions were made according to the relevant regulations. Upon privatization, the pension obligations of retained employees that were civil employees and employees retired prior to privatization entitled to receive future monthly pension payments based on the Labor Pension Act , Act of Privatization of Government-Owned Enterprises , and Enforcement Rules of Statute of Privatization of Government-Owned Enterprises were borne by the government. The settlement impact upon privatization of $20,648 million derived according to the actuarial report under IAS 19 shall be retroactively adjusted from retained earnings to additional paid-in capital privatization at the date of transition to IFRSs.

7) Award credits (often known as points )

Under ROC GAAP, the Company used their best estimates to accrue the liability of the points when the points are granted and adjust the liability subsequently based on the actual redemption of the points. After the transition to IFRSs, Chunghwa applied IFRIC 13, Customer Royalty Program retroactively. The award credit should be measured at its fair value and defer the recognition of revenue. When the customers redeem the points, the deferred revenue is recognized as well as the corresponding cost of the points.

Accrued award credits liabilities (classified as other current liabilities) were decreased by $70 million, and $121 million as of January 1, 2012 and December 31, 2012, respectively; net deferred award credits revenue (classified as noncurrent liabilities deferred revenue) were increased by $24 million, and $72 million as of January 1, 2012 and December 31, 2012, respectively; retained earnings were increased by $46 million and $49 million as of January 1, 2012 and December 31, 2012, respectively. The revenue was decreased by $48 million, the marketing expenses were decreased by $80 million and the operating cost was increased by $29 million for the year ended December 31, 2012.

8) Recognition of revenue from providing fixed line connection service

Prior to incorporation and privatization, Chunghwa was subject to the financial reporting requirements under the laws and regulations applicable to state-owned enterprises in Taiwan which differed from ROC GAAP as applicable to commercial companies. As such, Chunghwa recorded revenue from providing fixed line connection service upon the receipt of connection fees. Upon incorporation, net assets greater than capital stock was credited as additional paid-in-capital. Part of additional paid-in-capital was from unearned revenues relating to connection fees as of that date. Upon privatization, unearned revenue generated from one-time connection fees was deferred at the time of service performed and recognized as revenue over time as the service is continuously performed in accordance with ROC GAAP.

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Under IFRSs, following the revenue recognition guidance, the above service revenue was deferred at the time of service performed and recognized as revenue over time as the service is continuously performed.

Chunghwa retrospectively adjusted the deferred income of $1,926 million and $1,286 million as of January 1, 2012 and December 31, 2012, respectively, by decreasing retained earnings and increasing the deferred revenue from providing fixed line connection service ($640 million and $185 million were classified as other current liabilities; $1,286 million and $1,101 million were classified as noncurrent liabilities deferred revenue as of January 1, December 31 and December 31, 2012, respectively). Unappropriated earnings increased and the additional paid-in-capital decreased by $18,487 million as of December 31, 2012. For the year ended December 31, 2012, revenue from providing fixed line connection service increased by $640 million.

9) Recognition of construction contract revenue

The construction contracts did not meet the criteria in IFRIC 15 Agreements as the buyers are not able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress for the Construction of Real Estate ; therefore IAS 11 Construction Contracts does not apply. The Company could only recognize the revenues when the projects are completed and sold based on IAS 18, Revenue . Due to the reasons mentioned above, the Company reversed the revenue that was recognized based on percentage completion method, and recognize the related revenue, cost and expense when the project is completed in 2012.

Inventories decreased by $392 million and nil as of January 1, 2012 and December 31, 2012, respectively; prepaid expenses (classified as other current assets) increased by $42 million and nil as of January 1, 2012 and December 31, 2012, respectively; accrued expenses (classified as other current liabilities accrued expense) decreased by $2 million and nil of January 1, 2012 and December 31, 2012, respectively; retained earnings decreased by $348 million and nil as of January 1, 2012 and December 31, 2012, respectively. The construction revenue increased by $697 million, the construction cost increased by $306 million and the marketing expenses increased by $43 million for the year ended December 31, 2012.

10) Equity method investments

Associates and joint venture are accounted for using the equity method. Upon the Company s transition to IFRSs, the main adjustment of equity method investments includes employee benefit and share-based payments, etc. As a result, long-term investments were decreased by $7 million and $10 million as of January 1, 2012 and December 31, 2012, respectively; retained earnings decreased by $40 million and $52 million as of January 1, 2012 and December 31, 2012, respectively; unrecognized net loss of pension decreased by $38 million and $49 million as of January 1, 2012 and December 31, 2012, respectively; noncontrolling interests decreased by $5 million and $7 million as of January 1, 2012 and December 31, 2012, respectively. Share of the profit of associates and joint venture accounted for using equity method increased by $4 million and share of other comprehensive income of associates and joint venture accounted for using equity method decreased $18 million for the year ended December 31, 2012.

11) Share-based payment transactions

A portion of the employee stock options granted by subsidiary CHPT was not vested on the transition date. Therefore, the subsidiary accounted for these stock options under IFRS 2, Share-based Payment from their respected grant dates. Under IFRSs, paid-in capital employee stock option recognized by subsidiary does not belong to the equity attributable to parent company, instead it should be accounted as noncontrolling interests. As of January 1, 2012, retained earnings

instead decreased by $2 million and noncontrolling interests increased by $2 million. As of December 31, 2012, noncontrolling interests increased by $2 million and paid-in capital equity in additional paid-in capital reported by equity-method investees decreased by $2 million. For the year ended December 31, 2012, the compensation cost under general and administrative expense decreased by $2 million.

12)(a) Subscription of associates/subsidiaries new shares and (b) adjustments of paid-in capital reported related to equity-method investees

When an investee issues new shares and existing shareholders do not subscribe to the new shares at their respective proportion in share holdings, this would result in changes in the investor s shareholdings of the equity method investee. According to the Statements of Financial Accounting Standards ( SFAS ) No. 5 Long-term Investments under Equity Method under ROC GAAP, as since there are changes in the net book value of the equity method investee attributable to the investor, the investor shall reflect such changes by adjusting additional paid-in capital and long-term investments. However, under IFRSs, if the changes do not cause the investor to lose significant influence over associates, the change shall be treated as a deemed disposal with the related gain or loss recognized in earnings. If the changes do not cause the investor to lose control over subsidiaries, the change shall be treated as equity transactions. The Company reclassified such paid-in capital of $27 million as of January 1, 2012 to retained earnings. As of January 1, 2012 and December 31, 2012, the Company reclassified such paid-in capital of $27 million and $28 million to retained earnings and long-term investment decreased by $0.27 million. Gain on disposal of financial instruments increased by $1 million for the year ended December 31, 2012.

13) Prepaid cards

Prior to incorporation and privatization, Chunghwa was subject to the laws and regulations applicable to state-owned enterprises in Taiwan which differed from ROC GAAP as applicable to commercial companies. As such, revenue from sale of prepaid phone cards was recognized at the time of sale by Chunghwa. Upon incorporation, net assets greater than the capital stock was credited as additional paid-in-capital and part of the additional paid-in-capital was from the unearned revenues generated from prepaid cards as of that day. Upon privatization, unearned revenue generated from prepaid cards was deferred at the time of sale and recognized as revenue as consumed in accordance with ROC GAAP.

Under IFRSs, revenue from prepaid cards is deferred at the time of sale and recognized as revenue as consumed.

The amount of reclassification from additional paid-in capital to unappropriated earnings was $2,798 million as of January 1, 2012 and December 31, 2012.

14) 10% tax on unappropriated earnings

In the Republic of China ( ROC ), a 10% tax is imposed on unappropriated earnings (excluding earnings from foreign consolidated subsidiaries). Under ROC GAAP, the Company records the 10% tax on unappropriated earnings in the year the stockholders approve the appropriation of earnings which is the immediate following year.

Under IFRSs, the 10% tax on unappropriated earnings is accrued during the period the earnings arise and adjusted to the extent that appropriations are approved by the stockholders in the following year.

The aforementioned 10% tax on unappropriated earnings is also applicable to the underlying investees whom the Company invested and accounted for using equity method. And, as a result,

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investments accounted for using equity method decreased by $36 million and $49 million as of January 1, 2012 and December 31, 2012, respectively; current tax liabilities increased by $4,505 million and $3,819 million as of January 1, 2012 and December 31, 2012, respectively; retained earnings decreased by $4,442 million and $3,758 million as of January 1, 2012 and December 31, 2012, respectively; noncontrolling interests decreased by $99 million and $110 million as of January 1, 2012 and December 31, 2012, respectively. Income tax expenses decreased by $686 million and share of the profit of associates and joint ventures accounted for using the equity method decreased by $13 million for the year ended December 31, 2012.

15) Presentation of consolidated balance sheets

a) Piping fund

As part of the government s effort to upgrade the existing telecommunications infrastructure project, Chunghwa and other public utility companies were required by the ROC government to contribute a total of $1,000 million to a Piping Fund administered by the Taipei City Government. Based on the terms of Construction Funding Agreement, if the Piping Fund project is considered to be no longer necessary by the ROC government, Chunghwa will receive back its proportionate share of the net equity of the Piping Fund upon its dissolution. In order to conform to the presentation of the financial statements under IFRSs, the fund was reclassified as other noncurrent assets.

b) Time deposits with maturities of more than three months

Under ROC GAAP, cash and cash equivalents includes time deposits that are cancellable but without any loss of principal. Under IFRSs, cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of three months or less from the date of acquisition.

Time deposits and negotiable certificate of deposits with maturities of more than three months held by the Company were $40,982 million and $22,264 million as of January 1, 2012 and December 31, 2012, respectively. In order to conform to the presentation of the financial statements under IFRSs, such amounts were reclassified from cash to other monetary assets current.

c) Deferred expense

The deferred expense, which was classified as other assets under ROC GAAP, was reclassified based on its nature under IFRSs. Deferred expenses relating to decoration construction projects and advertisement signboard, etc. were reclassified as prepaid expenses of nil and $1 million as of January 1, 2012 and December 31, 2012, respectively. Deferred expenses relating to decoration construction projects and advertisement signboard, etc. were reclassified as property, plant and equipment of $158 million and $216 million as of January 1, 2012 and December 31, 2012, respectively. Deferred expenses relating to computer software were reclassified as intangible assets of $13 million and $34 million as of January 1, 2012 and December 31, 2012, respectively.

d) Assets to be abandoned

The property, plant and equipment classified as held for disposal (included in other assets others) under ROC GAAP, was reclassified based on its nature under IFRSs. Assets to be abandoned were reclassified as property, plant and equipment of $22 million and $1 million as of January 1, 2012 and December 31, 2012, respectively.

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e) Reclassification of financial assets carried at cost

Based on the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, stocks held by the Company which were not listed in Taiwan Stock Exchange or were not trading in the GreTai Securities Market and the Company did not have significant influence over these investees were classified as financial assets carried at cost. After transition to IFRSs, financial assets carried at cost were designated as available-for-sale financial assets. Financial assets carried at cost were reclassified as available-for-sale financial assets of $2,760 million and $2,550 million as of January 1, 2012 and December 31, 2012, respectively.

16) Presentation of consolidated statements of comprehensive income

After the transition to IFRSs, the consolidated statement of comprehensive income includes net income and other comprehensive income. Further, certain accounts were reclassified to conform to the presentation of the financial statements under IFRSs.

17) Summary of material adjustments of cash flow statements

Under ROC GAAP, collection and payment of interest and collection of dividends were classified as operating activity; payment of dividends was classified as financing activity. Further, for cash flow statement prepared using the indirect method, cash payment of interest expense is required for supplemental disclosure. Based on IAS 7 Cash Flow Statement , collection and payment of interest and dividends were disclosed separately with consistency for each period and classified as operating activity, investing activity or financing activity. The Company classified the payment of interest as operating activity, collection of interest and dividends as investing activity, and payment of dividends as financing activity in its consolidated statements of cash flows.

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